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June 29, 2022

Anthony Rendon, Speaker of the Assembly
California State Assembly
1021 O Street, Suite 8330
Sacramento, California 94249-0115

Honorable Speaker Rendon and Signatories:

Thank you for the letter dated June 16, 2022, signed by you and many Members of the California State Assembly. The California Energy Commission (CEC) shares your concern about the impact of gas prices on the people of California. The CEC hopes that the information provided here in response to your questions will be helpful as you seek answers regarding gasoline pricing in California and long-term solutions through meaningful legislation.

As California's energy policy and planning agency, the CEC gathers data and provides analysis related to the gasoline market. Periodically, the CEC conducts in-depth examinations of significant gasoline price spikes including observations and recommendations such as the Additional Analysis on Gasoline Prices in California, published in October 2019, or public meeting presentations, like the Petroleum Market Advisory Committee proceedings.

The CEC also supports emergency responses related to fuels in coordination with the Office of Emergency Services to help ensure an adequate supply of transportation fuels for first responders and other critical needs. The CEC serves as a central source of credible and timely information on statewide energy or transportation fuels emergency impacts. The CEC works to mitigate potential adverse impacts of an energy emergency by providing the Governor, Legislature, state agencies, local government, and policymakers with accurate and timely information for decision-making.

The following are responses to the questions in your June 16 letter.

Does it serve California to have just a few companies control 95 percent of the oil that is refined for our gas? How do we ensure that collusion and price manipulation is not present?

The CEC prepared the *Additional Analysis on Gasoline Prices in California* report, referenced above, in October 2019, at the request of Governor Newsom.

The report presented an explanation of factors around the higher fuel costs in California. Our analysis found that all California retailers increased retail margins above the national average. The CEC noted that the primary cause of the residual price increases in retail gasoline is simply that California's retail gasoline outlets are charging higher prices than those in other states.

The price of gasoline in California is unregulated and companies can charge prices based on what consumers are willing to pay. However, it is unlawful for market participants to fix prices or employ false advertising practices.

The CEC concluded that additional investigation was necessary to determine whether either occurred and suggested that the California Department of Justice may be best equipped to investigate possible price fixing or false advertising.

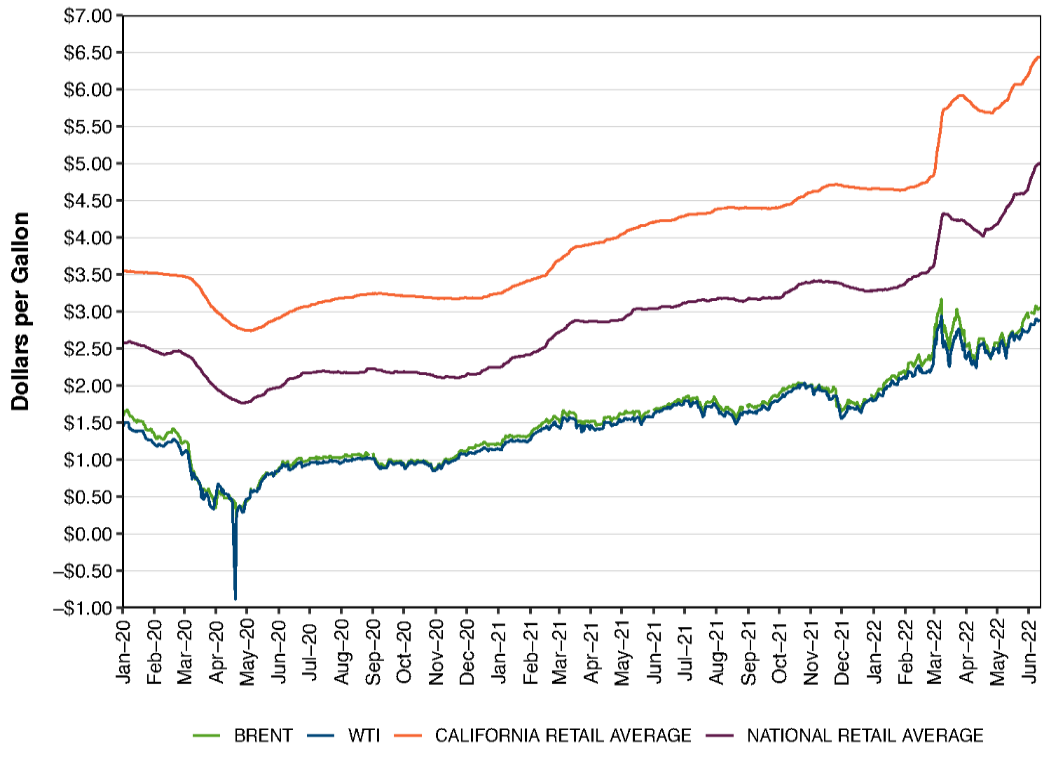
Why did we see gas prices rise both when crude oil prices rose and when crude oil prices fell?

Several factors affect gasoline prices, including crude oil costs, refinery costs and profits, distribution costs, marketing costs, and profits.

The cost of gasoline is unregulated and companies can charge prices based on what the market will bear. However, as noted, if competitors fix prices or employ false advertising practices, this may be unlawful and further examination is warranted.

Retail gasoline prices are heavily influenced by changes in the cost of crude oil. Figure 1 illustrates this consistent relationship between the price of crude and the price of gasoline at the pump.

