BEFORE THE

CALIFORNIA ENERGY COMMISSION

In the Matter of	) Docket No. 15-PMAC-1
	)
Petroleum Market Advisory	)
Committee Meeting	)

MEETING OF THE PETROLEUM MARKET ADVISORY COMMITTEE

CALIFORNIA ENERGY COMMISSION
1516 Ninth Street
Imbrecht Hearing Room, 1st Floor
Sacramento, California

MONDAY, FEBRUARY 8, 2016
9:30 A.M.

Reported by:
Kent Odell

APPEARANCES

Commissioners Present (*Via WebEx and telephone)

Janea A. Scott, California Energy Commission

CEC Energy Assessments Division Staff Present

Ryan Eggers, Transportation Fuels Data Unit Supervisor
Courtney Ward, Energy Commission Specialist
Gordon Schremp, Energy Commission Specialist
Ivin Rhyne, Supply Analysis Office Manage

Petroleum Market Advisory Committee Present

Severin Borenstein (Chair, PMAC), Professor, Haas School of Business Economic Analysis and Policy Group, University of California, Berkeley
Jim Sweeney, Committee Chair, Director, Stanford University Precourt Energy Efficiency Center
David J. Hackett, President, Stillwater Associates
Kathleen E. Foote, Senior Assistant Attorney General and Antitrust Chief, California Attorney General's Office
Amy Meyers Jaffe, Executive Director of Energy and Sustainability, University of California, Davis

I N D E X

P R O C E E D I N G S

FEBRUARY 8, 2016 9:35 a.m.

MS. WARD: Good morning. Happy Chinese New Year. My name is Courtney Ward, I'm with the California Energy Commission. And thank you, PMAC, for being here today.

A couple of items. The speakers can only record what you're saying if the red light is on and no more than four speakers can be on at a time. In the back, we have the Public Advisor's Office, so if you have any comments please see Demetri in the gray jacket for a blue card and he will kindly take your comments.

And the restrooms are located outside these doors to the right. We also have coffee upstairs on the second floor.

And in case of an emergency, please follow staff outside to Roosevelt Park. I think that is everything, so I'm going to turn it over to Chair Severin Borenstein for potential approval of our December 16th meeting Minutes. Thank you.

CHAIRMAN BORENSTEIN: Thank you, Courtney. We will approve the Minutes from the last meeting. I will note that there is also a full recording of the activities from the last meeting, so this is a summary of that. I hope the Committee has had a chance to review them. Would anybody like to move approval?

MS. FOOTE: I move approval.

CHAIRMAN BORENSTEIN: Can I get a second?

MR. HACKETT: Second.

CHAIRMAN BORENSTEIN: All in favor?

(Ayes.) All opposed? No opposition. The Minutes of the last PMAC Meeting are approved.

Okay, next up we're going to have Ryan Eggers do a quick review of the last meeting, and then Gordon Schremp will do a brief update on data. And I'm going to start apologizing now because I'm going to apologize throughout the meeting for cutting people off and moving them along so that we can stay on schedule; that's the job of the Chair. Thank you, Ryan.

MR. EGGERS: Is that better? Okay, good morning everyone. Sorry for the technical difficulties. My name is Ryan Eggers. I'm the Supervisor of the Transportation Fuels Data Unit. I'm going to give a very quick and brief sort of recap of what we saw in December at our December meeting.

First, to start off, we had five presentations and two discussion panels, they're all listed here.

But jumping right in, our first presentation was done by Gordon Schremp, Senior Fields Analyst for the California Energy Commission. And in December, California gasoline prices were running roughly about $.74 higher than the national average and this was despite production totals that seemed rather normal when we look at California as a whole.

But that was sort of masking some of the underneath story that was happening where we had very elevated Northern California production totals relative to very low Southern California production totals, as Northern California was trying to offset the loss in production from Exxon Torrance.

We also saw very low inventories in Southern California. And the other thing that Gordon brought to our attention is that, due to California Energy Commission accounting procedures, imports that come into the refinery gate are measured as production as they go out.

So as imports were coming in, they were being counted as production coming out, sort of masking the tight Southern California market that we were seeing. And in 2015, gasoline exports were very much down, even though we were seeing some California exports mainly in Northern California where almost 100 percent of the exports that we did see came out of the Northern California market. And we do believe that this was mostly non-California spec gasoline.

That being said, they were very much being swamped by imports of gasoline which were coming in at the tune of roughly about 62,000 barrels a day since March when Exxon Torrance went down.

So after that brief recap on what the current market conditions in December were, we moved into what attracts gasoline into the California market with a presentation by Skip York from Wood MacKenzie. Skip pointed out that price signals were attracting gasoline shipments into California, but the L.A. spot needed to be roughly about 20 cents greater than the Singapore spot just to overcome cost of shipping to get the gasoline blend stocks here to California. The differential for the Gulf was only roughly about ten cents, but there was a ship availability issue there.

And we did see imports into California just like we saw in Gordon's presentation. The other interesting thing was global gasoline demand in the world was very tight, as well. So the California market is currently competing with the world market in order to track those gasoline shipments into California. We then switched gears into refinery planning with the EIA and Lynn Westfall. Lynn brought to our attention that the refiners use a linear programming model in order to maximize their profits, things such as crude slate unit operations and overall run rates go into that. That being said, Lynn also said that the refiners are very Agnostic to demand in this particular case. Also, Lynn brought to our attention that California refiners tend to run the heavier crudes which are more residual and diesel fuel intensive, as opposed to the Bakken and Eagle Ford crude oils that the Gulf refineries have availability to get, which are more gasoline intensive, and it's easier to yield those particular gasoline.

Just for information, San Joaquin Valley, its API is roughly about 14.5, it's one of the heavier crudes. In this particular case, the lower number is the heavier crude.

Then we switched gears once again and brought in Jamie Court from Consumer Watchdog, who reported on some of the market irregularities we were seeing. Currently, branded prices are very much elevated relative to unbranded prices, and this is kind of a change from what we've seen in previous price spike events where unbranded tend to be the more expensive or the one that really increased relative to branded.

Refinery margins have also increased from an average of about 41 cents a gallon to 96, which is roughly double, and we really do have little to no knowledge of what's going on in the Dealer tank wagon which is a very huge part of the California market.

Then Amy Myers Jaffe came in and gave us a brief presentation on what was happening at the national level for emergency planning and for supply shortages. Amy gave that really quick presentation and then had a very specific question for the California Energy Commission, specifically what does the Energy Commission do in these particular situations? In my presentation later in the day, we'll address that question directly.

So to wrap up, the first panel was just the clarification of what the presenters had asked; the second panel focused on potential supply constraints unique to California, specifically we discussed the potential of Gulf refineries to displace more Arizona gasoline. We also asked about the potential of utilizing more California refining capacity, specifically what's been off line like ALON in Bakersfield, whether we could bring that back on line in order to help this particular situation.

There were numerous data requests that was also asked of the California Energy Commission. We've posted some of that information onto our website and we are still seeking and actually we got yesterday Skip York's presentation information, so we'll be able to give that to the Petroleum Market Advisory Committee right after this particular meeting.

If there's any questions?

CHAIR BORENSTEIN: Thank you, Ryan.

MR. EGGERS: Now I'm turning the podium over to Gordon Schremp, Senior Fuels Expert for the California Energy Commission.

MR. SCHREMP: Good morning, Committee Members and everybody else in attendance. I'll try to be as brief as possible, which will maybe be difficult for me. If you have any questions, please interrupt at any point, Committee Members.

So this is just a snapshot of where retail prices stand in California, nationally, and in Washington State, nearby locations similar to California in the sense that it gets most of its fuel from local refinery production.

So the message is: retail prices continue to decline because crude oil prices have also been going down, but the market on the West Coast was under supplied, temporarily tight, and has improved that situation. Prices as of this morning early are $2.50 (point 4) a gallon, so we're almost under $2.50 a gallon, statewide average for California. It's certainly a lot higher in Northern California compared to Southern California.

This chart shows the difference between Sacramento and San Francisco and Orange County and, as you can see, the relative gap between the lines has either reversed in the case of San Francisco/Orange County, or in Sacramento the Delta or Discount to Orange County is now bigger. That means Southern California prices remain more elevated than those in Northern California because the refinery problems have been more acute in Southern California, in particular ExxonMobil gasoline production equipment still remain down.

So this compares California's price versus all gasoline and we've recognized that there's a mixture of reformulated and non-reformulated gasoline in the United States, so maybe a better comparison is looking at only reformulated gasoline regions. No matter what you do, the takeaway in 2015, a record by a long shot. Retail prices in California much, much, much higher than any of these other periods, significantly so, due to very significant refinery problems.

So this tracks both retail prices on the top and peaking at $3.88 a gallon, not at $2.53 when the slide was created, but $2.50 this morning, so continuing to come down, but still much higher than prices should be because of refinery issues that still are prevalent in California.

So this is another snapshot breaking down what retail price components are exactly, and we have a new piece of information in this slide we didn't have last time, an SCL CFS evaluation, the top red marker. And that's essentially something that is now showing up at the distribution rack location on bills of lading, along with the fuels under the cap obligation, or Cap-at-the-Rack, or CAR price that OPIS publishes.

So previously you can't even really see that red line because it was really less than a cent a gallon last year; in fact, it averaged $0.08 per gallon, a very minimal amount of money, but it has gone up since that time because of how this value is calculated by OPIS. And I'll just go to this next slide.

So it takes the credit price in terms of dollars per metric ton, and it multiplies it by the carbon intensity difference between California gasoline and what that benchmark is. So as we all know, the California Low Carbon Fuel Standard is designed to become incrementally more difficult as time goes by, easier to apply early, a little tougher later on. So in 2016 that hurdle lowered. And so the gap between California gasoline and the hurdle is bigger, so now the calculated value jumped up.

And what's been going on over this entire continuum is the metric ton price is rising over time, and this is transactions between parties for the Low Carbon Fuel Standard not, fuels under the Cap. So what's I think important compared to 2014 is there are these two new obligations that are finding their way into the pricing of gasoline that are amounting to between 14 and 15 cents a gallon, that you didn't have back in 2014.

So refinery operations have been significantly poorer than they have in recent past. The gold bar on the right, each monthly period is 2015 and, as you see, between April and December, an average of 170,000 barrels per day more than the previous 2014 period was off line, unavailable. And that's equivalent to two large refineries. So why the gasoline market became very tight and constrained is understandable, but then even look in the fourth quarter and you see

October, 205,000 more; in November, 240,000, and December almost 300,000 barrels a day more than 2014 off line.

So we look at this information and think this is a very significant temporary decline in gasoline availability.

Looking ahead, yes, the situation is improving. Still no ExxonMobil back on line for the gasoline processing equipment, now that's estimated to be, or talked about in the trade press, to be second quarter sometime, maybe late second quarter.

And if you look at this data for the Fluidized Catalytic Cracking Units, or FCCU's, that's the main gasoline processing units. You can see the little bar, the little gold triangles on the far right-hand side, very high the very beginning of this year have come down, but remain elevated because of ExxonMobil and there's some additional refinery maintenance going on, but not nearly as much. But look on the far right-hand side of that chart, look where the 2015 line is, it's up almost 400,000 barrels a day, much, much more than sort of average. And if you look at -- I know the scales are different on the U.S. on the left, but you see 400 on the left-hand side in December is nearly – is 95 percent of the off line capacity in the United States was in PADD 5 or the West Coast, so not spread out through the United States.

So production has been middle of the road, it’s a little high seasonally right now, most recent data available, and as Ryan already talked about Southern California was chronically low in production because that’s where most of the refinery issues were, and Northern California consistently out-performing even the five-year highs in the high/low band, to compensate for ExxonMobil being down primarily.

Inventories have been down, but recovering. This is California-wide. In the Southern California, remarkably so, and this is due to a recent significant influx of imports of gasoline that do go into Southern California primarily. But some do go into Northern California. But we normally see a seasonal rise in the inventory levels because refineries that keep operating do so and gasoline demand usually declines in December relative to, say, you know, September and October. So we have a natural gas anyway as they do plan maintenance in January and February.

So here are the imports, and we do have 2016 data, weekly data from the IA. You are seeing those red bars are significantly greater than 2015 pre-ExxonMobil explosion February 18, and much higher than 2014. So imports still do continue and, as Ryan already covered, we had about almost four times the amount of imports in 2015 as we did the previous year.

So I think the last time we were talking about imports, I brought up the issue of some vessels do get redirected, they do arrive in California, but don’t offload. And I recall someone was saying, Amy Meyers Jaffe was saying there were two. And I said, no, there was just one. And I stand corrected, apologies, Amy; there were those two that were redirected and the SR American Progress seems kind of unusual, but go to Singapore, arrive in Los Angeles, and then go all the way to Florida. Well, in fact, that vessel had been making runs from the Gulf Coast to Florida, it’s a Jones Act vessel, on a regular basis up until May of 2015 when it went to Singapore, picked up a load, and came back and didn’t drop it off.

In 2016, we have another vessel that arrived, the Orion, and it did stop in the Port of Los Angeles, did make a partial discharge, we can tell from the change in the draft level, and then it went down to Mexico and has been doing some offloading down there and is now sitting at anchor off of Mazatlán waiting to go into harbor there.

But I think it’s important to keep in mind that vessels arriving, almost all of them discharge. You know, coming here and they’ll discharge, and have at least 39 gasoline cargos from foreign countries May-December 2015, and so far this year since the end of 2015, we have eight cargoes. I see three more pending -- this was Friday –- one of those pending vessels had crossed through the Panama Canal from the United Kingdom and stopped, halted, waited a couple days, and then it went back to the Canal the other way. So now its destination is New York Harbor. So one would ask why it would do that, the prices had fallen on the West Coast on the spot basis, and that may be a reason. It’s sort of one of the last of the ships to arrive and left holding the bag. So back to New York Harbor which is seeing a very large influx of gas in cargoes as we speak.

Ryan covered this, we have now updated October-November, you’re seeing really no 2015 exports, certainly, not even the level of 2014, and they’re very, very small, 8,000 barrels a day in November when you’re averaging about a million barrels a day of demand for gasoline, and almost all of these cargoes of gasoline leave Northern California, not Southern California which is net short gasoline.

Pacific Northwest, somewhat similar. Their 2015 values are pretty close to 2014, but still not a tremendous amount of gasoline, and more of late we read that some of these cargoes have gone to Southeast Asia were Premium gasoline where there was sort of a tightness and Premium gasoline components.

So gasoline demand, we want to just touch on this a little bit. Gasoline demand is up significantly both in the United States and in California. And by coincidence, both the California increased 2.87 percent compared to the previous year, and the rest of the U.S. demand increase are virtually identical, 2.87, 3.0, 2.71 percent increase. Most recent three months in California? Even higher, 2.92. So demand is up and clearly we all know since the Great Recession that unemployment rates have been improving in California, so that’s the dark blue line declining, that’s the unemployment rate in California. And we show the change in gasoline consumption in each year in millions of gallons per day -- I apologize for the different units being used here, but we want to show how we’ve seen a turnaround in our gasoline demand, it’s gone up so; in part, clearly, more people working, driving to work, using more gasoline.

We also recognize that price decline has been significant and that also can be something that allow people to travel a little bit more than they would otherwise.

So this is boilerplate language in how the fuels under the Cap is calculated, we’ll go through. This is what we’ve been showing, it’s just to see where do California prices retail relate to neighboring states in the U.S., all higher by at least 30 cents a gallon. And this is showing the price premium of both California refineries and Washington State refineries, and we see when that’s really spiking, the lines get really far above zero, and now they’ve gone down most recently to what would be sort of relatively normal levels, so the wholesale prices are much more of a normal basis and that’s why we’re seeing a drop in retail prices, about one to one and half cents a day in California occurring over the last 10 days.

Retail prices, same thing, or at least 12 cents higher than we were, 12 to 40 cents higher. And the same thing, the market for wholesale diesel is fine, not seeing issues there with these spot price differences.

And just to wrap up, we’re seeing that the fuels under the Cap of 10 cents is about 10.2, is within the range we’re seeing of the sustained difference between the neighboring states, and diesel fuel is -– I’m sorry, it’s below the range, excuse me, it’s below -– 10.2 is below the 15.6 to 42. And we’re seeing the diesel increase of 13 cents is within the range of 1.4 to 26 cents a gallon.

And those are my -– I’d be happy to answer any questions at this time if you have any.

CHAIR BORENSTEIN: Thank you, Gordon.

MR. HACKETT: Hi Gordon. Dave Hackett, and I've got some questions for you. Let's see, the ExxonMobil Torrance Refinery has not restarted yet. Can you address the reasons for that?

MR. SCHREMP: Well, from what we know the explosion damaged their 12-story tall structure, it's an electrostatic precipitator, reduces particulate in ammonia emissions from the gasoline processing or the FCC. So that unit still has not been repaired completely and that structure needs to be completely repaired prior to restart being initiated by ExxonMobil. And that process involves not only the engineers at ExxonMobil, it also involves the engineers at South Coast Air Quality Management District to agree on what the restart procedures are and should be, so that emissions are maintained at the refinery. So that's a very involved process. From what we understand, they still haven't been able to, you know, finish their work physically, and then have the plans ready to go to restart. So what we've been reading a lot is second quarter of this year.

MR. HACKETT: Okay, thanks. The next question is, on Slide 9, am I reading this correctly that the Low Carbon Fuel Standard credit market cost is currently about $130.00 a ton?

MR. SCHREMP: Yes, that's correct, as published by OPIS.

MR. HACKETT: And then I see this big jump up in LCFS valuation. Can you talk about that?

MR. SCHREMP: Yeah, so you take the credit price, dollars per metric ton, and you look at what the carbon intensity is, and the carbon intensity is a measure of where gasoline carbon intensity is and the hurdle, how much lower you need to get that fuel. And so in 2015, that hurdle was not very far below the carbon intensity of gasoline, itself. But in 2016, it became a little bit more challenging for the Low Carbon Fuel Standard and that bar went down. So now the gap got bigger. So it's more grams per carbon intensity, and so when you do the math multiply that bigger number times the metric tons that have been rising throughout 2015, you get that one-time jump up for 2016. This will occur again in 2017 and subsequent years as the bar is lowered, each of those years and the gap becomes bigger.

MR. HACKETT: Okay, so then when I read across to the left-hand Y axis, I see that the impact on the market is about 4.5 cents today?

MR. SCHREMP: Compared to early 2015 about four cents, yeah, 4 or 4.5 early 2015, yes.

MR. HACKETT: And then can you tell if this is being passed through to consumers? Or is it being absorbed in margins someplace?

MR. SCHREMP: Well, that's why in part – for fuels under the Cap we've been looking at the neighboring states and what the relative difference in the retail price has been, and we see that those differences are more, they've gone up more than the 10 cents a gallon for fuels under the Cap, and the 4.5 cents here. So we think it appears as though it's highly likely they've been passed through successfully to consumers. Where in the margin, whose margin is being, you know, eroded? We're not sure and that's how they actually post the prices, either imbedding them in their posted price, or a line item on their bill of lading.

MR. HACKETT: Okay, thank you.

MR. SCHREMP: You’re welcome.

CHAIR BORENSTEIN: I have a couple questions. First of all, today is February 8th and my memory of how California markets work is the end of February is often an unpleasant period. Can you tell us, generally there are a lot of refineries going into turnaround starting in the next few weeks and we often run into trouble?

MR. SCHREMP: Well, generally that is correct. Refineries like to perform planned maintenance when inventory levels normally are their highest, and gasoline demand is the lowest, that’s when they like to perform maintenance. But last year had a significant amount of planned maintenance involving gasoline processing units, and this is something that can be cyclic, they do very intensive large planned maintenance events on either crude units, gasoline process units, or hard to crack or things of that nature, about once every five years. So last year just so happens to be the time when there was very, very heavy gasoline process unit maintenance. Most of that fortunately has been completed now, and so we’re seeing I would say maybe a little bit higher planned maintenance, just initially right now. But it’s actually going to be fairly modest going into the rest of the first quarter, so we don’t see -– there’s not a lot on tap, Severin, coming up for gasoline processing units, there’s two refineries doing planned maintenance now, and of course the big one is ExxonMobil still not back to normal.

CHAIR BORENSTEIN: Can I just ask you, does the CEC get advanced notice of maintenance that is going to happen, or are you picking up from industry news? Or how does that work?

MR. SCHREMP: At this time there is no mandatory reporting requirement under our regulations for both upcoming plans of maintenance, nor impacts of unplanned outages. So we do use industry source information that does their best to track planned maintenance activity and announced unplanned events. What we then typically do is follow-up with the companies, contact them directly, or they’ll contact us to say, “Aw, that’s not true, that’s a rumor.” Or, “Yeah, that’s true, yeah, we’re down and we will be down, you know, this long.” And so we have some confidential exchanges of information to try to better either ascertain they actually had an issue and how bad that may be, and also when they’re coming out of planned maintenance because, as you mentioned earlier, February-March we’ve had some bad price spikes, and that’s also been because a company coming out of planned maintenance comes out late, a week late, two weeks late, and they’re buying in the spot market to cover their obligations. And so we’ve seen some pretty healthy price spikes in the past because of coming out of my planned maintenance late.

MS. MYERS JAFFE: How does the CEC regulate the refining industry to ensure that there isn’t any collusionary action in when they do high planned maintenance?

