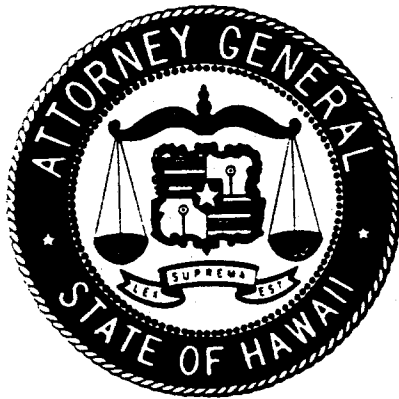


**AN INVESTIGATION  
OF  
GASOLINE PRICES IN HAWAII:  
A Preliminary Report  
September 1990**



**The Department of the Attorney General  
State of Hawaii**

## **ACKNOWLEDGMENTS**

*This report is the result of a considerable amount of tedious work by some very dedicated people. Deputy Attorney General Ted Clause took the laboring oar over the many months it took to work this report into a meaningful document. Deputies Robert Marks and Sonia Faust, First Deputy Corinne Watanabe, and Sandy Okamoto, my Executive Assistant, brain-stormed the data into a final product. Sharon Muraoka, my secretary, Joanne Yoshimi, Isabelle Miller and Claudia Asato were, as usual, indispensable.*

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*Warren Price, III  
Attorney General*

## FOREWORD

*Early in our review of gas prices in Hawaii following the Valdez spill, we realized there were no simple answers to the questions posed, and no quick fixes for the problem facing our consumers. Given the staggering complexity of the global oil industry in general, the confusing interrelationship of this massive industry with our state, and the underlying uniqueness of Hawaii's island economy in the first place, it became clear that we had to choose among a multitude of forms and directions to chart the course an investigation like ours could take.*

*One possible direction, which was appealing from several standpoints, was to try and provide an early report to the public within a couple of months after the spill. The problem with this, however, was that there was simply no way a comprehensive analysis of the complex situation in Hawaii could possibly be made within this time frame. This was because considerable data from the oil industry at all levels would be necessary for any report to be meaningful, and this could simply not be obtained in a short period of time. Without this data, little could be added by an investigation by our Department to what was being generally reported elsewhere. Other states that attempted to provide their outraged consumers with quick and simple answers, ended up telling them basically what they already knew and none of these investigations found illegal activities on the part of the oil companies. Yet, charges and counter-charges resonated around the nation, and more and more politicians and law enforcement personalities jumped into the fray.*

*Witnessing the lack of results from the "quick answer" approach to the problem, we chose to proceed on a broader scale in an attempt to get to the root causes of Hawaii's astronomical gasoline prices, both before and after Valdez. Our goal was to begin a process of information gathering so that legal, political, and administrative decisions could be made now, and in the future as well. Indeed, Hawaii, like every other state in the nation, has suffered from one significant deficiency in dealing with the gas price issue: a lack of data about how the oil and gas industry works, and more particularly, how the industry works in relation to our local economy. Absent solid information on this, it is apparent that no informed decisions can ever be made politically, much less legally, as to the solution to the problem. In a nutshell, it was, and is, our belief that the reason that no political or legal solutions have emerged from the various states and agencies that have "investigated" the gas price issue, is because there has always been an incomplete view of the industry and the particular market involved because of the absence of hard data.*

*This Report is but a brief summary of the data and findings involved in our investigation to this point in time, which is the most comprehensive state investigation in the nation thus far. Our Report also offers recommendations as to where we should go from here based upon our findings. This Report is, hopefully, the beginning of a process that can ultimately insure that the consumers in Hawaii are dealt with fairly, honestly, and legally by the oil companies with respect to gasoline prices.*

Warren Price, III  
Attorney General

AN INVESTIGATION OF GASOLINE PRICING IN HAWAII:  
A PRELIMINARY REPORT

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# **AN INVESTIGATION OF GASOLINE PRICING IN HAWAII:**

## **A PRELIMINARY REPORT, SEPTEMBER 1990**

**By the DEPARTMENT OF THE ATTORNEY GENERAL  
STATE OF HAWAII**

### **I. CHRONOLOGY OF THE INVESTIGATION (Exhibit 1)**

On Friday, March 24, 1989, the oil tanker Exxon Valdez went aground in Prince William Sound off the Alaska coast. As a result of the wreck, 10.1 million gallons of crude oil from the Alaska North Slope spilled into the sound.

By mid-May, 1989, retail gasoline prices in Hawaii had increased about 20 percent.

On May 19, 1989, Warren Price, III, Attorney General of the State of Hawaii, announced that the Department of the Attorney General would investigate this unprecedented increase in the price of gasoline.

During the summer of 1989, the Department of the Attorney General engaged an expert economist, consulted with numerous state and federal agencies, interviewed experts in petroleum including those with the energy program at the East-West Center, and reviewed countless public records and other documents, including the public portion of the court record in the Federal Trade Commission's action in the United States District Court of the Western District of Washington in late 1987 to enjoin the acquisition by Pacific Resources Inc. of all of Shell Oil Company's terminal and distribution assets in Hawaii. The Department of the Attorney General also reviewed the public reports of similar investigations conducted by the Commonwealth of Massachusetts and the joint study of the attorneys general of the States of Washington, Oregon, and Idaho.

On June 23, 1989, the Department of the Attorney General sent a voluntary questionnaire to the major oil companies in Hawaii, to all other distributors and jobbers, and to a sampling of the retail gasoline stations throughout the state. The questionnaire asked for hard data on the increases in the prices charged, increases in the costs of their



product, and the volume of gasoline sold at each increase in price. A total of 218 questionnaires were sent.

Responses were due in mid-July. By the end of August, there were only two responses that were complete enough to be of any help at all.

Therefore, in September 1989, the Department of the Attorney General served compulsory investigative demands on each refiner, each terminal operator, and about a hundred gas stations. Again, responses were slow. As before, only a few of the responses were complete enough to be of help.

By the end of December 1989, however, the Department of the Attorney General had received about 50 file boxes of documents and data in response to the requests made. Most of this, though, was from a single oil company, and the Department spent considerable time attempting to get the requested data from the other companies. The most frequent response was that the company did not keep the particular data the Department had requested.

The process of computerizing the data, which began in the fall of 1989, was frequently delayed by the data collection problem. Analysis of the data was even more complicated. This was mainly because each company supplied different information in responding to the same questions. Precise comparisons could not be made. Furthermore, only one company, Chevron, had furnished information in depth. In any event, the gathering and review of the basic data necessary to a meaningful investigation took much longer than it should have, and a solution to this problem is addressed in the recommendations section of this report.

By the end of June, 1990, the Department of the Attorney General had gathered, computerized, and analyzed the available data and had come to tentative findings and conclusions concerning some of the questions raised by the price increases after Exxon Valdez.

In early July, the Attorney General submitted his tentative findings and conclusions to the major oil companies for review and comment. Responses were received just as the events broke in the Middle East.

Exhibit 1 summarizes the course of the investigation.

The following is a brief summary of the data that we reviewed. We have attempted to place the summary in the perspective of both the Hawaii and world petroleum markets.

## II. THE SUPPLY OF CRUDE OIL TO AMERICA (Exhibits 2, 3, and 4)

Crude oil is the raw material for America's gasoline industry. The United States depends heavily on imported crude oil. Exhibit 2 shows the various sources from which it is imported.

Exhibit 3 shows American stocks of petroleum products on hand as of midsummer 1989 and midsummer 1990. Exhibit 4 shows American production for the same dates.

## III. THE SUPPLY OF CRUDE OIL TO HAWAII (Exhibit 5)

Hawaii is totally dependent on outside oil. About half our oil comes from the Alaska North Slope. The other half comes from foreign sources, mainly Indonesia and Australia. These sources are shown on Exhibit 5.

## IV. THE GASOLINE INDUSTRY IN HAWAII (Exhibits 6, 7, and 8)

Crude oil must be refined to be useful. The refining process produces a number of petroleum products. The list of products is called the "cut of the barrel." It is also called the "product slate." Generally, the product slate of Hawaii's two refiners, Chevron and Pacific Resources, Inc. (discussed later), is composed of gasoline, jet fuel, distillates, and heavy fuel oil. The make-up of the product slate depends on the relative demand for the products. The pattern of Hawaii's consumption of petroleum products is quite different from that of the United States as a whole. The following gives a comparison for 1987:

	<u>HAWAII</u>		<u>UNITED STATES</u>	
	<u>Thousand BPD*</u>	<u>%</u>	<u>Million BPD</u>	<u>%</u>
Gasoline	24.5	20.9	7.2	43.1
Jet fuel	51.4	43.8	1.4	8.4
Heavy Fuel Oil	28.2	24.0	1.3	7.8
Distillates	8.6	7.3	3.0	18.0
Other	<u>4.6</u>	<u>4.0</u>	<u>3.8</u>	<u>22.7</u>
Total	117.3	100.0	16.7	100.0

(\* Barrels per day)

Gasoline sales in Hawaii increased between 1985 and 1987 by about five percent a year. More recently the increases have been closer to two percent.

The two crude oil refineries in Hawaii, Chevron and Pacific Resources, Inc., are located in the foreign trade zone at Barbers Point and enjoy the special benefits of such location. Chevron has a rated capacity of refining 48,900 barrels of crude oil a day into the various products of the product slate. PRI recently expanded its capacity to over 95,000 barrels a day. The technology of both refineries is relatively sophisticated for their size. The two refineries together have the capacity to produce more refined products across the slate than Hawaii consumers presently require.

Gasoline is marketed to consumers in Hawaii by a fairly simple system of distribution. The system is summarized in Exhibit 6. Chevron and PRI store the gasoline they manufacture in storage facilities called "terminals." They sell some of it in bulk quantities to Shell, Texaco, and Unocal, the other major oil companies in Hawaii, who store it in their own terminals. Each terminal consists of several storage tanks, pipelines to a pier or refinery, and dispensing facilities known as "racks", where tank trucks, for example, fill up with gasoline to be delivered to gas stations.

The main terminal storage facilities are on Oahu. There are also terminal storage facilities on each of the other major Neighbor Islands. Chevron and Shell operate terminals on each major island. Chevron jobbers operate limited storage facilities at Kawaihae on the Big Island and on Molokai and Lanai. Unocal has terminals on Oahu, Maui, and the Big Island, and a jobber on Kauai and at Kawaihae. Texaco operates a terminal on Oahu and a Texaco jobber operates facilities on Hawaii. PRI operates a terminal on Oahu and a small terminal on the Big Island. Aloha Petroleum has an interest in PRI's terminal on Oahu. Aloha has no other terminal facilities of its own in Hawaii. These storage facilities are shown on Exhibit 7.

Gasoline is distributed from terminals to retail stations on the same island by tank truck. Gasoline is carried to terminals on neighbor islands by inter-island barge. Trucks then haul it to service stations on these islands.

There are approximately 350 retail service stations in Hawaii. Over 200 are on Oahu. Many, if not most, of these are franchised by one of the major oil companies.

Some are owned by the major oil companies themselves. We estimate that the retail market is presently divided approximately as follows:

Chevron	30 %
Unocal	21 %
PRI (Gas Express)	17 %
Shell	16 %
Texaco	7 %
Aloha	3 %
7-Eleven	3 %
Circle K	3 %

Exhibit 8 shows the market shares graphically.

V. **COMPONENTS OF THE PUMP PRICE IN HAWAII** (Exhibits 9, 10 & 11)

The price of gasoline at the pump is made up of four components:

- Cost of crude oil
- Refiner margin
- Retailer margin
- Fuel and excise taxes

Exhibit 9 shows these components. Exhibit 10 shows how they changed relative to each other over the study period of the report.

