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WSPA Comments on Nov 28 SB X1-2 Margin Cap and Penalty Workshop Docket #23-OIIP-01

Please see attached letter.

Additional submitted attachment is included below.

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December 12, 2023

California Energy Commission
Docket Unit, MS-4
Docket No. 23-OIIP-01
715 P Street
Sacramento, California 95814

Uploaded/E-mailed to docket@energy.ca.gov

RE: WSPA Comments on SB X1-2 Workshop on Maximum Gross Gasoline Refining Margin and Penalty [Docket #23-OIIP-01]

Thank you for the opportunity to comment on the California Energy Commission's (CEC) November 28, 2023, workshop to "explore potentially establishing" a maximum gross gasoline refining margin and penalty per Senate Bill (SB) X1-2 (2023). The statute is clear that the CEC *shall not* set a margin cap or penalty *unless* it finds that the likely benefits to consumers outweigh the potential costs to consumers and will "not lead to a greater imbalance between supply and demand" nor "lead to higher average prices at the pump on an annual basis."[1] We urge the CEC to do its due diligence – including determining the multiple factors that have long contributed to supply and pricing issues in California, and assessing whether a cap would exacerbate problems for consumers, the market, and California itself. We believe it would.

The Western States Petroleum Association (WSPA) is a non-profit trade association representing companies that import and export, explore, produce, refine, transport and market petroleum, petroleum products, natural gas, and other energy supplies in California. These comments are based on WSPA's review of the materials and statements at the workshop, and we reserve the right to amend these comments or add to the docket as necessary to reflect additional materials or changes in the CEC's decisions.

In responding to comments made and information presented at the November 28 workshop, this letter: (1) reiterates requirements in place to prevent disclosure of market-sensitive information and explains why refiners did not appear individually; (2) provides historical context for the CEC's decisions about whether or not to impose a penalty; (3) provides an overview of a literature review of the economic and policy impacts of regulatory intervention on fuel prices; and (4) responds to stakeholder roundtable questions from the workshop. WSPA would be happy to provide any further information or context that the CEC requests to answer the important questions it faces.

ONGOING NECESSITY FOR THE CEC AND INDIVIDUAL COMPANIES TO PROTECT COMPETITIVELY SENSITIVE INFORMATION

California law has long recognized the critical need to prevent public disclosure of business information that is required to be reported to the State, but which could cause adverse effects to market competition or harm to businesses if disclosed. The State Legislature strongly reaffirmed this principle in SB X1-2, which specifically addresses the confidential treatment, aggregation, or

[1] Cal. Pub. Res. Code ("PRC") § 25355.5(e)

anonymization of information if public disclosure of that information would: 1) “result in unfair competitive disadvantage to the person supplying the information;” or 2) “adversely affect market competition.”[2] Moreover, SB X1-2 amended and further strengthened the confidentiality provisions of California’s Petroleum Industry Information Reporting Act of 1980 (“PIIRA”) to provide that information submitted to the CEC pursuant to SB X1-2 “shall be held in confidence by the commission or aggregated to the extent necessary to ensure confidentiality if public disclosure of the specific information or data would result in unfair competitive disadvantage to the person supplying the information or would adversely affect market conditions.”[3]

Other provisions of SB X1-2 presume the confidentiality and prohibit the public disclosure of information regarding transportation fuel sales prices and contracts (including gasoline prices charged by retailers by location and gasoline grade),[4] related “business affairs and trade secrets” provided to the state in preparation of annual gasoline price reports,[5] and refineries’ maintenance and turnaround planning.[6] Still other provisions presume the confidentiality and prohibit the public disclosure of matters regarding crude oil transport and require aggregation of any such information publicly disclosed “to the extent necessary to ensure confidentiality if public disclosure of the specific information or data would result in unfair competitive disadvantage to the person supplying the information or would adversely affect market competition.”[7] Such information, if publicly disclosed in an unaggregated format, could be misused by a business’ competitors to harm the business, and could lead to adverse anticompetitive impacts in that market sector generally.

Accordingly, both Federal and State law recognize that certain information is inherently sensitive and should be protected from public disclosure. This information includes, for example, any price, cost, output, or strategic information that is likely to be confidential in nature and, therefore, a competitive concern. There are also multiple safeguards in place – not only PIIRA and the relevant provisions of SB X1-2, but also various other Federal and State antitrust and competition rules – to protect this sensitive information and to prevent anticompetitive practices. Release of such information could harm an individual company, a competitive market, and ultimately, California consumers.

There is, therefore, little that an individual refiner could share about how it might react to a CEC penalty without risking harm to market competition. Competition in the refining sector is critical to providing high quality transportation fuels at the lowest possible prices, and each refiner has a different strategy for how to compete. When it comes to pricing, for example, costs to acquire crude oil, transport it, produce gasoline, and then distribute and market it throughout California depend on the unique business circumstances of each individual company and thus are not uniform. The respective California markets each company chooses to serve similarly have unique facts and circumstances. This is in part why individual companies have their own sensitivities and tendencies when competing for consumers, who have choices in this market (unlike, for example, their regulated electric service provider – which operates as a monopoly). This dynamic means that each refiner has a unique and competitively sensitive market strategy

[2] Pub. Resources Code §§ 25354(f)(2), 25355.7(c), 25364(b), and 25372.4(a); *see also id.* §§ 25355(c), 25371.2, and 25372.4(c) (requiring aggregation of data gathered or reported by the CEC); *id.* §§ 25354(n)(1) and uncodified Sections 11 and 12 of SBX1-2 (declaring information submitted to the CEC exempt from the Public Records Act and Article I, Section 3 of the California Constitution)

[3] Pub. Res. Code § 25364(b). Elaborate procedures to prevent the disclosure of unaggregated information are set forth in subsections (c) through (i).

[4] Pub. Res. Code § 25355.7.

[5] *Id.*

[6] Pub. Res. Code § 25354(n)(1).

[7] Pub. Res. Code § 25354(f)(2).

that it cannot discuss in public without some risk of anticompetitive harm. It is better for the competitiveness of the market (and, in turn, for consumers) for industry participants to speak through WSPA about matters that affect all refiners in common.

In addition, individual WSPA members have their own reasons to avoid discussing potentially market-sensitive information in a public setting, including at this most recent CEC workshop. Because release of any business confidential or trade secret information can hurt a company's business position and diminish any earned advantage over competitors, nearly all companies will take pains to preserve the confidentiality of that information. That is why PIIRA provides protection for refiners when they turn over this type of information to the CEC.