MR. SCHREMP: Well, the Energy Commission doesn’t have the authority to dictate when they conduct planned maintenance, I don’t think any State agency, Division of Industrial Relations, nor the Attorney General’s Office, is able to tell them when to do that. But what we’ve seen over the years, Amy, is that these very significant planned events involve a specific type of specialized subcontracting, hundreds of workers that have to all be scheduled to be up, and specialized high cranes. And so what happens is, when they know they're doing these significant ones every five years, they plan for it in advance to say, "I want your services, let's get you under contract." And so what happens is they get booked up. And so what happens is then they naturally will get spaced out because you can only have so many of those specialized services operating concurrently in California.

MS. MYERS JAFFE: So why didn't that --

MR. SCHREMP: Oh, I think we were seeing that happen last year with these events. In fact, something else that does happen when there's significantly higher wholesale and retail prices is a company will defer a maintenance and that's if they can do something, say, safety. For example, if I'm changing catalyst in my process unit that is less and less efficient, and I'm doing that for economic reasons, and so they've deferred planned maintenance if it can be done safely from what we understand from talking to some of them, and they've done that because the prices are really high, so they're motivated to stay on line and go down a little bit later, and even reschedule to the following year if they can do that. But we don't have that consistent way of getting that information so that we could quantitatively verify, you know, how often that does occur now.

MS. MYERS JAFFE: So what you're saying in summary is that there isn't really an oversight process of the maintenance process, you just assume that market will correct it based on cost and other kinds of features of the market?

MR. SCHREMP: Yes.

CHAIR BORENSTEIN: A couple other quick questions. We are already behind schedule. You talked about Orion discharging gasoline in Mexico on that earlier slide; when they're discharging gasoline in Mexico, are they discharging CARB gasoline if they discharge some gasoline in Long Beach, and then went out down, diverted to somewhere, and discharged gasoline, would that be CARB gasoline?

MR. SCHREMP: It depends on what was in the Marine vessel to begin with. And I don't recall the Orion, I could get back to the Committee after lunch, but it depends on where it originated. If the cargo is originating in Eastern Canada and in the United Kingdom, usually are able to load base CARBOB, base gasoline, and so I don't know where this vessel originated specifically, so I'll have to get back to you, but it's possible it could be CARBOB, the base gasoline that was then taken down to Mexico, or it could be gasoline blending components, namely Alkylate being taken down to Mexico.

CHAIR BORENSTEIN: And likewise you talked about some tanker that came to California and then left and went to New York and is now bound for New York. And my question there is, while California spot prices are down, they've never been in the last three to four months significantly below New York, they bounced around New York levels. What would be the reason to take a tanker that's already in California when the spot price is at least as high as New York, and redirect it to New York?

MR. SCHREMP: I think the Zircon, which I believe originated in the United Kingdom reported to be carrying CARBOB, did transit the Panama

Canal, completed that transit on the 2nd of February, sat south of the Canal for four days, and transited back north through the Canal on February 6th. It is now slated to be going to New York Harbor. So when that was happening, the bases in California, the wholesale price spot gasoline, had been declining and got to one of the lowest points like in the last, you know, couple weeks. So don’t know why --

CHAIR BORENSTEIN: But it was still positive, and so ––

MR. SCHREMP: It was I think --

CHAIR BORENSTEIN: -- or it was about zero and the tanker was basically here, and they decided to turn it around and what seems like incur extra costs in order to deliver it at a price that’s no higher than California.

MR. SCHREMP: Yeah, the spot price basis in L.A. when it started to transit back through the Canal was 6.5 cents, relatively low if you look on this chart here, that’s the --

CHAIR BORENSTEIN: But still positive.

MR. SCHREMP: It’s still positive -- which I don’t have on the chart here is New York Harbor, and from what we’ve been reading in New

York Harbor there have been dozens of gasoline cargoes fixed to New York Harbor from Europe because of the tightness of gasoline supply in New York Harbor, so there have been lots of cargoes going to New York Harbor, and recently increased demand for imports into New York Harbor. So it’s unusual if it is going to be redirected back through the Panama Canal, exactly, you’re right, at a higher cost to pay the Panama Canal fee, again going back through.

MS. MYERS JAFFE: (Inaudible)

MR. SCHREMP: Well, CARBOB gasoline can be used to create –- the New York Harbor is Federal reformate gasoline, not too far off California, and then you could mix it with some other components and extend the barrels a little bit further.

CHAIR BORENSTEIN: But it does seem that –- it just seems strange to be shipping gasoline further to sell it at a price that’s no higher, unless they think that bringing it into California would actually really depress the California market so they couldn’t get much money for it. Is that possible?

MR. SCHREMP: Well, I don’t know about

motivations, but I do know that what had been going on with these earlier cargoes, the eight or nine cargoes since the beginning of the year, if you look on Slide 16 the inventories of gasoline have gone up, up, up. And so this is something else that, you know, either the owner of the cargo looks at this, or other people involved in the transaction say, “It appears as though there’s a lot more supply available locally, so why should the cargo come here if maybe I could fetch a higher price in New York Harbor?” So we just don’t know what they’re going to be paid in New York Harbor, and they actually won’t know until they arrive around the 10th – I think it’s around the 10th or the 11th, or maybe even a little bit later.

CHAIR BORENSTEIN: Okay, I’m going to turn it over to Jim Sweeney, but can you just explain, and I always wonder, the vertical axis is thousands of barrel per week, but this is a stock number, not a flow number, right?

MR. SCHREMP: That’s correct. It’s sort of the inventory level at the end of each week reporting occurred.

CHAIR BORENSTEIN: Okay, so it’s not --

MR. SCHREMP: It’s a snapshot number, you’re absolutely right. It’s not a flow number.

MR. SWEENEY: In Figure 7 where you have the component of the detailed gasoline, could you just let us know whether this is branded, unbranded, or an average? Because we’ve heard statements from Jamie Court that what seems to be a significant difference from the past between branded and unbranded, and we notice that the distribution dealer cost in this last time was relatively high, 43 cents, which is about as high as they’ve been during that time.

MR. SCHREMP: Yes, Jim, these are branded rack prices in here, not unbranded rack prices.

MR. SWEENEY: Okay. So that would be the biggest of the -– this would be the largest of the final retail prices?

MR. SCHREMP: Normally branded rack prices are higher than unbranded, yes. So that’s correct.

CHAIR BORENSTEIN: Okay, we’re already well behind schedule, but that was an excellent presentation. Thank you, Gordon.

MR. SCHREMP: You’re welcome.

CHAIR BORENSTEIN: And next we have

Dolores Santos from OPIS, who has agreed to come and talk to us about gasoline market issues in California. Thank you very much for coming.

MS. SANTOS: I’m just getting the PowerPoint set up.

CHAIR BORENSTEIN: We’re having microphone issues again. There we go.

MS. SANTOS: Can you hear me now?

CHAIR BORENSTEIN: Yeah.

MS. SANTOS: But thanks again for inviting me, it’s really an honor to be here today. I have a lot to talk about in a very short amount of time, so I want to hit on the things that I think are very important to this conversation and provide a little bit, maybe provoke some thought about the California marketplace.

I’ll just give you a quick background. Prior to joining OPIS in 2013, I worked 37 years for Petroleum Marketers in California. The last 10 years at Flyers Energy, I was the Director of Supply and Distribution. Needless to say, I have lived and breathed this market every day since about 1976.

I was asked to talk a little bit about

the market in California, why the prices are so much higher than other markets. You've touched already on a couple things. So AB 32 and Cap and Trade, LCFS adds about 15 cents a gallon to the price of fuel sold in California. Gasoline, it's 10 cents, a little over 10 cents on Cap and Trade, and four and a half cents on LCFS. Diesel is about 16 cents a gallon, which is 13 cents Cap and Trade and about three to three and a half cents for LCFS.

These programs are designed to go up every year and I don't think we should under estimate the significance of these programs and the cost it really brings on our fuel in California. There is intangible cost that you just can't assign a dollar amount to. And when I was at Flyers, I was an obligated party and I spent a lot of time trying to understand what was going to happen to me as an obligated party going forward, and the program is complex, LCFS is very complex.

We've talked a bit about product specifications. They are the strictest in the world. And that also cannot be underestimated. We are not close to other refining centers and there are a lot fewer companies trading product in this market now than there was 15 years ago, and the lack of liquidity really has an impact on the market volatility. It is also very difficult to hedge fuel in the California marketplace.

This slide, I mislabeled it, it's really California Market Share by Supplier, so it's not really by brand, it's by supplier. And I was trying to find a slide that I could talk to about retail prices for just a minute. These are taxable gallons really by suppliers, so when you look at that, there's a lot of unbranded gallons being sold in this pie, Tesoro, Valero, Phillips 66, they sell a lot of unbranded fuel. Well, what I wanted to point out is NACX in 2014 issued a report on the state of the retail. They stated that there's only about 450 company-owned retail stations left in the United States; of that, 400 are Chevron sites located in California. Now, those are the only sites that are actually priced by a refiner, a major oil company. The rest of these sites are priced by the dealer, the jobber, or the chain marketer, so retail price decisions are really moved down to the retail level for most of this. Those 400 Chevron stations are a pretty small amount in the State of California. But it’s important to look at how these market shares have changed over time. Tesoro has grown considerably and they supply a lot of unbranded fuel, as well as other brands.

I wanted to just give a visual about the locations of refineries that actually make CARB spec gasoline. None of them are very close to California. There are also other refineries that make important blend stocks for us, the condensate, and the Alkylate that we need to make Octane for CARB spec gasoline, and I didn’t necessarily show them all, but I wanted you to see just how far away the fuel is for when we have a refinery problem, where we have to go to get replacement barrels.

We went over this a little bit already, but this is just a snapshot of how 2015 spot market looked versus NYMEX, and Gordon already pointed that out. And he also went through the inventory, so I’m just going to kind of go through this.

What I want to point out is that a refiner outside of California has to make many adjustments to switch their production over to

CARB gasoline. They're going to change their refining process, dedicate specific tanks, and the decision takes about 30 days for them to actually decide to sell us CARB gasoline and actually start making the product. And again, the arbitrage absolutely has to be high enough to price this product to come here. Gordon mentioned 20 cents; that's got to be a minimum on what it would cost to get the product produced in these other refineries and ship it to California.

Most voyages to California are 12 to 16 days, they can also be longer. And I promise you, offloading can sometimes be held up by things like customs and immigration; you think the cargo is here, it's going to discharge, you're going to meet your pipeline obligation, only to find delays. So there has to be a lot of pre-planning and the ability to maintain current inventory levels to meet your obligations while waiting for these cargoes.

And as someone who has traded this market, I can tell you two weeks is an absolute lifetime in the Los Angeles spot market. I can come in one day and have four million gallons of inventory and the market is up 10 cents, and I look like a hero. The next day the market is down 15 and I'm instantly losing money, and I try to get rid of it as fast as I can, only to come in the next day and find the market back up eight cents, and it is not for the faint of heart.

And because of the lack of trading in California, the traders have pretty much exited this market. Hedging these cargoes can be very challenging. I can go out and lock in a contract on the NYMEX, but if I can't cover the basis differential, I am not hedged. And covering the basis differential in California is very complicated.

Gordon talked a little bit about moving product without California. The true lack of Jones Act's vessels has made it very hard to move product in the California market. He already pointed out Northern California had a good supply of product, but we couldn't get it to L.A. We were 30 cents cheaper than the L.A. spot market for gasoline, couldn't move it because we didn't have enough Jones Act vessels to get that product where it needed to be. You know, 15 years ago, or 10 years ago, once the market was four or five cents out of whack, we would just move the product north or south to where it needed to be, but we don’t have enough vessels that are American Flag to move between two American ports. And I really, really hope that the industry looks at this problem and finds a way to resolve it. Of course, once you spend millions of dollars on a ship, if you’re not using it, you know, it has to pay off to have it.

And there’s been a lot of talk about California’s storage, that we give traders access to the water to be able to bring in a spot cargo that they could bring in to the market. Like I said, most traders have exited the California market and absent a refinery issue, we truly are an export market now, rather than an import market. Other than Alkylate, condensate, jet fuel, we’re now exporting gasoline and diesel. You know, it’s a lot cheaper to make conventional product and take it to the water than it is to make CARB gasoline.

So tankage to bring in a cargo is very expensive. I mean, before I left Flyers, I actually tried to tie up some storage so that we could start bringing in some renewable fuels, and it was very difficult, there were very few tanks available and unfortunately they were too expensive for partial cargoes that were on the spot basis.

So right now most of the tanks are locked up with refiners who absolutely need that storage in order to manage their inventories and their production and keep the product flowing in the state. I mean, we have a very large demand in this state and the Kinder Morgan pipeline is just a miniscule size compared to the Colonial, yet we supply millions of barrels a day to the marketplace.

And just to summarize, California is an isolated island, there’s no getting around it. If there is a production problem, replacement barrels can be very far away and it takes time to get here. And it’s going to be expensive if you want to track those barrels to come to this market.

Our product specifications make it even more difficult and now you have the LCFS Program that’s just been getting increasingly more stringent. Traders willing to take the risk have to have some guarantee that they’re going to make some kind of profit before they’ll bring the cargo in. And I can assure you those cargos that got turned around were probably because they were losing too much money to offload the cargo, or the people who wanted to take the cargo simply couldn’t hold it and they had to go somewhere else.

And that’s really all I wanted to point out real quick. If you have any questions, I’ll be happy to answer them.

CHAIR BORENSTEIN: I’m sure we are going to have questions. I’ll let others start. Dave? Thank you very much, Dolores, that was great.

MS. SANTOS: Thank you.

MR. HACKETT: Dolores, it’s Dave Hackett. Thank you for your presentation. Can you talk just for a moment about storage? If you’re a trader and you want to bring in a cargo of gasoline, what are the sort of issues about finding dock and tankage space? Especially in Southern California.

MS. SANTOS: Well, in Southern California all the storage is pretty much tied up, except VOLPAC and, you know, to lease tanks, I mean, I looked in Northern California, I looked at two tanks, there was a 50 and a 60,000 barrel tank and it was going to cost me $72,000 a month whether I used them or not. And then I also had to deal with 1,100 barrel line fill every time I offloaded cargo. And that could cost me almost $100,000 just to get rid of that product because it's usually got water in it.

But tankage that's just sitting there waiting for someone to lease it is just really not available, there's not a lot of spot tankage. I know there was several tanks built in Martinez at the old Land Sea Terminal, I believe it's planes now. But those get termed up with long term deals for refiners that need that storage space for their operations. So other than Selby, which I worked at Wickland when we built those tanks, other than Selby and Northern California, and there's IMTT Richmond that had some tanks, but they've all been taken, Southern California I don't think there's a lot, Chemoil and VolPAC would be the only ones. But again, those terminal operators want long term commitments. And we really aren't a big import market anymore unless we have a problem.

MR. HACKETT: One other question from me. In the past when there were supply disruptions, sport market went way up and unbranded racks went up with the spot market, but the branded racks did not. And that would create a condition, call it an inversion, where unbranded gasoline was way higher than branded gasoline. Have you seen much of this, of that inversion scenario in the last year or so?

MS. SANTOS: Well initially when the spot market jumps up, anybody who is tied to a spot price is going to see that huge increase. And I will say, at Wickland, New West, and Flyers, our decision to ship in the pipeline was to pretend we had some control over that. So when the market went up 15 cents one day, I had inventory at a lower price, so I didn't have to pay that higher price that particular day. But it only works for a few days and then in a down market you need help. But as far as the inversion go, the initial rise in the spot market really hits the unbranded market first. And in the past refiners were slower to raise their branded prices to their branded dealers. But it seems like in 2015 we didn't see that quite as much; we had the initial shock of the spot market, but then the branded prices did tend to go up rather quickly.

MR. HACKETT: And so why do you think that is? What's changed that a significant inversion did not occur in '15 as it has in the past? What's different in the marketplace?

MS. SANTOS: I think when you have a true shortage of product, you're going to raise your price, it's a supply and demand issue, you know, and if people are having to cut batches of product to ship in the pipeline to meet their obligations, it seems to me like this year the refiners really did have a difficult time meeting their supply obligations.

MR. HACKETT: Do you see anything different in the mix of who is setting the price? Recently versus, say, a few years ago.

MS. SANTOS: I think, as I mentioned earlier, you're seeing retailers, the actual dealers, jobbers, the chain marketer setting the retail price. The majors aren't setting the prices. You know, I just want to clear up something about dealer tank wagon really quick. You know, dealer tank wagon is site specific, they're zone specific and so the branded supplier will set a DTW price that is their price with freight included to get to a particular location. So DTW is pretty much site specific.

MS. MYERS JAFFE: So just on that last point you're saying that the jobbers and the dealers are setting the price now, not the majors, but they receive a wholesale price from the refining industry. Is that correct?

MS. SANTOS: Absolutely.

MS. MYERS JAFFE: And so they are pretty dependent on what price is set by the refining industry. Is that correct?

MS. SANTOS: That's absolutely true, but if you're going to price higher than your competition on the street, you're not going to sell any fuel. So it does become a quandary.

MS. MYERS JAFFE: So are you saying that sometimes the jobbers and the dealers lose money because the refiners are setting the price too high compared to what the market will bear?

MS. SANTOS: The refiners really aren't setting retail price. You know, they set their wholesale price, but not the retail price.

MS. MYERS JAFFE: Well, what's the differential between the two this year, say, compared to history?

MS. SANTOS: It's hard to say. It could be more than 10 cents a gallon. I work at OPIS now, so I'm not looking at my retail stations every single day.

MS. MYERS JAFFE: So my point to you being it's very clear data that the refining industry has historic refining margins, I mean, really historic refining margins. So back in the day, a good refining margin is something like $4.00 a barrel. Today companies are reporting things in the $50.00, $60.00, $70.00 a barrel margin area. So they're taking those margins and then, from what you're saying, the jobbers and the dealers are price takers, and then they try to pass whatever they can through to the retail market. Am I accurately describing the market from your perspective?

MS. SANTOS: Well, I think today it costs about $8.00 a barrel just to turn on the refinery, but I don't know. I'm not a refiner. And if you're making a $50.00 crack spread, but you're only operating at 50 percent capacity, it's diluted. So I really can't speak to the refiners, but as a marketer, as a jobber that did both unbranded and branded, of course I was stuck with the price I paid at the rack. But what I'm trying to say is that, if I have a station and my next competition is three cents cheaper, if I'm not competitive with them, I'm not going to sell any fuel. So there's both the price I pay for the fuel, and then what I can sell it for on the street.

MS. MYERS JAFFE: But my point to you is, you're making a general statement that somehow prices are set by jobbers and no longer by the majors, but given the fact that the majors and the independent refiners are setting the price at the rack, and that they're enjoying historic profits, they are still very much an influence in what winds up at the retail price.

MS. SANTOS: There's no doubt the rack price influences the retail price, absolutely.

MS. MYERS JAFFE: Thank you. That was the point I was trying to make.

CHAIR BORENSTEIN: I have a few questions. First of all, back to Cap and Trade and LCFS, you said that this is -- there's a lot of complexity. If California had instead just gone with an increase in the gas tax based on the amount of gasoline, of hydrocarbons in it, would that have been simpler? Would that have changed the way –- and you also said that fewer companies trading, is that a big part of why there are now fewer companies trading?

MS. SANTOS: Fewer companies are trading for a lot of reasons, but not necessarily LCFS. I mean, we've lost liquidity in this market over the last 10 to 15 years.

CHAIR BORENSTEIN: But wait, wait, why? What's happened?

MS. SANTOS: Because the market is very difficult to trade. As we transition from an import market to an export or balanced market, the VTOLs, the Glencores, the Traffigura's, it didn't make sense for them anymore to try to set the arbitrage to get barrels to the West Coast. I mean, at one time the West Coast was the best market in the world for imports; that is not the case anymore. When we brought in 10 percent ethanol, we displaced 10 percent of our gasoline pool overnight, and it had an impact on our imports.

CHAIR BORENSTEIN: But that happened 15 years ago or 12 years ago.

MS. SANTOS: I know, but it's been over

the last 15 years that we have gradually gone from an import to an export market, and as the ability for the traders to make money and bring cargoes in has diminished, we've lost those. And they bring liquidity.

CHAIR BORENSTEIN: Okay. Can you tell us a little more about the customs and immigration delays? It was important enough for you to put it on a slide.

MS. SANTOS: Well, it was for me, I mean, real quickly, when we were at Wickland Oil, we had 130 gas stations and we didn't feel that we were getting a fair shake and we went, oops, turned it on. And we wanted to be in charge of our destiny, so we built a deep water storage facility in Soubee, and we started importing cargoes from the Far East. We were quite an importer at the time. And you know, sometimes the cargoes got delayed by weather, sometimes they got delayed by immigration, sometimes it got delayed by customs. And you know, 24 hours is a long time when you've got the pipeline wanting to supply barrels. Now, that may have changed, you know, between the late '80s and early '90s, but there's a lot of issues in bringing a cargo in and offloading it. I just wanted to point out things like customs and immigration can have an impact.

CHAIR BORENSTEIN: Okay. This is a question that, since we have you here from OPIS, I look at the spot L.A. prices every morning, they are shockingly volatile to me --

MS. SANTOS: Absolutely.

CHAIR BORENSTEIN: -- for a storable good, you wouldn't expect prices to be moving 20, 30 percent in a matter of a couple days.

MS. SANTOS: Yep.

CHAIR BORENSTEIN: Those are real prices? Trades are really -– can you tell us a little bit more about how those prices are determined and if we should really take those as serious prices?

MS. SANTOS: OPIS has their methodology on their website and they report every single trade, it's in the market assessment every single day and, yes, they really do trade.

CHAIR BORENSTEIN: So there are people who trade at $1.31 one day and who could have bought, it turns out, at $1.02 the next day, and then it's back up to $1.20 the day after that?

MS. SANTOS: Absolutely. I've been

there.