A. **The cost of crude oil, the first component**

The cost of crude oil to the refiner is the first constituent of the retail price of gasoline. Crude oil is the refiner's raw material for manufacturing gasoline.

B. **The refiner margin, the second component**

Some oil companies may use the word "margin" to refer solely to profit. In this report, the "refiner margin" does not mean the refiner's profit, but the difference between the price of crude oil, the refiner's basic raw material, and the refiner's price for gasoline, one of the products it makes from crude oil.

The cost of refining gasoline and delivering it to retail service stations includes the cost of land, plant and equipment, labor, working capital, other overhead, profit, and taxes as well as the cost of crude oil.

Chevron, PRI, Shell, Texaco, and Unocal for the most part deliver gasoline directly to the retail dealers who operate Hawaii's many gas stations. Because delivery typically is by tank truck, the price paid for gasoline by a retail dealer is often called the "dealer tank wagon price."

The difference between the cost of crude oil and the dealer tank wagon price is the second component of the pump or retail price of gasoline. This increment is referred to as the "refiner margin." It includes costs as well as profit.

The refiners in Hawaii, Chevron and PRI, deliver gasoline in bulk quantities to Shell, Texaco, and Unocal, who do not themselves refine gasoline in Hawaii. Shell, Texaco, and Unocal do refine gasoline elsewhere. Their bulk acquisitions of gasoline from Chevron and PRI are usually covered by "exchange agreements" rather than purchase contracts. For convenience, this report treats all five terminal operators as "refiners" for purposes of defining the refiner margin. And since the oil companies generally wholesale gasoline directly to retail dealers rather than using jobbers to do so, the refiner margin, as used in this report, also includes distribution costs and profits.

Another company, Aloha Petroleum, acts as an independent wholesaler of gasoline. Aloha neither refines crude oil nor operates terminal facilities of its own in Hawaii. It simply buys gasoline from one or more of the oil companies and resells it to retail dealers and other customers. Even though Aloha is a competitive element in the market, its margin is not otherwise identified in this report.

C. The retailer margin, the third component

The retail dealer adds its land costs, labor, overhead, and profit to the dealer tank wagon price. This is the retail dealer's basic price, before taxes, for self-service gasoline paid for in cash. If the customer pays by credit card, a credit card fee may be added. If the customer fills up at the full service pump, the basic pump price will include a further amount for the service. This third constituent of the retail price of gasoline is the retail dealer's margin.

D. Fuel and excise taxes, the fourth component

To get the actual pump price, the price to the public, you still have to add federal, state, and county fuel and other excise taxes. These include:

Fuel taxes:	<u>Amount Per Gallon</u>
1. Superfund tax (LUST*)	\$.002
2. Federal fuel tax	.091
3. State of Hawaii fuel tax	.11
4. County fuel tax	
Honolulu	
before 7-1-89	.115
after 7-1-89	.165
Other counties	.088

Hawaii State General Excise taxes:

1. On the sale between oil company and the retail dealer	1/2%
2. On the sale between the retail dealer and the public	4%

(\*LUST = Leaking Underground Storage Tank tax)

The breakdown of these taxes is shown graphically on Exhibit 11.

## VI. THE GASOLINE MARKETS IN HAWAII ARE OLIGOPOLIES

### A. Oligopolies in General

When a market has very few sellers in it, economists call it an "oligopoly." A market with five sellers or less is a highly concentrated oligopoly. When there are a limited number of sellers of product in a market, there is less price competition than when many sellers compete for a limited pool of buyers. (By "price competition", we mean the attempt by a seller to increase sales by lowering its own price in relation to its competitors' prices.) As a result, prices tend to be higher than they would be in a competitive market.

When there is only one seller, economists call it a monopoly. In such a market there is no competition for buyers. There being no competition, the monopolist may charge the highest price the market will bear.

Neither a monopoly nor an oligopoly is, in itself, illegal. As long as new competition is free to come into the market and compete for a share of the monopolist's or the oligopolists' profits, there is, ordinarily, little need for concern. Moreover, no violation of the antitrust laws is involved if the monopoly or oligopoly persists simply as a result of natural conditions in the market. For example, a market too small to support more than two or three sellers does not involve an illegal oligopoly.

But when a seller's business practices keep competition out of the market or when a seller conspires with other sellers to fix the market price, then that conduct will violate the antitrust laws.

#### B. Pricing in Oligopolies

There are so few sellers in an oligopolistic market that the withdrawal of the supply of one of them will drive the market price up as the demand on the remaining sellers is increased. Even when no seller leaves the market, price competition in an oligopoly naturally tends to be less aggressive than in a market where there are many sellers. This is because sellers, to maximize profits, must base their pricing decisions on the pricing decisions of each other. When one seller reduces its price of gasoline, for example, the others must follow to keep their customers, i.e., their market shares. If the lower price does not increase total sales, every one makes less money. When one seller increases its price, however, the others may or may not follow. If they don't, the one who increased its price must bring it back down. Otherwise it will lose some of its market share to those charging a lower price, assuming consumers shop around. But if the others follow the price up, everyone makes more money--so long as people don't stop buying gasoline because of the increase in price. The reason you do not find aggressive price competition in a highly concentrated oligopoly is that all the sellers end up making less money. They can make more money simply by not aggressively undercutting each other and by keeping their prices close together and moving up. In a freely competitive market, when the price gets high enough, new competition will come into the market and bring the price back down to competitive levels. If new competition cannot come in, prices can keep going up as long as consumers keep buying.

By itself, an oligopolistic market usually results in higher prices. When high entry barriers block new competition from coming in and restoring lower, competitive prices, the higher oligopolistic prices go on indefinitely.

#### C. Oligopolies in Hawaii

There are several gasoline markets in Hawaii. Gasoline on Oahu is one separate market. Each of the Neighbor Islands is a separate gasoline market. If you live in Honolulu, you can't drive to San Francisco to fill up with less expensive gasoline. You

can't drive to Hilo, either. And, for cars, there is no really good substitute yet for gasoline.

There are only five major sellers of wholesale gasoline on Oahu. There are only five on the Big Island. There are three each on Maui and Kauai. These are highly concentrated markets. The gasoline markets in Hawaii are highly concentrated oligopolies.

#### D. Other Petroleum Products

Refiners can't manufacture just gasoline. For example, a hundred barrels of crude oil may produce only 20 barrels of gasoline. There also would be 45 barrels of jet fuel, 10 barrels of distillates, and 25 barrels of heavy fuel oil. (There is some loss to shrinkage which the example does not take into account.) These products sell at different prices. For example, while the price of gasoline may be much higher than the price of crude oil, the price of heavy fuel oil, being the residual product, is characteristically about the same as or lower than the price of crude oil. It also must be kept in mind that the costs involved in producing and distributing these other products may be quite different, as well.

A refiner, to go on doing business, let alone expand it, must sell all its products "across the barrel" at a profit sufficient to make doing business worthwhile. Otherwise, all the products of the barrel are jeopardized, not just gasoline.

Obviously, an economic analysis of the profitability of the oil industry in Hawaii would not be complete without an analysis of the interrelationships among these various products. Such an analysis is far beyond the scope of our report at this stage. The observations made in this report are based on the fact that the markets for gasoline in Hawaii are separate from the markets for jet fuel, for distillates, and for heavy fuel oil. The legality of the pricing practices of the oil companies in distributing gasoline in Hawaii does not depend on whether any one of the oil companies' operations "across the barrel" are profitable or not profitable. It depends on whether the conduct or agreements of a company are illegal with respect to any product in any market.

### VII. FACTORS THAT DISCOURAGE PRICE COMPETITION IN HAWAII (Exhibit 12)

A number of factors lessen price competition in the highly concentrated gasoline oligopolies in Hawaii.

#### A. Entry Barriers Block New Competition In Hawaii

Various barriers block the entry of new competition into the gasoline oligopolies in Hawaii. To compete effectively on the wholesale level, you need access to a bulk



supply of gasoline, access to terminal storage facilities, and access to a sufficient retail market. Many factors make it difficult for new competitors to gain access to such facilities and markets in Hawaii. Not the least of these is the fact that it would not be in the interest of the existing oil companies to supply a new competitor with petroleum products in bulk quantities or with terminal storage. On the other hand, the cost of transporting bulk gasoline to Hawaii and storing it in newly constructed facilities would not only require a new competitor to bear higher capital and operating costs than do the existing companies, but also additional supply might depress the price of gasoline below the price a new competitor would need to make entry profitable. In other words, a new competitor in Hawaii would run the risk of reducing the price of gasoline to a point that, with the higher costs, he would go out of business! Clearly, in Hawaii, the economies of scale and the self interest of the already established companies work against new competition.

In a nutshell, whether new competition tries to begin a business in Hawaii by buying locally refined wholesale gasoline or by bringing in west coast gasoline by ship, the costs and risks are very high. Evidence of this fact is that it has not been done in many, many years.

#### B. Inelastic Demand Aggravates Reduced Competition

In Hawaii the demand for gasoline is relatively "inelastic." The demand for a commodity is inelastic when a substantial increase in price can be imposed without a significant loss in sales. The demand for essential commodities is usually inelastic. There is evidence that a 10 percent increase in price of gasoline in Hawaii will result in only a one percent loss in sales.

An inelastic demand is yet another factor that tends to discourage entry of new competition into the market. This is because total demand will not increase much unless the market price is reduced significantly. In other words, people who are not driving now because the price of gasoline is too high, probably won't start driving unless the price of gasoline goes down very significantly.

In addition, an inelastic demand tends to lessen competition among the few sellers already in an oligopolistic market by making it easier for them to keep prices together and to keep them moving up.

### VIII. OTHER FACTORS THAT MAY LESSEN COMPETITION IN THE HAWAII GASOLINE MARKETS (Exhibit 13)

Even though Chevron, PRI, Shell, Texaco, and Unocal are supposed to be competitors in Hawaii, they deal with one another in many ways. They exchange gasoline. They share pipelines. They buy and sell additives to and from one another. They provide

storage and terminalling services to one another. These dealings, and the interdependence they generate, appear to discourage meaningful price competition.

A. Exchange Agreements

Shell, Texaco, and Unocal do not refine gasoline locally. They obtain gasoline under "exchange agreements" with Chevron or PRI. Shell, for example, might obtain the gasoline it needs in Hawaii from PRI who, in exchange, takes the gasoline it needs in some other market where Shell has a refinery, say in California. At the end of the contract, any difference in quantity is paid at a price negotiated by the parties.

Exchange agreements enable Shell, Texaco, and Unocal to do business in Hawaii without having to import gasoline from the mainland and pay the cost of transportation to do so. Thus they insure that the prices charged by Chevron and PRI do not exceed the west coast wholesale price of gasoline plus the cost of transportation. Exchange agreements may have procompetitive effects in Hawaii.

In the context of the oligopolistic structure of Hawaii's gasoline markets, exchange agreements may have anticompetitive effects as well. They appear to discourage new competition by making it more costly for a new entrant to do business in Hawaii than the existing oil companies. Exchange agreements also appear to lessen competition among the existing companies by locking in existing supply arrangements.

A potential entrant into the wholesale gasoline market in Hawaii obviously would need a source of supply of gasoline. Obtaining unbranded gasoline from a local refiner is the least costly option. However, this would require local suppliers, Chevron, PRI, Shell, Texaco, and Unocal, to alter the existing exchange arrangements they have with one another. Or, it would require the local refiners to substantially increase their output of gasoline. Either course would destabilize the existing supply. Accordingly, the local oil companies likely would not find it in their interests to supply gasoline to a new entrant except at regular wholesale prices at the terminal rack or as a branded jobber. These prices doubtless would be higher than the new competitor would pay for unbranded gasoline in bulk from a refiner in a competitive market.