Figure 1. California and U.S. Oil and Gasoline Prices



Data Source: CEC analysis of Energy Information Administration (EIA) and Oil Pricing and Information Services (OPIS) data

While prices at the pump can quickly rise in correlation to higher crude oil prices, as retail fuel stations adjust to the higher costs of gasoline and increased delivery fees, declines are not experienced similarly due to other factors affecting the price of gasoline. For example, a significant unplanned refinery outage in California's isolated gasoline market can quickly cause gasoline price spikes, outweighing the effect of declining crude prices.

Economists have found that retail gasoline prices increase at a similar rate compared to wholesale cost increases during gasoline price spikes, yet decline at a slower rate when wholesale prices decline, due to a concept known as *asymmetric pass-through*. Mathew Chesnes from the Federal Trade Commission's Bureau of Economics published *Asymmetric Pass-Through in U.S. Gasoline Prices*, which provides an extensive analysis on this topic.

A recent report from the Federal Reserve Bank of Dallas offered two possible explanations:

- "The asymmetry of the response of retail gasoline prices need not be evidence of price gouging. One potential explanation is that *station* *operators are recapturing margins lost during the upswing*, when gas stations were initially slow to increase pump prices."

- "Another possible reason for this asymmetry is consumers' tendency to more intensively search for lower pump prices as gasoline prices rise than when they decline. This diminished search effort provides further pricing power to gas stations, causing prices to fall more slowly than they rose. This has prompted researchers to liken the response of gasoline prices to higher oil prices to a rocket—and the response to lower oil prices to a feather."

California retail gasoline prices are consistently higher than the U.S. average. There are several explanatory factors that influence that retail gasoline price gap:

- Higher Taxes on Gasoline: State and local sales taxes, combined with the state excise tax, account for part of the difference between California and the U.S. average.
- Higher Gasoline Production Costs: California's unique, cleaner-burning gasoline blend specification reduces air pollution but costs more to produce than other types of gasoline.
- Environmental Program Costs: California's world-leading environmental standards deliver significant public health benefits through various programs, including the Low Carbon Fuels Standard and Cap & Trade programs, where the cost of compliance is passed down through gasoline prices, contributing to higher costs to consumers.
- California's Longer Summer Season: Summer-blend gasoline evaporates at a higher temperature than winter-blend gasoline, meaning it is less likely to contribute to unhealthy ozone and smog levels. Summer-blend gasoline is also more expensive to produce. As a result of California's warmer climate, summer-blend gasoline is used for a longer period during the year than elsewhere in the nation.
- Isolated Nature of the California Fuels Market: Under normal conditions, California refiners produce enough gasoline to meet demand within the state. When needed, the state typically imports gasoline via marine shipments, which usually take three to four weeks to deliver. The state's prices rise to cover the additional delivery costs from securing these international imports via marine vessel.
- More Expensive Crude Oil: California's greater dependence on foreign oil increases the crude oil acquisition costs of California refiners relative to most other refiners in the U.S.
- Larger Retail Margins: Retail gasoline station margins in California are higher than in most other regions in the United States.

Is there an explanation for the so-called mystery surcharge of 30 to 50 cents that persists seven years after a temporary refinery disruption?

The *Additional Analysis on Gasoline Prices in California* report, referenced above, identified several possible causes for the residual price increase in California, ranging from refinery outages to potential market manipulation.

The CEC recommended further investigation by the California Department of Justice to determine the reason behind the increase in California gasoline prices.

Can we get more evidence from the oil companies to justify price increases?

The CEC is not the appropriate state agency to respond to this question.

Are there any assurances that reducing the gas tax would result in commensurate price decreases?

Gasoline taxes are considered a "pass-through" fee that are normally fully transferred from the wholesale to retail level over the long run. Taxes are applied equally to all competitors in a market, rather than other variable costs like manufacturing, distribution, and marketing. Although a temporary reduction in gasoline taxes would be expected to transfer through to retail gas stations, there is no assurance that such a transfer will be immediate or that it will equate to the amount of the tax reduced. It is possible that some gasoline suppliers and retail station operators will decide to retain a portion of the tax holiday to improve their margins. However, over a couple of weeks or more, these same wholesalers and gas station operators could elect to pass along the tax reduction to attract additional customers to their stations.

A recent study published by the Wharton School of the University of Pennsylvania concluded that tax holidays enacted this year in Connecticut, Georgia, and Maryland were not fully passed through to consumers. Gasoline customers in those states received between 58 and 87 percent of the total tax reduced. Industry retained the remainder. The following table lists other states that either have implemented or scheduled a tax holiday for gasoline.

Enacted and Pending Gasoline Tax Holidays			
State	Cents per Gallon	Start Date	End Date
Maryland	36.1	March 18, 2022	April 16, 2022
Georgia	29.1	March 18, 2022	May 31, 2022
Connecticut	25.0	April 1, 2022	June 30, 2022
New York	16.0	June 1, 2022	December 31, 2022
Florida	25.3	October 1, 2022	October 31, 2022

Data Source: CEC staff

What adverse impact could motorists and consumers expect from eliminating the road funding from the gas tax?
The CEC is not the appropriate state agency to respond to this question.

Consumer watchdog organizations have noted in the first quarter of 2022, the nation's 21 largest oil companies reported a record profit of $41 billion, which is $25 billion more in profit than the same period one year. What justifies this increase?

The CEC is not the appropriate state agency to respond to this question.

If evidence of price manipulation is discovered, what is the state's enforcement mechanisms supported by existing law, or options for response or legislative action?

The CEC is not the appropriate state agency to respond to this question.

We appreciate the opportunity to share the CEC's recent data collection and analysis of gas prices in California and we look forward to sharing our findings with the Select Committee on Gas Supply and Pricing, chaired by Assemblymember Jacqui Irwin, on June 30, 2022.

Sincerely,

David Hochschild
Chair