Knowledgeable about this context, the CEC understands that the release of competitively sensitive information could damage a company if it were to be disclosed, and therefore must provide protection as outlined in State and Federal laws. CEC Executive Director Drew Bohan recognized this during the workshop, noting "…the industry is opaque, partly by design, because we don't want industry players to know what their competitors are doing, because that could have a negative impact on prices."[8]

Even broad statements that refiners might be asked to make at a public event like the November 28 workshop could have the effect of summarizing, analyzing, and disclosing the vast amount of confidential information that they turn over to the CEC on a daily, weekly, monthly, and yearly basis under PIIRA, and would risk both competitive disadvantage and harms to the market. As the CEC continues to collect an enormous amount of information from WSPA members, any public disclosure of that information, including in summary format in response to questions posed at public meetings such as this workshop, could result in an unfair competitive disadvantage to the member supplying the information and to adversely affect market competition, contrary to the mandate of SB X1-2.

Accordingly, while refiners will of course cooperate with any CEC regulatory process to the extent doing so will not result in a competitive disadvantage or market harm, they will opt to participate through WSPA where necessary to avoid being placed in such a position.

A HISTORICAL CONTEXT WORTH REPEATING

WSPA has written in the past to address the causes of price spikes and the history of the refining industry in California, but this context is critical background for the CEC before it makes any decision in this matter and is accordingly worth repeating here. In particular, WSPA previously detailed why California has become a "fuel island," with policies intended to reduce the State's supply and consumption of fossil fuels – even as these fuels remain in high demand.[9] As a result, there are strong *dis*incentives for companies to make long-term investments necessary to maintain California's current level of refining capacity. The State is now – by design[10,11,12,13] – unable to supply all its own gasoline to meet consumer demand,

[8] CEC Event Recording, November 28, 2023, at 09:07 mark
[9] Western States Petroleum Association Comments on Transportation Fuels Assessment Report Workshop filed September 11, 2023 at https://efiling.energy.ca.gov/GetDocument.aspx?tn=252218&DocumentContentId=87224
[10] https://www.gov.ca.gov/2020/09/23/governor-newsom-announces-california-will-phase-out-gasoline-powered-cars-drastically-reduce-demand-for-fossil-fuel-in-californias-fight-against-climate-change/
[11] AB 1279 (2022) at https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220AB1279
[12] CARB 2022 Scoping Plan Update at https://ww2.arb.ca.gov/our-work/programs/ab-32-climate-change-scoping-plan/2022-scoping-plan-documents
[13] CEC Draft 2023 Integrated Energy Policy Report at https://www.energy.ca.gov/data-reports/reports/integrated-energy-policy-report/2023-integrated-energy-policy-report

which in turn increases costs for California consumers due to the need to import increasing amounts of gasoline from out-of-State and foreign markets.

Multiple CEC Integrated Energy Policy Reports (IEPR) over the past two decades predicted that California would have an increasingly difficult time avoiding market volatility due to the pressures of diminished local supply in the face of continued strong consumer demand. The CEC forecasted elevated gasoline costs to consumers in the 2003/2004 IEPR, given that fuel prices are driven by these larger market forces of supply and demand. It continued with the 2005 IEPR, which specifically noted that, "California's petroleum infrastructure operates at near capacity. Breakdowns and outages at in-State refinery and pipeline facilities quickly tighten gasoline and diesel fuel supplies and create market volatility. Since California is not directly connected by pipeline to other domestic refining centers, in-State refiners cannot readily procure gasoline, diesel, and other blending components when outages do occur. This contributes to higher and more prolonged price spikes." The 2009 IEPR further recognized the constraints additional imports would place on California's transportation fuels system: "Reliance on foreign oil imports increasingly puts the state's fuel supply at risk, not only because of security and reliability concerns, but also because the marine ports are not expanding to meet expected growth in demand...The Energy Commission forecasts that crude oil imports will continue to increase, requiring expansion of the existing crude oil import infrastructure. This infrastructure is critical in ensuring a continued supply of feedstocks to enable refiners to operate their facilities and maintain a reliable supply of fuel for California and neighboring states."

Given these conclusions, the CEC has made several recommendations towards improving and expanding petroleum infrastructure and facilitating the permitting process for nearly two decades. Unfortunately, little has been done; instead, California has actively sought to make it *more difficult* to domestically source, produce, and transport gasoline to California consumers, resulting in the need for greater and greater imports of refined transportation fuel from outside California (and the increased emissions and climate impacts that come with forcing more imports of refined product). The growing costs of the multitude of California's policies and programs are further compounded by multiple layers of Federal, regional, and local regulations; these add costs and impact a fragile, volatile, and constrained California fuels market.

It is in this context that CEC is now asked to consider the wisdom of margin limits, price controls and other measures that will have the effect of further limiting local supply of transportation fuels in California, thus worsening the existing disparities between market demand and local supply capacity.

ENERGY PRICE CONTROLS HAVE BEEN TRIED BEFORE – AND FAILED

In preparation for this workshop, and this Informational Proceeding more generally, WSPA commissioned Catalyst Environmental Solutions ("Catalyst") to conduct a comprehensive literature review on price controls in energy markets. This information is relevant to the CEC's careful consideration of whether attempting to determine price controls at the wholesale, spot, or retail levels would benefit or harm consumers. The Catalyst broad literature review includes the economic and policy impacts of regulatory intervention on fuel prices both in the oil and gas markets globally, and most specifically within the United States.

The annotated bibliography with a brief policy analysis and summary of the literature was previously submitted to the CEC[14] and contained several key findings we highlight here:

- Federal market interventions in the 1970's and 1980's, especially under the "Crude Oil Profit Tax Act of 1980" (Public Law No. 96-223), were ultimately ineffective in lowering consumer prices.
- Excise taxes aimed at capturing "excess profits" have had the opposite effect: creating artificial constraints in supply, often resulting in higher prices for consumers.
- Price setting laws and regulations in Hawaii and elsewhere in the United States, as well as experiments in windfall profit caps in the United Kingdom, have resulted in increases in demand for foreign crude and refiner products. One study on Hawaii's price cap, found that their formula may lead to higher prices in some situations, potentially led to gas shortages, and decreased future investment.[15]
- Retail price controls (i.e., price setting at the pump) or spot market price controls are usually out of sync with global crude markets, resulting in hedging and other strategies that increase consumer costs.