CHAIR BORENSTEIN: Wow.

MS. SANTOS: Which is why I quit trading flat price because it can keep you awake at night, that's why when I got the chance to go to work for OPIS, I got out of the business. It really does happen that way. You know, if you have a 50,000-barrel tender pumping and you lost an FCC unit, and all of a sudden you have to source a tender, you've got to go in the market and buy it.

CHAIR BORENSTEIN: And that actually will drive up the price by 30 cents?

MS. SANTOS: Well, the first trade might be a nickel, second trade might be 10 cents, but when they find out it's a major, guess what? You know, it's supply and demand.

CHAIR BORENSTEIN: And so losing 50,000 barrels sort of in the production chain is the sort of thing that will spike the price by 20 or 30 cents?

MS. SANTOS: So how Kinder Morgan works is there's four cycles a month, and you have to give your source eight days before that tender pumps. So let's say you have a 25,000-barrel tender going out of Carson and you lose a unit, and all of a sudden your inventory you have ready to ship is down to 18,000 barrels. Now you've got to cover that batch. Kinder Morgan is not going to wait for you, okay? You either need to get another supplier to supply that batch, or you're going to have to cut the batch. And if you have to cut the batch, now you don't have enough product necessarily to meet your obligations at the rack.

MS. MYERS JAFFE: Can I ask a question?

MS. SANTOS: Yes.

MS. MYERS JAFFE: Back in the old days when everybody in America was a very civil society to each other and we weren't in such competitive and aggressive times, the majors used to loan each other barrels when somebody had a market out, it was like that, that was the practice. People would do a time loan, and that was a standard practice of the industry in the '80s, and my understanding, I used to like yourself work as a financial journalist writing about the oil industry. I would say that was a practice up through the '90s. Right? So has that changed?

MS. SANTOS: I honestly think that refiners still help each other and they probably do trades between each other that don’t get reported, they’ll do an exchange. But we only track actual trades where, you know, it’s either over a certain amount over the NYMEX, nobody really does flat price anymore.

MS. MYERS JAFFE: So ultimately what you’re saying is, is if someone was a small trader, or independent player, and people in the market wanted to squeeze them, is what we call it in the trading community, to make a lot of money by making a squeeze in the market, then there’s too much market power, that could happen in California today because of the lower liquidity.

MS. SANTOS: Well, I’ll put it this way, you know, I started shipping barrels at Flyers and we had about a 300,000-barrel demand per month of diesel, which isn’t big in the real world, but it was big to me. And, you know, we really wanted to create liquidity and go out in the spot market and trade those barrels, which I probably could have done, but if a refiner goes down and -– I’ll just make an example, let’s just say Chevron had a diesel problem, and that refiner went down, there’s no way anybody is going to supply me, the little spot person trying to buy those barrels, I’m going to pay for them. So I moved all my contracts to buy on an OPIS three-day spot average, you know, a three-day wrap, simply because we wanted to find a way to smooth out the big fluctuations in the prices. But a small player like myself isn’t going to be able to go out and accomplish my small trades if there’s a shortage in the market.

MS. MYERS JAFFE: So what you’re really saying, I don’t want to put words in your mouth, but if you’re really saying is if you’re not one of these very, very large players that can do a loan to each other or not, it’s not a competitive marketplace.

MS. SANTOS: Well, we did pretty well shipping in the pipeline, but we didn’t depend on spot market prices because of the lack of liquidity, so we stuck with, you know, term contracts where we bought a set amount of volume based on a market benchmark.

MS. MYERS JAFFE: You know, prices are set at the margin and the spot market, so again it doesn’t sound like a terribly competitive market if you can't participate in that as a market player.

MS. SANTOS: We thought about it, but we made the decision not to go into the spot market.

CHAIR BORENSTEIN: So let me ask a little more about the hedging issue because this seems to be a major problem that you can no longer really -- there isn't a vehicle for making transactions that an importer particularly can lock in prices, and so they're rolling dice as to when they decide to bring gasoline into California.

MS. SANTOS: So for someone like myself who wanted to buy the basis differential to lock in a price, because as a retailer I'm at risk to the upside, right, so I would want to lock in the basis differential. That way, if there was a refining problem, you know, it would help protect me in that big blowout, okay? So remember what I said, there's not a lot of people importing product unless there's a refinery issue. So if I'm a trader and I want to bring a cargo to California, the first thing I do is sell the basis. I'm selling the basis as a way to help hedge myself. I'm going to lock in a basis swap at 25 cents, or 20 cents. I’m going to sell that basis, that will help hedge my cargo with the NYMEX and the basis to get it to California. Well, as the traders have stopped importing product, those spot basis trades have started to decline. Refiners aren’t wanting to do those basis trades. The traders are not doing them anymore. So when you try to lock in a basis differential, it can become difficult to find somebody to take the other side.

CHAIR BORENSTEIN: So just to be clear, you’re saying the side -– what’s gotten thin is the side buying the basis differential?

MS. SANTOS: No, I think there’s people willing to buy, it’s people willing to sell the basis. So an importer bringing a cargo in would sell the basis --

CHAIR BORENSTEIN: Right.

MS. SANTOS: -- as a way to hedge it. And people do like to buy, but I’m just saying for me as a buyer, there was less people selling the basis.

CHAIR BORENSTEIN: Oh, it’s simply because there were less people importing?

MS. SANTOS: Uh-huh.

CHAIR BORENSTEIN: But when somebody did see you're a refiner in Singapore, or you're somebody who makes deals with the refinery in Singapore, and the California price goes way up, you can now be in a position to sell the basis differential and there should be plenty of people out there to buy it.

MS. SANTOS: Uh-huh.

CHAIR BORENSTEIN: So why isn't that happening?

MS. SANTOS: So I'm in Singapore and I just sold a cargo because arbitrage was there. Now a couple cargoes make its way in from the Gulf, and pretty soon the basis went from 50 cents to 23. So now the Singapore guy is not so anxious to bring the barrels to the West Coast.

CHAIR BORENSTEIN: But he's –- oh, after it's gone down?

MS. SANTOS: Right.

CHAIR BORENSTEIN: But the whole idea of hedging is that both sides are locking in a differential now, and so they're protecting themselves from that drop.

MS. SANTOS: So if I sell it at say 40, and by the time the cargo gets there it's 20, I could lose 20 cents on the basis slot that I sold.

CHAIR BORENSTEIN: Wait, now I'm lost. If you sell it at 40, then you've locked it in.

MS. MYERS JAFFE: Wouldn't the refiner that needed the cargo and you just be able to do a swap?

MS. SANTOS: And they may do that, that may be very -- they may be doing that, but I know for me –

MS. MYERS JAFFE: They're not doing that because no one is bringing any product in.

MS. SANTOS: I know for me it was hard to lock in basis swaps, particularly in the Bay, that's even more illiquid.

MS. MYERS JAFFE: And that's because maybe the same reason why you can't do an extended trade in the Low Carbon Fuel Standard, because there's no refiner there willing to actually do a hedge.

MS. SANTOS: I can't speak to the refiner, but I just, the volatility is such that it makes it not for the weak, not for the faint at heart.

CHAIR BORENSTEIN: Yeah, but I would

think the volatility is such that both the importer bringing product into California and the buyer in California would have an interest in locking something in.

MS. SANTOS: Correct. I don't think you want to bring a cargo here without locking it in.

CHAIR BORENSTEIN: But if they're both interested in it, there's a deal to be made.

MS. SANTOS: And I'm sure there is.

CHAIR BORENSTEIN: Okay.

MS. SANTOS: It's just, I see less traders in this market.

CHAIR BORENSTEIN: So last question, and then I -- can you tell us a little more about building new tankage, it sounds like there is a tankage shortage on the Coast. Is that right? Is there a problem? Is tankage being used at a higher capacity utilization than it used to be?

MS. SANTOS: I'm not 100 percent familiar with inventory storage and tankage, but my observation is that, absent a refinery problem, we have enough storage. The problem is if there's a refinery problem and we have to bring in imports, it can squeeze the tankage that's available.

CHAIR BORENSTEIN: Okay. Jim.

MR. SWEENEY: Could you help me understand more fully about the microstructure of trades and how all this would cause them into the harbor? First, when OPIS is reporting the prices at the harbor and there is a hedging contract in place, exactly what price do you observe and report in your reporting system?

MS. SANTOS: You know, the Editors track all that, but they actually only report actual trades that commence.

MR. SWEENEY: The trades, and so anything hedged ahead of time they would not be able to see any element of that?

MS. SANTOS: No, they’re going to report specific trades for 25,000, 50,000, whatever, that actually occurred on that day.

MR. SWEENEY: Now, if there was a longer term contract that was set ahead of time, they were going to deliver it, would that be counted as a trade at the time it’s delivered?

MS. SANTOS: I don’t think so. I think it would be at the time it traded, the first trade.

MR. SWEENEY: Yeah, so is the prices that we're observing for OPIS at those trades not really the price at that time in the harbor, but a time sometime in advance when they've entered a contract? I'm a little bit confused about exactly how this market is working and how you report these data.

MS. SANTOS: I'm really more familiar with pipeline pricing on the West Coast. There are cargo pricing that OPIS tracks, but I don't really follow it that well, particularly the Harbor. But we do actually report trades that happen every day and we also have cargo trades, as well. So there is also assessments for cargo in the Gulf Coast and the Harbor.

MR. HACKETT: Dolores, can you talk about some of the features of, let's say, take a pipeline trade which you're very familiar with, can you talk about what things are in that trade, how you know which one this is being talked about?

MS. SANTOS: You mean --

MR. HACKETT: Timing, volume, quality, location.

MS. SANTOS: So when you do a pipeline trade, like I said, there's four cycles in the month, so if you want a prompt batch, that means you're going to supply that batch in the very next cycle, so a prompt batch is going to be more expensive than in any, so any means if I was to go out and nominate for March, if I went out and bought the product, I could take it any cycle, okay? If I wanted it just for first cycle, the price would typically be higher. Now, March is an interesting month for vapor pressure because you know we're right now going into RVP Switch in Southern California in March, the first two cycles, the first cycle of March is high RVP, the rest of them are low RVP. So if you were to do a trade in March, you would have to be very specific as to what cycle, the RVP, and the quality because Kinder Morgan won't take anything in Northern California after March 10th that isn't 5.99 pounds per square inch.

So in Southern California, they actually switch, they start the first week of February. So any time you do those trades, all those specifics have to be laid out, and then OPIS would report whether it was a high RVP trade or a low RVP trade.

MR. SWEENEY: So I want to go back to a

couple other things. We’ve talked a little bit about cargoes that fail to unload when in Southern California. Have you any speculation whether those are contracts that did not have a forward contract to sell it at that price?

MS. SANTOS: I have no idea. When I heard that it turned around and went back to New York, my first thought was it was off spec, but I don’t know anything about that cargo. I’m just saying logically I would have thought there was something else wrong.

MR. SWEENEY: Okay, so --

MS. SANTOS: I don’t know.

MR. SWEENEY: Let me ask you then a different question. Your graphs stopped -– inventory graphs, I think, on something like the 17th or 19th, went to the --

MS. SANTOS: Yeah, these were the 13th.

MR. SWEENEY: Yeah, you went to January 29th, and if you followed the Southern California this is the inventory.

MS. SANTOS: Uh-huh, inventory.

MR. SWEENEY: And not yours –-

MS. SANTOS: Right.

MR. SWEENEY: -- you’ll see that up to

January 29th, the inventory levels jumped over a thousand barrels and jumped from just below the bottom of the range to above the top of the range. So in the last couple of weeks it has to be the case that the imports plus production in Southern California are significantly exceeding the sales in Southern California, and yet the prices are still maintaining at a high level. Do you have any idea what's going on there?

MS. SANTOS: Well, the only -- the worst demand year or the worst demand for retail was January and the second worst is February. So, these are typically weak demand time frames.

In Southern California, I would think that refiners are stocking up on lower RVP product so that they can start supplying it. Well, they already are supplying it this week. So, that would be -- you know, you've got the imports along with stockpiling low RVP because they've got to ship that product in the pipeline.

MR. SWEENEY: Right. Inventories we went from below the normal range to above the normal range and the normal variation account for changes in the normal range. It wouldn't account for why there was that jump.

So, I take it you have not thought about it so --

MS. SANTOS: Well, I mean you've got cargoes that came in and, as they mentioned that there's going to be some refinery maintenance. Refiners are going to stockpile inventory when they have refinery maintenance coming up so they can meet their obligations.

Yes?

MR. HACKETT: This is Dave Hackett. Dolores, could you turn to your slide that's got the spot market graphs on it? And I'm not quite sure which number that is?

MS. SANTOS: It's right here.

MR. HACKETT: That one, okay. And so, what we're not saying that the latest data --

MR. SWEENEY: That's the latest data.

MR. HACKETT: And so the latest data, you see the red line at the far right, with a price of about 60 cents or so a gallon over the New York Mercantile.

MS. SANTOS: Yeah.

MR. HACKETT: Friday's price is 6 and a half over.

MR. SWEENEY: Oh, so it has gone way

down.

MS. SANTOS: It really dropped in January. I went on vacation so, I'm sorry, my slides are not quite as accurate as Gordon's.

MR. HACKETT: Thank you.

CHAIR BORENSTEIN: Kathleen?

MS. FOOTE: Just one quick question. Thank you very much for everything you've told us so far. Do you have any idea, does OPIS measure how much CARBOB is either produced or sold outside California?

MS. SANTOS: I'm not sure anybody has that information. I would think you guys would probably know better how much is produced outside of California.

CHAIR BORENSTEIN: Okay, we are way behind schedule, but this has been really great.

MS. SANTOS: Sorry.

CHAIR BORENSTEIN: Thank you, Dolores. This has been a lot of good information.

Next, we're going to have Bob van der Valk from Bakken Oil Business Journal.

MR. VAN DER VALK: Good morning.

CHAIR BORENSTEIN: There we go.

MS. WARD: Good morning, Bob. I'm just

going to bring up your presentation.

MR. VAN DER VALK: Oh, all right. While you're doing that, I'll give a basic outline of what it is that I'm going to present which is somewhat duplicitous of what Dolores just gave. So, this presentation may not last as long.

I'll give you an outline on the reasons why the average California gasoline price is higher than the national one. I'll also give you a comparison and reasons for the differences between branded dealer tank wagon, of DTW, and the unbranded rack gasoline price.

And last, but not least, will be an explanation for the differential in spot market gasoline prices between Northern and Southern California.

But I'll start out by saying in the -- Dolores, you might agree with me on this. We buy, in the trading industry here in California on the rumors and so on the facts. Every morning I had a door left and right, and the left door said buy and the other one said sell and between those two you had to make money.

So, with the CARB auctioning and blend costing 15 cents a gallon more than the reformulated gasoline, that’s 15 cents of the total 80 that I’m going to differentiate, the anti-global warming regulations and you’ve just gone through a whole explanation of that. At the time I wrote this it was 12 and a half, but it’s now 15 cents. The LCFS went from 2 cents to 4 and a half cents at the first of the year.

And then we have another 13 cents difference in just the average federal, state excise and sales taxes, as presented, or I picked that up off the API website.

The next slide. The pipeline system is owned by Kinder Morgan.

And now I’ll go to the next slide. And there it is, right there in the middle of my chart is Kinder Morgan. And you’ll notice one thing, they are not connected. And therein lies the problem. We have refineries up in the Bay Area and we have refineries in Southern California.

And in Southern California the demand is higher than it is in Northern California. My understanding from Ryan Eggers is that the capacity in Southern California is a little bit higher than Northern California, but there’s a lot more gasoline being transferred, sometimes by proprietary ships, including Chevron and Phillips, and maybe even Valero.

By the way, Valero Benicia is down as of today and this is per OPIS. I got that firsthand this morning from Lisa Street. They're in a turnaround. So, we might see some firming up in the spot market price as of -- well, we'll know by this Wednesday if the inventory's going to show up.

I'll leave this slide alone because the text is very small and I'm sure you're not going to be able to read all of it, but it will be in the next few slides in larger font.

So, go ahead and skip to the next slide, Courtney. In-state refineries, with operating a full capacity supplied 90 percent of the CARBOB or California grade gasoline. Now, given that we do use -- some areas in California still use reformulated gasoline, such as San Luis Obispo County.

But we also supply, by pipeline, Nevada, Arizona and, of course, with ships to Oregon and Washington. California accounts for over 50 percent of the overall PADD 5 gasoline demand.

The next slide. The fact is, however, that -- and I think we just had that covered by Dolores, so we'll skip it. But the terminals that I've located throughout California is where tanker trucks pick up gasoline for delivery to retail stations.

So, you can go to the next slide, Courtney. Tanker ships delivery cargos. You already heard that. It's typically 250,000 barrels, 10 million gallons.

And I heard a question asked about pricing and it's typically the day of, the day before, and the day after, business day after it arrives, the spot market price, if it's in L.A., Bay Area or in the Northwest.

The delays in arrival, such as what happened right after the July 4th holiday, in 2015, spot market prices at 60 cents a gallon, and it was automatically, almost instantly transferred into the branded, unbranded, and the dealer tank wagon price. But believe it or not, there are three different levels of gasoline prices going on in California.

CHAIR BORENSTEIN: Bob, this is --

MR. VAN DER VALK: Now, I've already --

CHAIR BORENSTEIN: Bob, can I ask you --
MR. VAN DER VALK: Can you all hear me?
CHAIR BORENSTEIN: Yeah, can I ask you a quick question? Can you hear me?
MR. VAN DER VALK: I don't know what you're saying, but go ahead. Yeah, I can hear you.
CHAIR BORENSTEIN: This is Severin Borenstein.
MR. VAN DER VALK: Hello, Severin.
CHAIR BORENSTEIN: Hello. You just said a delay in arrival drove up spot prices 60 cents. Can you tell us what --
MR. VAN DER VALK: I will even call that, it was a rumor started that was verified to not be true the week after it was circulated, that ExxonMobil Torrance was going to be back up by July 15th. It chased out any cargos arriving, even though the spot market price -- the price was still good enough to attract them. And so without those cargoes, on the day after the July 4th weekend, and I think it was the 6th of July, we had the spot market price not just jump 10, 20 or 30 cents, 60 cents. And it was instantly transferred into the unbranded, and the branded

rack price, and the dealer tank wagon prices.

CHAIR BORENSTEIN: So, can you just --

MR. VAN DER VALK: Instantly.

CHAIR BORENSTEIN: So, how much -- you said delays of cargoes. How much cargo were we talking about that got redirected or delayed? Are we talking about one tanker with 250,000 barrels?

MR. VAN DER VALK: There just weren't any scheduled because it was supposedly that (inaudible) was going to be repaired enough to run that SCC at the ExxonMobil Torrance Refinery as of somewhere between 50 and 60 percent of capacity.

Well, it turned out to be not what CalOSHA and the South Coast Air Quality Management District were going to allow them to do. Soon as that rumor was put to bed and it became fact that, in fact, the ExxonMobil was going to be down for the duration that market just -- it was two majors came out and bought every barrel of spot market gasoline. And I would even call it fixed the market.

CHAIR BORENSTEIN: So, I understand --

MR. VAN DER VALK: There were no pipeline barrels available to --

CHAIR BORENSTEIN: I'm trying to find out what --

MR. VAN DER VALK: There were no pipeline barrels available just to the spot market traders. Go ahead.

CHAIR BORENSTEIN: I'm trying to find out how big a surprise was this? How many barrels were they expecting?

MR. VAN DER VALK: Big.

CHAIR BORENSTEIN: Okay, can you put a number on it? How much did people think that the Exxon Refinery was going to start producing when the number turned out to be zero? Are we talking about 50,000 --

MR. VAN DER VALK: We need a cargo every three days to make up the shortage that the ExxonMobil has.

CHAIR BORENSTEIN: Okay, so that --

MR. VAN DER VALK: And there were no cargos scheduled for the first two weeks of July because they were going to be back up, you know, running and it was going to be a pity deal, a pity plea by ExxonMobil to the different agencies, including CalOSHA and the South Coast

Air Quality Management District and other agencies to get it up and running.

CHAIR BORENSTEIN: Okay.

MR. VAN DER VALK: Because by then the price of gasoline on the street was already at 3.85.

CHAIR BORENSTEIN: Okay, go ahead.

MR. VAN DER VALK: Okay, so the scarcity of longshore inventory we've already discussed.

Okay, dealer tank wagon is the dominant class of trade in California and that's very important. And in Southern California it accounts for 75 percent. And this following chart, from Lumberg, came out of their Lumberg letter. I will explain that.

So, let me turn to my -- go ahead. We can see by the -- if you skip to the July, that 60 cent jump. By July 16th we went to 4.18. And it was all based on, in the stock market, about the rumors that the ExxonMobil coming back up, but it did not. And two majors went out and bought every barrel of spot market gas made available the week after July 4th.

MS. FOOTE: Well, who are the majors?

MR. VAN DER VALK: But I cannot --

MS. FOOTE: Yeah, who were the majors?

MR. VAN DER VALK: Well, I know who they are, but I don't want to get anyone in the room aware that -- you know, that could be something that I'd have to verify with the particular traders. But I got that firsthand. Major, it was two major oil companies.

MS. WARD: That was Kathleen Foote, by the way.

MR. VAN DER VALK: Oh, yeah --

MS. WARD: If you could just state your names for us, thank you.

MR. VAN DER VALK: Yes, gasoline is all I'm talking about.

So, the next slide is that retail or station owners -- and by the way, I ran three 76 stations in Ventura County for 15 years, so I know all about running a gasoline station, including having a background in working for a major oil company for 20 years in supply and doing exchanges. That came up, you know, this again, with other major oil companies and they still do those. We have exchanges set up and we owe people, or we owe other oil companies that have refiner barrels at any one time.

