July 22, 2022

California Assembly Select Committee On Gasoline Supply and Pricing

Re: Why California Gas Prices Are So High And What You Can Do About It

Chair and Members,

I have studied gasoline prices in California since 2000, when I was appointed by then Assembly Speaker Antonio Villaraigosa to represent the California Assembly on the California Attorney General Bill Lockyer's Gas Pricing Taskforce.

Since then, I have followed and commented on many gas price spikes and though each has a different immediate cause, all are the result of the same problem.

Consolidation in the industry has allowed five oil refiners to control 96% of the gasoline produced in California. When the opportunity arises to squeeze us, they can and do.

I would like to offer some explanations for the current price spike and make some observations generally about the problems with the gasoline market, how it is policed, and what can be done.

The cause of the current gap between California gas prices and US prices is clear: extreme profit-taking by California's big oil refiners.

The proof is in the profit reports from the first quarter of 2022. California oil refiners' margins – the difference between the crude they purchase and the gasoline they sell – are at historic highs based on the reports provided to investors. Second quarter profit reports due out the end of the month could be even more revealing.

For example, PBF reported that profits from its LA refinery from January to March 2022 were the equivalent of 78 cents profit per gallon. This was before the big price spike, when California crossed $5 per gallon in the beginning of March. This suggests the company's profits per gallon were more than $1 in April, May and June.

Most significantly, refiner margins in California are as much as twice as high as in other parts of the nation, according to a review of first quarter reports to investors by Consumer Watchdog. (https://www.consumerwatchdog.org/energy/profit-reports-show-oil-refiners-are-gouging-californians-profits-gallon-double) This shows that the reason Californians are paying $1.50 more per gallon than the average US driver is about profit-taking, not environmental rules and taxes (which add 60 some cents per gallon over the US average price).

The reason for the profit-taking appears to be that oil refiners are buying crude oil cheaply through long term contacts and selling gasoline priced at the world cost of crude oil.

We don't know, however, how much oil refiners actually pay for their crude oil because that information is apparently not reported to the California Energy Commission (CEC). The CEC presumes the market cost of crude oil in its calculations and is not privy to the actual cost of crude oil that the refiners pay on their contracts. We do know, however, that the industry operates on long term contracts for crude oil.

This data gap skews the information the CEC provides to the public and this committee. Nor does the CEC appear to consider actual refiner margins. Its reporting is based on speculation --- the difference between world crude oil prices and the cost of gasoline.

SB 1322 (Allen) requires the oil refiners to report monthly their actual crude oil costs and actual refining margins (gross and net) to the CEC and for the CEC to publish information about the margins.

For as long as I have watched the market, the CEC has been the trusted confidential source of information about gas pricing. Yet the information it receives is much more limited than one would think and the information that it provides publicly is scarce and worse than being incomplete, it is often misleading.

For example, when the CEC testified to this committee that crude oil costs are half of the cost of gasoline, it is pure speculation, because it does not know what oil refiners actually pay for their crude oil through long term contracts or otherwise.

We trust the CEC to police the market. It does not have the tools to do so.

To protect consumers, more information about California refiner operations needs to be made public so that market watchers and others are in a position to monitor and hold the market accountable. SB 1322 is a small step. Much more needs to be disclosed and stronger laws enacted.

For example, **a limit on excess profits needs to be set** for California oil refiners. When their profits per gallon exceed a certain amount or are a certain percentage more than their profits from operations elsewhere in the country, those profits need to be taken back in the form of a tax on excess profits. In response to excess profits by Shell, the British government has instituted such an excessive profits tax. (https://www.nytimes.com/2022/05/26/business/uk-oil-company-profits-tax.html)

Most Californians will receive $1,050 from the state taxpayer treasury due to the high costs of gasoline. If California refiners are profiting excessively from California's pain they should have to pay the taxpayers back.

Consolidation is the biggest problem with the California market.

As previously mentioned, five oil refiners produce 96% of California's gasoline. They also control pricing through branded contracts at more than two-thirds of the state's gas stations.

This consolidation creates an opportunity for extreme profit taking when events conspire to give companies that opportunity. A good example is the profit taking from the price spike that followed the explosion at Exxon's Torrance refinery in 2015.

In the wake of the explosion, oil refiners pushed California gas prices up by failing to bring in refined supply to back-fill the lost capacity of the refinery. This has been demonstrated in multiple reports by Consumer Watchdog. (https://www.consumerwatchdog.org/holding-big-oil-accountable-0)

The refinery was down for over a year and in that time the refiners needed a way to sustain their extra profits. They developed what has come to be known as the "mystery surcharge," using their excessive market power. This phenomenon was first reported to the CEC's Petroleum Market Advisory Committee in 2015 by Consumer Watchdog and is included in this presentation.(https://consumerwatchdog.org/resources/wholesalegasolinemanipulaitonanalysis.pdf)

Since oil refiners set the price sold to their branded stations, they simply started charging their branded stations 30 to 40 cents more for the very same gasoline they were selling to unbranded independent stations at 30 to 40 cents less. The CEC confirmed this four years later. (https://www.energy.ca.gov/sites/default/files/2019-11/Gas_Price_Report.pdf)This allowed the refiners to make 30 to 40 cents more on every gallon, as the branded station owners had to charge the extra money to get their money back and the refiners pocketed the change.