It is worth noting, upon reviewing the literature contained in the Catalyst report, that Federal "price gouging" laws have previously been proposed in Congress, but have never passed. One key concern that stymied the passage of these proposals in past Congresses has been that any Federal regulation of energy prices could have the unintended effect of reducing competition, promoting dependence on foreign oil, and preventing the private market from operating efficiently. Indeed, the effect of the 1978 United States crude oil price controls was monopolization of U.S. crude oil producers, increased dependence on imported oil, and the subsidization of domestic consumption. The Crude Oil Windfall Profit Tax Act of 1980 was an excise tax on oil produced domestically; it was found that such taxes increased marginal production costs, resulting in reduced output and higher prices. The global fluctuation in crude prices was not easily accounted for in Great Britain's price cap formula – nor did the gas cap lower the price of retail gasoline for consumers.

Another concern for California, should the CEC seek to impose margin limits on transportation fuels, is that margin limits can result in the degradation of a reliable supply of gasoline. Investment supports a diverse infrastructure needed to be resilient and manage distribution under a variety of supply challenges due to geopolitics, weather, or unplanned maintenance.

Fortunately, SB X1-2 requires the CEC to gather real-world evidence on whether a cap on refinery margins could have unintended consequences that would harm California consumers. The law provides that the CEC "*shall not* set a maximum gross gasoline refining margin or accompanying penalty . . . *unless* it finds that the likely benefits to consumers outweigh the potential costs," considering factors such as whether action would lead to a greater supply and demand imbalance in California's fuels market or lead to higher pump prices."[16] No analysis can be adequate and accurate unless the CEC looks at *all* variables impacting the market, including land use decisions, the lack of permitting, and regulatory actions. The CEC will not be in a position to make a well-informed decision, supported by a meaningful and fair analysis, without considering and analyzing these variables.

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[14] "Western States Petroleum Association Comments - literature review on Energy Price Controls" filed November 27, 2023: https://efiling.energy.ca.gov/GetDocument.aspx?tn=253336&DocumentContentId=88551

[15] See Catalyst report at Brown, M., Rewey, C., & Gagliano, T. (2003). Findings on Hawaii Gasoline Prices and Policies. Honolulu: NCSL Energy Program. Retrieved October 2023, from https://energy.hawaii.gov/wpcontent/uploads/2011/10/HIGasPricesPolicies_2003.pdf

[16] PRC Section 25355.5(l) (emphasis added)

WSPA RESPONSES TO STAKEHOLDER ROUNDTABLE QUESTIONS

"Do the benefits to consumers outweigh the costs?"

The CEC cannot answer this question without first evaluating the potential impacts and any unintended consequences of adopting a gross gasoline refining margin cap. Only with this information can CEC then assess, based on actual market evidence, whether a margin cap will do anything to address the fundamental underlying market reasons for rising prices in California: i.e., ongoing market volatility due to diminishing supply capacity in a market accompanied by very strong demand. A cap that only further *constricts* local fuel supply capacity is no benefit to California consumers at all.

Yet it was troubling to hear indications by some State policymakers at the workshop that instituting a margin cap/penalty was seemingly a foregone conclusion – despite a number of variables suggesting less-than-full consideration of all necessary information, including a mere three months of data reported. These policymakers and some stakeholders seemed to show little interest in actually gathering the facts, or in giving the CEC a fair chance to consider those facts. In fact, the CEC's ongoing information gathering efforts are happening concurrently with a significant new CEC staffing effort, and a recently adopted and ongoing rulemaking to seek clarification of and consistency with the reported data that would underpin such a determination. Also, the CEC does not yet have the benefit of the yet to be released Transportation Fuels Assessment or Transportation Fuels Transition Study, and the vast majority of members of the Independent Consumer Fuels Advisory Committee have not even been appointed to opine on these critical issues. Indeed, implementing a penalty before the CEC takes these steps runs counter to what some of these same policymakers previously stated publicly: that the CEC's new authority is significant in nature (as it has been touted as a first-in-the-nation regulation), that the question itself is very complicated, that the CEC enters the process earnestly and would seek to tour all of California's refineries to better understand these complex issues, and that decisions must be made thoughtfully and in a transparent manner – which requires the CEC to be objective.

As outlined above, price caps have been tried before. They have failed, and resulted in net harm to consumers and the transportation fuel sector. Imposing margin limits, while simultaneously trying to lower prices *and* expecting the industry to comply with increasingly stringent regulations (which cost money and resources to implement), results in conflicting and often contradictory outcomes: *i.e.*, a lack of incentive to continue investing in California's energy infrastructure, degrading service quality, a more inefficient market, supply issues coupled with a greater dependence on foreign oil, and higher costs to comply.

In addition to the fact that margin and price limits have been demonstrated not to work, the CEC must seriously consider the troubling precedent it would set outside the utility context by attempting to replace market supply and demand with price setting by government fiat.

"What is the likely impact on gasoline supply?"

As discussed above, chronic structural fuel-supply obstacles that cause price volatility today remains unaddressed in California. Some of these supply constraints at work – even prior to instituting any first-in-the-nation regulation capping refinery margins – include the following:

1) Most refineries outside of California *do not* produce fuels that meet the State's strict gasoline specifications, leaving a very restricted set of suppliers who can supplement in-State refining

capacity. As will be discussed in more detail later, natural geography isolates and disconnects the West Coast from other supply centers – which adds both time and cost for out-of-State products.

2) California has become increasingly dependent on the global crude oil market and imported crude oils – which present efficiency and utilization challenges for in-State refineries.
3) California continues to enact and implement policies that do not promote greater availability of transportation fuels for Californians and that discourage capital investments in new infrastructure. WSPA previously noted that there is already an artificially expedited, downward trend on California's own crude oil supply. The California Air Resource Board (CARB) assumed an approximately 3% annual production decline in the 2022 Scoping Plan Update,[17] CalGEM data has shown an approximately 10-15% decline depending on the data set used.[18]

In his remarks at the workshop, Dr. Matthew Zaragoza-Watkins noted that a margin cap would be effective only if refiners have capacity to increase production.[19] If refiners "don't have an opportunity to increase output in response to a penalty, then…***prices will still be high for transportation fuel in California***." As he observed, California's refinery utilization is lower than in other parts of the nation. He did not, however, include the critically important description of *why* this is the case nor *how* refinery utilization was being defined. Without this explanation, only a partial picture of the current situation is presented.