A new entrant would appear to need a reliable exchange arrangement with Chevron or PRI to be a successful competitor in Hawaii. The new entrant might satisfy its redelivery obligations on the mainland with lower priced mainland gasoline. If it could do this, it might be able to charge wholesale prices in Hawaii that were lower than those charged by Chevron, PRI, Shell, Texaco, and Unocal. The resulting competition would tend to bring wholesale prices in Hawaii down.

Such a result, however, depends on one or more of the oil companies already in Hawaii being willing to enter exchange arrangements for the supply of unbranded gasoline

to a new competitor free of conditions that discourage competition with them. The Department has not yet been able to determine whether a new competitor can obtain an exchange partner in Hawaii who will supply unbranded gasoline free of such conditions.

Although exchange agreements may not be price fixing agreements in the classic sense, they may lessen competition in Hawaii. They appear to us to lock in existing supply arrangements. Moreover, they appear to lock out new competition seeking to introduce aggressively competitive pricing strategies.

The end result may well be that in Hawaii these agreements tend to discourage aggressive price competition from within and from without.

#### B. Ownership and Control of Retail Marketing Facilities

The oil companies have each constructed elaborate vertical networks for the distribution of gasoline to consumers in Hawaii. They give their gasoline brand names. They supply gasoline under formal franchise and supply arrangements with retail dealers. They lease the service stations to the retail dealers. They condition the supply of their gasoline on the use of their signs, tanks, and other facilities. They arrange promotional programs providing benefits to dealers who meet sales goals. These arrangements may involve important efficiencies that reduce the cost of distributing gasoline in Hawaii.

These arrangements, however, also may have effects that lessen competition. They may exclude potential competitors. A new entrant into the market at the wholesale level would need the assurance of sufficient retail outlets to justify risking the substantial investment that entry into the Hawaii market would require. But the branded distribution networks of the incumbent oil companies are so extensive that the likelihood of a new entrant constructing an adequate and competitive distribution system of its own seems remote at best. Aloha Petroleum has made the effort. However, it is dependent on Chevron, PRI, and the other incumbents for its supply of gasoline.

These arrangements in the Hawaii market may be yet another factor limiting aggressive price competition. Generally speaking, branding a product indicates that the product can be differentiated from similar products in a substantial way. Gasoline, however, is a relatively homogeneous product. It's the price that counts. Gasoline wars are fought with prices. The vertical arrangements that make up the branded distribution systems in Hawaii, however, tend to promote price maintenance rather than aggressive interbrand price competition, especially at the wholesale level. This is because vertical distribution arrangements in a context of a high level of concentration, high entry barriers, and an inelastic demand make price wars very foolish for the industry. It is inconceivable that any of the major oil companies would allow a branded distributor or retailer to lose such a war. The harm to its distribution system is simply not justifiable. It would have to be a fight "to the death," and all the others would have to treat it the same. Since

sellers in an oligopolistic market are interdependent in their market responses, aggressive price cutting would tend to cause a market-wide war. The result would be that everyone would lose--except, of course, the consumers. This may be why, at least in recent memory, there has never been a real price war over gasoline in Hawaii.

C. Closed Terminals

There is some evidence of discrete instances of a terminal operator in Hawaii refusing to deal with an outsider seeking unused space to store gasoline that would be imported from the mainland. Such practices clearly lessen competition. The result is that such practices help the local oil companies to maintain the status quo of the market. And maintaining a high level of concentration locks in the tendency toward mutual interdependence, which in turn reduces the likelihood of vigorous competition.

D. Other Practices

The foregoing is a brief discussion of three practices of the oil companies that raise serious concerns in the structural context of Hawaii's gasoline oligopolies. The listing is not intended to exhaust the practices that raise questions. The Department is in the process of analyzing the listed practices and a number of others in close detail.

IX. RESULTS OF LESSENE**D**COMPETITION IN HAWAII (Exhibit 14 and 15)

Even before the Exxon Valdez incident, prices in Hawaii were far higher than one would expect in a freely competitive market. This has continued since that time to the present. Exhibit 14 shows Hawaii pump prices compared with mainland pump prices since 1978, and both of these are compared to the price of crude oil.

The higher prices in Hawaii cannot be explained by differences in the cost of crude oil. The crude oil markets of the world are no less accessible to Hawaii than to any other gasoline market. Nor can the price differences be explained by the cost of transportation. Most oil companies own their own tanker fleets. Hawaii's location is just as advantageous as the mainland's in relation to foreign crude oil sources. Therefore, location differentials appear to be strictly a matter of perception and negotiation on the part of the oil companies. On the other hand, the cost of transportation does appear to function as a barrier to the importation of lower priced mainland wholesale gasoline.

Nor can the higher retail prices in Hawaii be explained entirely by higher Hawaii taxes. Gasoline taxes in California (9 cents) are among the lowest in the country. Only Alaska (8 cents), Florida (4.4 cents), Georgia (7.5 cents), and New York (8 cents) are lower. The difference between Hawaii fuel taxes and, for example, those in California may occasionally be great enough to account for higher retail prices in Hawaii. However,

a comparison of annual average retail prices for Honolulu and California reveals that the higher retail price for gasoline in Hawaii cannot be explained by higher taxes in Hawaii. The difference between Hawaii and California prices has been significantly greater (between 3 and 13 cents) than the difference between the taxes in every year at least since 1978. In any event, higher Hawaii fuel taxes do not explain why the wholesale price for gasoline is higher in Hawaii than elsewhere. Fuel taxes are added on top of the wholesale price, not included in it.

On the other hand, it appears true that generally it costs more to do business in Hawaii than most places on the mainland. We do not know whether the differential is great enough to explain the difference in gasoline prices. We suspect that it is not. The responses of the oil companies to our investigation did not provide the data needed to resolve the point. We will be examining this issue in detail as we carry our investigation forward.

In any event, the higher cost of doing business in Hawaii does not explain why the wholesale price of gasoline in Hawaii after Exxon Valdez continued to rise until mid July, 1989, even though the wholesale price of gasoline on the west coast had fallen since May. Nor does it explain why the disparity between the price of wholesale gasoline on the west coast and the higher price in Hawaii continued to widen during this period until August 1989. On the other hand, if the gasoline markets in Hawaii are not freely competitive, but are driven by anticompetitive practices of the oil companies, that fact would tend to explain these discrepancies.

It appears to us that a combination of the oligopolistic market in Hawaii, the inelastic demand for gasoline by Hawaii consumers, the entry barriers to new competition, and the interdependence and interrelationships of those oil companies doing business in Hawaii have resulted in "margins" in Hawaii far greater than those found on the mainland. These margins exist because there is virtually no price competition for wholesale gasoline in Hawaii. Exhibit 15 summarizes these points.

#### X. WHAT'S LEGAL AND WHAT'S NOT (Exhibit 16)

Hawaii law does not prohibit independent pricing by individual firms. Thus, it is not illegal for a company, acting independently, to raise its price. Nor is it illegal for a company, acting independently, to make as much profit as it can. Indeed, in a truly competitive market, you would expect a firm, independently, to maximize its profits and minimize its losses. Any other action would be contrary to its interests.

Hawaii antitrust law, like the federal law, prohibits agreements to "fix" prices. For example, an agreement between any of the oil companies to raise gasoline prices in Hawaii after Exxon Valdez would violate Hawaii antitrust law. It would also violate

Hawaii antitrust law to make an agreement to do something that would have the effect of controlling prices. For example, an agreement to limit output would violate Hawaii's antitrust law because limiting output would have the effect of increasing the market price of gasoline in Hawaii. The law also forbids oligopolists to agree on collateral matters that in purpose or effect facilitate noncompetitive pricing. Moreover, the law forbids oligopolists to act together in ways that raise entry barriers.

Hawaii antitrust law also prohibits monopolization and attempts to monopolize. What is illegal is not "monopoly", but "monopolization." For example, it is not unlawful to win the game of competition. On the other hand, it would violate Hawaii antitrust law for one of the oil companies to reduce prices below cost with the intent to drive all the other companies out of business in Hawaii. It would also violate Hawaii antitrust law for that company, after it had driven all the others out of business, to increase prices above competitive levels for the purpose of extracting a monopoly profit. In the first situation, the company would be guilty of attempted monopolization. In the second, the company, now a monopoly, would be guilty of monopolization.

Hawaii antitrust law also prohibits unfair methods of competition and unfair or deceptive trade practices. For example, it would be illegal for an oil company to use collusive, coercive, predatory, or exclusionary practices to bring about a profitable increase in the price of gasoline in Hawaii. Even in the absence of collusive, coercive, predatory, or exclusionary conduct, business practices are "unfair" if those practices either have an anticompetitive purpose or cannot be supported by an independent legitimate reason or are contrary to the company's individual self interest. Price increases depending on such illegal practices are sometimes called "price gouging."

#### **XI. THE NATIONAL GASOLINE SITUATION AFTER EXXON VALDEZ** (Exhibit 17)

As noted above, on March 24, 1989, the Exxon tanker Valdez ran aground on Bligh Reef in Prince William Sound, Alaska. It spilled 250,000 barrels of ANS (Alaska North Slope) crude oil into the sound. The port closed to tanker traffic for four days. Crude oil shipments through the Trans-Alaskan Pipeline were reduced from 2 million barrels a day to 800,000. Although the port was reopened within 14 days, the U.S. market was deprived of a total of about 12.5 to 13 million barrels as a result of the spill. The events after Exxon Valdez are summarized on Exhibit 17.

At the time, U.S. production for 14 days was about 238 million barrels. The loss from Exxon Valdez was only about 5 per cent of that amount. U.S. crude stocks at the time were about 348 million barrels. That is enough to cover the loss from the Exxon Valdez spill 29 times.

West coast United States production was about 2.5 million barrels a day. The drop that resulted from the spill was about 33 per cent of west coast production at its peak, and about 26 per cent over the 14 days. West coast crude oil stocks were about 80 million barrels, about 6.7 times the loss from the Exxon Valdez spill.

Most experts are of the opinion that the loss of crude oil from the Exxon tragedy did not have a substantial effect on the supply of oil to the U.S. market.

Nevertheless, a number of striking events occurred during the weeks after the spill. Exxon and British Petroleum invoked the "force majeure" or "act of God" terms of their supply contracts and cut deliveries to west coast refineries by 15 to 20 per cent. Chevron and Shell announced that they would ration their supplies to west coast distributors. The market price for west coast gasoline shot up about 30 cents and reached a dollar a gallon in Los Angeles in the second week in April. Undoubtedly as a result, gasoline shipments bound elsewhere were diverted to the west coast.

Since supply contract price formulas are commonly tied to spot market prices, these events affected the contract and futures markets as well.

Other events occurred, entirely independent of the Alaska spill, that at least must be noted. During the winter and spring of 1989, various accidents curtailed production at several sites. Shell UK shut down production in the North Sea for two weeks as a precautionary measure in response to a sudden increase in pressure in an exploration well. The loss was 48,000 barrels a day. Norway's Ekofisk oil field closed for about a week owing to a fire. The loss was 245,000 barrels a day. There were disruptions in supply in Venezuela and Columbia due to civil unrest. Also, North Sea petroleum producers had cut back production about 300,000 barrels a day to increase prices.

Then, on April 9, 1989, a major fire occurred at Chevron's Richmond refinery in California. Richmond supplies about 10 per cent of the west coast's gasoline. On April 18, 1989, a major explosion and platform fire occurred at the Cormorant Alpha Platform in the North Sea. The platform was shut down for about six weeks, cutting off about 472,000 barrels a day, or about 10 per cent of Britain's petroleum production.

