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# THE ENERGY ANTIMONOPOLY ACT

INTRODUCTION

As the nation struggles to adjust to higher oil prices and smaller supplies, the apparent prosperity of the large oil companies presents a striking and, to some, a frustrating contrast to the predicted private hardship. The resentment is intensified by such actions as Mobil's acquisition of Marcor, Inc. and Atlantic Richfield's purchase of Anaconda Co. Rather than investing all of their returns in exploration and research, the oil companies have chosen instead to diversify their holdings through the acquisition of unrelated industries.

To remedy this alleged abuse, Senator Edward M. Kennedy (D-Mass.) has introduced a bill, S.1246, the Energy Antimonopoly Act, which would effectively restrict or prohibit sixteen of the largest oil companies from acquiring controlling interest in any corporation with over $100 million in assets. Passed out of the Subcommittee on Antitrust & Monopoly by a 6-4 vote on July 11, S.1246 awaits mark-up before the full Judiciary Committee. That action is expected in late October.

Critics of the oil industry believe oil company mergers and conglomerates are contrary to the public interest. They charge that such transactions tighten the already powerful economic and political grip of the cash-laden oil companies. Furthermore, it is claimed the public interest demands that profits from the sale of precious petroleum be invested in oil exploration and research, not in such frivolous and self-aggrandizing enterprises as department stores or coal mines.

Contrary to the sponsor's expectations, The Energy Antimonopoly Act will reduce U.S. oil production, possibly by as much as 2 to 3 million barrels per day in 1990. Based on the unsupported thesis that oil-based conglomerates are an economic and social

*Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.*

threat, the bill is, in essence, an attempt to weaken the oil companies. If enacted, S.1246 would reduce the ability of the oil companies to undertake the risky and costly exploration necessary to ensuring the adequacy of future oil supplies. The proposed legislation would also greatly hamper the development of alternative energy sources by impeding the transfer of much-needed capital and technology from petroleum to non-petroleum energy uses.

## THE ENERGY ANTIMONOPOLY ACT

The Energy Antimonopoly Act, an amendment to the Clayton Act, would prohibit any corporation which produced more than 35 million barrels of crude oil, condensate, and natural gas within the United States in 1976 from acquiring control or a majority of the assets of any corporation possessing $100 million or more in assets. Effectively, sixteen of the largest oil companies would be subject to the Act's provisions.

Although the Subcommittee acted upon S.1246, Kennedy has drafted an as yet (Oct. 15) unnumbered version of the Energy Antimonopoly Act which incorporates the Carter Administration merger restriction proposals. Any U.S. oil company which produced an average of 150,000 barrels of crude oil and natural gas per day in 1978 would not be permitted to acquire control or a majority of the assets of a corporation with over $100 million in assets unless it could be demonstrated that the merger would substantially enhance competition. The restriction would also apply to foreign affiliates of U.S. oil firms. It is possible that full committee mark-up will be based on the unnumbered version.

## ANALYSIS

Certainly, the major motive behind the Energy Antimonopoly Act is a populist reaction to the energy crisis and high oil prices. It is assumed that because the public is so highly dependent on petroleum (a dependency which the public has exhibited little inclination to reduce) the federal government has the right, if not the duty, to dictate how profits from petroleum sales shall be used.[1]

A second, more subtle motive might be the desire of some congressmen to rid themselves of the difficult political choices created by the presence of, and U.S. dependence upon, the oil companies. The conflict between the economic logic of the oil companies' case for decontrol and the populist reaction against the oil companies places the politicians in a difficult position.

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1. For a provocative examination of oil profits see, William E. Simon, "Tilting at Windfall Profits" in Policy Review, Winter 1980 (forthcoming).

One means of alleviating this pressure would be to weaken the oil companies.

ACQUISITION AND CONCENTRATION

Proponents of S.1246 argue that the oil companies should not be permitted to acquire corporations of over $100 million in assets for two reasons. First, it is claimed that purchase of an existing corporation is merely "financial capitalism," producing little benefit for the public. No new jobs or services are created. The second and more important rationale behind the proposed merger ban is the charge that oil-based conglomerates possess a social and political power disproportionate to their proper role and inimical to our democratic system.

Financial Capitalism

The only real effect of "financial capitalism," according to Kennedy is to place an additional layer of corporate bureaucracy between consumer and product. "Businesses run by bureaucrats become immobile, reluctant to change, fearful of innovation, and unresponsive to the needs of the public and the demands of the market."[2]

It is interesting to note that the symptoms described as afflicting the bureaucrat-ridden acquisition are typically reserved for monopolies. Yet existing anti-trust legislation is sufficient to prevent a merger which would create a monopoly. There is no economic evidence to suggest that a merger of corporations operating in unrelated markets decreases competition in either market. As anti-trust legislation, S.1246 is entirely superfluous.