Understanding the reasons for lower utilization of California's refineries is a key point. Some of California's remaining refineries were designed to process *California crude oil*. The declining availability of *California crude oil* means that some in-State refiners are not able to run as efficiently as they were designed to; where some units in a refinery will be overworked others will be under-utilized. WSPA also notes that refinery utilization itself is a metric that can easily be misunderstood. Capacity can change depending on the crude type. It can also change with a reduction in hydrofiner capacity space necessary to produce renewables. To ensure consistency in terminology and meaning, it is important to cite the data being referenced. The federal Energy Information Administration uses data about the number and capacity of petroleum refineries;[20] this standardized data shows a lower utilization rate, though similar on average since 2011 data in Petroleum Administration for Defense Districts (PADD) 5.[21] It is important to ensure we are collectively referencing the same terminology and data sets with a common understanding.

a. **Dwindling California Crude Oil Supply Can Lead to Some Under-utilized California Refineries**. For a variety of reasons, crude production has declined significantly in California in recent years, as outlined above. This decline is largely due to statutory, regulatory, and permitting issues, both for in-State oil producers and for the pipelines that deliver that oil to refineries. Producers depend on the pipelines to deliver their product, and the pipelines depend on sufficient crude supply to maintain their operations. Thus, limitations in one part of the system may affect the entire supply chain. For example, the new "setback rule" (SB 1137, 2022) is expected to cause further shutdowns of in-State crude production. This may,

[17] CARB. 2022 Scoping Plan for Achieving Carbon Neutrality, Page 103. Available at: https://ww2.arb.ca.gov/sites/default/files/2023-04/2022-sp.pdf. Accessed: August 2023.
[18] California Department of Conservation, WellSTAR monthly production data reports, 2018-2023, https://www.conservation.ca.gov/calgem/Online_Data/Pages/WellSTAR-Data-Dashboard.aspx
[19] See Event Recording at 50:00 mark, emphasis added, at https://www.energy.ca.gov/event/workshop/2023-11/sb-x1-2-workshop-maximum-gross-gasoline-refining-margin-and-penalty
[20] https://www.eia.gov/dnav/pet/PET_PNP_CAP1_DCU_SCA_A.htm
[21] https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=W_NA_YUP_R50_PER&f=W

in turn, lead to operational challenges for some pipelines. As in-State production continues to dwindle, and pipeline infrastructure continues to age, these issues may compound and lead to the further loss of local supplies.

To offset the loss of local crude supplies, some California refiners increasingly rely on imports of *foreign crudes*. However, the chemical composition of these foreign crude imports is different than *California's local crudes* – which some California's refineries *are designed to run on*. ***Because of these chemical compositional differences, it is not possible to operate some California refineries at the same utilization rates with foreign crudes.*** The chemical composition mismatch exacerbates this issue. While the refineries could be reconfigured to optimize for processing foreign crudes, this would require significant capital investments – at a time when the State is actively seeking to shut down the refining industry.[22] CARB specifically noted in its 2022 Scoping Plan Update that, "[a]n assessment of ongoing progress and efforts to reduce demand for petroleum fuels and of opportunities to phase down oil and gas extraction and refining will be included in the next Scoping Plan update."

The relationship between crude composition and refinery throughput rates is complex, but it is a major factor in the underutilization of some California's refinery assets and therefore must be considered in the economic analysis. Because refineries have a rating that is based on the maximum crude throughput they can physically handle (and sometime this is based on permitted local/regional limits), when crude oil is processed with a different composition, some portions of the refinery will be "maxed out" while other portions of the refinery will not be. Therefore, the overall crude processing rate is less than the rated volume. When a portion of the refinery is under-utilized, it may be able to be loaded with refinery intermediate feedstocks. However, to do this optimally requires a flexible pipeline/waterborne delivery system for the refinery to receive the feedstocks; and, as discussed below, infrastructure constraints may limit availability of these feedstocks as well.

Moreover, it must be noted that California crudes have a cost advantage over crudes imported from overseas. The delivery of crudes from around the world comes with a high transportation cost (and, incidentally, a higher carbon footprint) relative to locally produced crudes. Thus, artificial constraints on California crude add directly to the price Californians pay at the pump. Any accounting for the cost of California gasoline would be incomplete unless this factor is considered.

b. **Waterborne Access and Other Logistical Asset Constraints Lead to Underutilized Refineries.** The CEC noted in March 2020 "[t]he only way for California to receive large amounts of crude and refined products is by marine."[23] Refineries rely on waterborne vessel and barge movements for an increasing proportion of their crude feedstock and movements of finished products. However, access to docks is limited, due to physical limitations and regulatory constraints and permitting issues. In some cases, the size of cargoes may be limited due to tankage limitations adjacent to the dock – and permitting for new or expanded tank capacity is difficult, if not impossible, to obtain in California.

[22] California Air Resources Board's 2022 Scoping Plan Update, at pages 74, 87, 100-01, 106; https://ww2.arb.ca.gov/sites/default/files/2023-04/2022-sp.pdf
[23] CEC, March 2020. Petroleum Watch: How Petroleum Products Move. https://www.energy.ca.gov/sites/default/files/2020-03/March_2020_Petroleum_Watch.pdf

There is increased need for additional dock access in part due to shifting feedstock and product demand within the State. The increased demand for foreign crudes is one obvious example. Another is the need to export diesel; it is impossible to produce gasoline at a refinery without also producing a certain amount of diesel. However, much of the diesel demand in the State has been displaced by renewables, so diesel exports must be increased to maintain sufficient gasoline supplies. Limitations on dock availability may place constraints on the ability to move materials in and out of a refinery, in turn constraining its ability to produce at maximum rates.

A complex balancing act is required to optimize California's refinery operations while also accounting for limitations of the surrounding logistical assets including tank storage, pipelines, and dock access. Under some circumstances, a refinery may be forced to operate under otherwise suboptimum conditions due to limited availability of dock space or tank storage. In other words, inadequate infrastructure leads to underutilized refineries. Therefore, an analysis of refinery utilization must account for these factors. Particularly when comparing California's refinery utilization to that of other states, it is essential to account for the relative inadequacy of refining logistics assets in California (versus other states), and how that inadequacy affects the ability of California refineries to run at optimum rates.