The price of crude oil was increasing at the time of the wreck of the Exxon Valdez. The incident, itself, does not seem to have had a significant effect on reported prices. By the end of April, crude markets had stabilized. By the middle of June, WTI (West Texas Intermediate, a crude oil used in the industry as an indicator or index) was \$20, ANS was \$17, and Arab light was just over \$15. By the middle of July, WTI was about \$20.45, ANS was \$17.45, and Arab Light was \$15.85. By the middle of August, WTI was \$18.60, ANS was \$16.35, and Arab Light was \$15.15. Prices recovered some in September. And by early October, WTI had returned to just over \$20, ANS to over \$17.75, and Arab Light to just under \$17. In the year and a half since May 1988, the spot price of ANS crude

increased about \$3 a barrel or about 7.2 cents a gallon. The increase in WTI was only slightly more.

Wholesale gasoline prices rose steadily throughout the United States after the Exxon Valdez spill. The increase was considerably sharper on the west coast. Prices stabilized in most markets by May. In the middle of June, the wholesale price of unleaded regular gasoline on the west coast was 69.7 cents a gallon. In the middle of July it was 62.9 cents. In the middle of August, it was down to 49.4 cents. The price went up in September, and by the first week in October it was 60.60 cents.

## **XII. PUBLIC OUTCRY AND THE RESPONSE OF THE OIL COMPANIES**

The increase in gasoline prices after Exxon Valdez caused a public outcry. The oil companies, however, did not roll back their price increases. Rather, they justified them. The oil companies gave several reasons for the increases:

- 1) The higher cost of crude oil
- 2) Seasonal increases in demand
- 3) Decreased stores or inventories of gasoline
- 4) Refinery problems (Richmond refinery fire)
- 5) Stricter EPA regulations
- 6) North Sea production problems
- 7) Panic and/or market uncertainty
- 8) Refinery capacity problems
- 9) Refinery downtime for maintenance and turnarounds

The oil companies denied any collusion in fixing gasoline prices. Generally, the oil companies asserted that the price increases were the result of market forces determined by competition.

## **XIII. THE MAINLAND INVESTIGATIONS**

There were calls from many sources, including the Attorney General of Hawaii, for investigations by the United States Justice Department and the Federal Trade Commission. Neither agency commenced an investigation in response to them. On the other hand, four states investigated: Washington, Oregon, Idaho, and Massachusetts. The conclusions were similar. Those of the Oregon report are typical.



The Oregon report concluded:

- 1) that the Valdez spill did not cause the retail price increases, but it gave the oil companies an "opportunity" to increase prices;
- 2) that there was no persuasive evidence of illegal price fixing or pricing collusion;
- 3) that the increase in the price of crude oil does not by itself account for the retail price increase; and
- 4) and that an important factor explaining the increase was that refiner margins increased "very significantly."

#### **XIV. CONCERNS OF THE STATE OF HAWAII**

Our Department, however, thought that the causes of the price increases in Hawaii should be studied in greater depth and detail. Gasoline prices in Hawaii were already substantially higher than on the mainland. They were substantially higher than one would expect in a truly competitive market. We wanted to find out whether the oil companies could explain their price increases in Hawaii in terms of business decisions and practices that were legal under Hawaii's antitrust laws. The questions raised by Exxon Valdez precipitated the formal investigation, but the intent was to go far beyond that one incident.

#### **XV. THE HAWAII INVESTIGATION (Exhibits 18, 19, 20, and 21)**

Up to now, this report has explained the reasons for our formal investigation. The data we gained from our requests of the oil companies are outlined in Exhibits 18 through 21. As shown on Exhibit 18, the price of ANS crude oil, used by both Chevron and PRI in making gasoline, rose from about 39 cents a gallon in early January 1989 to a high of about 45 cents in April. (The Valdez spill was March 24, 1989.) The price then fell to about 40 cents in August. It rose to a high of about 53 cents in January 1990 and then fell continuously until June to a price of under 34 cents, lower than it was before the Exxon spill.

Exhibit 19 shows what happened to the pump price of gasoline in Honolulu during the same period. From March through April of 1989, the pump price of gasoline and the cost of crude oil both went up, but the pump price went up much more than the cost of oil.

After April, the cost of crude oil fell, but the pump price of gasoline continued to increase until August.

But in late July and early August, when pump prices began to fall, the price of crude oil was increasing. The pump price began to increase again about the first of the new year, 1990, and has continued to increase since. Meanwhile, the cost of crude oil fell and then rose.

Exhibit 19 shows that the cause of the increase in the pump price cannot be explained entirely by increases in the cost of crude oil. Indeed, the evidence is clear that on more than one occasion in Hawaii after Exxon Valdez, when the price of gasoline to the public was going up, the cost of crude oil to the oil companies was going down.

Exhibit 20 shows that the retail dealers were not responsible for the increase in the pump price while the crude oil price was falling. The retail dealers for the most part merely passed on the price increases that the oil companies charged them. Based on the data furnished to the Department of the Attorney General by the oil companies, it is clear that the oil companies are responsible for increasing the price of gasoline and that the increases they imposed were more than were justified by contemporaneous crude oil costs.

Exhibit 21 compares the price of wholesale gasoline on the west coast and in Hawaii during the period. A comparison of the west coast and Honolulu prices for wholesale gasoline indicates that between April and July of 1989, the price in Honolulu was increasing when the price on the west coast was decreasing. Furthermore, the difference between the two during this same period was more than five to six cents, the amount usually cited as the cost of transporting gasoline between the west coast and Honolulu. Under these circumstances one would have expected someone to import the cheaper west coast gasoline. But, according to the information so far available to us, none came, at least not in any significant quantity.

If it is true that lower priced west coast wholesale gasoline did not come into Hawaii markets during this period, the oligopolistic structure of the gasoline markets in Hawaii may explain why it was not brought in by firms new to the Hawaii markets. But it does not explain why it was not brought in by one of the non-refiner competitors already here, namely, Shell, Texaco, or Unocal. If the price of west coast gasoline plus the cost of transportation were lower than the bulk price of gasoline refined in Hawaii, it would seem in the best interest of those companies to bring in the west coast gasoline rather than buying higher priced gasoline from Chevron or PRI. The Attorney General has not yet found a satisfactory explanation for these concerns.

## **XVI. INITIAL FINDINGS AND CONCLUSIONS (Exhibit 22)**

Based on a study of the market for gasoline in Hawaii, the gasoline industry in Hawaii, and the history of gasoline pricing in Hawaii by the industry, the following are our initial, tentative findings and conclusions:

1. Gasoline prices are higher in Hawaii than on the mainland primarily because of the absence of a competitive alternative supply of gasoline. Hawaii refiners and terminal operators, together, have the ability to maintain gasoline prices at a level above the cost of mainland gasoline plus the cost of transportation. While it is true that general business costs and taxes may be higher in Hawaii than on the mainland, this by itself does not explain why Hawaii's gas prices are so high, nor does the cost of transportation.
2. Gasoline prices are higher on the Neighbor Islands than in Honolulu primarily because of a similar lack of an alternative competitive source of supply, the power of the terminal operators on the Neighbor Islands to maintain gasoline prices above Honolulu levels, and perhaps, in some cases, the lack of effective competition among retail dealers in certain remote areas.
3. The oil spill from the Exxon Valdez did not cause the price increases in Hawaii.

There were two major causes. The first was the rising price of crude oil in the world market before Valdez. The other major cause was the ability of Hawaii's oil companies, taken together, to increase the price of gasoline without losing business, and the decision of some of them to do so when the opportunity presented itself after Valdez.

4. A portion of the gasoline price increases in Hawaii in the spring of 1989 after Exxon Valdez, not being explained by contemporaneous increases in the cost of crude oil, probably was the result of decisions and practices of the oil companies, or some of them, intended to increase profits.

It must be re-emphasized that increasing profits by itself is neither unconscionable nor illegal. It must be remembered, too, that the oil and gasoline markets in Hawaii are probably too small to support more than a few refiners and terminal operators. Some barriers to entry into the Hawaii markets are the natural result of characteristics unique to Hawaii. And it also must be emphasized that the oil companies in Hawaii engage in practices that improve their efficiency in producing and distributing goods and services to the public. To the extent that such practices result in lower prices and more and better goods and services, the public is benefited.

5. However, the Attorney General is of the opinion that, although there is no present evidence of "price fixing" in Hawaii, certain practices of some of the oil companies, while perhaps not illegal or even anticompetitive by themselves in a freely competitive market, may be illegal because of their anticompetitive impact in the context of the Hawaii gasoline oligopolies. Exchange agreements, the ownership and control of retail facilities, and closing terminals to potential competitors, in particular, appear to the Attorney General to make it less likely that the oil companies will compete in their pricing and will make it harder for new competition to enter the market successfully. The oligopolistic character of the Hawaii markets magnifies the anticompetitive tendencies of these practices. As a result, these practices tend to aggravate the otherwise natural tendency of the Hawaii markets, especially because of their limited size, to discourage aggressive competition.
6. Because of the incompleteness of most of the responses of the oil companies to the Investigative Demand, we cannot say at this time that the practices of the oil companies we believe to be anticompetitive are entirely without justification. To make that determination, a complete economic analysis will have to be undertaken of each practice, its interrelation with the other practices of the company concerned, the interrelation of the practices of the different companies, and the actual singular or collective impact of the various practices on the pricing structure of the Hawaii market. This investigation is already underway.

## **XVII. THE RECENT EVENTS IN THE MIDDLE EAST** (Exhibit 23)

On July 27, 1990, the members of the Organization of Petroleum Exporting Countries (OPEC) agreed to limit production for the purpose of increasing the world price of crude oil. As soon as it was apparent that the members of OPEC would reach agreement, the price of crude oil throughout the world began to rise. On August 2, 1990, Iraq invaded Kuwait. This action has caused the loss of some 10 million barrels of crude oil per day to the world market. The price of crude oil immediately shot up about ten dollars a barrel. That is 23.8 cents a gallon. The retail price of gasoline on the mainland over the weekend of August 3-4 went up as much as 15 cents. The price of gasoline in Hawaii went up as well. But the increases were not more than six cents. Texaco announced a temporary reduction of gasoline prices. Unocal and PRI announced a short moratorium on gasoline price increases. Governor Waihee announced a ten-point plan to protect the public against undue fuel price increases and prepare for the possibility of fuel shortages.

By August 24, 1990, the price for crude oil was about \$31 a barrel and the price of unleaded wholesale gasoline was about \$1.05 a gallon. On August 27, crude oil fell \$4 to about \$27 a barrel (i.e., to about 64.3 cents a gallon). Gasoline fell about 17 cents to 87.9 cents a gallon. The prices of crude oil and wholesale gasoline have remained fairly steady since.

Since July 26, 1990, the day before OPEC agreed to limit production, wholesale gasoline prices on the mainland have risen more than 20 cents a gallon. The retail price of gasoline in Honolulu on August 30, 1990 was generally between \$1.35 and \$1.45. It is interesting to note that during the week before the release of this report, gasoline prices in Hawaii were no longer significantly higher than those on the mainland.

The Department of the Attorney General is watching the local situation closely, and we have joined with other state attorneys general in seeking a national investigation into the situation.

#### **XVIII. THE ATTORNEY GENERAL'S RECOMMENDATIONS** (Exhibit 24)

- A. The Attorney General's investigation should be continued. The oil companies should fully explain the potentially illegal agreements and practices that appear to discourage competition in the Hawaii gasoline markets.
- B. Legislation should be adopted.
  - 1. Requiring refiners, terminal operators, and other wholesalers of petroleum products to report to the State of Hawaii their:
    - a) raw material costs, production costs, storage costs, and marketing costs;
    - b) sales revenues and volumes;
    - c) profits for Hawaii operations; and
    - d) weekly foreign and domestic imports of petroleum and petroleum products.
  - 2. Requiring refiners, terminal operators, and other wholesalers of petroleum products to file with the State of Hawaii a tariff listing all prices at which they offer goods or services for sale or lease.

