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Additional submitted attachment is included below.

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April 25, 2024

By Email

California Energy Commission
Docket Unit
Docket No. 23-OIIP-01
715 P Street, MS-4
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Re: Comment on April 11, 2024, SB X1-2 Maximum Gross Gasoline Refining Margin and Penalty Structure Workshop

Dear All,

Idemitsu Apollo Corporation ("Idemitsu") appreciates the opportunity to continue to work with the California Energy Commission ("CEC") to further CEC's goals of (1) increased transparency, (2) decreased price spikes, and (3) increased liquidity in the liquid transportation fuel marketplace. Idemitsu is a fuel reselling company located in Sacramento, California that buys and sells products, primarily to jobbers and independent gas stations. Resellers like Idemitsu benefit consumers by providing an alternative to refinery-direct sales, bringing additional competition to the market and ensuring that independent, non-branded gasoline retailers have ample supply.

Idemitsu was happy to participate in the April 11 workshop and believes the results of that workshop demonstrate that a maximum gross gasoline refining margin and penalty will harm consumers more than it will benefit them. As evident from CEC's presentations, its own paid consultants, and comments provided to CEC on the spot market transaction reporting requirements, there are many reasons why margin caps would harm consumers, including, (1) refining margins and penalties cannot reduce costs to the consumer when refineries are constrained in production capacity, and (2) imports will not be able to supplement refinery capacity as CEC's muddled regulation of the spot market has already contributed to a substantial decline in imports of gasoline to the State. Although the comments from CEC's paid consultants lead only to the conclusion that CEC should not implement margin caps, comments from other participants suggest that CEC is considering implementing caps nonetheless.[1] Accordingly, Idemitsu offers the following comments in response to the April 11th workshop. Given the

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[1] Vice Chair Gunda noted in his remarks that CEC "is really kind of beginning to put our foot on the gas pedal here to [ ] really move forward on making sure the penalty lands this year."

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substantial complexity and far-reaching implications of the proposed caps, Idemitsu strongly urges CEC to fully consider all aspects of the issue, and to fully involve the public, by speaking with industry participants and carefully considering all forthcoming comments in an open and transparent manner. Otherwise, California may find itself dealing with a failed market regulation that only *increases* consumer costs, as evidenced by Hawaii's short-lived price cap experiment in the early 2000s.

Meaningful Stakeholder Participation Requires Transparency

From a procedural standpoint, Idemitsu, again, urges CEC to provide stakeholders with the opportunity to meaningfully participate in the rulemaking process. That means providing the information the agency is considering in its rulemaking efforts well in advance of public workshops and comment deadlines.[2] It is only with that information that stakeholders can make their voices heard. Waiting until the last moment to open the doors to the rulemaking process only silences all stakeholders.

Here, while the information presented during the April 11th workshop on the SB X1-2 Maximum Gross Gasoline Refining Margin and Penalty was valuable to hear, CEC did not provide that information to the public until *after* the public workshop. Moreover, CEC still has not provided the technical data and reports underlying the analyses set forth in the presentation materials. As a result, Idemitsu (like all other stakeholders) could not adequately prepare for the workshop and is hamstrung in providing comments now. CEC's comments regarding public participation reveal that CEC wants to hear from the public, but its actions suggest otherwise. Idemitsu respectfully requests that CEC take the actions necessary to ensure meaningful public participation.

The topic of margin caps is a good example of why a full, open, and collaborative process is so important. Globally, the fuel market is multifaceted and exists in a delicate ecosystem. Various factors, including supply chain dynamics, geopolitical tensions, changing regulatory frameworks, and many others, intersect to influence price and supply. California's unique market presents further challenges. This is because the gasoline sold in California is not generic and abundant. Instead, California-grade gasoline is scarce and difficult to produce because of strict environmental regulations and formulation requirements. As a result, factors that impact the global market are magnified in California. The prospect of margin caps adds an overarching factor that may well throw off the delicate equilibrium. One potential result of this may be, for example, the cessation of imports into California. This will only reduce supply and increase