These are significant constraints on California's refining sector which limit its ability to increase gasoline output. We urge the CEC to consider these constraints in its analysis, including the concerns raised by WSPA's Catherine Reheis-Boyd in the stakeholder roundtable discussion. These constraints are a fundamental and well-documented reason for higher gas prices in California, and the reason a margin cap would be ineffective (and could in fact exacerbate the issue) in providing relief to California's gasoline consumers. The most effective way for the State to moderate gas prices is by addressing these concerns directly.

Resupplying California's market has increasingly been, and remains, difficult. This will likely only worsen as new, more restrictive State policies take effect or are pending approvals. For example, because CARB's new At-Berth Regulation will soon require all tankers to utilize emissions control technology that has not yet been implemented in practice, many existing tankers may not be able to meet the Regulation's requirements by the first compliance deadline of January 1, 2025. If these tankers are prohibited from calling on California ports and terminals, the overall result will be to limit the number of calls and/or the availability of tankers that can call on California's ports beginning in 2025 – the very same facilities that will need to absorb the delivery of increasing imports due to artificially constrained in-State production and refining policies. In addition, WSPA previously shared concerns with the CEC's other effort under SB X1-2, to change refinery maintenance/turnaround schedules based on market dynamics instead of existing safety standards, which could constrict fuel supply and create serious health and safety concerns.[24] These market and policy dynamics that constrain California's fuel supply are all already occurring – before the CEC even seeks to establish a first-in-the-nation gross gasoline refining margin cap and penalty.

The West Coast is increasingly reliant on gasoline imports. This is especially due to planned and unplanned refinery maintenance, an increasingly constrained infrastructure supply system, and refinery conversions to renewable facilities. When refiners have advance awareness of a supply disruption, they can mitigate the effects on consumers. For example, when refiners

[24] Western States Petroleum Association Comments on November 3 SB X1-2 Pre-Rulemaking Workshop; filed November 21, 2023 at https://efiling.energy.ca.gov/GetDocument.aspx?tn=253283&DocumentContentId=88484

schedule maintenance in advance, they can import finished gasolines (i.e., CARBOB) or gasoline components (e.g., alkylate) from other refineries along the West Coast.

Finally, under the margin cap proposed in SB X1-2, the motivation for capital investments would be further dampened. The literature cited elsewhere in this comment letter makes it clear: imposing limits on a free-market system leads to underinvestment, which ultimately leads to diminished supply. By design, the margin cap ensures refiners' future profits are less than they otherwise would be. In an environment where refiners' future prospects are limited by fiat, there is a diminished rationale for making the long-term investments so badly needed to maintain and improve infrastructure and indeed the refineries themselves. The margin cap therefore creates a risk that the supply/demand imbalance will worsen over time.

"What is the likely impact on the price at the pump?"

Passage of SB X1-2 indicates that State policy leaders are increasingly concerned about the affordability of gasoline in California; a concern WSPA has long shared. Yet the documented facts and expert analyses show that affordability concerns have consistently been related to the ongoing influences of diminishing local supply capacity in the face of steady or increasing consumer demand. The CEC's own IEPR predicted elevated gasoline costs to consumers dating back 20 years based on the same considerations we have outlined above – *i.e.*, that fuel prices are driven by larger market forces of supply and demand. Due to these factors, and the relative inelasticity of Californians' demand for gasoline, even relatively small disruptions in supply can have large impacts on fuel costs for California consumers. The 2005 IEPR specifically noted that, "California's petroleum infrastructure operates at near capacity. Breakdowns and outages at in-State refinery and pipeline facilities quickly tighten gasoline and diesel fuel supplies and create market volatility. Since California is not directly connected by pipeline to other domestic refining centers, in-State refiners cannot readily procure gasoline, diesel, and other blending components when outages do occur. This contributes to higher and more prolonged price spikes." Natural geographic boundaries (i.e., the Pacific Ocean and the Rocky Mountains) isolate the West Coast and make the import of refined petroleum products more expensive, so disruptions in supply can have an outsized impact in California compared with other states. But WSPA members and their refineries cannot change these geographic realities.

Adding to the impact of California's unique geography on gasoline prices is the fact that the State has enacted policies in the last 20 years that have caused consumers to become increasingly dependent on a global commodity market that WSPA members do not and cannot control.

"What other factors should the CEC consider?"

In order to comprehensively understand supply and pricing issues for gasoline in California, the CEC should also compare California's market with other domestic markets – such as the Gulf Coast – while taking into account the unique aspects of the California market, including, but not limited to, logistical constraints and the unique regulatory environment. Gulf Coast refiners produce gasoline in accordance with the United States Environmental Protection Agency (EPA) standards, which protect environmental and consumer safety. But refiners can produce EPA-compliant gasoline more efficiently and cheaply without having to comply with California's regulations required for CARBOB production. Additionally, this EPA-compliant gasoline is easier to produce, easier to transport by pipeline to the rest of the United States, and has the major

advantage of being fungible across a much larger market. The CEC should consider these differences between the California and Gulf Coast markets as factors explaining California's higher gasoline prices:

1) The West Coast refineries represent 13% of U.S. refining runs while having 16% of gasoline demand, whereas, the Gulf Coast has 55% of refining capacity with 15% of U.S. gasoline demand.
2) The Gulf Coast has incentivized and enabled significant capital investments in its energy infrastructure, enabling increased crude production and refining capacity, whereas, California has disincentivized such investments.
3) The Gulf Coast markets are also home to more producing, midstream, refining, marketing, and retail companies compared to California, which enables increased competition and efficient, flexible markets to supply the lowest-cost gasoline to its consumers; in comparison, California has imposed burdensome and complex legislation that has made operating current businesses and investing in new businesses difficult for new entrants and market participants, stifling further competition and causing unintended consequences that could further eliminate existing businesses. Fifteen years of environmental policies explicitly targeting the hydrocarbon industry have brought California to where it is today, as it has devalued energy security in favor of ever more aggressive climate goals.
4) In addition, the CEC must consider the continued motivation for investment into California's gasoline production infrastructure. There is an investment dilemma that oil companies have when reviewing the cracked spread, a metric used to help monitor gross refining margin potential, from the West Coast versus the Gulf Coast. Since 2020, the 5-3-2 cracked spread comparison between these coasts, there is no longer a West Coast premium. This shows it is even more important for California to help define a more certain regulatory environment to be more competitive as a place to do business as investors are looking to safeguard investments from risk.