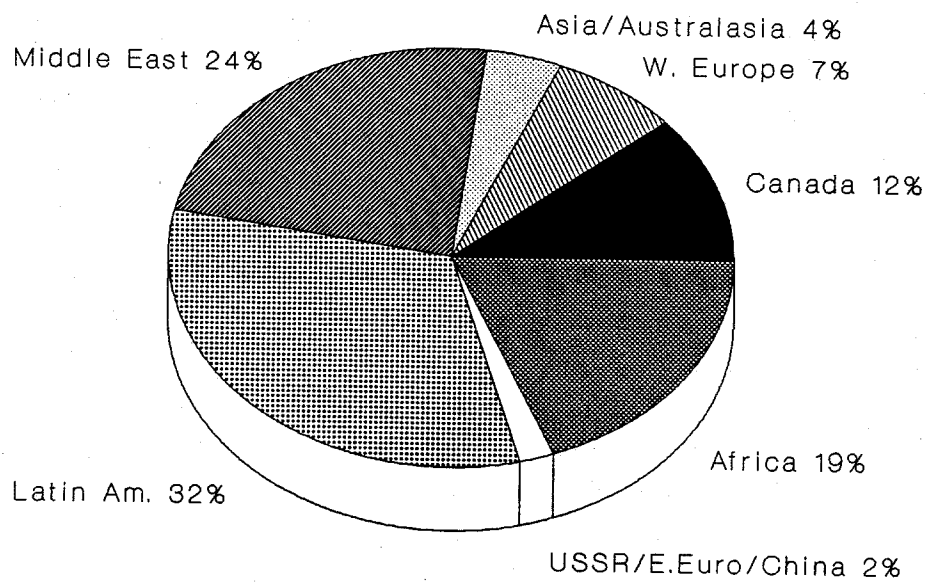
3. Prohibiting any terminal operator with excess capacity from refusing to provide terminalling services to any person at the prices published in the tariff on file with the State of Hawaii.
4. Funding a unit of state government whose job it would be to monitor and analyze oil industry data and provide this resource to the Department of the Attorney General in its continuing gasoline price investigation. In addition, this unit should study:
  - a) whether a public petroleum products storage authority with power to import, store, and market oil products should be established;
  - b) the desirability of adopting an oil industry excess profits tax;
  - c) the desirability of adopting uniform rules and standards in Hawaii for measuring amounts, including marginal cost and marginal revenue, used in antitrust economics;
  - d) ways by which concentration in the Hawaii gasoline markets can be reduced;
  - e) ways to lower barriers to the entry of new competition;
  - f) the desirability of prohibiting refiners, terminal operators, and other wholesalers of petroleum products from entering exclusive dealing or tying arrangements in the distribution of products;
  - g) ways to reduce the costs of oil companies doing business in Hawaii.

### Course of the Investigation

March 24, 1989	Exxon Valdez went aground in Alaska
May 1989	Gasoline prices in Hawaii up by about 20%
May 19, 1989	Attorney General announced Investigation
Summer 1989	Attorney General engaged experts, consulted officials and other experts, reviewed public records, court records, oil data, etc.
June 23, 1989	Attorney General sent voluntary questionnaire to oil companies and gas stations
July-August 1989	Responses to questionnaire slow and incomplete
September 1989	Attorney General served compulsory investigative demand on oil companies and about 100 gas stations
Oct-Nov 1989	Responses to investigative demand slow and 1989 data incomplete with few exceptions-Most frequent excuse was that the company did not keep the data asked for
December 1989	Attorney General began analysis of responses to investigative demand
December 1989- June 1990	Attorney General obtained responses from June 1990 a delinquent companies, input price data into computers, studied agreements and other documents received from oil companies, consulted with experts, and prepared report
July 1990	Attorney General sent draft report to oil companies for review and comment
July 31, 1990	Comments from oil companies due-Comments received from two companies
August 2, 1990	Invasion of Kuwait by Iraq

# America's Oil Imports 1989

(Includes Crude and Product Imports)

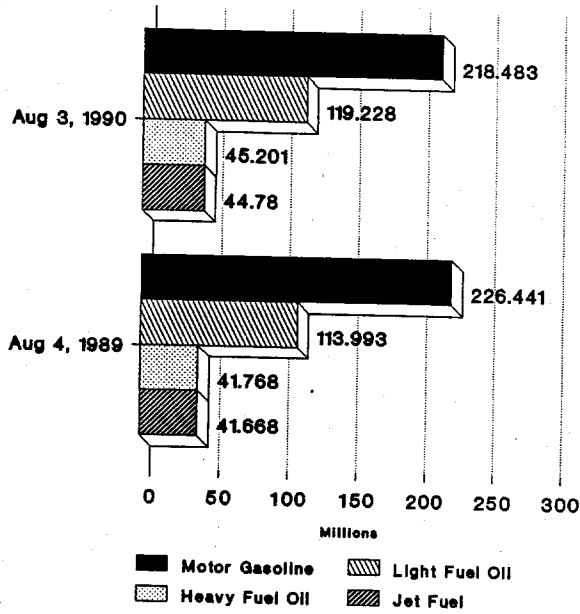


Source: BP Stats Review of World Energy

EXHIBIT 2



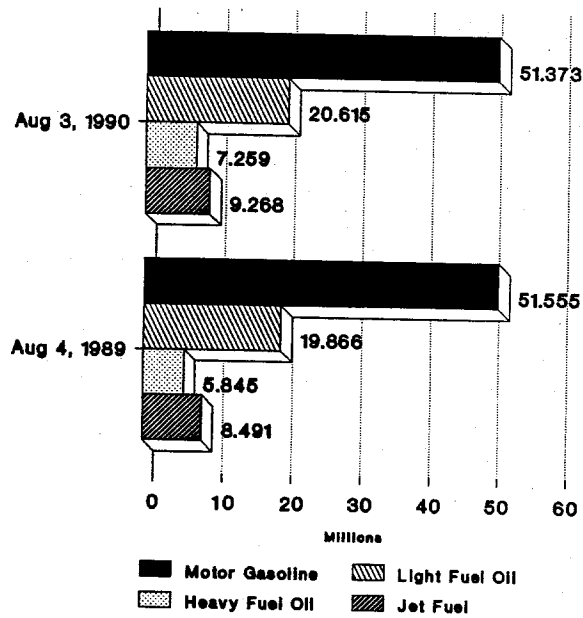
### U.S. Oil Stockpiles Motor/Light/Heavy/Jet



Source: Am. Petro. Institute/WSJ 8/8/90

EXHIBIT 3

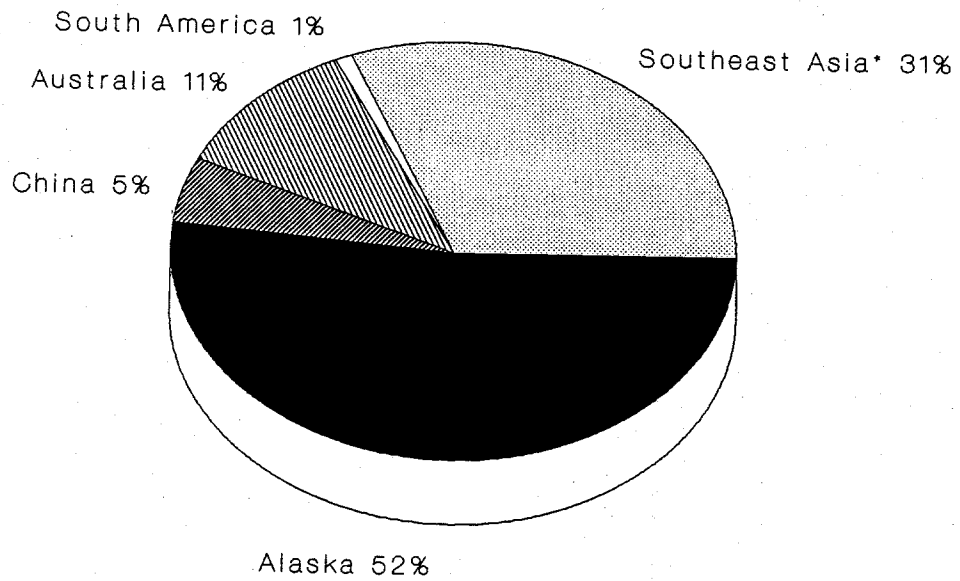
### U.S. Oil Production Motor/Light/Heavy/Jet