[2] Walking into the workshop blind, stakeholders are not able to engage meaningfully in the discussion and are left to resort to general comments which undoubtedly are less helpful to CEC. For example, DPMO's Chief Economist Dr. Gigi Moreno discussed that there were a number of different ways to model "excess" refiner margins that are highly dependent on an assumed margin "benchmark." Without understanding what CEC's "benchmark" is, or *could be*, it is difficult for stakeholders to provide meaningful insight on how a margin cap may impact consumers or the industry.

price. From the workshop presentation, it is unclear whether CEC has considered the complex factors that influence California's gas prices. Indeed, as discussed below, the workshop speakers indicated CEC has *not* considered critical factors like refining capacity. Idemitsu strongly encourages CEC to make public all of the information the agency is considering, to invite industry participants to discuss these important issues, and to carefully consider all comments.

Dr. Moreno's Model Relies on Increased Supply, But Refining Margins Will Not Increase Supply Because Refinery Output Is Already Constrained

A central part of the workshop was a presentation by DPMO's Chief Economist Dr. Gigi Moreno. In her presentation, Dr. Moreno outlined a model for margin caps to lower prices at the pump. However, Dr. Moreno's presentation only served to highlight a major pitfall to the potential use of margin caps – the need for increased capacity. Because California lacks the prospect of increased refining capacity or countervailing imports, Dr. Moreno's model is flawed and consumers will face *higher* prices at the pump if a margin cap and penalty are introduced.

Dr. Moreno began her presentation by explaining that a maximum gross refining margin and penalty does not dictate price, but rather "provides incentive to increase output, [and] *if capacity is available* . . . decreases price." Thus, a key part of the analysis is whether excess capacity is available. Put another way, supply still dictates price. As Dr. Moreno made clear, when capacity is not available, "you have a situation where the policy looks more like a price cap within the refining sector" where "what's going to happen is that you could potentially increase price at the retail end of the market." Dr. Moreno's testimony thus presents a fundamental factual question – do California refineries have excess capacity? The answer is "no."

To quote Mr. Tom O'Connor's presentation, refiners are "running as hard as they can." The implication of this comment is that refiners do not have excess capacity, and the public record (including relatively recent closings of two important refineries) bears this out. As a result, imposing a maximum gross gasoline refining margin and penalty in California will not incentivize refiners to increase supply for the simple reason that they do not have additional capacity to do so. Instead, as Dr. Moreno mentioned, the margin cap will operate as a price cap on gasoline. This will hurt consumers because price caps mean less competition, supply shortages, and increased prices at the pump.

Imports May Help Supplement Refinery Output, But CEC's Extensive Regulation of the Spot Market Has Disincentivized Imports

While fuel imports may have been able to help supplement refining capacity, CEC's regulations are *decreasing* imports and will exacerbate the margin cap problem. In her testimony, Dr. Moreno suggested that fuel imports *may* help supplement refinery output. Notably, however, she conceded she has not evaluated if and how this would occur in practice and conceded there would be a "need to also consider the additional pollution that we create by

shipping fuel." And, in practice, it is clear that CEC's regulations are decreasing imports. For example, Idemitsu understands there was a 25% reduction in imports for the month of March.

In light of Dr. Moreno's testimony, CEC cannot ignore the impact of imports—both how imports affect the market price and the environmental impacts of increased imports—when imposing a maximum gross gasoline refining margin and penalty.[3] And nonetheless, CEC has made it much harder to import gasoline under its new regulatory regime. That is, the first set of emergency rules promulgated by CEC under SB X1-2 require extensive spot market transaction reporting. As discussed in various written comments submitted to CEC, these requirements are unclear, duplicative, and in some respects impossible to comply with. These regulations, accordingly, impose a burden that has and will continue to disincentive imports of gasoline to the State.

Presentations from Hackett and O'Connor Highlight Concerns with Margin Caps

In addition to Dr. Moreno, Messrs. Hackett and O'Connor also demonstrated why margin caps will not reduce the price at the pump. CEC should heed this testimony too and decline to set margin caps.

In his presentation, Mr. Hackett described why consumers "might be worse off" with a maximum gross gasoline refining margin. He noted that refiners will not violate the margin but will instead move their margins to the maximum, "leav[ing] prices up close to the maximum level." He explained this would result in the State effectively controlling gasoline prices, which will incentivize market participants to charge as much as the government will allow, instead of charging what the market demands. Mr. Hackett also suggested that spot market transparency alone will significantly limit any sort of market manipulation CEC may be concerned with.