A comparison of fuel costs – and indeed refinery utilization rates – between these two regions is incomplete unless all the above factors are properly accounted for.

WSPA has also submitted additional information from HSB Solomon Associates LLC for the CEC's consideration.[25] The key takeaways identified in their report:

1) That California refiners have faced growing operating cost pressures since 2000;
2) That California refiners' margins (gross and net) have eroded since 2000 due to increasing crude prices and increasing operating cost pressures; and
3) That, since crude is a global commodity, replacing California crude increases costs.

WSPA previously urged[26] the CEC to consider fundamental fuels market issues, including: (1) how a gross refining margin would impact petroleum cost or statewide supply; (2) what precedent the CEC would set as a government entity attempting to determine the "allowable" income for California businesses; (3) why the State government should determine the "appropriate" profit (or loss) for privately-owned companies in just one industry singled out by the government; (4) what specific factors the CEC would consider in even attempting to set such a level; (5) how to determine what percentage of a refiner's income it would be required to pay to the State; and (6) what financial support the CEC would offer to facilities operating at a loss (as California has already done for the electric industry with respect to power plants).

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[25] Western States Petroleum Association Comments – Solomon Report: California Refiners' Cost and Margin Analysis, 2000-2002 filed November 27, 2023 at https://efiling.energy.ca.gov/GetDocument.aspx?tn=253316&DocumentContentId=88543
[26] Western States Petroleum Association Comments – WSPA Comments on SB 2 Implementation filed May 30, 2023 at https://efiling.energy.ca.gov/GetDocument.aspx?tn=250404&DocumentContentId=85146

We continue to be concerned that use of SB X1-2 and SB 1322 (2022) data collected to date would be misleading. This data cannot be reasonably relied upon to establish a maximum gross refining margin and penalty without first addressing the inconsistencies and ambiguities in the statute itself and through the completion of a formal rulemaking, as we have previously explained and requested.[27,28,29,30] It is evident from the CEC's posting of public data that there are widely varied and inconsistent interpretations of statutory text and of informal CEC guidance offered to date. The importance of needing accurate data was repeatedly raised during the workshop – including by Division of Petroleum Market Oversight Director Tai Milder,[31] who proceeded to ask CEC-invited panelist Dr. Matthew Zaragoza-Watkins to expand upon "why it's critical to have accurate data" towards setting any penalty – indicating that a "firm may leave the market if the penalty is set at the wrong level."[32] Dr. Zaragoza-Watkins' response was, "…fundamentally, the reason it's important to have accurate data is because you want to understand the incentives the firms face."[33] He later underscored that the importance around data about costs that are necessary to support the continued operation of the refining industry and that those costs are covered.[34] It would be unfair to assess any penalty on gross margins that fails to account for operation costs.

"Why is what the refineries report to CEC in the 1322 form different than what is reported to the SEC? This is even more evident when you look at companies that only have California refineries. Do diesel and jet fuel production really make a difference in net margins?"

Just as we have noted in our prior letters, WSPA continues to strongly believe that a formal rulemaking process is necessary to ensure clarity, consistency, and accuracy for both the CEC staff and all regulated entities in interpreting, implementing, and properly complying with SB X1-2 (including SB 1322). At the outset, WSPA seeks clarification as to what the CEC is referring to by "SEC filings." Based on comments made during the workshop, it appears that the CEC might be referring to quarterly press releases and *not* materials filed with the U.S. Securities Exchange Commission (SEC). In some quarterly press releases, one can find non-Generally Accepted Accounting Principles (GAAP) measures, such as gross margin detail for refineries, whereas in a SEC filing, companies generally provide a GAAP-consolidated gross margin for all refining operations.

More broadly, some of the key distinctions between data reported in the CEC's M1322 form and SEC filings are that:

1) The CEC's M1322 form calls for the calculation of something that does not exist: a gross gasoline refining margin. It improperly focuses on one product, but that is not how refineries operate or report data. Refineries purchase and produce *slates of products*. The SEC filings include profit or margin numbers for *all* products – not just gasoline.

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[27] WSPA Petition for Formal Rulemaking Regarding SB 1322 Implementation filed January 6, 2023
[28] WSPA Request for Reconsideration of WSPA Petition for SB 1322 Rulemaking and Stay of Penalties filed February 15, 2023
[29] WSPA Petition for Formal Rulemaking filed May 11, 2023
[30] Western States Petroleum Association Comments – Request for SB X1-2 Data Reporting Clarifications, filed June 8, 2023
[31] CEC SB X1-2 Workshop on Maximum Gross Gasoline Refining Margin and Penalty, November 28, 2023, Event Recording, at 00:53:40 mark, https://energy.zoom.us/rec/play/wU2L-vR2hfe2L4R8Fl1toxwaE5V63sjiRGlb8edbI5u3Sy9o14VJhxW3EEUl9JxoNiJbkNxU4jXVCb9G.jsolS8uIU0HN-ueJ?canPlayFromShare=true&from=share_recording_detail&startTime=1701191019000&componentName=rec-play&originRequestUrl=https%3A%2F%2Fenergy.zoom.us%2Frec%2Fshare%2FuXIrCUuIYKe0C2uVD-1oA104IYqFYS_22ajzZnIWxY5GR0aIA5IpVCweJZUtpCGm.ZS35oDRJ1t5n6vo8%3FstartTime%3D1701191019000
[32] CEC Event Recording, November 28, 2023, at 00:54:02 mark
[33] CEC Event Recording, November 28, 2023, at 00:54:15 mark
[34] CEC Event Recording, November 28, 2023, at 01:11:52 mark

2) SEC filings usually follow GAAP or some other appropriate accounting methodology for calculating profit or margin, where the CEC's M1322 form does not. Companies may apply GAAP differently to their margin calculations. For example, some companies record turnaround costs as expenses when incurred, which impacts margin, while others may opt to capitalize such costs, which impact costs vs. depreciation over time.
3) SEC filings are usually based on *quarterly or annual periods*, where the CEC's M1322 form calls for *monthly* data.
4) The geographic, location, and/or commodity split detail might also be different for SEC reports; for example, these could include operations *outside of California* in some cases, where the CEC's M1322 form focuses *solely* on California operations.
5) Each company's segment reporting to the SEC may differ. For example, some companies combine refining and market results in the same segment while other companies may account for the results of these distinct businesses in separate segments.
6) In SEC reporting, companies define measures that are intended to be most comparable to industry benchmarks, such as realized refining margin and realized marketing margin. These measures are defined by each company and may be defined differently between companies. The measures "gross margin," "net margin," and "realized margin," for example, may be defined differently at each company and differently from the CEC's definitions.