The case against financial capitalism ignores completely the economic tests imposed by the marketplace. Following Kennedy, it might be expected that Montgomery Ward, now infused with a cadre of Mobil Oil bureaucrats, will be less efficient, less innovative and less responsive. Should this occur, Montgomery Ward will lose part or all of its market share to competitors such as J.C. Penney or Sears. The subsequent decline of Montgomery Ward would reflect poorly on both Mobil's management and balance sheet. Thus, Mobil has the strongest incentive to ensure that Montgomery Ward does not fall prey to the arrogance and inertia of the corporate bureaucracy. Failure to do so will impose the harshest penalty of all.

An outright ban on corporate mergers as a competitive device is not only unnecessary but counterproductive. The separation of ownership from management has often insulated inefficient management from rigorous evaluation. The threat of a corporate takeover

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2. Senator Edward M. Kennedy, Congressional Record, May 24, 1979 p. S6702.

by organized labor and the self-described consumer and public interest groups. The remarkable rise of the latter and the myriad regulatory strictures which they advocate suggest they possess a political strength at least commensurate with the business interests. Legislation which weakens the oil companies will alter, perhaps substantially, the present balance among the competing special interests.

Implicit within the argument that concentration leads to undue political power is the presumption that our elected representatives have failed either to identify or protect the public interest. Instead they have succumbed to the blandishments of the oil companies and have pursued a course counter to the public welfare. Surprisingly, the bill's sponsors view this failure with equanimity, even sympathy. Since our elected representatives are apparently incapable of protecting the public interest, the Energy Antimonopoly Act sponsors propose to insulate these delegates from the legitimate pressures exerted by the oil industry.

The beneficiaries of the legislation will be the congressmen and other elected officials who no longer will be forced to make a public choice. The cost of freeing the legislators from performing their proper function will be borne first by the oil companies' stockholders, and ultimately by the public through less than adequate energy supplies.

## OIL PRODUCTION

Critics of the oil companies' performance assert that the ban on mergers will force investment in oil exploration and research. Acquisitions of non-oil-related enterprises, it is charged, is a misuse of funds which would be better utilized in oil production.

An objection to this claim is that outlawing one source of investment will not necessarily force investment in another. The funds accumulated by the oil companies can be used for a variety of purposes, including the purchase of outstanding stock, or distribution to stockholders.

Secondly, contrary to arguments of the bill's proponents, a merger ban will actually reduce U.S. oil production. Diversification enhances the oil companies' ability to produce petroleum. As the more readily accessible petroleum reserves are consumed, additional supplies become more costly and risky to produce. Acquisition of corporations with stable, predictable earnings reduces the volatility of earnings and inherent risk of a corporation engaged solely in oil production. As a consequence, external financing will be available at lower rates, thereby making more projects feasible. In addition, by reducing the general riskiness of the corporation, diversification permits an oil company to engage in more risky projects.

The Energy Economics Division of Chase Manhattan Bank has estimated that the Energy Antimonoply Act of 1979, by impeding oil company diversification, will reduce 1990 domestic oil production by 2 to 3 million barrels per day.[3] The risk disincentive within the legislation will reduce investment in offshore leases, lower tertiary production, severely limit synfuels development, and generally lower capital investment. This calculation is based upon the S.1246 version of the Act. The unnumbered bill, while ostensibly permitting mergers, would at the very least discourage acquisitions by increasing the cost of the transaction and creating uncertainty as to the court's approval. Other factors which would militate against otherwise acceptable mergers are the shift in the burden of proof from the government to the oil companies and the lack of an accepted test for a "substantial enhancement of competition."

Table 1

Potential Oil Production Losses Resulting From S.1246
(Thousands of Barrels of Oil Equivalent per Day, 1990)

| | |
|---|---|
| Offshore | 700-1,000 |
| Tertiary Production | 500 |
| Synfuels | 500 |
| Conventional Oil and Gas | 1,000 |

Source: Energy Economics, Chase Manhattan Bank

NON-PETROLEUM ENERGY SUPPLIES

Common to all future energy plans is a greater reliance on non-petroleum energy supplies. The Energy Antimonopoly Act would damage the development of such alternative sources.

Through the infusion of capital and the transfer of technology the oil companies are capable of making a substantial contribution to non-petroleum energy sources such as coal, uranium, or geothermal. The oil industry has developed mining, drilling, waste disposal, and transportation technologies which are applicable to a variety of industries (Table 2). Transfer of these resources would be greatly impeded by the restriction.

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3. Testimony of Dr. James P. Wallace, Vice President, Chase Manhattan Bank N.A. before U.S. Senate, Subcommittee on Antitrust, Monopoly, and Business Rights of the Committee on the Judiciary, June 21, 1979.