And then if we have to, only if we have to, we go out into the spot market. It's kind of the last, desperate measure.

So, the two weeks has already been mentioned. The spot market, if it goes up today, you'll see it on the street in about two weeks. Well, the 60 cents was almost immediate. We had, within two to three days, everything went up including the street.

We have the other thing that's really important is that the shock is like when we have a hurricane warning. Everyone goes to the store and buys every loaf of bread, and stick of butter, and carton of milk around.

Well, so retail stations, and I'll just give you an example, Costco has as much as 300,000 gallons at their stations at any one time. Now, they may sell 50,000 gallons, but they can play the inventory to be low, medium or high. And they have got somebody in charge of that to make sure that they are low when the market's going down, and it's filled up as soon as there's even a hint of the market spiking up. And, of course, that causes terminals to run out, that causes refineries not to be able to ship as fast as the terminals run out.

And then, of course, you have the people now reading their newspapers almost every day with the latest story about crude oil either going -- today it's going down, but tomorrow it goes up. And they say, well, I better keep my tank filled up even though it's about $2.60 a gallon right now.

And by the way in Sacramento, I just checked, we can actually buy gasoline at $1.87 somewhere. So, the market is working in Northern California.

Okay, let's show the next slide, Courtney. This is the slide that is again provided or it was from the Lumberg letter. And you can see the inventory, which I think you've already had the inventory show that we build a big inventory by the end of last year. But it shows you that we had a perfect storm in July, when we saw the inventories dip down to 27 million barrels, and that set up that 60-cent spike.

So, let's go to the next slide. We make the call by buying and selling on the L.A. and Bay Area spot market. They're not connected by pipes so if we want to sell in Northern California, typically they have like what Dolores was doing with Flyers, somebody working in Northern California. I was a Southern California trader when I was in the market. And we buy to fulfill contractual obligations. We have agreements with customers to supply with a certain amount of gasoline at a fair market price.

And the typical trade is 25,000 barrels, but you can get as low as 5,000 barrels. And remember, there’s 42 gallons to a barrel.

All right, into the tube. Pipelines can export gasoline from refineries and ports to terminals. And when traders purchase gasoline on the spot market, they arrange to have it delivered into the pipeline system and they pay a fee.

Kinder Morgan owns nothing. Title passes as soon as that pipeline system is in the tank and it could be a proprietary tank or it could be a community tank. That’s when the title passes, it’s in the tank but there’s a 30-day storage fee. But we try to move it within a week or so after it gets into the pipeline and its terminal storage facility.

The next slide. More factors, comparison and reasons for the difference between branded, dealer tank wagon and unbranded rack gasoline prices.

Severin, I sent you something last night that shows that there’s three different prices. And we’ll just use Valero for an example. They’re probably more competitive today than they were a month ago, but their unbranded rack is $1.28. Their branded, at the rack is a $1.40 and their dealer tank rate is $1.414. That seems to be a fair way to do it.

Although today, we just had the spot market gasoline price, and that’s CARBOB before you blend it with alcohol, drop to under one dollar. It went to 99.9 cents.

So given that, there’s still enough profit at the rack to keep a station in business or a refinery in business.

Now, we have Chevron at a dealer tank wagon price of $1.615. That’s 20 cents higher than Valero.

I remember it mentioned that there’s company direct-operated stations in California that have absolutely no influence on the market, which I totally disagree with. They use those stations to discipline their non-direct operated stations, either directly owned by the service station owner or leased to a service station owner. And thereby, effectively are able to police their price.

But the dealer tank wagon price is the one that the service station dealer, the owner of the station actually pays to the major oil company. So the additional, and I'll call it 40 cents, is going into the pocket of the major.

Tesoro is now, in Southern California, running all the Arco stations, including their refinery. They own it. They own the refinery and the stations. And they inherited a company-operated, direct operated chain called Prestige. And in San Diego County, between their operating the USA stations, their Arco and some of the Shells, because Shell has some direct-operated stations and, of course Tesoro, in Southern California, also delivers to Shell stations and they control 40 percent of the market in San Diego County.

So, direct operations are alive and well and are kept in place in order to discipline and police the other stations that are getting the dealer tank wagon price. And at this point Valero seems to be competitive, but they don't really have a brand out there. Whereas Arco, Shell and Chevron do.

And by the way, the Arco price today, and I got this direct from a service station owner in L.A., is $1.628. It's the highest dealer tank wagon price. Chevron is $1.615.

Now, remember, this is before taxes. And compared to the dollar that we're paying for spot market prices today, that infers a 60-cent profit. However, with the 15 cents for the LCFS and the GHG I call it, the greenhouse gas fee, which by the way is shown on the invoice as two separate line items with an asterisk saying it's included in the price per gallon, but they do break it out.

Okay, the big event of course, back in February last year, was the ExxonMobil Torrance refinery, ESP blowing up. Along with, well the same week, the 15th of February is where we switched from the high RVP, the 13 pounds down to 5.99. And so with that, supply automatically is reduced because of the extra refining it takes to make the 5.99 re-vapor pressure gasoline by about 10 percent.

And then we have the strike that was endured and the Tesoro up in the Bay Area, in Benicia, actually closed their refinery down after the strikers started striking in front of their gate.

And so the cross between those three events have caused the price to spike up.

It's kind of an -- there's some run up in spot prices we find as they'll raise their branded via tank wagon or unbranded retail prices.

Okay, the last slide and then I'll let you ask questions. My final conclusions. Okay, again, a trader purchases -- there we go -- implementation of AB 32 definitely had an effect. It chased a lot of traders out. We have 16 refiners left trading in California and 36 traders, and I think half of those are now inactive. So, we have an illiquid market. I think Dolores mentioned that already. So, it is prime to be manipulated and it is being manipulated.

The United States Steelworkers strike has been settled and it's no longer a factor, but it did interrupt, earlier in the year, some of the production.

The annual switch over, we took MTVE out of the gasoline back in 2003. I think that was mentioned already. And if it was also mentioned, that's 10 percent of a petroleum product, MTVE is, and we're now substituting ethanol which today is being priced out at $1.43 a gallon. And, of course, then there's a 50 cent per gallon rebate that was just recently instituted and backdated so that we're able to get a nickel a gallon rebate out of it.

So, that would be about it. If there are any questions, I'll be more than happy to answer. Is anyone there?

CHAIR BORENSTEIN: Yeah. Hold on just a second. Okay, Jim Sweeney.

MR. VAN DER VALK: Oh, I thought I lost you.

MR. SWEENEY: Yeah, this is Jim Sweeney. your last statement you said these markets are being manipulated. Could you explain the mechanism by which they're being manipulated and by whom?

MR. VAN DER VALK: Well, the few players left know that, you know, the last desperate step for a major is to go out in the spot market. They know fully well that when they do they'll drive up prices. And they look at each other, the market is an oligopoly so they know when a refinery is down, like this morning Benicia is down, and the fact that there's a maintenance issue at some other refinery up goes the price and we try to -- the majors, anyway, try to cover their bags. And by doing so, they drive up the spot market and then in turn the unbranded, and branded and dealer tank wagon prices.

Also, they could manipulate the cargos. If the price goes down and the cargos are being deferred -- I think the cargo that was deferred back to New York, or rerouted, was probably the high RVP. And in California, in Southern California, actually, the pipeline, Kinder Morgan is the one that sets the law on the RVP. You cannot ship after the 15th of February any of the 13-pound RVP. You have to be 5.99.

MR. SWEENEY: Now, you're saying they're manipulating the cargos. You mean there's somebody stopping the cargos from coming in. I think of manipulating it as being able to either change supply or demand, or do something directly about prices. So, could you expand what you're saying about how they're manipulating the cargos?

MR. VAN DER VALK: Well, in fact it happened twice last year. The biggest one was right after July 4th, in that we got from July 4th, and then again the week after Labor Day.

But the fact that we're dealing with an unknown quantity, not knowing because of the refineries, like ExxonMobil, if you ask them a direct question about when do you think that refinery will be back up, you won't get an answer. And they went out and tried to -- you know, not manipulate, but try to get the public to be on their side, the Torrance community to back them up that, you know, it would be good for everyone, especially the gasoline prices, to have that refinery up even though it was the old ESP would put out more emissions than the new ESP.

And so, this has been the most unusual year, 2015, that I've seen in my 58-year career. I started in 1959, so I guess I'm getting old.

MR. SWEENEY: Thank you.

CHAIR BORENSTEIN: Dave Hackett, do you have comments or questions?

MR. HACKETT: Yes, thank you. Hey, Bob.

MR. VAN DER VALK: Hello, Dave.

MR. HACKETT: How are you?

MR. VAN DER VALK: How are you?

MR. HACKETT: I'm doing well, thanks. I'm glad you --

MR. VAN DER VALK: Old home week.

MR. HACKETT: I'm glad you did this. Thank you very much for taking the time to talk to us today.

I had a question for you. You cited Lundberg and Lundberg produces a letter about the petroleum business. Is that something you subscribe to, anybody can subscribe to the Lundberg letter?

MR. VAN DER VALK: Well, like how they get the information they use to gather the data all the dealer tank wagon price. Triple A gathers the information that they're passing along that's called the Triple A Fuel Gauge Report, which is basically all the sales for gasoline in any particular area that, you know, they have. And it doesn't include any tank sales. And it doesn't include, for instance, any of the Arco gasoline sales.

But going back to your question --

MR. HACKETT: Yeah, my question was if somebody wanted to subscribe to the Lundberg letter, they could subscribe to the Lundberg letter?

MR. VAN DER VALK: No. It's a you give me something and I'll give you something back. The service station owner gets a daily log, he doesn't even get a call anymore, he automatically sends the dealer tank wagon price notification they get every day to Lundberg. It's called the Lundberg letter, but it's actually the Lundberg survey that gathers this information. And they go right to the corner, whichever time you want to get the zone pricing on.

And then if I'm working for 76 and I want to know what my Chevron station competition is doing across the street, I will get that survey information from the Lundberg survey and I will verify that they got three cents and I will then meet it.

And I used to do that. That was part of my job when I worked for Unoco.

MR. HACKETT: Okay, thanks. One more question. Did I hear you say that there are 16 companies trading the market today and that's down from 30 some? Is that correct?

MR. VAN DER VALK: Well, the refiners are still in there, obviously. They're not going anywhere. There are 11 refiners in the market. That includes Flint Hills. I have the list right here. But I can give you the list. But there's 16 refiners.

MR. HACKETT: And so how do they -- hey, Bob? Hey, Bob, what I'm really interested in --

MR. VAN DER VALK: Yes.

MR. HACKETT: -- how has that changed over time. The number of traders, how has that changed over time?

MR. VAN DER VALK: Oh, AB 32 changed our world. Just like Dolores said, I wouldn't be in the pipeline business today. I wouldn't sleep at night. I had a hard time sleeping as it was, back when I was doing it, knowing I could, you know, be behind by one or two cents.

MR. HACKETT: So, you and Dolores both got out of the spot market.

MR. VAN DER VALK: I know.

MR. HACKETT: But how many others got out?

MR. VAN DER VALK: Well, pipeline savings. We're still doing spot market. And what's happened, and we haven't discussed it, yet, are the back board deals being done by Phillips 66, Valero, Tesoro and ExxonMobil.

MR. HACKETT: But there are fewer traders today than there were before?

MR. VAN DER VALK: Yeah, who is this talking?

MR. HACKETT: Dave Hackett.

MR. VAN DER VALK: Dave, okay. Dave, I could today make a deal with Valero and I can buy at the 99-cent, let's call it a dollar price, throw in the extra 15 cents for the LCFS and the GHG, the greenhouse gas fee, the CAR, and that's $1.15. And I can buy, right now, about two loads a day for the rest of the month, for February, at that price, $1.15. All I have to do is sign a contract I'm obligated to buy.

All those companies are selling what I call backdoor gas. Why are they doing that? It's because they're still selling 75 to 80 percent of their gasoline at that higher dealer tank wagon price. And that gasoline, by the way, is being sold to super-jobbers, like Flyers Energy, like XE Fuels. So, I've given the names of some people so that, you know, it's pretty well known out there. But it's not being tracked by OPIS. And I would say 15 percent of that spot market gasoline is not sold at the unbranded rack price, it's sold at that special backdoor gasoline price, in Southern California.

MR. HACKETT: And so one other question, then.

MR. VAN DER VALK: Sure.

MR. HACKETT: Does that, what you call a special backdoor price, I assume that's relative to spot price. And then --

MR. VAN DER VALK: Well, it would be by the pipeline, Dave.

MR. HACKETT: And the next question I've got is are the retailers, who are getting that spot price, putting that price on the street?

MR. VAN DER VALK: No.

MR. HACKETT: And so consumers aren't getting the benefit of that low price?

MR. VAN DER VALK: Right. Even Costco, which is one of the companies enjoying that price, is not passing it along right now. And then we can get the majors at $2.65 and if they can be at $2.45, they'll still making 40 cents a gallon and the major's making more. But so what? They're buying lower, as well. But they're really not a big factor in the market anymore.

In Southern California, back in the 90's, 50 percent of the gasoline was sold at the unbranded mom and pop stations. And now, we have the majors controlling that market. The mom and pops have disappeared with the Phase 2 vapor recovery laws that went into effect. In California, we went from 12,000 gas stations down to eight. And guess what those 4,000 gas stations were? Old mom and pop unbranded, they couldn't afford the $120,000 improvements it took to put in that vapor recovery, and the majors did. They didn't stand in the way of having to spend that money because they knew it would chase off the old branded mom and pops.

CHAIR BORENSTEIN: Okay, thank you very much, Bob.

MR. VAN DER VALK: All right, you're welcome.

CHAIR BORENSTEIN: That's very helpful.

And we’ve got to move along here, we’re way behind schedule and we have Consumer Watchdog up next.

MR. VAN DER VALK: Okay.

CHAIR BORENSTEIN: But thank you, Bob.

MS. WARD: Thank you.

MR. VAN DER VALK: Bye.

MS. WARD: Bye Bob.

MR. COURT: This is Jamie.

MS. WARD: Hi, Jamie. I’m just pulling up your presentation.

CHAIR BORENSTEIN: Good morning, Jamie. This is Severin. We’re getting your presentation up.

MR. COURT: Well, thank you. I’m here with Cody Rosenfeld. So, we’ll try to go quick because we know you’ve had a long meeting and we appreciate all your --

CHAIR BORENSTEIN: Yeah.

MR. COURT: We’ll try to do this in ten minutes. I just want to -- I’m going to be drummed out of the Consumer Advocates League if I don’t remind you that, you know, since we met last time we had fourth quarter refiner profit reports come out and so we know what the whole year looked like.

And for the whole year the oil companies -- the oil refiners that report their oil refining profits in California had their best year ever on oil refining in California. So, if you want to just go back to that first slide for a second. Whatever strategies we're talking about today and whatever hurdles the industry says is a problem, you know, Tesoro made $1.9 billion on California refining last year. It was the best ever by over a billion.

Valero, which also reports its refining profit report, $852 million in California profits, more than triple its average profits over the last five years.

And Chevron, which doesn't provide state-specific information, but does have all of its U.S. refining and over half of its refining in California, made $3.1 billion in refining. And that was the most profitable year for refining ever in California. So, whatever the industry said, it is doing well.

And this is a final piece of the puzzle, we hope. This is a report that Cody crunched the numbers on, it's called *Against the Tide.* And it’s really about the pieces we haven’t talked about, shipment.

And if you go to the next slide, what we’ve found is that oil refiners in the State and other importers have calibrated the imports and exports as a way of artificially inflating prices. So, the methodology, real quickly, and I’ll let Cody go into more if you have questions, in a bit, is we’ve looked at Lands Commission data, through the Public Records Act request, which shows all ships coming and going after the fact, only, with oil. Excuse me, with gasoline and additives. And so we have a tracking of what came and what went.

But we also looked at what was happening at the market in real time, which is what the fixtures are. The fixtures are, if Cody’s been saying this right, a contract to deliver a gasoline at a future date. So, we looked at what the market knew at the time, what the fixtures were out there and whether they arrived or didn’t arrive. And that’s how we analyzed the shipments for the first three quarters of 2015, when California obviously saw these prices that were a buck higher than the rest of the nation, that can’t be explained on any supply and demand basis that’s normal.

So, if you go to the next slide, we will -- the next slide. We have, this is what the State Lands Commission looks like. And you can see we’ve added, you know, whether there was a fixture or not to the actual reporting. And you can see we’re going by ship, by company, bringing it in by date and also by what’s on that ship, to the degree that we talked about, gasoline and additives. We don’t necessarily -- it doesn’t necessarily say, you know, CARBOB, but it does say gasoline.

The next slide, please. And what we found was, as a big picture finding here, that while Exxon, you know, was offline for seven and a half months of this first 9-month period we looked at, and they lost 800 million gallons of fuel, all that was imported by Chevron -- excuse me, by Exxon, was 12 million gallons, which is three days of supply made by the Exxon refinery. So, it was out for 224 days and it brought in three days of gasoline.

And what that means is it had to buy from the rest of the market and it did buy from the rest of the market. And when that happens, you dry out the market.

What did Exxon import? This is interesting, if we can go to the next slide, Exxon did import alkylate, which is an additive added to gasoline to oxygenate it, to sell the higher octane premium blend. And Exxon, we learned, is the one making -- of all the premium, unbranded blends around Southern California for everyone. So, that’s why it brought in the alkylate. But it brought in only three days’ worth of gasoline.

If you go to the next slide, here’s what the imports look across the refiners and the -- I guess Petro-Diamond and Kim Lowe is more like a super-jobber or a super-trader, a super-importer. And you can Shell brought in an awful lot of gasoline. Tesoro. But the one refiner that had a down refinery didn’t bring it in.

Move to the next slide, which is exports, and you’ll see what the export picture looks like. And we’ll go a little bit more detailed into this, but I wanted you to see the big picture.

So, while Exxon was not bringing in, it

was not pulling it in, Chevron was pushing it out. And the timing of this is really fascinating. It took out 250, 3 million gallons of gasoline and a lot of that was in that July period, right when we were in the crunch on gas prices.

If we go to the next slide, you will see these green lines are the imports coming in and the blue line is the same CEC supply line that you've seen. And you'll see how in that period of June and July, when we had the price crisis, as we've talked about, the imports really ceased. They just stopped. They stopped all the way into the latter part of July and that's why the price stayed so high for so long.

If we go to the next slide, this is the flip side. This is the exports in red versus the inventories. And you'll see that during this period not only did we have the market dry because we didn't -- we had Exxon not coming back online, as we talked about on July 1, that misinterpretation, but we see Exxon's not bringing it in, no one's bringing it in, and Chevron mainly, but other refiners, are also taking it out in a pretty significant way.

We'll go to the next slide. Eight of 12 exports, and this is just the June and July period, when we hit over $4 in L.A., June and July Exxon had eight of the 12 -- excuse me, Chevron had eight of the 12 exports coming out. So, Chevron, which has 28 percent of the refining capacity in the State, during this entire period of the first nine months exported 65 percent of the gasoline and additives of the State. And in the period when we had the July price spike, you'll see that it took out eight of the 12 exports, which is really --

CHAIR BORENSTEIN: Jamie, this is Severin.

MR. COURT: Yeah.

CHAIR BORENSTEIN: Can I just ask you a question here?

MR. COURT: Yes.

CHAIR BORENSTEIN: When you're talking about exports, you're talking about exports by tanker?

MR. COURT: Gasoline.

CHAIR BORENSTEIN: By tankers?

MR. COURT: Yes, these are all tankers. These are all shipments based on the Land

Commission data, leaving the U.S.

CHAIR BORENSTEIN: Okay, so not borne by pipeline out to Nevada or Arizona?

MR. COURT: No, this report -- yeah, maybe I -- in my haste, I should have said it a little more clearly, the data. We've only analyzed shipments of exports to foreign nations of the Lands Commission data.

CHAIR BORENSTEIN: Okay, go ahead.

MR. COURT: And shipments coming and going.

MS. JAFFE: Jamie?

MR. COURT: Yes?

MS. JAFFE: Do we know if any or all of those shipments were RBOB in the form it was exported?

MR. COURT: We only it was gasoline because that's what the Lands Commission keeps track of. In a minute we'll go to the fixtures, which won't give us much more information. Actually, it gives us less information about what's coming and going. We just know it's either gas -- it's either listed as gasoline or additives, and it tells you what kind of additives. So in the case of Exxon it told us, which was more than the fixtures do, I think, that it was an alkylate.

The fixtures, Cody, what do the fixtures tell, generally that it's --

MR. ROSENFELD: A fixture is just whether it's clean, clean or dirty. So, not much information there.

MR. COURT: So, we know it's a refined product and not crude oil. But the last Commission data, which isn't available online or it's publicly available only through the Public Records Act. The CEC, I believe, gets it. That will tell you gasoline and you actually see those -- in the second slide you'll see exactly how it's classified. But it doesn't say CARBOB, it doesn't say what it is.

But we can gather this is gasoline, this is clearly gasoline in a California refinery, likely made in a California refinery. That's all we can say.

The next slide will show you what happened as a result. It is the gas price during that same period, where we went and we discussed this, the $4.31 a gallon in L.A. And I don't need to say much more about this, other than the fact that if you look at the time period, you know, and we're going to go into this right now, you'll see it coincides with the summer drive time season, and adding to the information a little bit of what Bob was talking about, you know, previously, with the avails being bought. Whatever came into the market during that time being bought by two refiners. And I believe those were Chevron and Tesoro. That was another factor during this period.