It is otherwise difficult to comment on the specific sub-set of this question without being able to review data cited and how data figures are being calculated.

"Today you saw some scoping around the max margin and the penalty and an introduction to energy markets. How are refineries avoiding manipulating the market? With over 5 companies producing more than 90%, how can we ensure that price fixing is not occurring?"

The transportation fuel refining industry, like all other major industries in the United States free market, is bound by and adheres to strict antitrust laws. Refineries do not "manipulate the market" and do not engage in "price fixing," and decades of real-world research have confirmed this over and over again.

Gasoline markets are amongst the most highly scrutinized and regulated in the world. California's gasoline industry has been subject to multiple investigations by different Attorney Generals. No evidence of price fixing or any anticompetitive conduct by refiners has ever been found. Yet certain California policymakers continue to promote the false claim that high fuel prices in California are somehow being caused by "market manipulation."

We urge CEC to reject that false claim. With so few refiners left in California, the State should be actively working to help keep those that are left – operating under the strictest regulatory environment in the world – to meet our ongoing energy demands in the world's third largest fuels market.

Further, in April 2019, the CEC undertook a study of "the causes of the increased differential between national and California gasoline prices" from 2015 forward. After studying the issue for five months, the CEC released its final report on October 21, 2019. The report found that, while refiner margins had some "short term" spikes, due primarily to refinery outages (e.g., the extraordinary impact of the 2015 Torrance outage), refiner margins "do not account for the sustained price elevation seen over the past five years." The CEC explained that, except for the short-term "outage-driven spikes, there has been little to no growth in the difference between

the United States and California refiner margin" – i.e., that refiner margins in California are consistent with those in the rest of the United States – such that it was "*ruling out refinery price margins as the cause of the residual price increase*."[35]

Indeed, at the workshop, the CEC made clear that the "penalty" being considered as part of a margin cap is ***not linked to any evidence of market manipulation whatsoever***. CEC Executive Director Drew Bohan also made clear at the workshop "that one thing that the penalty is ***not*** meant to be [is] a punishment for conduct that is already criminal"[36] (e.g., price fixing)…and that "the penalty we're talking about today is not about illegal behavior." He also noted that, "***We are not suggesting that as the staff of the Energy Commission today, we don't have clear evidence that something like [market manipulation] is happening***."[37] WSPA submits that, in the absence of any evidence to substantiate fears of improper market manipulation – the ***very*** fears that prompted consideration of a margin cap in the first place – the CEC should decline to impose a margin cap and reject unsubstantiated claims of manipulation as both misplaced and improper.

"The industry says that the transition is going to bring volatility to the market. How do we protect affected communities from the downsides of this volatility and transition?"

To be clear, SB X1-2 is not the appropriate means to address an energy transition. There are numerous other California laws, regulations, and policies in place to address various components of an energy transition. The legislative intent of SB X1-2 was clear in including provisions regarding data collection and monitoring requirements from across the petroleum sector; refinery maintenance; the authority to be able to establish a refining margin cap and penalty ***if*** certain conditions are met; establishing an Independent Consumer Fuels Advisory Committee, an independent new oversight division, and three distinct near-term reports – on gas prices, an assessment to identify methods to ensure a reliable supply of affordable and safe transportation fuels in California, which will then inform a Transportation Fuels Transition Plan with CARB. Any discussion regarding how to use a margin cap or penalty to shift away from fossil fuels would be misplaced and improper. Director Tai Milder specifically noted at the workshop that the CEC's singular mandate here is "how do we protect the consumers."[38]

WSPA is concerned that increasing *market volatility*, as noted above, will affect all Californians. Ensuring the availability of an affordable, abundant, and reliable quantity of transportation fuels is a central tenet of SB X1-2, and what this Commission is tasked with achieving. We have urged the State to incorporate more robust cost containment mechanisms in California's policies, especially as they result in increasingly higher costs for consumers. This could include affordability guard rails to protect low- and moderate-income Californians, supply-based guard rails to address unforeseen implementation or manufacturing challenges, and infrastructure guard rails to address reliability impacts (e.g., due to ongoing permitting challenges).

With regard to *air quality* issues and the protection of affected communities, WSPA urges the State to better fund and support the Community Air Protection Program developed in response to Assembly Bill (AB) 617 (2017). As a member of the AB 617 Consultation Group since the program's inception, WSPA is deeply committed to the protection and reduction of exposure in

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[35] Additional Analysis on Gasoline Prices in California, CEC, October 2019 (emphasis added) https://www.energy.ca.gov/sites/default/files/2019-11/Gas_Price_Report.pdf
[36] CEC Event Recording, November 28, 2023, at 07:55 mark (emphasis added)
[37] CEC Event Recording, November 28, 2023, at 10:13 mark (emphasis added)
[38] CEC Event Recording, November 28, 2023, at 55:37 mark

communities most impacted by air pollution. These communities are also likely to be vulnerable to the unintended consequences or growing pains associated with this transition. Many of WSPA's members and staff live and work in affected communities and we remain committed to finding solutions that result in real emission reductions and thriving communities; a well-funded and robust AB 617 Program provides the framework for those efforts.