Table 2

Transfer of Petroleum Technology to Alternate Fuels

| Process | Resource Development | Resource Extraction | Transportation | Resource Processing | General |
|---|---|---|---|---|---|
| Petroleum Technology | 1. Exploration techniques - geological - geophysical<br>2. Data Bank Information | 1. Well-drilling technology<br>2. Formation fracturing<br>3. Reservois engineering technology | Pipeline Technology | 1. Petroleum refining technology<br>2. Mathematical modeling | 1. Materials Scienc<br>2. Engineering skil<br>3. Chemical enginee ing expertise<br>4. Plant health and safety experienc |
| Alternate fuels to which petroleum technology is applicable | 1. Coal<br>2. Uranium<br>3. Geothermal<br>4. Oil Shale | 1. Oil Shale<br>2. Coal<br>3. Geothermal<br>4. Uranium | Coal | 1. Coal<br>2. Oil Shale | 1. All alternate<br>2. Energy Sources |

Source: D. Teece, Research and Development in Energy.

Advocates of the merger ban justify its application to alternative energy endeavors on two grounds. First, they claim the proscription is necessary to prevent the oil companies from controlling the entire energy field. Secondly, since the law only prohibits acquisitions, the oil companies are quite free to apply their expertise from the ground up by creating their own enterprises.

The first defense is essentially a charge that any and all horizontal acquisitions are monopolistic. The rebuttals are two. One, there is no economic support for the notion. Two, existing monopoly law is sufficient to forestall any horizontal acquisition which would be anti-competitive.

The most effective means of transferring technology between industries is through horizontal integration.[4] While this can be achieved through de nova investment, horizontal mergers are more efficient for a variety of reasons. These include time and the ability to benefit from the expertise and technology existing within the alternative energy industry. The ban or restriction on mergers would therefore, consign technology transfers through inferior channels.

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4. David J. Teece, Research and Development in Energy (Palo Alto Ca.: Stanford Univ.,1977), p. 38-43.

INTERNATIONAL IMPLICATIONS

The inclusion of foreign affiliates within the scope of the legislation presents several perplexing questions not only for worldwide oil production but also for international relations. An immediate objection is the bill's inconsistent treatment of U.S. and foreign companies.[5] Domestic companies and foreign affiliates would be greatly inhibited in their efforts to strengthen through diversification. Foreign oil companies with affiliates in the U.S. (Shell and Standard Oil of Ohio are both controlled by foreign interests) would be free to engage in any transaction desired.

A second consideration is the bill's effect on the development of oil consortia, particularly in the North Sea. The restrictions placed against U.S. oil companies and their affiliates would prevent participation in the consortia and thus withhold vital resources from pursuit of the globally precious oil. This legislative barrier to oil exploration would be reflected in less oil production and even greater OPEC leverage.

The international implications are also quite startling. Already the British government has lodged a protest over the bill's threat to joint ventures in the North Sea. In addition, the application of the merger restriction to foreign affiliates threatens to arouse resentment within the host countries. Often these nations, Germany for instance, encourage or require foreign oil affiliates to engage in joint ventures with local concerns.[6] U.S. legislation forbidding such participation could be seen as an intrusion in domestic affairs.

CONCLUSION

The Energy Antimonopoly Act, as its sponsors intend, will weaken the oil companies. The imputed benefits of the oil companies' decline are, at best, dubious and most likely nonexistant. The cost however is clear: fewer energy supplies in the future. Oil production, both domestic and international, would be lower, the most efficient development of non-petroleum energy sources thwarted, and international ties strained.

An additional concern posed by the Energy Antimonopoly Act is the manner by which it attempts to achieve its end. The oil companies, in an attempt to maximize profits and ensure future prosperity, have diversified their holdings for economically sound reasons. Certainly, the dwindling availability of U.S. petroleum resources dictates a search for alternative investments. Proponents of S.1246, however, would force the stockholders of

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5. Testimony of George W. Ball, before U.S. Senate, Committee on the Judiciary, October 4, 1979.
6. Ibid.

the sixteen major oil companies to invest their personal resources in an increasingly unproductive and unrewarding endeavor. Implicit within this proposal is the assumption that the federal government has the right to command private resources.

The federal tax system supposedly acts as a barrier between public and private sectors. Through the willingness to pay taxes, and thus surrender personal resources, the taxpayers indicate their preference between public and private expenditures. The desire for more public goods is restrained by the knowledge that such a choice excludes private consumption. The Energy Antimonopoly Act evades this obstacle by promising higher levels of public goods with no reduction in private consumption. (A notable exception is the oil companies' stockholders who are indeed financing the promised benefit.) Understandably the taxpayer is more enthusiastic and less skeptical about such a proposal than he would be if it were financed out of general tax revenues. In this manner, the government increases the scope of its activities and yet still maintains a constant level of spending and taxes.

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