So, the market dried out. One going out and then what was coming in. And why was Chevron, it's a good question, buying up the market and then exporting it at the same time. That's some data we didn't have until, you know, we heard it from Bob.

So, if you go to the next slide, you'll hear this as a question on shipment. Why are we not bringing fuel in? You heard it from our friend at OPIS, which is really interesting because Jones Act vessels, which are the vessels used to carry gas or from port to port, U.S. port to one U.S. port and they have to do it that way, because they're safer, they're more expensive to operate. The list of available Jones Act tankers to carry it was more available in 2015 than any year in recent memory.

And if you look at the cost, and this is reported by OPIS, at the end of August, the cost of a vehicle was 20 percent less in 2015 and 2014 and, yet, we did not see Jones Act vehicles -- Jones Act ships being used to carry gasoline from a U.S. port to a U.S. port.

But more importantly, the next slide, please, we have a real interesting instance of a Jones Act vessel, which is the flagship at Exxon, and we've talked a little about this, the SR American Progress, that spent months in Singapore.

Now, I just want to put this in a little bit of context. A Jones Act vehicle is much more expensive to operate and you don't need to operate in foreign ports. So, why would a vessel that's supposedly scarce, that costs a lot more to operate in a foreign port, why would it be in foreign waters for months during the year? That's where we found the SR American Progress.

Why is Exxon refusing to bring gasoline in and the industry saying there's no Jones Act vessels, the SR American Progress spent the first fourth months in the Gulf Coast, going back and forth. It didn't come to California. It arrived empty in California on May 15th, sat in the port. And then it arrived in Singapore on June 20th, where it sat for over two months, until August 30th.

And the ship returned to L.A., and this is what we talked about, full of a tank of product, on September 21. But it didn't unload, it brought t hose blend stocks to Florida. So, you have a Jones Act ship, if you go to the next slide, that is spending 70 days in Singapore, 70 days in Singapore. And what did it do in Singapore? Because we thought, well, maybe it was broken. It was moving around to different places in Singapore on GPS.

And that's the other thing that Cody did with this research, he cross-referenced in the fixtures, the Lands Commission, and he tracked every ship by GPS to make sure that it got to where it said it was going to go. And the Lands Commission data actually was complete on that. But the fixtures, as we'll talk about in a minute, were not anywhere near complete.

So, the excuse for not importing the

gasoline, the need to use Jones Act vehicles doesn't seem to hold up. But even more importantly, when we look at the SR American Progress, there's real questions about why is this idling in Singapore for two months, during the peak of this crisis. This ship and others hips could have been used to bring CARBOB and gasoline into California, but this ship wasn't.

Now, how do we know that can happen? How do we know that they CARBOB in Singapore? Well, next slide, please. We know that Exxon has a refinery in Singapore, two connected refineries that are a lot greater than the capacity of California refineries.

And if you go to the next slide, you'll see that when the market dried out in July, Exxon actually did import, from Singapore, gasoline to fulfill its contractual obligations.

Because what was happening until that complete drought was Exxon was sucking down the inventories in the market, not refilling its production with imports. But it took this vehicle, the FMPC 21, which is not a -- it's a Liberian flagship, I believe, it's not owned by Exxon. But it contracted it so that on August

2nd it dropped gas in California.

How do we know that was to meet the contractual obligations? That's what Platt's reported. They said there was a shipment scheduled to meet a contractual obligation and they confirm that Exxon was meeting its contractual obligations basically by buying from other refiners. Which, of course, makes the market less available and dry, and creates an inventory problem that drives up price.

So, if we go to the next slide, what we learned is during the summer price crisis Exxon doesn't pull it in, Chevron pushes it out, and during these peak periods we had the refiner responsible for losing 20 percent of California's gas having its flagship idle in Singapore, a Jones Act vessel, and not bringing shipments here.

Of the imports, by the way, during the 9-month period, just three of the shipments of gasoline, of the 32 gasoline shipments that arrived came from Exxon, just three of the 32.

And in terms of Chevron, we saw it was responsible for eight of 12 export shipments during the period. And the result, of course, was this price spike we saw in the summer.

The next piece of information we just want to put into --

CHAIR BORENSTEIN: Jamie, this is Severin. You're running a bit long here, so why don't you try to --

MR. COURT: Well, this is the last piece of information, so it was a pretty ambitious --

CHAIR BORENSTEIN: I can't see the slides, so I can't tell, okay.

MR. COURT: We only have four slides. I think, you know, I think that the last piece of information is just this that we have a real troubling, dysfunctional market. And we can look at Exxon and Chevron's -- and I'll let Cody just do this piece because it talks to how the market is uninformed in real time about what comes in and what goes. And that causes traders not to know what's coming or going and that causes price volatility.

And the question you've always asked, Severin, is why is the L.A. market so volatile? And I think Cody's just going to give you a couple-minute answer here.

MR. ROSENFELD: Yeah, I'll be pretty

quick. What you're looking at right now, those dots represent all of the exports of gasoline additives that we could officially confirm, both with Lands Commission data, and GPS data, and fixtures.

And what you'll notice here is that of those 47 exports of gasoline or additives, only seven of those appeared on fixtures. So, less than 15 percent of those were actually known by the industry when they occurred. It was only after the fact, when I looked at State Lands Commission data, that it was clear that an export actually did happen. So, a lot of these exports are happening in the dark.

If you go to the next slide, these are imports. And of the 48 confirmed imports, the industry knew of even less, just four, less than ten percent. These imports and exports, when the market isn't prepared for them or they don't see any amount of information about them, it leads to the volatility that we've been talking about in the harbor. So, that's the answer very briefly for you.

MR. COURT: Can you go to the last slide or the second to the last slide, please?

So, this is the big picture on this. Sorry, one back, yeah. Of the 95 confirmed imports and exports, the market, meaning Bloomberg, or a trader, or anyone who's not a refiner, who wasn't bringing it in, we're aware of just 11.

So, how do you price something accurately, without volatility when that's the case. And it's this dark market that's created the huge volatility we've seen, particularly in the L.A. Port.

If you could go to the last slide, our solution is pretty simple. Which is that we believe refiners should be required to make up the lost production with imports, rather than sucking supplies from other California refiners.

If Exxon had just used its idle flagship to bring in more shipments, we wouldn't have had this type of problem.

If we required a publicly-disclosed refinery inventory plan, we've talked about before, that showed how refiners will make up for lost production, not necessarily having them have it on hand. But say, hey, if we lose it, if Exxon goes out we've got the SR American Progress and we're going to use that from our refinery in Singapore, which it's sitting next to for two months, that makes gasoline for California, that's a big solution.

CHAIR BORENSTEIN: Okay, Bob, thank you.

MR. COURT: And the last import, the last solution is that all imports and exports should be disclosed in real time so that we allow for adequate supplies and stable prices, because we think it's the darkness here that's the problem. And we need to let in the sunlight.

So, thank you very much.

CHAIR BORENSTEIN: Okay, this is Severin. Can you tell us why you think Exxon would choose to buy in a very expensive spot market, rather than supply itself?

MR. COURT: Well, by driving up the price of gas, and I don't know what it's buying for because I don't know what the costs of his trades are, but I do know that there's a big difference between what the actual cost of buying on the retail market is, as Bob said, at 99 cents a gallon and selling it at -- in L.A., it's selling some places for $3.80 a gallon.

And we talked about this at the last

meeting, that the dealer tank wagon prices can be artificially inflated above what even is a branded rack price by 40 or 50 cents.

So, in a market where Exxon has that type of control, or major refiner has that type of control, even buying from the other refiners you can make a good profit.

The other thing is when it brought that second shipment it was to meet its contractual obligations. But you wonder, if they had brought that ship into a real dry market and sold some of it, and possibly they did because we don’t know those trades, would they have made a lot of money on some of that? I don’t know.

But I do know this, because there’s such a difference between what’s happening in the wholesale and what’s happening at the retail, that even a refiner that’s lost its refinery and is in this type of situation, is choosing to artificially inflate the price by not using all their capacity to bring it in, for whatever reason. I think you should ask Exxon that question.

CHAIR BORENSTEIN: Well, I got to tell you, Jamie, it’s really interesting, but that piece of the story really doesn't make much economic sense that they --

MR. COURT: Why not? If you can sell gasoline at $4.30 in L.A., and you're buying it, and I don't know, Bob can maybe share light on it --

CHAIR BORENSTEIN: If you can supply it yourself. I mean, a lot of what you're saying makes sense. The Chevron story, I think Chevron's a major -- is selling a lot of gasoline.

But the Exxon part, I think that it --

MR. COURT: It doesn't make economic sense to me in a competitive market, either. No, not in a competitive market but --

CHAIR BORENSTEIN: Even in a market where they have market power, I don't understand why they -- a firm that has no gasoline would go out and buy it at an extremely high price.

MS. JAFFE: Because you're going to sell -- I mean I'm not saying this is what they did, but you're selling -- you're buying a very small volume that's going to move the market up very high, instead of -- it's like price discrimination. It's price discrimination. I'm going to buy a small amount of volume and lose on that, and then for the rest of whatever refinery output I have, I'm going to make a much higher profit.

CHAIR BORENSTEIN: Well, my understanding was that they didn't have refinery output. That they were actually short, painfully short.

MR. COURT: But they're making this premium gas for the unbranded market, for the entire unbranded market.

MR. ROSENFELD: In Southern California.

MR. COURT: In Southern California. They're still making that. Because all they had to do is get that Alkylate and add it to blend it. Now, the stock was obviously costing them more than it would otherwise.

But I think it's a great question and I think Exxon should --

CHAIR BORENSTEIN: So what you're saying is they were still producing significant quantities of gasoline for Southern California?

MR. COURT: No, not producing. Not producing gasoline. Adding -- well, I don't know what production is. They're not using their refinery to refine gasoline or bring blend stocks together. But they were oxygenating gasoline in order to create a -- to meet their obligations. But their obligations included premium, basically the entire unbranded premium market, which is probably a significant market, which is why they brought all that alkylate in. They brought the alkylate in not to -- it's not making gasoline, but to fulfill and meet a contractual obligation they had to meet.

Now, why wouldn't they -- I don't know why they were buying it from other refiners. But I do know this that Exxon at that point, in my view, had every reason to believe its refinery was going to be out for another six months, in July. I mean, maybe it was wishfully thinking, like everyone else --

CHAIR BORENSTEIN: Okay, other questions?

MR. COURT: I don't know the answer, Severin, but I do think Exxon can give it to you, if you can get them --

CHAIR BORENSTEIN: Let's move on. Other questions?

Okay, thank you very much. We're going to move on and move on to the -- actually, Ryan, I think we're going to delay you until right --

where are you? There you are. Until right after lunch because we have to do the public comment before lunch and it is now almost noon.

Well, let's at least do the public comment and then we will see what there are. So, do we have any public comments live, here in the room? No.

Do we have comments on the WebEx? Well, that's going to simplify things, isn't it. Is that right?

MS. WARD: All right, so Dimitri, no blue cards? Okay. And nobody on the WebEx? If there is anyone on the WebEx, just raise your hand or type a comment in and Nani will unmute you.

But Severin, if you'd like, we can go through --

CHAIR BORENSTEIN: Yeah, why don't we have Ryan do his presentation then, and then we'll come back and if there's anybody, we'll do that before lunch.

Ryan Eggers is going to talk to us about Energy Commission emergency response plans.

MS. WARD: Sorry, one second, it looks like someone on the WebEx has a comment.

We have a comment from Tom Slander

(phonetic), we’re going to unmute him. Sorry if I said his name incorrect.

CHAIR BORENSTEIN: Is Tom Slander on the --

DIMITRI: Charles, are you on the line?

CHAIR BORENSTEIN: Charles?

CHARLES: Oh, I am. Can you hear me?

CHAIR BORENSTEIN: Yeah, we can hear you.

CHARLES: I’m a little confused about the dark work that it says here and the -- I mean, there is no question as to about the -- the claim that 30 percent of the market in San Diego kind of is controlled by, I believe, Tesoro, which surprised me. But I was also hoping that Jamie or Cody could clarify it. I wasn’t quite certain, when Mobil -- ExxonMobil was buying alkylates when their refinery was down, are they suggesting that ExxonMobil was actually manufacturing gasoline and what they were doing was importing just enough gasoline to supply their dealers and but they weren’t actually refining gasoline. They were using, I guess, splash forming it?

CHAIR BORENSTEIN: I’m sorry, we’re not going to use the meeting time to have a Q and A with Jamie. While it would be interesting, there's just limited time. So, if you want to make a comment, now's the time to do it. But I just don't want to get into a back and forth.

CHARLES: Okay, thanks. I was thinking that I had a comment on Bob van der Valk's question and it wasn't responded to. So, when we're going through that and I asked and I was -- but thank you. Thank you.

CHAIR BORENSTEIN: Okay, thank you.

MS. WARD: All right, do we have a commenter here in the room? Okay.

CHAIR BORENSTEIN: Okay, then we are going to go with Ryan's presentation.

MS. WARD: All right.

MR. EGGERS: Hello again, everyone. My name is Ryan Eggers. I'm with the Supply Analysis Office.

Back in December, Amy Jaffe asked a question on what sort of emergency or shortage response plans that the Energy Commission might have in place in the case of, you know, incidents such as this. And I'm going to briefly talk about that, really quickly.

So, here at the Energy Commission most of our authority, which is listed here, is in response to a natural disaster type of event. And in this type of event, Cal OES, or the Office of Emergency Service would be the lead agency in this particular event.

In the case of the sort of oil embargo or a trade war, then the Energy Commission would be the lead agency in that regard.

That being said, in order to get to the Energy Commission's sort of active participation in this type of event, we would need Emergency Order 6 to be evacuated -- or executed. And this is a pre-specified emergency order that requires the Governor's signature in order to enact.

In this particular case, this empowers the Energy Commission to hold and control petroleum stocks, as needed, to ensure the health, and safety, and welfare of the public in sort of a natural disaster sort of situation.

Now, right out of our actual emergency response plan, which is found on the internet, this particular set-aside program, which is for petroleum fuels, only, is intended to interfere minimally with the market. And it's really only there to supply emergency in a central services with the fuel that they need.

It’s really, as later in the document says, it’s really hoped that market forces will really take care of the supply and demand fundamentals as a whole, or even take over eventually, at the very end.

Now, we do have two basic versions of the fuel set-aside program. In the case of the Emergency Order 6, which is the formal version at the bottom, this is where the Chairman of the California Energy Commission would be empowered to actually direct petroleum firms to hold a certain amount of fuel that we could then redirect to emergency services to make sure that they had the fuel that they need.

That being said, we do need that Emergency Order 6 to be signed and in effect before we could get to that point. And we do have an accounting system in place in order to track these fuels as a normal market sort of transaction would have to take place if we did decide to redirect those fuels.

Now, we also have something that’s called an informal version, which is always sort of active in all cases. We recently used this for the Northern California fires, where we had a run on jet fuel at the Redding Airport. What happens is we get the call in and we quickly try to check for different stores of jet fuel, or any sort of fuel that's needed, and then put those particular parties in touch to make a normal market transaction.

It's our PIIRA reports that allow us this sort of ability to quickly check where the different fuels are. And then, yes, it's just our function here is just to bring two parties together in order to make an actual market transaction occur.

That being said, you know, the Energy Commission does have a full emergency response plan for all different type of energy on resources. The contact is Justin Cochran, who's in the room with us today. He works in the Executive Office. And he would be happy to answer any sort of questions, via his e-mail, that might occur on this.

Now, if there's any further questions?

CHAIR BORENSTEIN: I have one quick question. I guess it still seems like a fuzzy border between an earthquake knocking out a couple refineries and a couple refineries having internal problems. But that is the difference, that it has to be some external natural disaster, or is that your impression of that's the only thing that would trigger this?

MR. EGGERS: I believe the real difference is whether the Governor of California determines that this is an event that requires our intervention or not.

MR. SCHREMP: Well, Severin, this is Gordon Schremp with the Energy Commission. Actually, as Ryan mentioned, we're always following the market very closely, looking at real time, you know, near-term pricing, and looking at all of these kind of events, whether they're pipeline interruption, unplanned refinery outage, a problem at a port, a refinery strike. So, we look at those events and assess whether we think there could be a pending shortage of supply. Meaning terminals that are going to be shut down and not have product available temporarily.

So, that's what we're doing. And so this example of ExxonMobil last February, we understood the refinery could be down for quite a while, but there seemed to be enough supply in the marketplace, albeit a much higher market clearing price. So, we saw no evidence or pending evidence of a temporary shortage, a lack of supply in a particular location of California.

So, that's what we normally do. And as Ryan says, we do receive requests on occasion for some informal issue that's happened. We go about our business contacting people to make sure the fuel gets where it needs to go and get that taken care of before it can become a potential supply issue.

CHAIR BORENSTEIN: Okay. As an economist, I have a hard time making that distinction. If the price had not spiked, there would have been a shortage. The price spiked and demand went down as a result.

MS. JAFFE: How do you define authority?

MR. SCHREMP: This is Gordon, again. On occasion, this happened back in 2012, supplies can be limited and this is especially the case for the unbranded markets. This was discussed earlier, how those market participants who don't have a standing contract with distribution terminals will be cut off temporarily.

So, this is a normal practice, or at least it has been up until recently. And we saw that occurring in 2012, very high price spike, unbranded supplies being out at specific terminals. But there was still branded gasoline available at all these terminals, which are 60 distribution terminals in California.

But when unbranded is out at specific terminals, the unbranded clients go to other terminals where they have standing security clearance to get in and contract standing, and seek out supplies usually at a much higher clearing price for those unbranded.

So, we saw instances where product was out but it was for a class of trade, non-contract, and we did not see terminals that were completely out of fuel because they couldn’t get any.

CHAIR BORENSTEIN: Any other comments?

MS. JAFFE: Could that ever actually happen? I mean, so you’re basically saying unless an earthquake cut off the State from every barrel of supply and ambulances can’t get fuel, that anything short of that doesn’t count as a supply disruption?

MR. SCHREMP: Yeah, I think it would be fair to -- well, since the Emergency Order Number 6 has never been executed in California and we've seen several instances of significant price spikes, and occasional intermittent supply problems involving pipeline outage, marine terminal issue, refinery issues we've never executed that. So, I think it's fair to say that in the future we would anticipate when that would likely need to be executed is a catastrophic event, like a catastrophic earthquake, where we've actually lost the ability to obtain supply from refineries because either they're damaged or can't get into that pipeline distribution system, and we're actually short gasoline/diesel fuel in the Southwest United States. Both Arizona, Nevada and California would all be drawn into an actual shortage of product.

CHAIR BORENSTEIN: Okay, it looks like we have a comment.

MS. WARD: All right, Jay McKeeman, we're going to unmute you so we can hear your comment.

MR. MC KEEMAN: I'm here.

MS. WARD: Oh, sorry. Hello.

MR. MC KEEMAN: Jay McKeeman from the

California Independent Oil Markers Association. So, we work with Gordon extensively in emergency supply. Our members typically supply local governments and emergency response agencies with fuel. And that’s really the critical juncture of our members’ ability to get fuel.

If they’re locked out of particular racks and they have to go hours to get an alternate supply that effects the ability of the emergency response agencies to do their jobs. So, with Gordon’s help we can make sure that if -- and, typically, these are unbranded contracts that supply the local agencies.

So, we work with Gordon and other emergency response entities to make sure that we get the fuel to the location that it’s needed, at the proper time.

CHAIR BORENSTEIN: Thanks, Jay.

MR. HACKETT: I’ve got one quick comment.

CHAIR BORENSTEIN: Dave, yeah.

MR. HACKETT: My practice involves emergency response planning. And what I would say, and generally it’s at the state level, and say it’s California’s ability to communicate with the ministry is probably better than any other state in the country, where the people understand what's going on. They've got the connections with the industry locals. So, I think we're in pretty good shape as far as this is concerned.

CHAIR BORENSTEIN: That's reassuring. I would say that California's need to be able to communicate with industry is greater than any other state, as well, given that we don't have such a cutoff -- we have such a separate gasoline market. But it's good to know that that communication is there.

Okay, I think we're going to take a break, unless the Committee would like to ask questions of the previous speakers. Because, otherwise, we're going to not ask them, although they're certainly welcome to stay, not ask them to stay. Did we get all our questions in along the way?

Okay, then we are going to take a break until 1:00 and we will start at 1:00 sharp. And the Committee will meet and deliberate then.

(Off the record at 12:02 p.m.)

(On the record at 1:03 p.m.)

CHAIR BORENSTEIN: Okay, I guess we have all the Committee Members and Commissioner Scott here. Let's start. And everybody else has left. We have one member of the media, I believe, and probably some people online, still.

So, the agenda for the afternoon is a discussion. And we have up on the screen a listing of the various alternatives of policies that we might recommend. And one policy that's not listed there is nothing. That is, we could recommend to the State that we've looked into this, yeah, prices go up sometimes, but we don't think any policy would do more good than harm.

That's probably not where I come out, but I think that it's one that should also be on the table.

I'm not sure how to structure this. We could go through the various alternatives. Does that sound like the way to go? Do you want to start with concepts? I mean, another way --

MS. JAFFE: Maybe what we could do is -- maybe what we should do, conceptually, is start with policies that would be very difficult, near impossible to implement, identify what those are and maybe cross them off the list first.

So for example, I'll just give an example. I'm not saying that we discuss that one first, but increasing refining capacity in the State. The State has no way to implement it.

CHAIR BORENSTEIN: Good point.

