DOCKETED

Docket Number:	15-PMAC-01
Project Title:	Petroleum Market Advisory Committee
TN #:	212817
Document Title:	Presentation - Comments on potential California gasoline price policy levers
Description:	Presentation by the Wood Mackenzie at the August 16, 2016 Petroleum Market Advisory Committee Meeting.
Filer:	Ryan Eggers
Organization:	Wood Mackenzie
Submitter Role:	Public
Submission Date:	8/17/2016 8:53:23 AM
Docketed Date:	8/17/2016

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Comments on potential California gasoline price policy levers

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August 2016

State of California already has a number of policy levers to address rapidly rising prices

- **CARB can grant a variance to an applicant unable to produce compliant fuel for reasons beyond the variance seeker's reasonable control**
  - » Maximum duration of 120 days duration, with possible extension up to 90 additional days
  - » Limits the volume of variance fuel sold
  - » Alternate fuel would pay a penalty of 15 cents per gallon, in advance of being sold
- **California has a vast program for responding to emergencies**
  - » Once an emergency has been declared, price increases for many goods and services – including gasoline and other motor fuels – are capped at 10%
  - » Supervised by the California Governor's Office of Emergency Services
  - » Applies to federal, state and local emergencies of all kinds
- **Little history of any of these provisions being used and none were during the Torrance refinery outage**

New policy would need to address gaps in existing regulations during non-normal market conditions

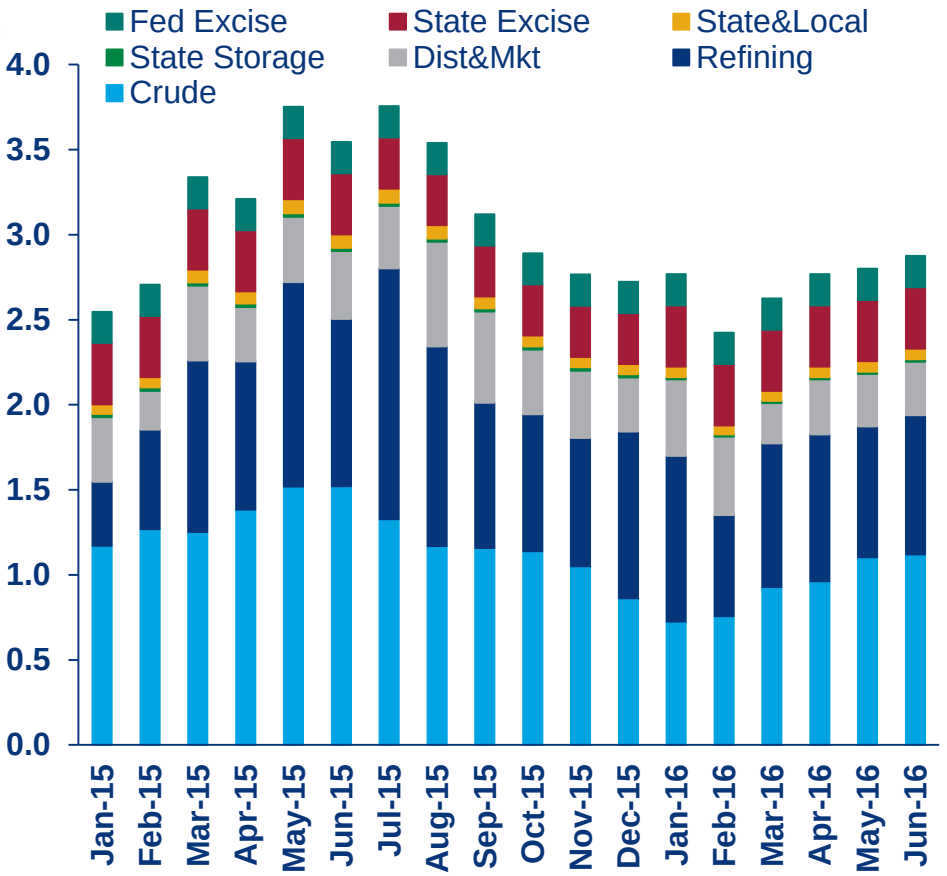
- **There have been a number of policy levers suggested, including these, over the years**
  - WSPA made a good faith effort to look at these suggestions in the current market
  - There continue to be a number of unanswered questions and unintended consequences that would need to be addressed
- **Policy cohesiveness raises questions, such as:**
  - How would adding another market intervention policy reduce price escalation or volatility?
  - Which agency chooses to implement which policy?
  - What criteria is used to pick a market intervention?
  - What criteria is used for that selection?
  - What are the unintended consequences of different agencies triggering different policies at the same time?
- **WSPA continues to conclude these market intervention ideas are not good policy**

Broadly speaking, any new policy needs to address a number of issues and concerns

- **No company intentionally upsets a refinery because of the cost of repair and the lost margin (ex-upset) opportunity**
- **Policy would be proactive actions to a reactive event, leading to questions such as:**
  - What caused this price increase?
  - What price increase threshold triggers a policy?
  - Which components of gasoline price formation are impacted in this event?
  - Which policy levers address the impacted components?
  - How is triggering a relief policy determined?
  - Which government agency determines which policy is implemented?
- **Following are additional comments specific to each potential lever**

Price pressure relief valve: non-CARB gasoline to be sold with a surcharge paid to the state

California gasoline prices ($/gallon)