Mr. O'Connor undercut a fundamental assumption in Dr. Moreno's theory. As noted above in connection with Dr. Moreno's testimony, a key component of margin caps is the possibility of expanded capacity. Mr. O'Connor explained that refinery output in California lacks capacity to expand. Mr. O'Connor further explained that, in response to the State's transition to electric vehicles, CARB has forecasted the state will constrict capacity, first by reducing its reliance on imports, then by reducing refining capacity. That trend bodes ill for consumers at the pump, because as Dr. Moreno testified, a margin cap and penalty without the potential for increased supply is a price cap in all but name. Such a price cap would, as discussed above, result in decreased competition, shortages, and increased prices at the pump.

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[3] It is worth noting that CEC has not indicated whether it will perform a California Environmental Quality Act ("CEQA") analysis before imposing a gross gasoline refining margin or rely on its original Notice of Exemption from February 2024. Much like how there are environmental impacts inherent to moving fuel across long distances with imports, a gross gasoline refining margin raises significant potential environmental impacts.

<u>Hawaii's Experience Shows Margin Caps Do Not Work</u>

California's margin-cap proposal is not the first time a state has attempted to control prices of gasoline. Hawaii's experiment ended in failure, and all signs point to the same result in California.

In 2005, the State of Hawaii established maximum pre-tax wholesale prices for gasoline sold in the state. In support of this effort, the Hawaii legislature made various findings of fact, including that "the major oil companies have been realizing profit margins far in excess of the margins realized in other oligopolistic and equally concentrated markets." Ha. Rev. Stat. Ch. 486H (2002). But once implemented, consumer costs only went up, not down. This was, in part, because supplier prices rose to the maximum allowed under the price cap. Associated Press, "Hawaii Gives Up on Gas Price Controls," NBC News, May 8, 2006.

In a report to the legislature, the Hawaii Department of Business, Economic Development and Tourism found the law cost consumers as much as $54.9 million in a *five-month span* between September 2005 and January 2006.[4] Melissa Pavlicek, "Another Perspective – Gas Cap Has Been Costly for Consumers," Honolulu Star, Mar. 26, 2006. That is approximately $11 million dollars a month out of the pockets of consumers. After just eight months, in May 2006, Hawaii's Governor Linda Lingle suspended the program, noting that the program was a "failed experiment to artificially control gas prices." Greg Wiles, "Hawaii Gas Prices Above 'Cap' Level of Suspended Law: Governor Not Planning to Revive Regulation Suspended since 2006," The Honolulu Advertiser, Jan. 27, 2010.

Idemitsu is concerned that California is ultimately headed down the same path.

Hawaii's legislature had similar goals to CEC when it passed a price cap on gasoline. Indeed, Dr. Moreno's explanation as to why a maximum gross gasoline refining margin and penalty might be necessary was eerily similar to the legislative findings behind Hawaii's 2005 law. Dr. Moreno began her presentation by noting that the California gasoline refining industry should be regulated because it is "imperfectly competitive," or in other words "oligopolistic." She went on to posit that the "Mystery Gasoline Surcharge"—a phenomenon wherein California gasoline prices have persistently exceeded prices from other states after 2015 when controlling for market-specific regulatory differences—is attributable to excess profit margins among refiners. That is, both Hawaii and CEC were trying to address the same concerns.

And a closer look at the gross gasoline refining margin and penalty indicates CEC is intent on solving those problems the same way. As discussed above, Dr. Moreno explained that a maximum gross gasoline refining margin is effectively a price cap on gasoline when gasoline supply and refiner capacity are constrained like they are in California. CEC has the benefit of

[4] Adjusted for inflation, this would be more than $85 million in 2024 dollars.

hindsight and should capitalize on it and avoid imposing a maximum gross gasoline refining margin and penalty.

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Thank you for your consideration of these comments. Idemitsu is committed to working with CEC to minimize disruptions to the California transportation fuels market to the benefit of California consumers.

Regards,

Maureen F. Gorsen
Partner