Source: Am. Petro. Institute/WSJ 8/8/90

EXHIBIT 4

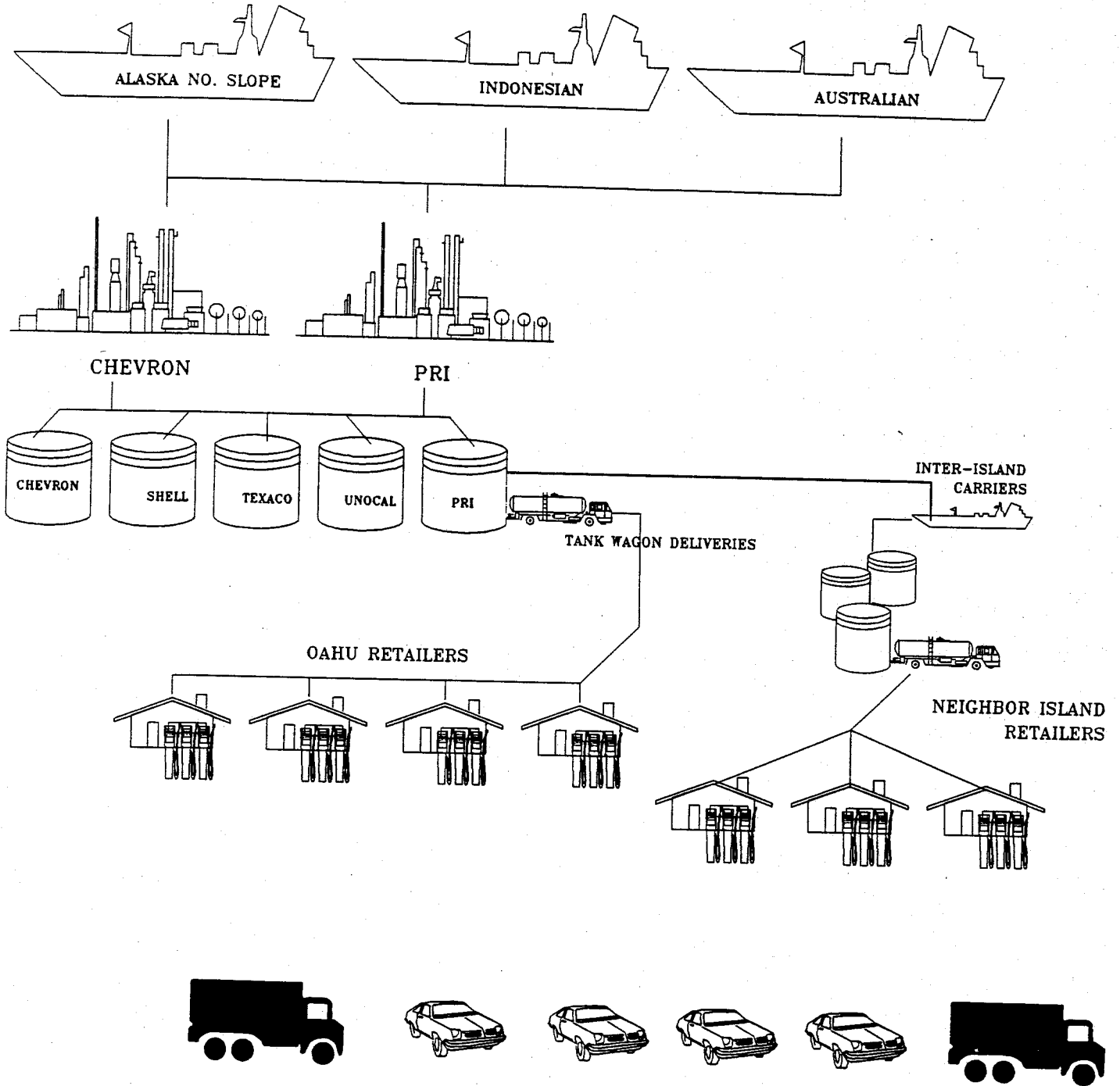
# Hawaii's Crude Oil Imports 1989



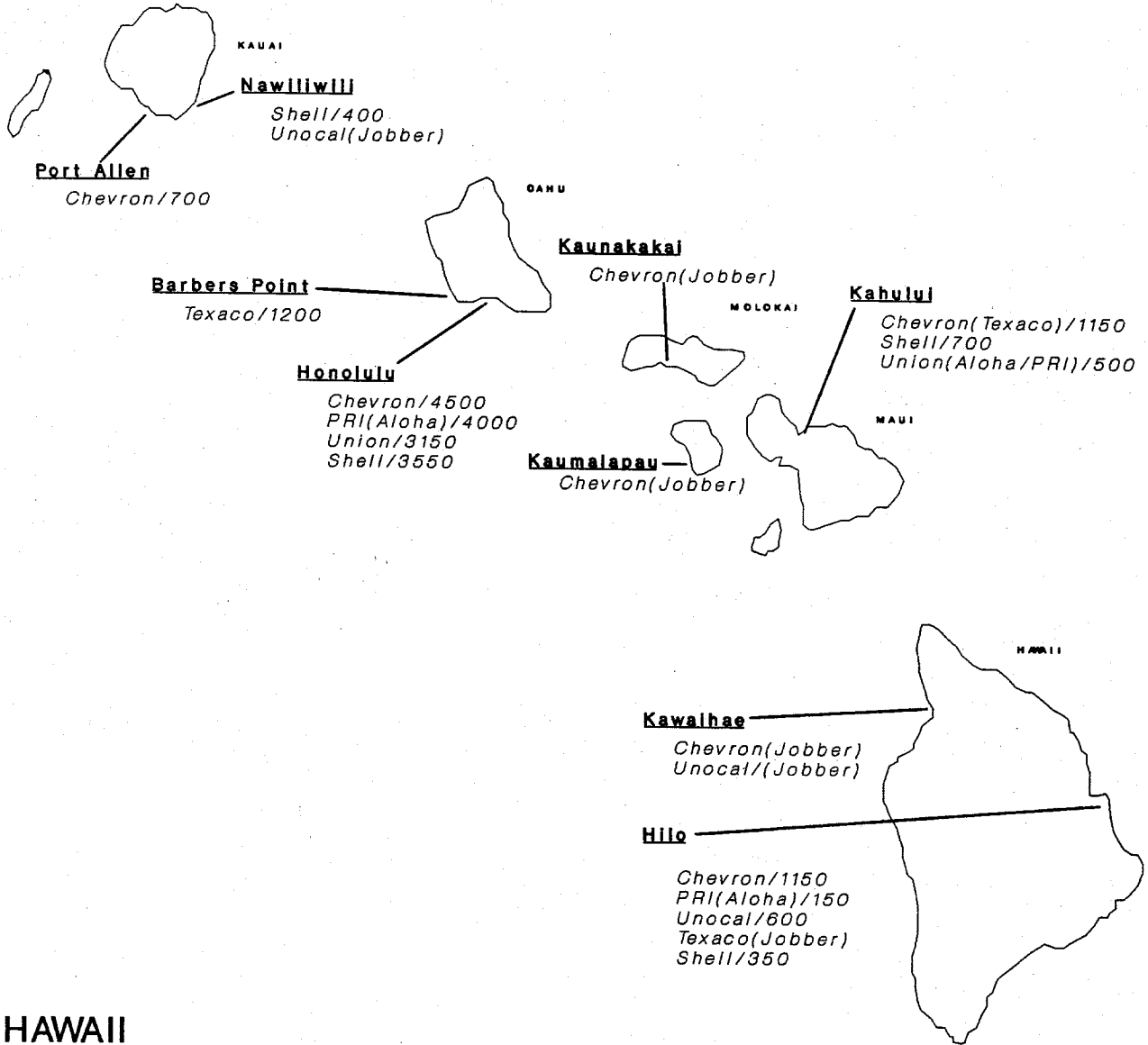
\*Includes Indonesia, Malaysia, Singapore

EXHIBIT 5

# Distribution of Gasoline in Hawaii



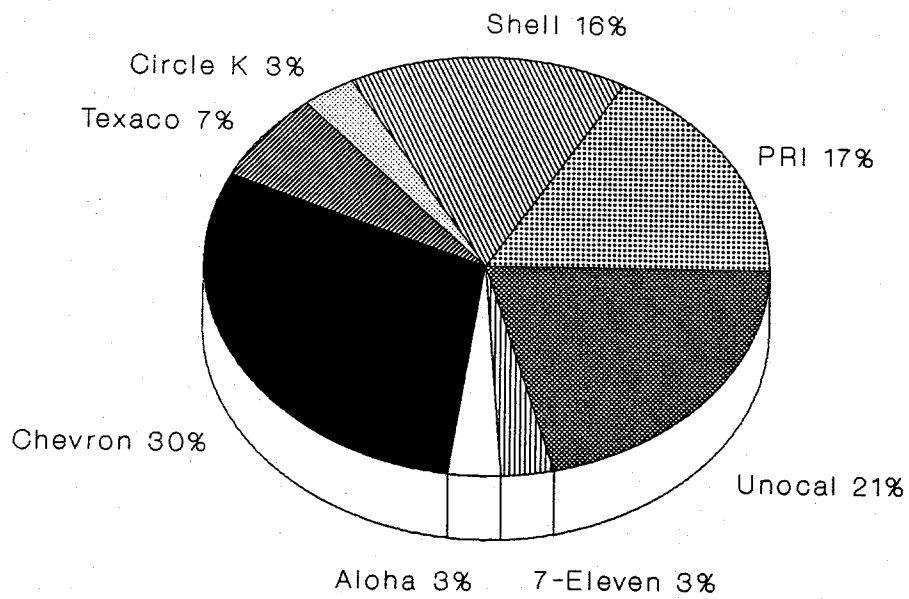
# Terminal Facilities (All Islands)