Source: California Energy Commission, Wood Mackenzie

- Each component to determine gasoline prices is a potential driver for a price run-up. In the Spring of 2015, price increase drivers were:
  - » Rising crude oil prices (20%)
  - » Higher operating costs, e.g., natural gas (15%)
  - » These drivers impacted California gasoline prices ($0.35/gal) independent of the accident at Torrance
- Would the surcharge be considered a tax or a fee?
- Which agency would receive the surcharge funds?
- Would a $0.35/gal increase in gasoline prices trigger a non-CARB price relief valve (with a $0.25/gal surcharge)?
- Triggering a non-CARB with price surcharge could have unintended consequence of exacerbating a local refinery supply decrease
  - » For example, a logistics bottleneck would not be relieved by more volume
  - » Surcharge could have a negative impact on refining economics and thus supply

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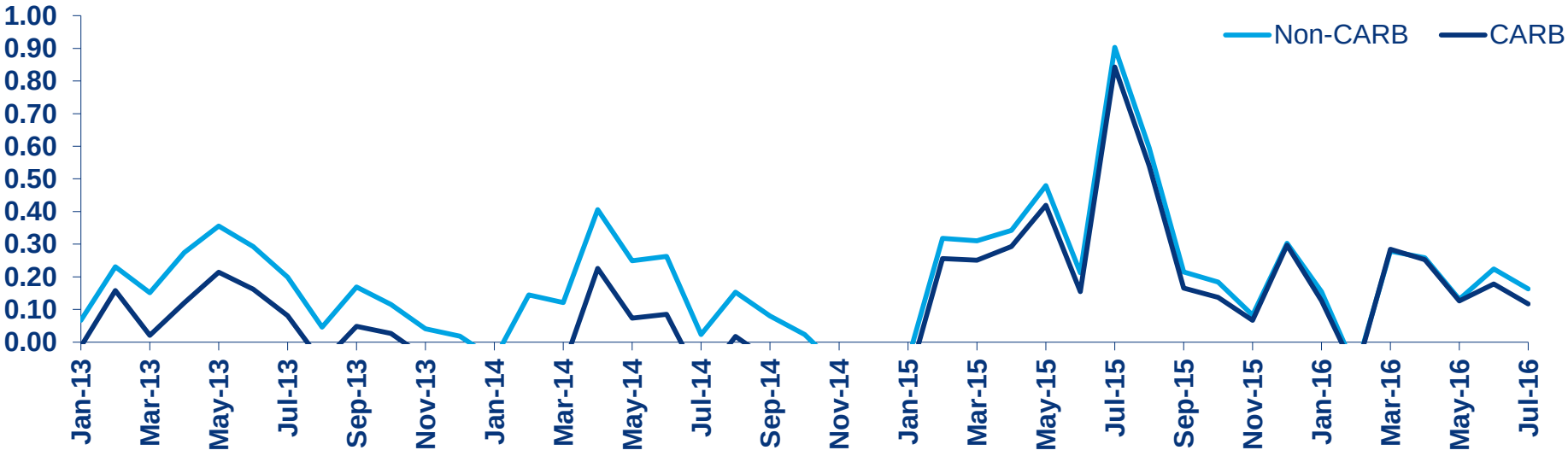
A surcharge on non-CARB gasoline would not necessary open the import window more often

California gasoline import window ($/gallon)



Source: EIA; Wood Mackenzie

- Non-CARB surcharge opens the import window only 20%
- Would the trigger be automatic or require a regulatory decision?
- If a government decision is the trigger, what is the criteria and timing to make a decision?
- Which agency would hold the authority?
- How would this surcharge be coordinated with other policy levers?
- Potential infrastructure to encourage imports would be inbound (marine) logistics. California is essentially balanced under normal conditions so much of the incremental infrastructure assets could be stranded outside of interruptions

Inventory requirement floor – could be relaxed to release more supply to the market

- Where along the supply chain would the inventory be required to be held?
  - » Blend stocks at the refinery?
  - » CARBOB at the wholesale terminal?
  - » Finished gasoline at the rack (including an inventory requirement for certified ethanol)?
- How would the rate of inventory drawdown be determined?
- How long would the seller have to rebuild required inventory after the market rebalances?
- Would imports in transit be considered part of the inventory obligation?
- How to determine if structurally higher gasoline prices (from taking volume off the market) is a cost-efficient insurance premium for mitigating potential future price increases?
- How would be the working capital cost tied up by the inventory floor be handled?
- What would be the tax treatment of the operating cost of holding the required inventory?

- Potential infrastructure issues from adding additional storage capacity
  - » Location – the farther down the supply chain inventory must be held, the more locations
  - » Footprint – large tanks in a centralized location or smaller (and more) sites
  - » Regulatory approval of sites

Forward purchase of gasoline by State of California to reduce import price window risk

- How much impact on price if the forward contract volume is less than the refining disruption?
- How does the State fund program operating costs (e.g., storage, working capital, hedging, G&A) of rolling contracts?
- How does the State diversity contracts across suppliers?
- How does the State allocate volumes across California?

- Potential infrastructure constraint could be inbound logistics
  - » Would the ratable flow from rolling contracts provide sufficient support in off-loading storage?
  - » Would there be sufficient volume commitment for a pipeline from Nevada or Arizona?

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- Skip holds a PhD Economics from the University of Virginia, as well as a Masters of Science and Bachelor of Science also in Economics from the University of Wyoming.

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