MS. JAFFE: Right. So, I thought we should maybe look quickly at some of those as to which ones could actually be implemented by the government. And I don't even know what incentives you'd give industry in the market of eventual fall in demand and increased capacity. So, you know, I just throw that out there and maybe there's other ones that people feel the same way, that there's something up there that's just really not practical. Then I think we could eliminate those and then we can have a number of conversations around the other ones.

CHAIR BORENSTEIN: That makes sense to me.

MR. HACKETT: Yeah, this is Dave Hackett. One question I think we should address to make sure that I'm clear on what our task is. Is our task to curb price spikes or is it to encourage policies that the current climate will result in lower prices for consumers?

CHAIR BORENSTEIN: And I'm going to put Commissioner Scott on the hot seat here and ask her to address that. I’m not sure.

COMMISSIONER SCOTT: Sure. I think -- so, this is Commissioner Janea Scott. I think really a little bit of both. I had a chance to talk with Chair Weisenmiller about what would be most helpful and we agree that the chance to talk to so many experts, like you’ve done over the last couple of months, has been very enlightening. It’s provided a lot of great information.

I think key things that you learned there, that you’d like to highlight for us, is one thing that would be really useful.

But the other thing we talked about are ideas or solutions in the policy space. And I think it could be both for curbing the price spikes and for providing more stable, lower costs to the consumers. So, both are within what would be useful to the Chair and I.

CHAIR BORENSTEIN: While we’re putting you on the hot seat, I don’t think from the beginning there was ever a clear direction of this is what the Committee should produce. When I became Chair, I sort of assumed what the Committee should produce is a report to, and I guess I’m a little unclear on this part, the CEC and/or the Legislature, maybe and. Because some of these things clearly could not be done without action outside the CEC.

Yeah, and so what do you think we should do?

COMMISSIONER SCOTT: So, we did leave it a little open-ended because we didn’t want to sort of prescribe exactly like please provide us a 10-page report that has these things in it.

But I think that a report for us would be very helpful. The way that the Energy Commission does our Integrated Energy Policy Report, a lot of times we’ll assess a key issue and then we make recommendations and suggestions at the end. The suggestions really go towards the Energy Commission staff because those are things that we, as the Commission, can ask our staff to do and get done. The recommendations sometimes go towards other agencies or folks who -- like, look, if we wanted to do X thing, we need these three key players to also help out.

And so I think if you wanted to provide solutions that were sort of Energy Commission centric, you could say so. You could say this is something we think the Energy Commission could do or should do differently or better, and here's why we think that.

But you could also say, as part of the market it's key to get, I don't know, X set of information. And so, we'd like for the Legislature to include that as part of PIIRA, or we'd like -- I'm not quite sure, you know, who.

But I think you can do it both ways. And this topic is so broad. And the Energy Commission is data collectors, as you all know, in this space, and so I think that making recommendations for both what we can do and then what others can do, and then I think that makes it more helpful if we're really looking to implement solutions in this space. Which I think everyone is, which is why we called you all together, even though we're just the -- not just the data collectors. We're great data collectors, we have a lot of information.

But we don't regulate in this space, for example. So, if it's something you think needs to be regulated, you would need to say that, but then note that, you know, Energy Commission doesn't regulate in this space, but maybe ARB does, or maybe DOGGR does, or maybe -- and make the suggestion for them.

MS. FOOTE: Well, I think I would lean in favor of limiting ourselves, for now, to just the issue of price spiking. We've certainly -- that's mostly what we've been hearing about. It's the biggest thing that has plagued the market for the last 12 months, anyway.

And we seem to have a fair amount of information or at least theories about what went wrong. I mean, things have gone wrong in the last year. A lot of good things, you know, crude prices are going down and all of that. But there are distinctly things that are going wrong that kind of something ought to be done about. I think that's the general sense that we've heard from the comments, both from industry players and from consumer representatives.

And even that, there's a fair amount of discussion as to what might be -- what policies might be recommended. But I think if we limit ourselves to that for now, you know, then maybe we can move on at some later time to other things.

MR. SWEENEY: And I'm in general

agreement with Kathleen's comment there. What I feel quite uncomfortable about is jumping to solutions without understanding what the problem is.

Yeah, high prices are higher than we thought that they should be. I don't know if they're economically inefficiently high or not. I've heard a lot of explanations and theories, some of which, even today, could on the surface might be right. But for example, Chevron's exporting a lot of gasoline, but I don't know whether this is CARBOB or something else. So, I don't know if that's right.

And then other explanations that make no sense. That is Exxon, which is not producing anything, is making decisions to purchase the stuff in a more costly way than it could have otherwise for nothing that had a good economic motivation.

So, I just feel very uncomfortable about recommending a solution without knowing the nature of the problem.

Now, that said, there is one thing that I do think we -- I'm convinced, now, we do the nature, and that's transparency is nonexistent.

And so, I can see -- I see there's lots of evidence of transparency issues that we can move forward.

But all of the things above, which are physical recommendations, you know, one through seven up there, I think really to do that would depend upon some understanding that that is the problem is that we either didn't have enough refining capacity or that we didn't have enough import terminals, or whatever. And I don't know that that's the problem.

MS. JAFFE: Let me add to that. I think that we could say, at a minimum, that there seems to be undue market power that could be exploited in the market. There seems to be some problems with what I would call market design, in other words the way the market is functioning. There are parts of the market which function in uncompetitive ways.

MS. WARD: Can you talk directly into it? Some people on the WebEx can't hear.

MS. JAFFE: Yeah, so we've sort of seen evidence of inefficiencies or noncompetitive either practices or results.

And what I would say, getting to

Kathleen's point about having an 11-month, or however many months we think it's been aberration in prices that can't be explained by simple arbitrage, and supply and demand. What I would say about that is that we have the State and consumers have the benefit of having that happen at a time when there was falling crude oil prices.

And so the burden on the State's economy and the burden on individual consumers, having this happen this year, instead of three years ago was not severe. And that is why we have not had large amounts of people participating and telling their own personal stories as a consumer.

But if we don't do anything to address some of this market/power/inefficiency/externality/non-transparency that is inflating prices above what one would imagine in a clear supply/demand way we run the risk that sometime in the future war in the Middle East escalates, or something else were to happen and we're in a much higher priced oil environment. That the burden on the State and the burden on consumers of having this little blip in prices that seem small at the time, you know, 50 to 70 cents, could seem extremely burdensome in a different kind of market environment.

CHAIR BORENSTEIN: So, let me pitch in my view on this. I think it’s been a really interesting few meetings. I have learned a lot. It’s been a little frustrating at times to try to get sort of consistent explanations out of some of the people who have participated, but I think even those people have given us a lot of facts.

I think where I’ve come away from this is there are -- it’s a very complex business and there are interactions that I didn’t previously appreciate, but that we need to be aware of in thinking about how different regulations and requirements end up changing the nature of competition.

But at the same time, as much as I have tried to push and say, and find out, well, tell me why a firm with this much market share wouldn’t be exercise market power, I really haven’t felt like I got a satisfactory answer. In fact, I think I am more convinced now, than I was when we started, that firms, some of the firms are in a position to exercise market power.

Whether they're actually doing it or not is, I think, harder and maybe it's regulatory threat that keeps them from doing it.

But I would be -- it's hard to see how some of these firms, when we're told that 50,000 barrels disappearing from the market causes a huge price spike, wouldn't occasionally find it in their interest to have 50,000 barrels disappear from the market or not be quite so quick to repair something that is reducing their output or so forth.

But I don't want to get into did they do it? First of all, we have no subpoena power, we have no investigatory power, so we're not going to settle that question.

And second of all, in some ways I think that some of the solutions, including ones I agree with and ones I don't agree with that are up there would likely have an ameliorative effect regardless of whether this is market power or scarcity.

My personal favorite still remains waiving CARB gasoline requirements or allowing a fee to be paid if the price differential gets large enough. And that would address both the scarcity issue and a market power issue.

But so would, for instance, the State holding inventories would undermine market power and would also potentially smooth natural disruptions.

Now, both of those have potential downsides to them and we may not agree or we may end up agreeing on which are worth it and which aren't. But I think that it is worth sort of, given the body of evidence we have -- that we have heard, thinking about are these recommendations on that worth it, even if we're never going to know exactly did this firm not repair their refinery as quickly as they could have, or did they send a tanker to the wrong location, or whatever.

Because first of all, I don't think we are going to come to definitive conclusions on those topics. And second of all, even if did I don't think there's actually a -- I'm almost certain, as a non-lawyer I can say this, that there is no legal ramifications of that, of unilateral exercise of market power.

And secondly, we're not in any position to take care of that.

Jim Sweeney.

MR. SWEENEY: And let me slightly amend what I said because I wasn't reading carefully enough, I think your number one, your favorite one is something that I think can make a difference and be valuable without imposing significant costs on the system. It may cause some environmental costs, but if you have that surcharge significantly above any reasonable estimate of the environmental cost, then I think you can get net benefits.

Two through seven all do require significant additional cost whether -- and particularly you take the one, having California hold a strategic inventory. That becomes very, very costly because of the dynamic nature of the market and just the cost of holding, simply holding refined products is so much higher than the cost of holding crude oil under the ground.

So, I think that all of the rest, the two through seven, in order to make that recommendation we'd have to make some sort of judgment that the cost of imposing it on the system was gooder than the benefits.

Number eight, the transparency, yeah,

transparency can be good. Number one, you should be able to do it in a way that it's net economically beneficial.

So, I would like to have this point of view as asking whether the benefits exceed the costs, if we think of all of those.

MS. JAFFE: I'd like to add one more item that's not on the list, which would be requiring some kind of license or a reporting for exporting gasoline from the State. Which would be a bit under Jim's -- I would put that as a transparency measure, right. But would have the benefit of giving the State a lever to say, geez, there's a shortage right now and, therefore, we're not going to -- we're going to suspend, you can have an automatic -- you could have an automatic license that people use for exports, but you would have the right to suspend it if there was some kind of supply disruption that was creating the price spike at a particular time.

CHAIR BORENSTEIN: I'm no lawyer, but I am pretty sure that the State of California can't do that. That is it would -- exporting to Nevada would violate the interstate commerce clause and exporting to Singapore, or wherever, would violate a different clause that says only the Federal Government can trade, though I'm not sure of that second one. The first one I'm almost certain of, that they're not allowed to regulate interstate sales.

But the reporting part I think is just part of the transparency. And even if the license -- even if the State has no enforcement power, signing a line on it and saying what are you doing? You're shipping CARB gasoline to Mexico at a time when California gasoline costs X more than Mexican gasoline. Boy, that sure looks fishy. And you would at least, I think, make companies think twice about doing that.

Jim.

MR. SWEENEY: And if we get back to the information, I do understand and maybe somebody else can correct me on this, that there does exist a ticker tape that is reporting each one of the import and export volumes and prices as they happen. One has to subscribe to that, but it exists. It's not clear whether that is a price, it is not clear to me whether that's a price set at the point that it's a freight-on-board price. This is a delivered price. I'm not sure about that.

But if there does exist such a ticker tape where all of these, or some people, I would imagine the cost of a systematic way of making that more transparent to the government agencies and possibly to the public, that doesn't look like a high cost way of doing it and may have significant benefit.

CHAIR BORENSTEIN: Just to clarify, Jim, are you suggesting that, for instance, the CEC subscribe to such an information service and make it public, which the information service wouldn't agree to.

MR. SWEENEY: I don't know what I'm suggesting. I'm just saying that --

CHAIR BORENSTEIN: Or maybe with a lag.

MR. SWEENEY: -- there has to be some way. You know, there's a lot of data that's reported for the transactions.

MS. JAFFE: Well, yeah, we're in the age of big data. All right, whereas as ships come in and out of the ports in California, they get logged in and they have to file paperwork. So the fact that someone else is making a profit on that information and selling it back to the industry, it seems possible that the State, itself, could collect that data and make it publicly available since it's getting logged in.

MS. WARD: Sorry, Amy, people can't hear you.

MS. JAFFE: Oh, sorry. So, what I was questioning, since most of this import and export data, if I'm not mistaken, is at least collecting by customs, and there is a time lag in its available to the public and to the CEC, if they're not subscribing to a private service.

It seems to me that some kind of big data solution, where the State would invest to be able to have that data available in real time, and have it be available to the public, and for people like academics, like ourselves, or others that are concerned or interested in what's happening in the market could readily accessible, find that accessible data both historically, in what happened yesterday at the Port of Los Angeles. That transparency might add a lot of value to people who cared about this issue and wanted to track it.

CHAIR BORENSTEIN: I think we're going to move forward with the transparency proposal.

First of all, I think we need to think about some of the downsides or if there are downsides. The one to an economist that comes up is the potential for actually facilitating collusion, if this allows them to -- I mean, one reason we like competition and even sometimes chaotic competition is that firms aren't sure what other firms are going to do and so they can't easily coordinate activities. Which at times clearly has benefits to society, but at times has costs because once they're coordinating it's natural to start coordinating, as Adam Smith said, to the disfavor of consumers.

I wonder if there are other potential harms that would come up with transparency?

Jim, you have some --

MR. SWEENEY: No, I just want to respond quickly to this. That ticker tape is available to every single person who subscribes, every -- therefore, all oil companies who have an interest and have probably subscribed now.

So, making this more broadly available to the public doesn't add to the ability for those companies, who collude, because they already have the information, now.

MS. WARD: And you’ve got to get closer to the microphone, everyone.

MS. JAFFE: So, this is Amy again. I would second that attitude and, you know, as somebody who lived through and watched the California electricity process, just to give you a case in point. So, many of the companies that participated in that, and we now since know, or prosecuted or otherwise, the data that those companies have go beyond even the published I-can-subscribe-to data.

So, the data, companies collect the data about everybody else’s cargos with great accuracy. And so the companies that have market power in the market are probably tracking movements of product in such a detailed fashion that the concern about what they would do with that information is probably less than the benefit that would come from having the public and the government also have that information.

MS. FOOTE: I was going to say one question in my mind is how much of the instability that we’ve seen recently is relatively temporary. I mean, people ascribe it to a lot of different things, to the Torrance outage, to the ramping up of the AB 32 requirements, and all, you know, the exit of traders from the spot market, you know, all of the sort of perfect storm thing as one of our commentators said.

And it’s, you know, you kind of wonder how much of that is likely to be replicated in the near future? Are there traders that are going to come back in the market after some time has gone by and things stabilize. Others of you may have a better sense of that. Dave?

MR. HACKETT: Yeah, let me address that. This Committee sort of had its genesis with the volatile gasoline market in 2012, especially with ExxonMobil Torrance FCC outage caused by a power failure, and that happened in October. And the spot market at that point went up a dollar.

And then the spot market was quickly recovered because they could practically restart it within a few days. And so, it wasn’t one of these long-term outages like we’ve seen.

And so if you look at a price series for the next two years, for ’13 and ’14, everything was pretty flat. There was nothing interesting that happened. You know, nobody was going to be calling a Committee like this one.

All right, and that's because the market was well satisfied, there was plenty of gasoline on the West Coast and, indeed, the market shifted to an export market.

The reason that the big traders got out of the West Coast market at that point was because there was no arbitrage for them to take advantage of. They made their money in the prior period by buying cargos around the world and bringing to California. Once the flow switched and went out that went away and they left.

There were still small traders in the market and, you know, Dolores is one, Bob van der Valk was another. And so, those people survived fundamentally because they satisfied the unbranded rack market.

All right, now, Exxon goes down in February, the market goes from being probably 50,000 barrels a day long for the West Coast system to about 50,000 barrels a day short, more or less. And so, it's making up that shortfall, having to bring supply in from around the world has resulted in sustained higher prices.

So, your question of how current or

temporary this is? I think history would say as the market goes long again, then prices will get back to where they should be. Let's call it 35 or 40 cents, you know, a gallon, and it's back asleep.

That doesn't mean that there aren't transparency issues that shouldn't be addressed. I think they likely should be. But, you know, this problem will go away assuming the ExxonMobil refinery starts up and nobody else goes down.

MS. FOOTE: Just to comment again on the whole market power thing, you know, I'm not advising anybody on anything legal as the -- from my office to the Committee, but just as someone who obviously pays attention to market power issues.

I think what it demonstrates, I mean whether market power is being exercised or not, I won't really comment on. But I will say that it seems pretty clear that if you have -- if you have the Torrance refinery out, then basically you have fewer players in a market that already has very few players to begin with. And any moves, collusive or otherwise, any moves by any one of them has a much more significant effect on pricing. You know, whether ships are sent away, or brought in, or anything, delays of any kind.

So, what it really demonstrates is that there were already -- you know, California's right on the edge in terms of the number of players to make it a competitive market. And just one less, suddenly it's less competitive in a way that if we knew everything, we could probably measure.

CHAIR BORENSTEIN: Yeah, I think that was basically the point. That we are clearly just balanced on any one refinery and we are, given history, almost certainly going to have another refinery problem, and that will knock out a significant share of production of some refinery in the State, because it happens. It's a very complex business.

And so, there is an interesting question of which way the California market, as a whole, will go from here. I would have said, a couple years ago, that we're clearly declining and we're going to become more and more self-sufficient and less and less dependent on imports. But that's not, that hasn't been the case in the last few months. In fact, both the stronger economy and cheap crude oil may turn the whole thing around and we may actually increase gasoline consumption. And maybe those traders will get back in the market because there will be a lot of business setting up imports, again.

In some ways this seems to have happened at the worst possible moment, where we were just short after having been long enough that people weren't really paying much attention to imports. And now we're in a situation where the system was remarkably lacking in resilience, unusually lacking in resilience.

But I don't think that the event is likely to not happen again in some form and it would still be useful to, I think, think through it. And it may happen again in exactly the same way, where we are exactly on the edge again and the refinery goes out.

And in some ways this is, I think, a better case from a market power point of view because despite what Jamie Court was saying, Exxon seems to have all the right incentives to get their refinery back online.

If it had been a Tesoro refinery, where they have other refineries that are still producing and their margins have now tripled or quadrupled, then it’s much less clear they’d have as much incentive to get back online. And I think then we’d really be wringing our hands about how do we make sure these guys are actually doing everything they can to get their production back up.

MR. HACKETT: Yeah, sort of two points. One is a side point. There’s been a lot of misstatements about how things work in the market, in this meeting. If we get a chance, I’d like to discuss that. I’d like to bring those forward. No need to do that now.

The second thing is that when the market was way short, then cargos flowed on a regular basis. There was a ship every other day, or whatever, on its way. So, there was a whole supply chain of vessels coming here.

Well, when it was long there was a whole supply chain going out. It’s this in between that we struggle with.

CHAIR BORENSTEIN: Actually, I think clearing up misstatements would be very useful before we get too much further down the line. And you have the most industry expertise of us so

--

MR. HACKETT: Okay, Amy asked about exchanges. Exchanges where one refiner has a problem and it borrows the barrels from another refiner. That used to be standard practice but it stopped some time ago mainly because oil got to be too expensive.

And what would happen is that if I lent barrels to somebody else and they still had them over at the end of the month, then all of the sudden then my inventory is sitting in that guy’s tank. So, it becomes a balance sheet issue.

And so, all of those big type exchanges like that have transitioned to invoicing events, they buy or they sell.

There’s still smaller exchanges out there that are used to help optimize logistics. For example, my batch isn’t getting to San Diego on time, can I borrow some barrels from Unocal for 12 hours in order to get me over. That sort of stuff is not invoicing.

But the big, my FCC went down, will you lend me some barrels? That’s done and it’s been done for some time. That’s one.

Another one was about the volume of

inventory. Gas stations don't carry a lot of inventory. You know, there's not a lot there. There's a few days, at most. And could Costco stations hold a lot of inventory? Yeah, they do. But they've got a huge turnover. You know, the Costco station I go to does six trucks a day. So, whereas a normal, kind of big station does one. So, there's not a lot of capacity there.

Let's see, one thing that you note is, and you've sort of heard about this, is that it's very difficult to determine how individual refiners distribute to the retail chains. You know, and in talking about this before where, for example, ExxonMobil doesn't own any gas stations in Southern California. All the Mobil stations are owned and operated by somebody else. And Mobil happens to sell them gasoline generally at the spot price, but they don't have any -- there's no retail -- ExxonMobil doesn't have any market share in California.

CHAIR BORENSTEIN: Can I just ask about that? Are you saying that -- a Mobile station is required to buy their gasoline from ExxonMobil, aren't they? Or, are they operating as --

MR. HACKETT: It's a contractual

arrangement. And generally it is --

CHAIR BORENSTEIN: Right, so long as they're flying the Mobil banner, they have to use gasoline that has the Mobil additives. And that's true with Chevron, right?

MR. HACKETT: That's true with Chevron. But Chevron is probably the last participant in the market that is very focused on supplying gasoline that it has, either they made it or they got it from somebody else, and they put Chevron's additive in it and they deliver it to a Chevron station.

The other companies have different contractual relationships so it sort of depends. I would think most of the Southern California Mobil stations have -- people who bought those stations, distributors who bought those stations have a long-term purchase agreement with ExxonMobil. So that they're buying the gas from ExxonMobil, who's putting the Mobil additive in.

But there are other cases where that may not be the case. All that's up there is the sign and not any Mobil gas or Mobil additive in the station.

Another on exports. RBOB, which is the

Federal reformulated blend stock or oxygenated blend, and CARBOB, which is the California version, those are not -- those gasolines are not ready for retail. You wouldn't burn that in your car. You have to blend it with ethanol in order to make it retail ready.

That means that gasolines that -- if somebody was -- nobody would ship RBOB or CARBOB to a non-ethanol-blending location because you can't make it retail gasoline. Now, maybe you could take it in and blend it with other gasolines, and you could use it as an extender. But as a practical matter, you can't get it to retail without ethanol. Mexicans don't blend ethanol.

