NEXTGEN CLIMATE Consumer Watchdog

March 30, 2015

Honorable Kevin de Leon
Senate President Pro Tem
California State Senate
State Capitol, Room 205
Sacramento, CA 95814-4900
(916) 651-4024

Honorable Jim Beall
California State Senate
State Capitol, Room 5066
Sacramento, CA 95814-4900
(916) 651-4015

Honorable Ben Hueso
California State Senate
State Capitol, Room 4035
Sacramento, CA 95814-4900
(916) 651-4040

Dear Chairmen Hueso and Beall, Senate Pro Tem de Leon, and Members of the Committees,

The public owes you a debt for the hearing you held on March 24 about recent gasoline price spikes. Your investigation of the cause of the one-dollar run-up in February gasoline prices is vital to giving consumers a fair shake at the pump. Unfortunately, the hearing raised more questions than it answered because those with the answers—representatives of the oil industry—refused to attend the hearing. Instead the oil companies sent an economist, Phil Verleger, whose first words were that he doesn't speak for the industry, though Western States Petroleum Association paid him to attend.

Mr. Verleger avoided a straight answer to Senator Hueso's questions as to why price spikes rise so precipitously in the wake of refinery outages and shutdowns and whether refineries should have to publicly justify their price hikes as is done with auto and home insurance. The Senator asked, "We try to scrutinize insurance rates, we try to scrutinize utility rates, we have the PUC who does it, why can't we do that with gasoline?" Mr. Verleger answered, "You have walked into a really dark part of economics."

It's outrageous that the oil industry would refuse to answer for the $550 million extra California consumers were forced to pay in February for their gasoline above the U.S. average, particularly as the hearings proved the oil companies were the ones profiting from the California price spike.

The oil industry must answer for this half-billion dollar cost to Californians. The Senate hearing on March 24 provided some tantalizing insights into the opaque workings of the gasoline market that are a solid basis for future inquiry.

The hearing confirmed that the market is rigged to the benefit of an oligopoly and the rules need to be changed to benefit consumers rather than the oil industry.

As Consumer Watchdog noted, two refiners control 55 percent of the state's refining capacity. According to California Department of Justice Anti-Trust Chief Kathleen Foote, California has "what is generally called an oligopoly" due to consolidation in the refinery industry in the state. She also noted that by not having adequate reserves, short-term impacts on supply can drive prices upward. Ms. Foote also noted that "demand is pretty inelastic" because consumers who drive gas-powered cars, and have no other transportation options, have no choice but to buy gasoline.

Gordon Schremp of the California Energy Commission stated that refiners selling gasoline to another refiner with an outage jack up their price because they know refiners with outages are desperate for product to meet their contractual obligations to gas stations. "What happens is prices rise at the wholesale level, and they rise for everyone," he said.

Keeping inventories low exacerbates the perception of shortages, regardless of how much capacity refineries are actually using and how much margin they have to refine more gasoline. Schremp stated it succinctly: "Inventory levels themselves do not cause price spikes, but lower than normal inventory levels can exacerbate conditions for a price spike." Schremp noted that inventory levels are lower in 2015 than they were in the last two years.

In summation, Senator Hueso made a logical point at the hearing. "If my competitor has a disadvantage, why am I going to help them by increasing *my* prices, it doesn't seem like I am contributing to a competitive market. That's what we call gouging." Hueso's comments highlight a fundamental problem — the market in California is structured to benefit oil producers and refiners at the expense of consumers.

We call upon the Senate to demand answers to the following questions directly from the oil companies:

1. Why did Tesoro tell investors that the company can continue operating refineries indefinitely even with the steel worker strike, yet shut down its refinery, precipitating the price spike?

2. Why didn't the refineries act more quickly to increase supply when it became clear that prices were going to spike?

3. Why do refiners keep so little inventory on hand compared to the rest of the country? Why should they not be required to keep the same amount as the national average?

4. Why won't refineries publicly disclose real-time information about their operations and outages?

If oil company executives refuse an invitation to answer these and other questions, we urge you to use your subpoena power to compel them to testify. In addition, others with knowledge about refinery operations should be brought forth under oath to answer these outstanding questions.

We look forward to your continuing investigation.

Sincerely

Tom Steyer

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Jamie Court

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