HAWAII

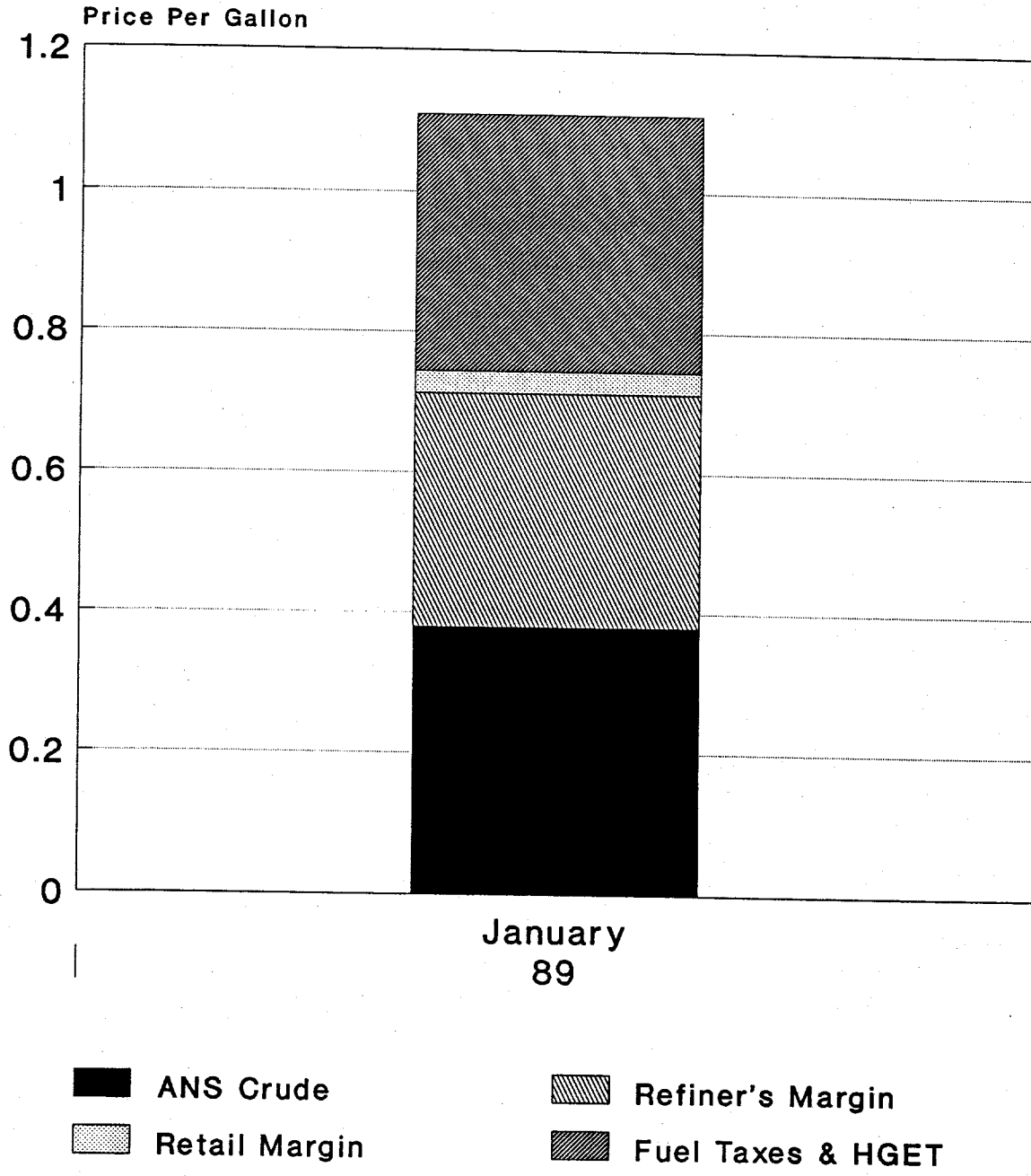
Thru Put Estimates/BPD

# Hawaii Motor Gasoline Market Shares 1989 - 1990



# Average Component Gas Costs

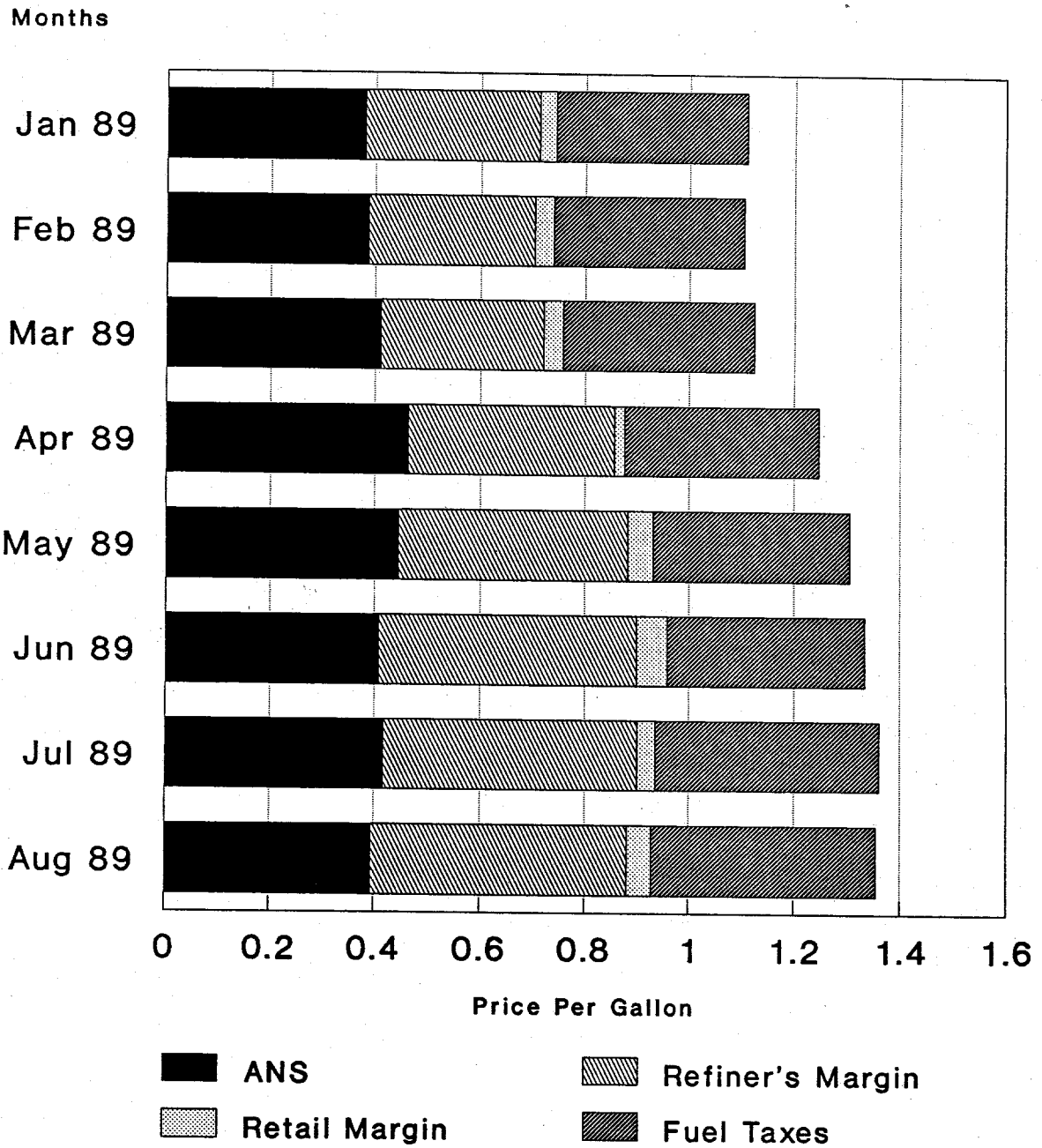
Honolulu Regular Unleaded



Source: Platt's, CID Resp. & HSB

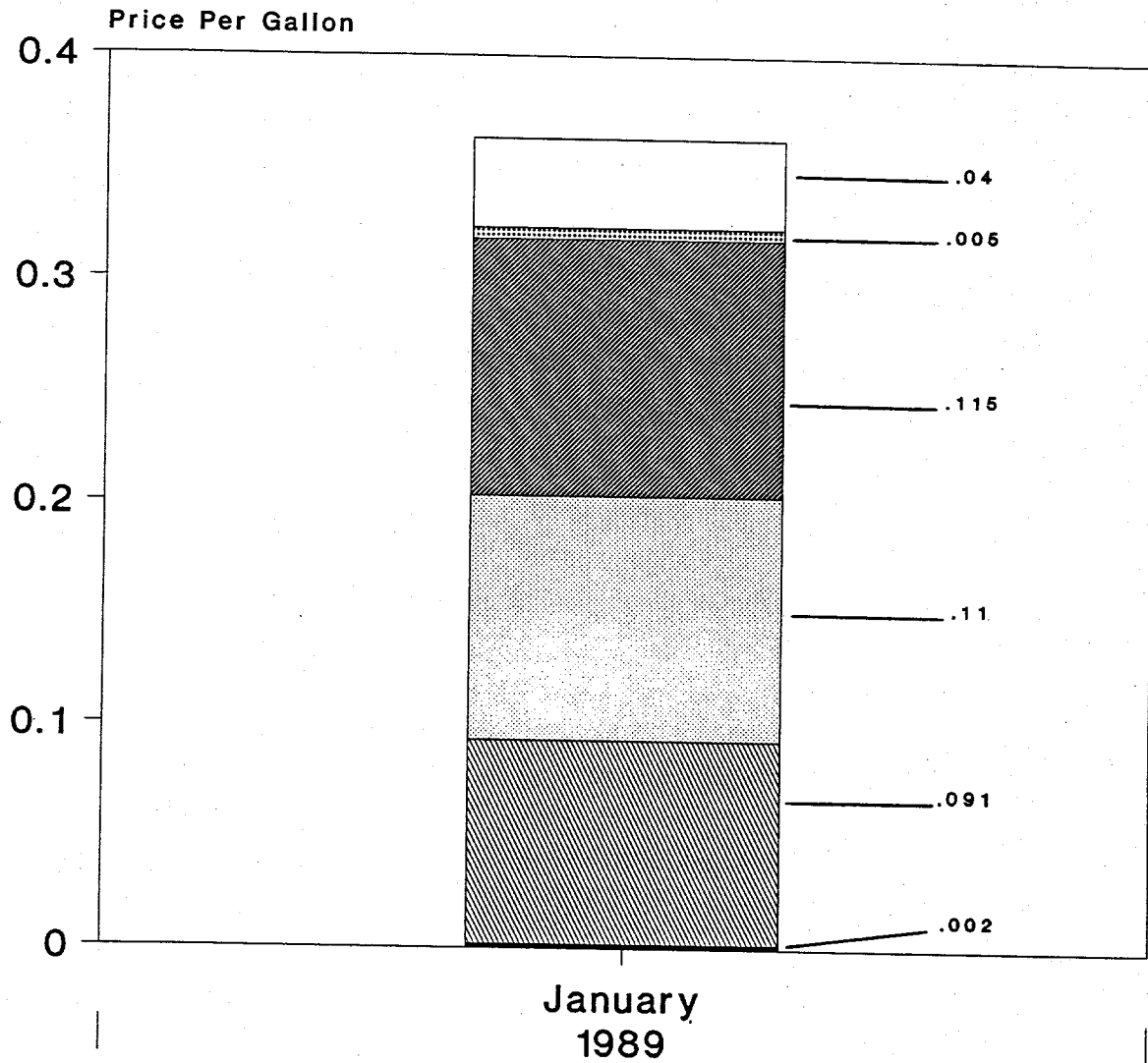
# Average Component Gas Costs

## Honolulu Regular Unleaded



Source: Platt's, CID Resp. & HSB

# Tax Components of Gas Cost



- Fed Superfd\*
  Fuel Tax-Fed
  Fuel Tax-Sta
- Fuel Tax-Cty
  Whls Ex Tax\*
  HGET\*

Note: On 7/1/89 Hon cty tax increased by \$.05 per gallon.

\* Calculated on Jan 89 avg retail price



Factors Discouraging Price Competition  
In The Hawaii Gasoline Markets

Concentration: There are only 5 sellers of wholesale gasoline  
Chevron, PRI, Shell, Texaco, and Unocal.

The Hawaii gasoline markets are highly concentrated oligopolies.

No possibility  
of new  
competition: Barriers block the entry of new  
competition into Hawaii.

These barriers include:

- Size of the market
- Economies of scale
- Unrecoverable capital costs
- Environmental restrictions
- Land costs
- Others

Inelastic demand: When a commodity is essential and there are no good substitutes,  
people will continue to buy just as much at a much higher price.

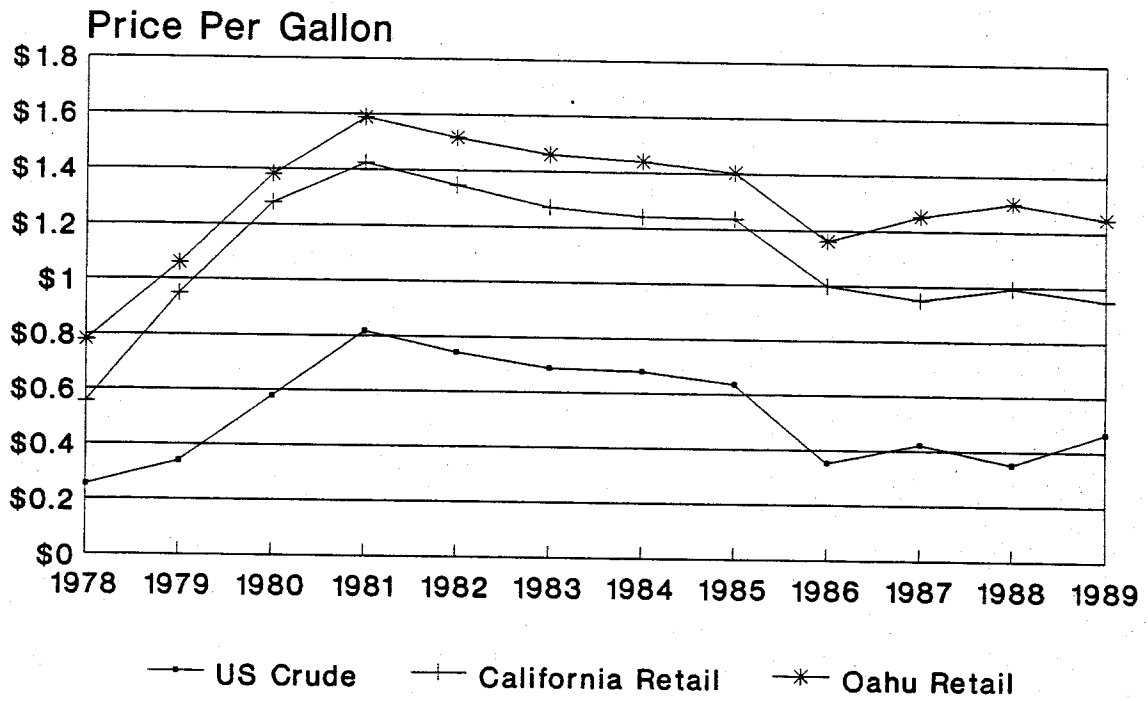
When that happens, economists call the demand "inelastic."

The demand for gasoline in Hawaii is relatively inelastic.

## Practices of the Oil Companies

1. Intercompany dealings.
2. Exchange agreements.
3. Control of retail distribution facilities.
4. Closed terminals.
5. Other.

## US Crude vs CA Retail vs Oahu Retail (Simple Averages for 1978-1989)



Note: 1989 - Jan only

Summary of Factors Discouraging Competition in Hawaii

1. Oligopoly: A few interdependent sellers control the market
2. Higher costs for new competition than for existing oil companies
3. People must buy gasoline no matter what the price
4. Practices of the oil companies that tend to lock in existing market arrangements and lock out new competition

## What's Legal and What's Not Legal

### **What is Legal:**

1. A price increase is not by itself illegal.
2. A price increase to increase profits is not by itself illegal.

### **What is Not Legal:**

1. Price fixing agreements or agreements having that effect.
2. Monopolization and attempts to monopolize.
3. Unfair methods of competition
  - a. Business practices that are collusive, coercive, predatory or exclusionary, or
  - b. Business practices having an anticompetitive purpose, or cannot be supported by an independent legitimate business purpose, or practices that are contrary to the firm's individual self interest.