And so, sending this stuff, sending CARBOB to Mexico that goes into a retail-type location, that doesn't have a refinery with it, doesn't make any sense.

CHAIR BORENSTEIN: They can't blend something else, like MTBE in?

MR. HACKETT: Well, they certainly could but you've got to have the facilities to do that. You've got to have the MTBE, you've got to have the tankage. You've got to be set up to do that.

It’s not simple.

Pardon me?

MR. HACKETT: Oh, because the refinery in California is making gasoline but it doesn’t meet CARB specs. They can’t make distillation, or they can’t make sulfur, or there’s something else wrong with it that it won’t fit in here, it’s off-spec, yeah.

CHAIR BORENSTEIN: But still, does that mean when it gets to Mexico they can just sell it straight up or don’t they still have to blend something into it?

MR. HACKETT: No. Likely, they make it to Mexican specifications.

CHAIR BORENSTEIN: Okay, so here’s the problem. That then, once you get to that point it, I think from our perspective, becomes impossible to tell are they utilizing the capacity to produce for Mexico in order to keep utilization up, while still restricting supply to California? Or, did they happen to produce something or because of production constraints couldn’t produce more CARB gasoline?

And my guess is we just are not going to know what the true production, complex production model of the refinery is and whether they are actually doing this because that’s just the price-taking response to the market or because they actually have an incentive to reduce supply to California and drive price up?

MS. JAFFE: Then why would you park a cargo for several days at Los Angeles, if you knew you were selling it to Mexico? You would send it to Mexico.

So, I think that, you know, we’re not going to be able to get -- I mean, it would take a subpoena or something to get behind the weeds of these cargos that were brought in and then transferred to other markets.

I think we can conclude two things. Number one that on the face of it there appeared to be cargos that moved to locations that would have given them less income than if they could have released the cargo and sold it in California.

And number two, you know, and I think more on just focusing our discussion here today, right, is if we’re understanding that the movement of a particular cargo, at a particular time, can have a pretty dramatic market impact, right.

Then I think really more to the point, and maybe there’s no solution, but the question of how is the market structured, do we -- you know, in other kinds of markets the regulator says there has to be this many players and no player can have this percentage share of the market, right. And we’ve decided in California that we’re not going to do that. That we’re going to have a fee that there’s this many refining companies and they each have the following facilities based on history, right, regardless of what it means for the market.

You know, working within that framework to come up with some kind of solution to the inherent market problem that’s currently in the market is actually difficult.

CHAIR BORENSTEIN: Well, actually, I think it’s more complicated than that because the Federal Trade Commission and I think the California State Attorney General’s Office chose not to try to block the various exchanges that have occurred, the BP sale to Tesoro, some of the other earlier sales and so forth on the idea that the market would remain sufficiently competitive.

And I think a big piece of that, at least on the FTC end, I didn't work on it but I have talked to FTC people about it, was that imports are a real disciplining device. And so, particularly back when California was generally importing that was driving the price and there was a good market.

And I think if they had heard what we've been hearing for the last few meetings, they might have had some second thoughts about that, about how well imports actually would discipline the market, and that might have changed the views on some of this.

But we're here now, and although there is some sort of antitrust law about undoing mergers, it's never utilized. So, I think that we need to thank about what's the best policy going forward.

MR. HACKETT: A couple other points that I had. Exxon got taken to school, essentially, by Consumer Watchdog. But despite their research, there's a bunch of things they don't understand. One is that the Exxon refinery in Singapore is not a very good CARBOB-making refinery. It has a hard time making the specifications.

The second is that Exxon's import logistics are poor. They've got a dock in the Port of Los Angeles, in San Pedro, but it has shallow water and constrained tankage. They can't take in a full cargo.

I think because they -- you can't read anything into the fact that it didn't import very many cargos. They may not have been the importer of record. So, what comes up on the data as who brought in the cargo is not exactly -- not always does it show you where it went. Sometimes it does.

And so, and then they don't own any stations. So, I thought those were important points.

So, that's my list of corrections. Come back to this, there were several issues that we brought up. Courtney's got my presentation up from a few times ago. You know, because once we get -- if we get to the point where we're talking about prices, and transparency, and that sort of thing -- I'm sorry, Severin. Then I thought that --

CHAIR BORENSTEIN: (Off-mic comment)

MR. HACKETT: I thought that could be

useful in our discussion this afternoon. We don't have to talk about it now. But some of the things that we said, that I said in the earlier meeting was that the market is less liquid. There are fewer participants in it. We heard that from Dolores and you heard that from Bob today, there's fewer participants.

Because it's less liquid, it's thought more volatile. And you can see that volatility, the intraday volatility in the OPIS daily report.

And so something we may want to ask staff to look at is go back to the OPIS data and look at all of that relative volatility. I mean that's going to tell us something -- if nothing else, it will corroborate that the market is thinly traded and is very volatile. I'm not sure what you do about it just yet, but that might be a useful data point to have. We're dealing with facts at that point.

And then, finally, in our -- we wrote a report in *Strategic Fuel Reserve* that was the result of a task force that Severin sat on a few years before that. And so many of the items that are in our list were dealt with in that report.

And if we want to go through those

quickly, I could tell you which ones are out and which ones we may want to do a little bit of cost analysis on. Because I support Jim. We need to do something that's cost effective.

CHAIR BORENSTEIN: Dave, are you saying you actually are ready to do that now or that at the next meeting you could do that?

MR. HACKETT: Well, I could tell you which ones we definitely would strike out because they're non-starters based on my experience with this.

CHAIR BORENSTEIN: I think that would be useful, if you're willing to do that right now. And I'll even move my chair back around.

MR. HACKETT: Sure. I think that the pressure relief valve needs to be studied. I don't automatically assume that that's easy to do. I think there's all kinds of potential problems with that one.

Inventory requirements for gasoline sellers, strike that.

Strategic CARB inventory --

CHAIR BORENSTEIN: Wait, tell us why you're striking it?

MR. HACKETT: Oh, because I don't think

that the State can compel anybody to hold inventories. And I think that it's an additional requirement. For example, it's a requirement that might very well lead to even fewer participants in the market. Bob van der Valk said there were 16, right. What are there, six or seven refiners left. So that implies that there's eight or nine traders. Well, if the traders have to hold inventory because they're gasoline sellers, they might view the economics of that as being poor and not participate.

MS. JAFFE: What about the refiners having a minimum inventory requirement --

MR. HACKETT: I don't think -- that's been talked about for a long time. I'm not sure that you can compel them to do that. I don't know one way or the other, I'd have to ask the lawyers. But I already know that there are refiners who don't like this market. And they've been making good money lately, but having one more requirement is another thing that might very well push them out.

MS. JAFFE: I don't think anybody's leaving a refining market that's giving them margins that are in double digits, when the rest of the country doesn't make that.

CHAIR BORENSTEIN: I think I'm going to let --

MR. HACKETT: BP got out. BP got out, Exxon's getting out.

CHAIR BORENSTEIN: I think I'm going to let Dave continue, as long as we note that these are Dave Hackett's strike outs.

MR. HACKETT: Yeah, you can put my notes on this, that's fine, yeah.

So, the strategic inventory might be worth running the numbers again. We know what it looks like, we can run the numbers. That's not hard. Staff can do that, probably, because we've got everything we need.

Straight forward purchases, that's not much volume and it takes an expert to be able to do that. You'd have to hire somebody. I wouldn't get into that one at all. We didn't -- I think we rejected that when we wrote our paper the last time.

CHAIR BORENSTEIN: Well, I think we rejected that when I was on the Attorney General's Gasoline Task Force. But in part that was because, and for the same reason as number two, that in both cases you do need some expertise on how you're actually going to manage the purchases or the inventory and it's not clear who would do that.

MR. HACKETT: Fair enough. Build a new pipeline, not going to happen.

CHAIR BORENSTEIN: Yeah.

MR. HACKETT: It's too far.

Expand the capacity of import terminals. Well, we've been in favor of that for a long time. Indeed, you heard Dolores talk about how Martinez built gasoline tankage. Well, that was one of the outcomes of the *Strategic Fuel Reserve Report.* The business development people for a couple of these pipeline companies took the report that the CEC published and they took it to their bosses in Houston and said, look, California is short of capacity. Give us the money to build these tanks. And they did, they built them in Martinez and they built them in Carson.

So, you know, understanding what's going on in that space I think is useful.

CHAIR BORENSTEIN: Yeah, I think that --

MR. HACKETT: I mean, I wouldn't

recommend that until I understood it better.

CHAIR BORENSTEIN: Well, also, there’s a question of whether you were talking about private companies doing it or whether we’re going to say there’s a market failure that the government needs to address.

It sounds like in the case you’re referring to they just put the information out there, and that was enough and the private market built the storage.

MR. HACKETT: Indeed, that’s what happened.

CHAIR BORENSTEIN: Import capacity.

MR. HACKETT: This isn’t something that happens overnight, it took a while to do that.

Increasing refining capacity, that’s not going to happen. But I would argue that we should do things that don’t decrease refining capacity. Because in my view, that’s likely the way things are going to go is that refining capacity is not -- is going to slowly get ground down.

CHAIR BORENSTEIN: And can you tell us a little bit more about why you think that?

MR. HACKETT: Oh, sure. Today’s

regulatory environment layers additional costs on refineries to meet cap and trade, Low Carbon Fuel Standard. South Coast Air Quality District is rolling out a NOx reduction program that's going to be fairly expensive. And so refiners, the refining companies in California are all national companies. In many cases international companies. And so while they're making money, good money now, they are, everybody knows that when the market flips to the other direction then their margins are going to be average.

And so while I --

MS. JAFFE: So, maybe it's actually the other way around.

MR. HACKETT: Well, let me finish my point. My point here is that these companies will make decisions about how they're going to invest in their facilities based on their outlook for profitability. And, you know, I think they see better profitability outside of California in the long run because of the direction that the State's going.

MS. JAFFE: So, I would beg to differ. I would say that for the companies that stay in California, a market where there's a lot of market power, if you're the one who stays in, right, and you have a strong position, the beneficial nature of refining profitability, which we've seen this year for taking one guy out, accidentally, goes to how much money can be made for the other refiners that stay in. And that that's ultimately the bet that people make.

MR. HACKETT: And I would agree that some will make that and others will not. And I'm not quite sure how that's going to go.

And then transparency measures, we can get into those. I think transparency is important. I'm not sure these would be on my list but, nonetheless, I'm a big supporter of transparency.

CHAIR BORENSTEIN: So my impression is that when we hear back from the industry about transparency, they're going to come up with a lot of reasons why it's a bad idea. And I'm sure just regulatory burden will be one of them, but I'm trying to think of what the others would be. Maybe we have to invite WSPPA back again to tell us what they think they'd be. But I'm trying to anticipate what those would be before we get too far down this line.

Jim was waiting.

MS. JAFFE: Oh, can I just say one last thing, which is that there are new data providers today that provide the industry with GPS data of the location of every vessel in the world. And so, the idea that there's some kind of regulatory problem with having -- to have to disclose where your vessel is or have somebody else know where your vessel is, that that is not -- that is an Old World way of talking about the movement of vessels in today's world.

And so, really, the only cost that could possibly come from having a program like that is the cost on the State of California to have to make that data available.

CHAIR BORENSTEIN: Well, I think there's a lot more to it than just where tankers are. It's also what's in them and where -- in fact, here, it's even what prices they're selling for, what inventory they're holding, what maintenance they're doing.

And so, I'm not sure we're going to fully settle those questions but I think going down that road might be useful.

Jim.

MR. SWEENEY: And let me throw on something else that I guarantee is a non-starter, but I have to put it on. I was really pretty startled when I looked at the graph that Gordon showed, I think it's yours, that showed the Low Carbon Fuel Standard, the carbon credit having gone from $20 a metric ton to $130 per metric ton over the last six months and just, basically, steadily going upward.

The Air Resources Board has put a limit on it of $200 per ton, but it is very hard to believe that $120 per ton of carbon dioxide is within the cost-effective measures as required by AB 32. So, if we're imposing a cost of, if I read this correctly, $120 per metric tons of the value of the Low Carbon Fuel Standard credit, to me we're really violating that one provision of AB 32 that said it will be cost effective, all of the measures.

Now, they've been violated in so many other ways that's why I say I know this is a non-starter because cost effectiveness has been so far down the criteria that the Air Resources Board has been using, but I've got to raise that as an issue.

It's only worth five cents a gallon on gasoline, but it's the principle of the thing.

CHAIR BORENSTEIN: Yeah, although if it's $200 a ton -- if right now it's four and a half cents at $130 a ton, it's linear, then we're talking it maxes out at seven or eight cents a gallon. Is that right?

MR. SWEENEY: Well, actually, I think the fractions are --

CHAIR BORENSTEIN: Oh, right, right. As the requirement goes up, it could get much more than that, that's right.

MR. SWEENEY: The price is going up, as I said.

CHAIR BORENSTEIN: Right, but year after year they're going to lower the carbon content.

MR. SWEENEY: And you see the real jump from about a penny and a half to four cents on January 1st --

CHAIR BORENSTEIN: Right, that's right.

MR. SWEENEY: -- without a change in the price, but just year after year. So, I don't think the issue is -- four cents is not a big deal relative to what we're talking about now. I think looking forward it may become a big deal.

CHAIR BORENSTEIN: Yeah.

MS. FOOTE: Yeah, one thing that was not on the list, although I think it may have been on some earlier lists, maybe that report you were talking about, but maybe it was discussed. But rather than have the State be involved on the supply side by having a strategic reserve and having it become simply a purchaser, a player in the spot market.

CHAIR BORENSTEIN: Actually, I think that is on the list as the State-forward purchasing.

MS. FOOTE: Oh,

CHAIR BORENSTEIN: Number four. And in fact Dave knocked it out, but I'm not sure why. Maybe he can remind us. Because in some ways it's as attractive because we heard from a number of participants that the inability to hedge is a huge barrier to importing fuel. Dave, were you saying it's just not enough or -- there's also the issue of whether the State wants to be in the business of importing fuel, even when it's not cost effective in the short run, just to make sure the import vertical chain is maintained.

MR. HACKETT: This gets to be --

MS. FOOTE: I guess I was not thinking

that that simply being a trader in the spot market was not quite the same as that.

MR. HACKETT: I think the thought here, from 2003, when we last kind of worked on it, was that the State's a consumer of CARB gasoline in a measurable amount, one or two percent, I think.

CHAIR BORENSTEIN: I think the Attorney General Study said two percent, but yeah, somewhere around there.

MR. HACKETT: And it's a natural short, right. Because it's a consumer, it's going to be buying all the time. So, that's why it seems to be attractive.

But when you kind of drill down and you look at how the State got supplied that gasoline, it gets supplied mostly by Jay McKeeman's members, who are doing a truckload or a tank load at a time. And so, nobody wanted to take on that complexity of managing, really, hundreds of different consuming spots.

Gordon, do you remember it that way?

MR. SCHREMP: This is Gordon Schremp with the California Energy Commission. Yes, the Department of General Services lets contracts for fuel for safe purchases. They are all over

California, in all kinds of difficult-to-get-to locations. A lot of independent jobbers successfully bid on those contracts. And so they're very small volumes, in many different locations, like Dave is saying.

So, there's an awful lot of players involved in that, even though it's a relatively small amount of volume statewide.

MR. SWEENEY: I'd like to raise one other question where I may be sharing my confusion, but it's been asserted over and over again that it's impossible to hedge, and that's making an impact on the decision to export -- import gasoline to California.

Yet, my understanding is that some of those contracts are set based upon a price that's established at the moment that the ship is loaded, not that the ship is unloaded.

If that's the case, then you've basically hedged against any future price movement between then and the time that you're delivering the ship. And so, I think it's fair to state that it's not an organized market for hedging but to me, unless I've got that wrong, the contracts alone are almost a complete hedging of the price between the time it’s loaded on the ship and the time it’s delivered.

Does anybody know the facts there?

MR. HACKETT: Well, I would say that it goes -- it will work any way you can think of it. The price of that -- the price at the load port, they try to price it at the discharge port. But it gets to be -- it may get to be difficult when they choose to bring it ashore and sell it in parcels.

And so, it would be useful to have somebody who’s done this talk about the ins and outs of it.

MS. JAFFE: Can I just make a point. I think what people were saying is that if you were going to hedge it by using a market, or the futures market, or some organized market that you would have a basis for this between the California location and the focal point of that market, whether it’s Singapore, or New York Harbor, or Gulf Coast.

So, I think that people were concerned about the specific California basis, right. But, you know, if the State brought in a cargo and then distributed it back to the jobbers, sold it back to their own jobbers, I don't know why the State couldn't do a procurement from someone who has, you know, an Indian-sourced refinery, some international purchase, and then put it through its own network. I mean, it doesn't have to be just passage.

MR. SWEENEY: Well, I guess it seems to me that you can have a hedging contract based upon the New York Mercantile Exchange. So, that can happen.

You can have locked in the actual delivery price because you set the time, the contract at the time you load the ship.

What you don't have is a market for the differential between the bases and that. But you can hedge, almost completely, the price that you're going to face by setting the contract at the time the ship sails.

CHAIR BORENSTEIN: I think the fact, though, is that somebody can't hedge it. That if the seller is hedged, the buyer is locked in on the price. But if the price drops in the meantime, they are buying a load that's arriving at price X, but the market price has dropped and they're losing money on that, and so they're taking the risk. And so, somebody is absorbing that risk.

And I think, I'm a little surprised because some of the companies we're talking about -- I mean, this should be a risk that on average zeros out. And some of the companies we're talking about are multi-billion dollar firms that should be able to absorb this risk but, obviously, some of them aren't. Some of them are pretty small firms.

MR. SWEENEY: And in addition, if you enter a contract for a differential, somebody is taking the risk. One's selling the risk to another. This is just -- this doesn't change the idea that somebody is taking a risk at the time. The thing is -- the thing is that oil is moved over time and whatever the market is somebody is taking risk.

MS. JAFFE: And let me just say, to some of the companies that operate in the market here, in refining, so I'm not talking about the jobbers or the trading factors, but the actual refining companies. Most of them have refineries in all their locations. Many of them have refineries all around the world. They do logistics trading for gasoline, again, internationally. And they have complex systems that they use to hedge those transactions through the over-the-counter market, through -- you know, you also have to hedge the currency. You know, when you're buying a cargo someplace that you're not paying in dollars and you've got to hedge, or you have the currency risk. I mean, there's so many risks involved, right, that I find in a market where, you know, you might feel you're short supply for your network, right, the idea that you wouldn't -- you know, that you've got some couple of days -- I don't know, how many days is the sale from India, how many days is that?

MR. HACKETT: Call it 40.

MS. JAFFE: Forty days. So, I've got this 40-day risk that I'm going to bring a CARBOB cargo to California and Exxon Torrance is going to be repaired within that 40 days. I mean that was the risk that people were unwilling to take for 11 months.

You know, you're going to know at some point. You know, it seems unusual that no one was willing to take that risk for 11 months.

MR. SWEENEY: And that's consistent with

my point. The fact that it was all inability to hedge and so forth just doesn’t pass the laugh test to me, as what was making the big difference.

MR. HACKETT: The problem is that people can’t lay off the risk. You know, if you do a deal for 20 cents over, right, and then the market -- by the time the ship shows up the market is 50 cents over, somebody’s going to be unhappy. And it’s really -- and so, this is not a new phenomenon. This was the same, that we addressed this in 2003 when we talked about the inability to hedge and how we thought perhaps there was some way we could create a market by using the State’s gallons as part of it. So, it’s not new stuff.

CHAIR BORENSTEIN: And Dave, you’re saying that you’re not optimistic on that, since you drew a line through number four?

MR. HACKETT: That’s right. That’s right, I don‘t think that’s going to happen.

CHAIR BORENSTEIN: Would any other members like to go down the list and -- Dave has sort of given us his views. And we could sort of sequence this and maybe get some idea of what are the policies that we should really dig in on.

MS. FOOTE: Well, we've been kind of leaving the transparency one. I think we all agree that transparency is going to be a big thing. And we probably need to go through all of those and talk about, you know, the costs and benefits of each one.

As to the others, I guess I would agree that number one is an interesting (inaudible) -- and I don't know how much that's ever been studied before or whether there's a change -- whether kind of the rest of the world is now aligning well with California so that (inaudible) -- but it would be very useful to know more about that.

And on the others, my sense -- well, on number six, the import terminals, I do recall that was a major recommendation. You guys, who were part of the Attorney General's work, back 15 years ago. And certainly for a time that was a real interest area whenever mergers came up was whether or not some of the merger impacts might be offset with an expansion, and a company expansion of storage. And it did not -- the one example of that, that might have happened, I think, didn’t ever really come to fruition.

But the feasibility of that, in my mind, continues to be attractive with the right kinds of incentives involved. And I think there would need to be incentives or at least we would have to think about it. That you wouldn’t be able to just sort of, you know, wave the wand and say this is something that the private market should do. There needs to be something put in place to make the private market much more interested in doing it.

And there also probably would need to be coordination. At the moment, essentially, those kinds of things are very much subject to local land use controls, which are not at all coordinated with any kind of a State policy relating to the gasoline market.

So, extremely complicated to do that. If you think of other areas that have traditionally been subject to local land use control, and now the State has a policy, something like landfills for example. That’s the example that comes to mind most easily. It is a very complicated and long-term process, although certainly not one that couldn’t be implemented if the will were there to do that.

And then on transparency, I think we should sort of just take them one at a time.

CHAIR BORENSTEIN: Jim.