California has made tremendous progress in addressing air quality issues. The State has the nation's cleanest-burning gasoline, regulates increasingly stringent engine standards, has incorporated liquid fuels under the world-recognized Cap-and-Trade program, and is soon set to further increase the carbon intensity (CI) targets for transportation fuels under the Low Carbon Fuel Standard (LCFS). However, this ongoing and nation-leading pursuit of innovative policies to reduce greenhouse gas emissions does come at a cost. For example, CARB recently noted in its "Standardized Regulatory Impact Assessment" for the 2023 LCFS amendments,[39] that the estimated pass-through cost for gasoline to California consumers would increase from $0.12 per gallon in 2024 to $0.47 per gallon in 2025 due to a "near-term step-down in CI benchmark stringency in 2025." Next year, CARB is also expected to finalize amendments to further strengthen the Cap-and-Trade program, anticipated to become effective on January 1, 2025. Recent independent modeling commissioned by CARB demonstrated there that "most of the alternative scenarios yield prices that follow the price ceiling through at least 2035" with Cap-and-Trade program prices reaching the "price ceiling" in all four alternative scenarios by 2030.[40] (For reference, the 2023 price ceiling is $81.50;[41] the auction settlement prices have increased from $12.10 in the first auction held in 2014 to $38.73 at the 37th auction held most recently on November 15, 2023.[42]) Also on January 1, 2025, CARB's Ocean-Going At-Berth Regulation will newly apply to tanker vessels visiting the Ports of Los Angeles or Long Beach.[43]

With these (and other) compounding regulatory requirements – all of which come at a cost – WSPA is concerned about imposing an unproven margin cap and penalty on refiners. It is extremely hard to imagine how such a policy would make matters better for California consumers – especially low- and middle-income consumers who can least afford and are highly dependent on an abundant, affordable, and reliable supply of transportation fuels for their everyday lives.

"California is the third largest gas market in the world after the United States and China. Would refineries leave the state if a max margin was imposed, and if so, why?"

WSPA does not know how each refinery would respond, but a margin cap in any industry – including this one – would undoubtedly make it more difficult for market participants to continue operations and to continue to justify investment of capital in their California assets.

Stakeholders are correct to recognize that a maximum margin under SB X1-2 could have dramatic impacts on the continued viability of California's refining market. The gross gasoline refining margin dramatically undercounts fuel costs and excludes operational costs altogether.

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[39] CARB LCFS SRIA, Table 22, at https://dof.ca.gov/wp-content/uploads/sites/352/2023/09/LCFS-SRIA-to-DOF-ADA-Compliant.pdf
[40] CARB/Quebec Joint Cap-and-Trade Program Workshop, November 16, 2023, at slides 34-45, "Modeled Prices Under Different Scenarios" at https://ww2.arb.ca.gov/sites/default/files/2023-11/nc-combinedSlides_Nov162023.pdf
[41] https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/cost-containment-information/price-ceiling-information
[42] https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/program-data/cap-and-trade-program-data-dashboard
[43] CARB FAQ, revised November 8, 2023, at Page 10, https://ww2.arb.ca.gov/sites/default/files/2023-11/Updated%20At%20Berth%20FAQ%20ADA.pdf

That means that even if the CEC allows refiners to make a positive gross margin, it could still be imposing a negative *net* margin – i.e., preventing refiners from operating at a profit, at least for parts of the year. This could, in turn, force refiners to choose between producing gasoline at a loss and exiting the market altogether.

Compounding this problem, a SB X1-2 penalty would force refiners to engage in a high-stakes guessing game: refiners would be forced to try to adjust their prices *in real time* so that their *monthly* gross refining margins would remain below any maximum imposed by the CEC. And although refiners purchase crude oil weeks in advance of using it, they draw on different sources of oil throughout the month based on availability, need, and chemistry – making monthly acquisition costs impossible to reliably predict in advance (i.e., what prices will be later in the month). This, again, places refiners in a position to choose. They can try to adjust their prices to bring their margins below the maximum – but risk violating any CEC-imposed cap if they guess wrong about the future of wholesale prices or acquisition costs. Or, they can set prices so far below what is required to comply with any maximum margin that it would no longer make economic sense to refine in California. Either option would jeopardize the transportation fuels markets and give rise to serious constitutional concerns.

Imposing a gross gasoline refining margin would thus likely run counter to meeting the ongoing demand of Californians for their energy needs for the foreseeable future. The CEC should seriously consider what could happen to California's already-volatile fuels market if another refiner decides to leave the State, with no one willing to take their place given the ever-increasing burden imposed upon in-State refineries, including the extremely challenging regulatory environment they are required to operate in. It is also important to recognize that strict regulations and eroding profit margins have *already* forced many refiners to shut down their operations in, and leave, California.

We fully recognize that managing volatility in the world's third largest fuels market will not be easy. Nor will it be easy or inexpensive to significantly upgrade and dramatically expand California's electric grid to accommodate the anticipated electrification of the transportation (and building) sectors – especially in underserved areas. It is therefore equally important that the State closely evaluate what investments must be made in both systems to meet the diverse energy demands of all Californians, as well as steps that can be taken to facilitate a more expedient permit review process to enable these necessary investments. This includes ensuring that the remaining refineries can operate safely, efficiently, and profitably to ensure their continued in-State presence.

Imposing a gross gasoline refining margin would be counter to meeting the ongoing demand of Californians for decades into the future.

"Is the current gasoline market structure appropriate for California with OPIS essentially setting the spot price?"

This question rests on the disputable premise that the Oil Price Information Service (OPIS) "sets" the spot market price. OPIS collects information about spot trades and then, using a publicly available formula, calculates and reports a daily price assessment. WSPA does not presume to speak on OPIS' behalf about its price assessment, and questions about its methodology would be more appropriately directed to OPIS itself.

CONCLUSION
WSPA appreciates the opportunity to provide you with our comments on these issues of critical importance not only to us, but to all California citizens who rely on affordable and reliable sources of transportation fuel every single day. At the same time, we are concerned that – aside from proposing a staff recommendation on the margin cap and penalty by "Late 2024" – the CEC has not provided the public any specific timeline for further workshops, hearings or other opportunities for public input. We believe the stakeholders and the public are always better served with a full accounting of the anticipated timeline for debating major changes to CEC regulations, and are provided enough time to fairly weigh and discuss the facts relevant to those proposed changes. As stated above, the overwhelming evidence gathered by the CEC and other independent researchers over the past few decades demonstrates that market forces, and not illegal market manipulation, have been and continue to be responsible for chronic pressures on fuels supply and market prices. Basic concepts of due process require CEC to allow for sufficient time in this proceeding to properly consider that evidence.

Thank you for considering our comments. We look forward to working with the CEC to provide ongoing input and to ensure that all market-sensitive, confidential, and proprietary data is well-protected. Please do not hesitate to contact me at with any questions.

Sincerely,

Sophie Ellinghouse
Vice President, General Counsel & Corporate Secretary