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Consumer Response to Staff Report on Fuel Delivery Temperatures

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The staff report on Fuel Delivery Temperatures: 1. leaves some questions, previously asked by the commission, unanswered; 2. raises new questions about the study's final methodology; 3. states conclusions that contradict other sections of the report; and 4. accepts assumptions that are not supported by real world practice or experience.

The report's first page contains a very cogent and material question to the entire exercise of doing a cost benefit study for California retail fuel buyers:

> **"If temperature compensation has been instituted for most wholesale transactions, for the purpose of removing the inequity of temperature variations from financial transactions, why has that practice not extended all the way to the California retail consumer?"**

Does the staff contend here there is a "financial transaction," rationale for temperature compensation on the wholesale level, and yet there is not such rationale for the consumer transaction for the same fuel? This contradiction is not explained, nor is the original question posed by the staff answered within the report.

One of the new questions raised by the report is, that although 80% of the California retail fuel is sold through C-stores, there is no attempt to characterize the other 20% of the sales. Why did the staff find cost benefit results only for C-stores, and then extrapolate their findings to the entire rest of the market, especially since the rest of the market is very dissimilar to the C-store sector?

The staff's report concludes that all retailers would pass through the complete cost of ATC retrofit and the temperature differentials to the customer, yet there are large box-houses which are selling fuel at the break-even point or even as a loss leader. If they are using their fuel pumps to draw customers or club members into their parking lots already at a level below wholesale costs, why would they pass any ATC additional costs through to consumers? [Bill Lockyer, Attorney General, "Report on Gasoline Pricing in California, May 2000 (Updated 2004)]

By recognizing $3.2 million in annual state-wide consumer benefits, the report reverses the earlier staff preliminary benefits estimate presented at the previous public meeting of this group. Those estimates were of a 6 month return on investment, and an annual savings of $12 each for Fresno and Alameda counties. This is such an extreme shift in results, the staff has a responsibility to explain this huge shift in thinking.

The staff also assumed that every retrofitted pump will have to be financed and paid off in a one year period. For a retrofit which has a life expectancy of the pump, and which should be depreciated over that period of time, there is no substantiation of 100% financing and a one year loan period. I would also draw attention to the statement of a previous commenter, that most all the resisters were replaced in the 1990s, due to not going higher than $3.00. If that is true then they are all drawing to the close of their 20 year working life-span now.

In the report the staff is suddenly very concerned about consumer confusion should the switch to ATC be permissive. The Canadian retail fuel market voluntarily converted to ATC over a ten year period and there is no evidence Canadian consumers were confused. The status quo is based upon total consumer ignorance. So does the commission prefer consumer ignorance over confusion?

And speaking of the Canadian experience, the staff in an earlier part of the report states consumers were benefiting from cold fuel gallons and retailers were finding it tough to maintain their margins due to inventory shrinkage. This is true. Canadian retailers spent lots of “real” money, because they saw a “real” benefit to changing the way they sold fuel. If the economics of Canadian ATC adoption were actually the “No Difference” findings of the staff, does anyone really believe those retailers would have spent all that “real” money?

Canadian fuel retailers are just as savvy a bunch of business people as are US fuel retailers. They adopted ATC in a cold climate for just the same reason US retailers are against ATC in a warm climate. It makes them more money.

When the staff report first visits the consumer benefits of ATC, it acknowledged: price transparency; information symmetry; more accurate measurement; and equity. However, in the conclusions these benefits are ignored and they are replaced by monetary benefits, which if you assume as the staff has, there are none. Does that not leave these four very important benefits unaccounted for? These benefits are very important to the California weights and measures officials.

In my next slide I stated that there were only two economic models which allow additional costs to be passed through at the 100% level: 1. a Theoretical Pure Competition or 2. a Theoretical Pure Monopoly. As you will recall, Kevin M. Murphy of the University of Chicago challenged that statement, and I admit I was in error in making it. Although a monopoly is one of the models which will allow 100% of cost to pass through, there are surely others. I am not a trained economist, and I'll defer to Murphy's expert opinion. In fact, I was also wrong on the other model being pure competition. My own industry, trucking is highly competitive, and has a great deal of difficulty passing through increases in fuel costs due to that competition. We have gone to the extreme in asking for legislation that would make a fuel surcharge national policy, as well as 100% pass through to the party actually paying for the fuel. However, to date we have not succeeded in obtaining that legislation. If anything, in a model of pure competition, the prices for goods and services can fall below the cost to produce those goods and services. In trucking we see this same situation. Freight is proffered for hauling at a rate that is below the cost for operating the truck with no regard for paying the driver, because truckers are also price-takers not price-setters.