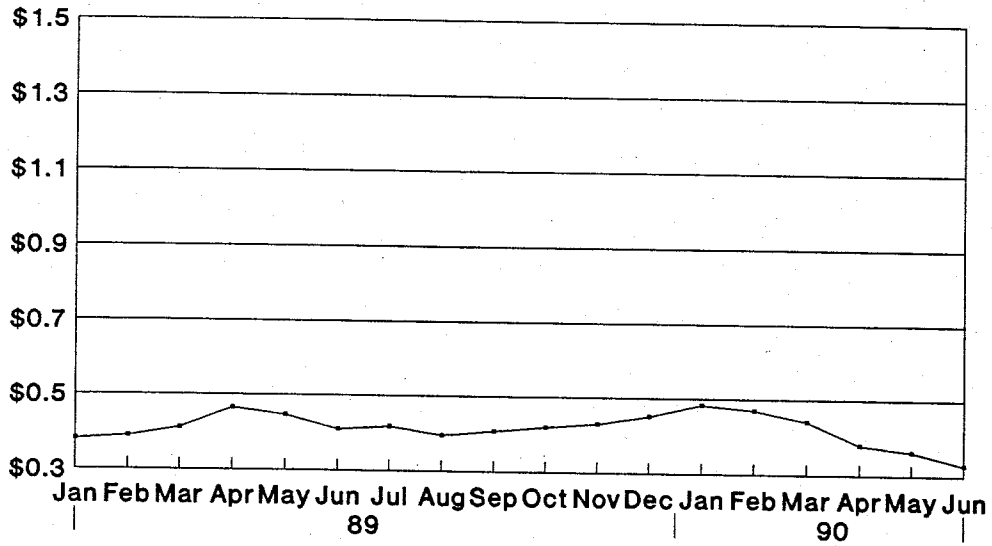
## What Happened Nationally After Exxon Valdez

1. Gasoline prices went up.
2. Crude oil prices didn't go up nearly as much as gasoline.
3. Oil companies explained the price increases with various reasons:
  - a. The higher cost of crude oil
  - b. Seasonal increases in demand
  - c. Decreased stores or inventories of gasoline
  - d. Refinery problems (Richmond refinery fire)
  - e. Stricter EPA regulations
  - f. North Sea production problems
  - g. Panic and/or market uncertainty
  - h. Refinery capacity problems
  - i. Refinery downtime for maintenance and turnarounds
4. Attorneys General of Washington, Oregon, and Idaho conducted a joint investigation; the Commonwealth of Massachusetts also conducted an investigation.

The conclusions of the Oregon report are typical:

- a. The Valdez spill did not cause the retail price increases; it gave the oil companies an "opportunity" to increase prices
  - b. There was no persuasive evidence of illegal price fixing or pricing collusion
  - c. An important factor explaining the increase was that refiner margins increased "very significantly."
5. Hawaii joined in calling for a national investigation, and started its own.

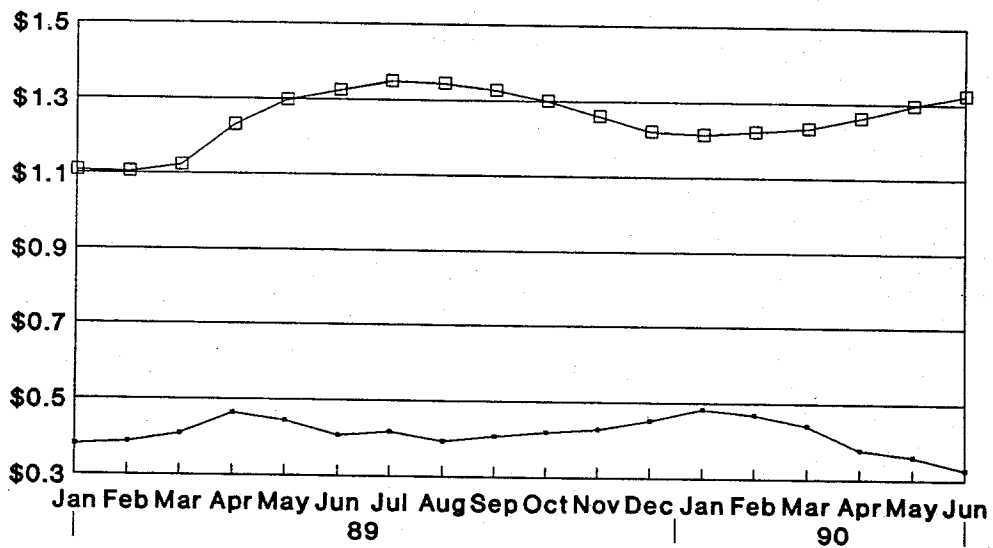
### ANS Crude To Hawaii 1989 - 1990



—●— Platt's ANS Crude

EXHIBIT 18

### ANS Crude And Honolulu Retail 1989 - 1990



—●— Platt's ANS Crude    -□- Hon Retail w/ Tax

EXHIBIT 19

### ANS Crude/Hon Whlse/Hon Retail 1989 - 1990

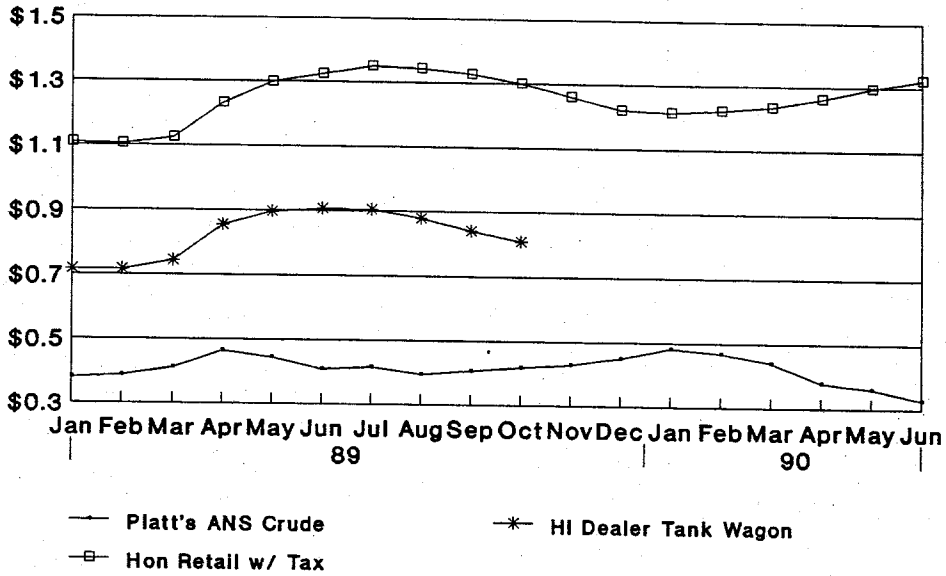


EXHIBIT 20

### ANS Crude/LA Whlse/Hon Whlse/Hon Retail 1989 - 1990

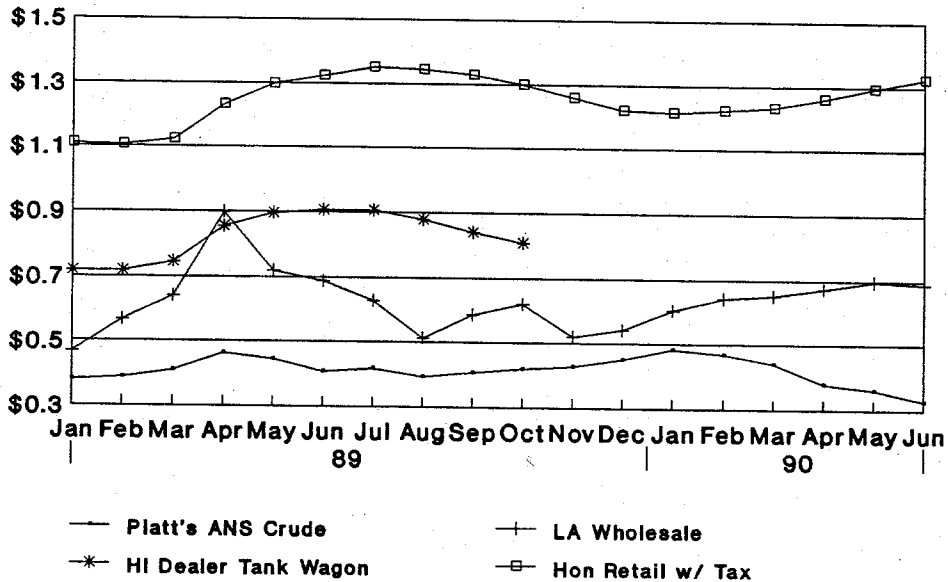


EXHIBIT 21



Initial Findings and Conclusion of the  
Attorney General of Hawaii

1. Gasoline prices are higher in Hawaii than on the mainland primarily because of a lack of a competitive supply of gasoline.
2. Gasoline prices are higher on the Neighbor Islands primarily because of a similar lack of a competitive supply of gasoline.
3. Exxon Valdez did not cause the increase in gasoline prices in Hawaii. The increase was caused by:
  - a. Increases in the cost of crude oil
  - b. The ability of Hawaii's oil companies profitably to increase the prices and the decision of some of them to do so.
4. The desire for profits by the oil companies probably caused that portion of the price increases not accounted for by increases in the cost of crude oil.
5. Anticompetitive and/or unfair practices by some of the oil companies may have been involved.

The practices we think may be anticompetitive include:

- a. Intercompany dealings
  - b. Exchange agreements
  - c. Control of retail distribution facilities
  - d. Closed terminals
  - e. Others
6. Because the oil company responses were incomplete, we can't say at this time that the practices of the oil companies are not justified. Therefore, we will investigate further.

### Recent Events in the Middle East

- August 2, 1990: Iraq invades Kuwait.
- August 3-4, 1990: Crude oil prices increase nearly \$10 per barrel (23.8 cents per gallon).
- August 3-4, 1990: Gasoline prices on the mainland increase as much as 15 cents per gallon.
- August 3-4, 1990: Gasoline prices in Honolulu increase no more than 6 cents per gallon.
- Week of August 5: Price of crude oil falls some. Some oil companies declare moratorium in gasoline prices for one week.
- Week of August 20: Price of crude oil over \$31/barrel and expected to go higher. Price of wholesale gasoline over \$1.06 and expected to go higher.
- Week of August 27: Price of crude oil falls to about \$26-\$27/barrel and gasoline to about 85-87 cents/gal.

Retail unleaded regular self-serve gasoline in Honolulu generally between \$1.35 and \$1.45.

## The Attorney General's Recommendations

1. The Attorney General's investigation should be continued. In particular, the Attorney General should seek full details from the oil companies about potentially illegal practices.
2. Legislation should be adopted.
  - A. Requiring oil companies to report to the State:
    - 1) costs;
    - 2) sales;
    - 3) profits for Hawaii operations;
    - 4) imports of crude oil and product.
  - B. Requiring oil companies to file with the State of Hawaii a tariff listing all prices.
  - C. Prohibiting any oil company with excess capacity from refusing to provide storage at tariff prices.
  - D. Funding a unit to monitor and analyze oil industry data for the use of the Attorney General. This unit would also study:
    - 1) whether a public petroleum products storage authority with power to import, store, and market oil products should be established;
    - 2) the desirability of adopting an oil industry excess profits tax;
    - 3) the desirability of adopting uniform rules and standards in Hawaii for measuring amounts, including marginal cost and marginal revenue, used in antitrust economics;
    - 4) ways by which concentration in the Hawaii gasoline markets can be reduced;
    - 5) ways to lower barriers to the entry of new competition;
    - 6) the desirability of prohibiting terminal operators or refiners from entering exclusive dealing or typing arrangements in the distribution of oil or oil products;
    - 7) ways to reduce the costs of oil companies doing business in Hawaii.