Prior to 2015, the difference between branded and unbranded prices was pennies. This was a way for California oil refiners to continue making extra profits following the Torrance refinery coming back online. The practice continues to this day – which is why you pay 30 to 40 cents less at unbranded stations.

While we cannot un-ring the bell of consolidation, we can update our anti-trust laws to deal with their new threats and impacts.

This committee can either accept that this is an unrestrained commodities market that will allow for extreme profit-taking by oil refiners or it can propose new restraints on that market.

The two main fixes debated for the last twenty years don't address the root cause of the problem, consolidation, and will only have limited effectiveness.

Creating a unified clean-burning fuel standard for the West Coast: It is true the Big 5 oil refiners are a virtual cartel because only they make our clean-burning fuel and that gives them the ability to constrict its supply and drive up its price. The idea of creating one unified standard of clean burning fuel for the West Coast has been kicked around for a long time, making the gasoline supply more fungible. However, refineries across the West Coast already make CARB gas and ship down the coast. The fact is this plan won't likely add much competition to the California market as refining capacity is limited along the West Coast, there is not likely to be a new refiner that enters the market, the refiners control port access in which the fuels must be shipped and received, and the refiners control the distribution channels.

It's hard to imagine renegade refiners busting into California's market and adding more fuel to the market, except in times of extreme price spikes that make it worth its while, such as in the wake of an Exxon Torrance refinery outage. The candle does not appear to be worth the flame.

Creating a strategic reserve of refined supply: This idea came out of the Lockyer taskforce. It never took off for various logistical reasons, which still exist, as well as for practical reasons. The cause of the current price spike, for example, and that most spikes are not actual shortages in supply. They are caused by a perceived scarcity in a commodity, not an actual shortage. Just as President Biden's release of oil from the Strategy Petroleum Reserve had little impact on the price of gasoline, the creation of a strategic reserve isn't likely to have an impact. Moreover, where to store the gasoline creates a major logistical issue. The current system allows for little inventory and works on a real-time basis.

The only way to deal with a cartel that will take profit at every opportunity is to create greater disincentives for the profit taking.

The high cost of gasoline affects every Californian. In order to address this issue, dramatic steps must be taken.

New oversight: History has shown the California Energy Commission is ill-equipped to watch this industry, let alone regulate it, which it doesn't have current authority to do in any case. We have allowed our biggest market, the one that drives inflation in all others, to go unregulated.

California needs a new Gas Pricing Czar with the power to look at the oil refiners' books, be granted full subpoena power, and be able to obtain real-time information about profits, supply, costs, etc. We have just spent $9.5 billion in give-back to the public for the high price of gasoline. It's time to create new oversight to make sure we get the money back if we have been ripped off.

The oil companies have avoided testifying at every investigation, including the CEC's Petroleum Market Advisory Committee, and have had to answer virtually no questions about their operations. A Special Gas Pricing Counsel, directly accountable to the Governor or Attorney General, should be empowered to ask and get answers from the companies. The head of this

office would ideally be appointed, have training as a prosecutor, and be provided the necessary staff to monitor the industry appropriately.

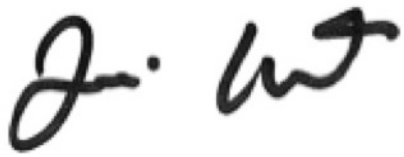
New excessive profits and price-gouging laws: Price-gouging laws only apply after a state of emergency. They state that no price increase shall exceed a certain percentage unless justified by the cost. A new gasoline price-gouging law could be enacted to prohibit such similar price spikes at the pump if not justified by the cost regardless of the declaration of a state of emergency. As previously stated, a new excess profits tax should also be enacted to take back profits above a certain level made by oil refiners.

Collusion and updating anti-trust law: When the Big Five refiners want to squeeze us, they can. Absent proof of a tacit agreement among them to do so, there is no anti-trust case against them. California needs to update its anti-trust laws to create a new standard for the type of tacit collusion that exists in the gasoline market.

The refiners do share gas pricing information among themselves in the form of the Lundberg survey, a detailed, corner by corner gas station price survey that is not available to those outside of the industry. This allows the companies to know what its competitor is charging every gas station owner for gasoline. This type of information sharing among refiners should be considered a tacit agreement that constitutes an anti-trust violation under the law. In addition, refiners have shared storage facilities and terminals. When they know how much supply their competitors have and how much they are charging for that supply, they can collude. This shared information allows competitors to act as a cartel even if there is no smoky back room where they have agreed to a set price. This type of information sharing among companies should be severely restricted under penalty of anti-trust prosecution.

I stand ready to assist with any further information you may need.

Sincerely,



Jamie Court
President, Consumer Watchdog