MR. SWEENEY: Yeah, I'd be happy to go down for it, first. The relief valve, I agree it would be complicated, but I think that it -- my gut feeling is that we can design a system that allows that to happen. That there would be some way of organizing the system so that there would be allowing non-CARB gasoline with a surcharge. You are going to have to set some controls on under what circumstances it's done, but I think that can be devised.

Inventory requirements, I agree that there's just no way that you're going to pass a law saying you must hold so much inventory.

State-strategic CARB inventory. I've thought a little over time how a strategic petroleum reserve has worked and that's much easier to do than a refined product, and much cheaper to do. And then, the difficulty of deciding when you should release that strategic petroleum reserve, you know, what circumstances.

The degree to which the owner of the

reserve chooses to manipulate the market to compensate for some judgment about the market being manipulated. I think you just get into a morass and it becomes a very costly way of doing it. So I would say number three, in my mind, is a non-starter.

Pay forward purchases of gasoline to reduce the risk. Well, you know, forward purchases at the time that you believe that there's going to be a price spike, if you can anticipate the price spike ahead of time, that would be a good thing to do. That may be a little bit risky and we get back to the idea of when you're purchasing ahead at certain prices somebody's going to win and somebody's going to lose. And my bet is that half of the time the State of California will lose on that deal and half the time they'll win.

And I'm not sure that our net will get a gain, but I'm not totally opposed to that one.

Number five, building new pipeline capacity. It's going to be too costly and the State compelling somebody else to make an investment in pipeline is an absolute non-starter.

Expanding capacity of import terminals. Well, I wouldn't want to see the State expand it, so then it would be creating incentive for private sector to have more input. So, I could see, I could envision that. I could envision that. Now, you have to understand what the incentives are going to be.

Particularly, as Kathleen points out, is that terminal facilities for petroleum are not exactly popular for local communities. So, you're going to have to do some overriding of local preferences to force an expansion. But, you know, it's possible to think about.

MR. HACKETT: Let me have a caveat, which is don't increase the disincentives for terminals.

MR. SWEENEY: Okay, don't increase the disincentives, that's fine. Increasing refinery capacity, no way the State government's going to do that. But I can accept the notion we've got a lot of disincentives, so you might want to discourage more disincentives, so that's on number seven.

The transparency measures, I think we've got to look one by one. I don't know what A means, all deals should be disclosed. Do we mean sales to an independent -- yeah, well, I'm -- yeah. I actually -- okay, I'm not sure about those.

Dealer tank wagon prices should be publicly disclosed. I feel a little bit uncomfortable making sure that -- because those dealer tank wagon prices are not typically one broad price, but there's geographic locations, then we're going to have to have a very rich array of geographic price disclosure, which are going to lead to problems in themselves.

I'll just give you one simple example of a litigation I was involved in. It was a retail at Half Moon Bay was complaining that some of the gasoline refiners were charging higher prices for a Half Moon Bay delivery than in the Bay Area. And when we started looking into it, it was true. But the reason was very interesting, the same retailer was the proprietor of every single gasoline station in Half Moon Bay. They were all different brands, but the same retailer had it. He was exercising a monopoly, monopoly pricing, and the oil company understood that and they were taking that monopoly profit from him.

Well, you're going to have to -- by disclosing all of those, you get into some really complicated issues that I'm not sure the benefits are going to exceed the cost.

Publish data on maintenance schedules. Yeah, maybe scheduled planned maintenance, I don't see a particular problem on that.

But once you start getting too much information about forward plans of reductions of supply, you do have opportunities for coordination in the market, but in a way that may be anti-competitive.

So, we've got to be really careful that we're not -- any of these forward-looking supplier adjustments we may have to be careful for.

Inventory plans, I don't see that you can do that.

Unplanned maintenance repair timeline. Well, my guess is that any of the companies that have unplanned maintenance, that they're trying to repair it, are going to have to give at best probabilistic estimates because they're not going to know how long some things are going to take and how quickly the approval processes are going to go online. So that you may be able to get some information, but it’s not going to be anywhere near objective because of the difficulty of doing it.

Imports and exports, I think good publishing data on that is really a high payoff for information.

MR. HACKETT: And so, let me ask Gordon a question. Gordon, on the issue of maintenance, planned maintenance, can you talk about any data around how planned maintenance issues have caused price spikes?

MR. SCHREMP: This is Gordon Schremp with the Energy Commission. I don’t think there is price spikes associated with the information of planned maintenance. Planned maintenance data, in and of itself, is something that various proprietary entities endeavor to collect accurately and are paid to provide that to a variety of clients, including ourselves. When we’re looking at planned maintenance activity, we want to know who’s out, what the extent of the impact is on gasoline production and diesel fuel. And we’re most interested in when the planned maintenance will be completed.

So to your point, when are we seeing price spikes associated with planned maintenance, it’s when the planned maintenance is completed longer than originally anticipated per these schedules, whether they’re exactly right or wrong. But that’s when we hear that the company is not -- as Dolores was saying, is not normally in the spot market, now is an active buyer. We can’t confirm or deny that, but that’s what OPIS will say is happening. And that’s where we’re seeing some rapid escalation in the spot prices when they’re covering their obligations because they’re in for another week or so.

So, knowing the planned maintenance, knowing when they’re coming out, and seeing if they’re coming out on time or not is very telling to temporary market spikiness, yes.

MS. FOOTE: Gordon, I have a couple of -- Kathleen Foote. A couple of questions on that.

We were hearing earlier, from Dolores, that the planned maintenance is done with major equipment and hundreds of employees. Are these company or do they tend to be outside contractors? And if outside contractors, how many of them are there?

MR. SCHREMP: This is Gordon, again. I was saying that.

MS. FOOTE: Oh, you were, okay.

MR. SCHREMP: And it’s our understanding that during significant planned maintenance activity that can last 30, 45 or even 60 days, there is normally a couple of hundred of additional employees who will come into the facility. They can be some union, they can be some non-union players under contract. And there are a number of subcontracting entities for specialized high crane, heavy lifting, extra welding, things of that nature. So, there’s a lot of new parties that do come into the refinery, besides the couple of hundred or even up to a thousand workers who are normally there. And those workers, at the facility, do participate as well in these planned maintenance events, in assisting with the other temporary help.

MS. FOOTE: So, I guess my question is, if you have, for example, a year in which most of the majors are actually -- most of the refineries are actually having significant amounts of scheduled maintenance done, is it likely to be with the same contractors, or subcontractors? Are those so specialized that they actually have, to some extent their schedule represents a fairly comprehensive schedule of the planned maintenance of the entire industry within California, or not?

MR. SCHREMP: This is Gordon, again. it’s fair to say that the more specialized the labor is, the more in-demand your services will be and the likelihood you’re going to be booked up far in advance and have plenty of work.

You go down that spectrum to laborers, pipefitters, carpenters who come in for planned maintenance, they could pretty much move around and do other types of jobs not associated with refining activity. But they’re not the limiting factor. The limiting factor is the specialized labor, specialized heavy-lift cranes. That’s the limiting factor.

MS. FOOTE: So, if you have a schedule, so if you knew that those folks were booked into California solid for some period of time, you -- it might actually affect investment decisions or not?

(Off-mic comment)

MS. WARD: You’re muted.

MR. SCHREMP: This is Gordon. I think you circle back to what information is available? Is it a hundred percent accurate on planned maintenance that's coming up? Not always, as it turned out to be the case, but it's pretty close. Everyone sees that, that cares, they buy that.

And so, the competitors know what's going on. The traders know what's going on. The traders have contacts within the refinery to burrow down and say, well, are you guys really going to come back on time?

They call when there's flaring at the refinery. A lot of the traders in Southern California have offices where they can see the refineries, and see the flares, and understand which flare is tied to what process unit. So, they do their best to obtain intelligence to try to give them an advantage when it comes to transactions at the market.

CHAIR BORENSTEIN: Yeah, this is Severin. I, on the one hand, would be a little nervous about the idea of everybody knowing exactly what everybody else's production constraints are because in some sense it's a field guide to when to reduce output and exercise market power, when you know the other guy can’t expand.

On the other hand, as I get told that all the industry players already know this, that’s a more compelling argument that making it clear to the rest of the world is potentially valuable.

MS. FOOTE: Yeah, well, the reason I ask is one of the arguments regarding competition in California and why we need not worry that there’s not enough competition in California, at the refinery level, is there is some now, as there used not to be, some unused capacity in each of the refineries. Maybe not this year. And that that, in and of itself would be essentially a kind of lurking potential competition anytime anybody wanted to cut back.

So, essentially, what this suggests is that to the extent that everybody already knows when the planned outages are going to occur, that may or may not be an actual competitive option.

CHAIR BORENSTEIN: Amy, do you want to take a shot at these? Because I think, I know we need to break up fairly soon. But what I’d like to do is get to the point of where we have an idea of which ones we should pursue. And then for the next meeting, actually, decide do we need to bring in other people to talk to us or our next meeting are we ready to start reaching decisions, or what?

I'm happy to go, but I'm happy to let you go.

MS. JAFFE: Okay, well, I have researchers waiting for me at ARB, for another meeting, so I will just quickly go through. I think people's comments have been thoughtful.

So, you know, price pressure, gasoline with a surcharge seems like it can work. It's what's been done at a Federal level when we've had refining emergencies in the past.

I would just say that the difference between the Federal level and California is that people care very deeply here, in California, about air quality. And we could have, as we've had in recent years, a lot of refinery accidents. So, I'm not sure how that would square exactly with the public, given the high level of refinery accidents we've been having.

I might mention that in Canada, with pipelines, there was a more proactive regulatory or study of accident prevention and corporate sustainability policy that was undertaken to try to reduce the number of pipeline accidents in Canada. That might be a regulatory policy that one would want to look at, that's not an obvious one that's up here.

You know, in Europe, Japan and South Korea it absolutely works to have the refining industry have a minimum level of inventory that the inventories cannot go below. So, it's not actually requiring inventory, it's just having a minimum standard below which the industry can't go. I still like that idea but --

CHAIR BORENSTEIN: Can I just ask how, if they can never go below it, then it's not useful inventory. So, there must be some --

MS. JAFFE: Well, I mean in an emergency you wind up using it.

CHAIR BORENSTEIN: And who decides?

MS. JAFFE: But it's coordinated. There's like a coordination with the government in emergencies, in times of emergency.

So, the way we hold the SPR --

CHAIR BORENSTEIN: Yeah.

MS. JAFFE: -- other places don't actually hold, the government doesn't hold the stocks. They have these minimums that the companies hold and then the government works together, with industry, to determine how and when to deploy inventory.

CHAIR BORENSTEIN: So are you saying we should keep number two on the list?

MS. JAFFE: I mean, I'd like to see number two stay on the list, but if no one agrees with me, I'm not going to make a big fuss.

CHAIR BORENSTEIN: Okay.

MS. JAFFE: I agree with Jim that -- and they've done it in Massachusetts and other places, so we might look into that. Because products have to be replenished, because they have shelf life, I think it's seven months, there is some complications to having CARB inventory.

And certainly, year-to-year, we would have to sell it every year and then buy it back the next year.

Forward purchases could work but, you know, like Jim says, very hard to implement. You have to have someone who really knows how to trade in the market or hedge in the market.

Import terminals. I don't see how the import terminal thing helps you because my sense was the companies just wouldn't bring in the imports. I don't think the terminals were the barrier.

I agree there's no way to increase capacity in the State, especially since we have forward-looking laws that are going to inhibit demand.

I think that on transparency I would say my emphasis would be on import and export real-time reporting. I think it would make a huge benefit, even if it was just -- I think it was, Severin, you might have been the one that suggested, even if it's just from the psychological commercial reality having everybody in the State know that you're exporting CARBOB at a time when there's a shortage, it might have a chilling effect on people's decision to do that.

I might add a last thing. If we have a market power problem in the State, but we have mostly "good citizens" when it comes to that, then it seems to me it's sort of an AG problem. And the question is does the AG have the staffing it needs to, number one, have someone watch the maintenance schedules in the State and how people respond to accidents and emergencies, so that that could be monitored actively by the AG's

Office. And the companies would be aware that it's being actively managed.

And then the second would be the AG's Office could also have a professional staff that would absolutely monitor import and excessive export into competitive practices, and actually monitor that on a regular basis.

Again, when we're in this kind of situation it might be more of a monitoring issue, that there would be a specialist that monitors into competitive practices. And knowing that there was a human being that did that every day, and it wasn't just there's going to be a hearing, again, might influence the one or two bad actors that might be out there and tempted to not think about the public's interest.

Those are mine.

CHAIR BORENSTEIN: Kathleen, do you want to say anything about the last one or do you not want to say anything? Mic on.

MS. FOOTE: Well, yeah. I mean, I would want to think about some of that and confer -- if we actually were to formulate a recommendation obviously my office, and several people in my office, besides me, might want to weigh in on it.

One question then rises would have to do with the interaction between the AG's Office and the CEC. And since anti-competitive practices -- I mean, to have a separate information gathering unit within the Ag's Office, as opposed to having a comprehensive one here, with some kind of a reciprocity arrangement, or something of that kind might make -- might make more sense. I mean, you know, it's something that we would want to think about.

The other -- I would venture to guess that, I mean, when we monitor anti-competitive practices, an anti-competitive practice isn't going to kind of -- you know, your data's not going to tell you whether there is an anti-competitive practice.

It may tell you that there's something funny going on that requires a subpoena, as Amy has been referring to. And when we say a subpoena, we probably actually mean many subpoenas. And, you know, one heck of a load of people's e-mails to go through. And, if possible, telephone transcripts and things like that. Back in the days of the energy crisis, for example, people made an effort.

So there are -- it’s two very different functions, I guess is what I would say. But there is -- and there is, of course, the issue that Severin mentioned, which is that if the action is unilateral there’s no authority under California anti-trust law, really, to go after it.

There is some authority under Federal anti-trust law to go after it, but under extremely limited and difficult circumstances.

So, yeah, I mean these are things that we would need to think about long and hard, kind of institutionally. But it’s not something that -- it’s not something that should be ruled out by any means. I mean, it certainly falls within, you know, very much within the charge of my office. And, you know, I don’t want to suggest that I’m backing away from that. Only raising some of the sort of realistic complexities to it.

CHAIR BORENSTEIN: Okay, I’m going to run through my views very quickly so that we have a little time to decide where to go next.

I think price pressure relief valve is definitely something we should explore further.

I am willing to look at inventory

requirements for gasoline sellers, but I'm still not at all sure how you actually make that function and I guess I would need to be a lot more convinced that somebody would actually be willing to release those inventories.

Likewise, with California, I think in both cases it's just -- it will require some administrative decision making that in the case of the strategic petroleum reserve it's not been well handled.

Forward purchasing, I think I've become convinced that despite the fact that in theory it seems like a great idea, in practice it's probably not really doable, either politically, because I think on average the State would lost money on it because they'd be buying at a time when prices go up, basically in order to drive prices back down.

So, if they succeeded, they would lose money on it. And so, I think it's politically impractical.

I think it's also the administrative burden and reviewing would be pretty political and difficult.

Building new pipelines I think is just

not going to happen.

Expanding capacity of import terminals. I wasn’t as clear from the participants we’ve heard that import terminal capacity is really the constraint. I heard more that it was storage capacity that was the constraint.

So, I guess I would want to expand that to think about. And again, the State probably wouldn’t want to own it. Instead, the State would probably want to have some incentives.

Increasing refining capacity. I think the answer is don’t do anything unnecessary to decrease refining capacity. Be careful with our regulations.

And transparency I think is a large issue and we should spend some time on. I do want to, if we go down this road, invite the industry to come and talk to us again, and tell us why they think it’s a bad idea. I assume they’re going to tell us it’s a bad idea. But I’d like to hear the explanations.

So, here’s what I’d like to propose. With the exception of the ones that are crossed out at this point, I would like this to be our agenda for the next meeting.

As Chair, and because of the Open Meeting rules, with no ability to speak to you in between, or very limited, I get to talk to Jim, who I will talk to, I would propose that I try to balance bringing in a couple more people who might be useful. I think you're allowed, under Bagley-Keene, to tell me what you think. To send me a one-way e-mail saying I think it would be good to invite this person. I'm not allowed to respond to you.

But the idea being just to sort of form an agenda that moves us forward but, at the same time, to the extent we need more input now that we've sort of narrowed this down, now is the time to get it.

Do I have general agreement on that? Have I worn you down?

MS. FOOTE: Well, the one thing, if it's going to be the next meeting, we might want to focus it even a little bit further. You know, maybe do just transparency. It kind of strikes me that that's plenty enough for one meeting.

And then, maybe after we do that we can go back to the other, sort of larger ones.

CHAIR BORENSTEIN: Jamie, I hope you're

on the WebEx. You're dream has come true. Jamie Court has been pushing for transparency and I think that makes sense.

MR. HACKETT: Yeah, this is Dave Hackett. I would say that many of these items, there's already been some analysis in the past. Perhaps the State could go -- Gordon and Ryan know where a lot of that stuff is and it might be useful to pull it out, dust it off, so we have some numbers to look at. And let the Committee then focus on transparency issues.

CHAIR BORENSTEIN: Wait, you're asking them to look into transparency or to look into the other issues?

MR. HACKETT: Look into the other issues.

CHAIR BORENSTEIN: Okay, do you think that any data exists on transparency or previous studies of transparency?

MR. HACKETT: Well, I can think of some work we did a long time ago in Hawaii. Hawaii had a gasoline price control law.

CHAIR BORENSTEIN: They did, a brief one.

MR. HACKETT: And so, we suggested transparency to that. I'll send you that or we're circulate it.

CHAIR BORENSTEIN: So, here's what I'm hearing. The next meeting will focus on transparency. We will ask Ryan and Gordon to pull up anything they're aware of on that, and then to start working on any previous studies on the other solutions. But transparency, we'll do first.

Also, contact Jamie Court and see if they have anything, since they were the ones who suggested it, that would be a study.

And then we will also contact WSPPA and industry folks and see if they would like to participate and tell us more about their views on transparency.

MS. WARD: And we do have a public comment coming up, as well, just one gentleman on the WebEx.

COMMISSIONER SCOTT: Before we go to public comment, when you're done wrapping up what we want to do for the next meeting, I just want --

CHAIR BORENSTEIN: I think we're done.

COMMISSIONER SCOTT: Okay.

CHAIR BORENSTEIN: I yield to Commissioner Scott.

COMMISSIONER SCOTT: All right, thank you. So, this is Commissioner Janea Scott.

I just wanted to go back to the original question that you had asked about the product. It doesn't necessarily need to be a report. I can be a white paper, it can be a letter, it could be a presentation. I mean, a report may make sense because there's some things that you probably want to discuss in a little bit of detail. But I just wanted to make sure that that was clear.

And it should be, you all are the advisory committee to the Energy Commission, so it should be a report or a document to the Energy Commission.

And I've had the privilege of being part of all of the conversations, and the discussions, and listening to the experts, but the other Commissioners have not. And so, one recommendation I would make is maybe -- you know, and I don't know that you need to spend too much time on what you put together, but characterizing kind of the conversation. And it started with looking at the Southern California and why the prices were higher there, and providing a little bit of color and information there for the Commissioners, in the report.

And I think, also, you are considering taking a few of the solutions -- or not solutions, but the potential policies off the list. I would suggest maybe just a short paragraph, it doesn’t have to be a lot, but just so that the Commissioners will understand sort of the full range of everything that you considered, even if it’s not something that you want to dig into or give us additional information.

So, those are a couple of thoughts I had based on this afternoon’s conversation.

CHAIR BORENSTEIN: Thank you. Yes, and I will rely heavily on the staff to help us with that.

Okay, so did you say there is a public comment, Courtney?

MS. WARD: Yeah, we’re just going to unmute this person and start the three-minute timer.

CHAIR BORENSTEIN: Go for it.

MR. COURT: Well, it’s Jamie Court. Thank you all, first. I mean, for looking into transparency. And we will definitely provide some information.

I just wanted to make one comment. You know, Southern California really is the place where this shook our market. I mean, I went by a station in Beverly Hills that was $3.80, yesterday.

And I don’t want to inconvenience anyone, but I do want to make the suggestion that perhaps, if not at the next meeting, which I think would be great, transparency would be a great subject, but to maybe do a meeting in Torrance, near the Exxon Refinery or somewhere in L.A. You know, so the drivers down here are really paying the lion’s share of the extra ten billion this year could feel like, you know, there is a State discussion.

And so I just would maybe put on your thought list whether you’d be willing to come to Southern California this time or next time to have this discussion, and to bring the debate down here.

So thank you for everything, for listening today, and all your deliberations, and everything you’ve been doing on this.

CHAIR BORENSTEIN: Okay, I’m going to

just say for the record the constraint on that is CEC funding. While the Committee members operate, have been donating their time, and Dave Hackett has been nice enough to donate his transportation, the rest of the Committee aren't that excited about flying down to L.A. on their own dime. And so far, the funding has not been there.

So, but we will take that under advisement. I can certainly see the point of it.

And we have another comment?

MS. WARD: Yes, Ostop, on the WebEx.

CHAIR BORENSTEIN: Okay, we have another comment. Commenter, go ahead.

MS. WARD: We can't hear you.

CHAIR BORENSTEIN: Hello?

MS. WARD: I'm not sure if I'm pronouncing your name correct, but Ostop, we cannot hear you. It looks like he disconnected.

CHAIR BORENSTEIN: Okay, in that case I think we are going to adjourn, if I don't hear any other comments.

Okay, then we are adjourned and we will be in touch to set up the next meeting, which will focus on transparency. Thank you.

(Whereupon, at 2:53 p.m., the meeting was adjourned.)

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