The California Retail fuel market is made up of:

1. 10% retailers that are owned by refiners.
2. 46% retailers which are major leased dealers,
3. 26% are branded independents and
4. 18% which are unbranded independents.

[Severin Borenstein and James Bushwell, “Retail policies and Competition in the Gasoline Industry,” University of California Energy Institute, April, 2005] Also, [Attorney General Bill

Lockyer, “Report on Gasoline Pricing in California,” May, 2000 (updated 2004)]

It is only that final 18% of unbranded independents who are free to seek out the cheapest supply, and set their own margins independent of long-term supply contracts with one specific producer. [Frank A Wolok, “Why California Gas Prices are so High,” Department of Economics, Stanford University, April 1, 2004]

Oil producers do not produce fuel to fill all the orders that come in to them. Rather they produce the correct amount to hit the “Sweet Spot” of that demand, or the point at which the price remains low enough to keep sales at a maximum, but not so high as to curb consumer demand for the product. [Borenstein, Bushnell, & Lewis, “Market Power in California’s Gasoline Market,” University of California Energy Institute, May, 2004]

In a local competition are where there is one independent unbranded station, and that unbranded station either goes broke, or becomes a branded station or a major leased dealer, the price for fuel in that local competition area will raise a nickel. [Justine S. Hastings, “Competition in Retail Gasoline Markets,” The American Economic Review, Vol. 94 No. 1, pg 325, March 2004] This illustrates the tacit collusion amongst the stations which are tied to a producer with long term supply contracts. [Borestein and & Shepherd, “Dynamic Pricing in Retail Gasoline Markets, National Bureau of Economic Research, October, 1993]

C-stores in California say they have experienced fuel sales margin shrinkage from 12% to 5% over the past 10 years due to wholesale pressures. [Jay McKeeman at one of our past meetings] C-stores are loath to raise fuel or in-store prices because their customers are very price sensitive, and will switch to cheaper independent fuel retailers if the prices rise too far. However, C-stores do not have to depend solely on fuel sales margins to make a profit. For them there is more profit on a $10 sale of chips and soda than they generate on a sale of $50 of fuel. [Michael Coit, “It’s not in the Fuel” Press Democrat.com April 20, 2007]

The staff also stated their calculations assumed that 10% of all sales at C-stores were fuel only, but that they had found reference to fuel-only sales reaching the 28% range. On the NACStech web site, in a power-point presentation Jeff Kline, President and CEO of Island Magic Vending states, “Over 56% of C-store purchases are gasoline only. (Meyers)” [Slide #63 in Mobile Commerce presentation April 30, 2007]

Refiners and wholesalers are the agents contracting the C-store margins, and yet refiners and wholesalers who are experiencing ever stronger margins and profits say the retailer is out there “totally on his own.”
The refiners and wholesalers are using their collective market power to keep the retail “golden goose” as lean as possible, but it is not in their best interest to stand by and watch them go bankrupt. After all, you can produce all the fuel in the world, but without a retail outlet you could not sell a drop. The oil market is in a very uneasy stasis where the retailer is powerless to demand more margin, and ATC threatens to unbalance this unnatural market where producers and wholesalers can now say, “Yes, the wholesale price is high, Mr. Retailer, but you can always make it up by selling all those extra ‘hot gallons’ we deliver to you.”

I found it personally curious that Michael Flynn stood to comment on the “Staff’s” report, while the completed OMB survey of the literature stated he was doing a separate cost/benefit study for the PUMP coalition, and that it should be available for consideration by the CAEC report and the NCWM meeting. This separate Flynn cost benefit study was also mentioned in the NOV 1, 2008 Update on the HOT GAS/TEMPERATURE COMPENSATION update on the NACSONLINE.com web site. Neither Mr. Flynn, nor the PUMP coalition has reported on the content of that study, and in my opinion, I contend it was appended very clumsily to the very astute work begun by the commission staff. Since the reason for PUMP to exist is to quash acceptance of ATC by any US regulatory group, it is a small wonder the staff report met every talking point of PUMP to the letter.

In conclusion, this Commission should ensure that its decision and rationale are internally consistent. Conclusions should flow naturally from a well-considered analysis and all available and reliable information , and not be based upon a single, dubious assumption; that there is no benefit to consumers. With other variables and assumptions the Staff presented ranges of impact, but when it came to consumer benefits there was no range, just an unsupported assumption of 100% pass through of costs to consumers.