California State Senate

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# FIRST EXTRAORDINARY SESSION
# INFORMATIONAL HEARING

## Petroleum Windfall Profits Penalty:
## Will Californians Get Relief at the Gas Pump?

1021 O Street, Room 1200
Wednesday, February 22, 2023
1:30 p.m.

## BACKGROUND

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"California's drivers are heading full-speed down a rocky road toward an uncertain gasoline future." – Roland Hwang, NRDC *Fueling the Future* report, September 2002

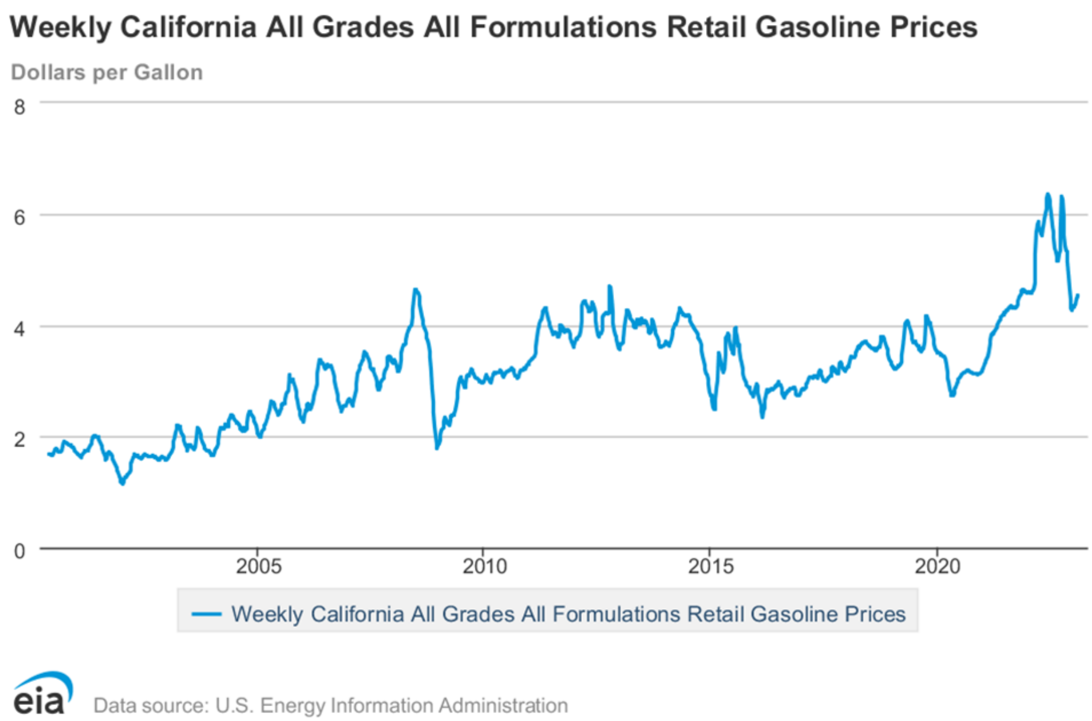
Unlike other consumer goods, gasoline is ubiquitous in our lives and largely needed by most everyone, every day. Consumers are not able to postpone gasoline purchases in the same way they can wait out higher prices of other goods. From the wellhead to the consumer, gasoline supply and pricing is a complicated market with varied players, some vertically integrated companies, marketers, traders, limited transparency, and affected by both a global crude oil market and regional market for refined gasoline. Additionally, California's air quality and climate change-related policies are transitioning the state away from fossil fuel uses, most notably Governor Newsom's Executive Order (N-79-20) to require 100 percent of in-state sales of new passenger cars and trucks to be zero-emission by 2035, thereby prohibiting the sale of new gasoline-fueled vehicles by 2035. This combination of factors, along with the isolated nature of the California transportation fuels market, creates a challenge for the state to ensure consumers are protected with adequate gasoline supply at affordable prices, all while advancing California's climate policies that shift demand away from petroleum fuels. The balancing act of providing adequate supply with uncertain demand is no small feat. Yet, the implications to Californians can be significant to their health, well-being, and quality of life, if policies do not achieve the intended relief.

Today's informational hearing is intended to provide members of this committee, stakeholders, and the public the opportunity to learn more about the Governor's proposal and the issue of gasoline prices, more generally. The hearing will also provide the opportunity to hear from market experts and other stakeholders about considerations in adopting policies to address gasoline prices. While members of this committee will not be taking a vote at today's hearing, the discussion may reference the concept in the proposed legislation and whether the proposed concept, or any other proposals, will provide relief to Californians at the gas pump.

The hearing will begin with a presentation from Governor Newsom's Administration quickly explaining the California gasoline fuels market, and the delving into the considerations underpinning the proposal for a Petroleum Windfall Profits Penalty, and more details on the mechanics of the proposal. Specifically, California Energy Commission (CEC) Vice-Chair and Commissioner Siva Gunda and Director of the California Department of Tax and Fee Administration (CDTFA) will present on behalf of Governor Newsom's Administration. Next, the members of this committee and public will hear from a panel of experts, most who have been following the gasoline markets closely, and will provide the committee with perspectives on considerations regarding the proposal and other suggestions about tackling gasoline prices in California. This panel includes experts from the Legislative Analyst's Office (LAO), the Anti-trust Office within the Office of Attorney General Rob Bonta, as well as, former chairs and members of the now-dissolved Petroleum Market Advisory Committee (PMAC). Afterwards, a subset of stakeholders representing the oil industry, consumers, retailers, and environmental interests will provide brief commentary. Lastly, this committee will hear from the public.

**Gasoline price volatility at the gas pump.**

Californians are no strangers to price volatility at the gas pump.  Over the past twenty or so years, Californians have experienced gasoline prices that have fluctuated from a low of $1.16 a gallon in December 2001 to $6.40 a gallon during the week of October 3, 2022, with weekly price swings of $0.30 per gallon not uncommon (based on data from the United States Energy Information Agency noted in the chart below). Higher prices on gasoline fuel can have crippling effects for residents on fixed or limited incomes, especially those who rely on long commutes to get to work or home, or those who require driving as part of their job. Higher prices also take a toll on the overall economy, affecting all residents, with potentially higher prices for goods that use gasoline fuels to get to market.




**Gasoline prices trend higher in California compared to the rest of the nation.**

Californians, generally, pay higher prices for gasoline compared to the rest of the country. According to the CEC, there are five main reasons why California retail gasoline prices are higher than the average price in the United States, specifically: higher taxes on gasoline, higher gasoline production costs, environmental program costs, California's shorter winter season, and the isolated nature of the California fuels market. California's unique, cleaner-burning gasoline blend costs more to produce than other types of gasoline, accounting for an additional 10 to 15 cents per gallon (according to the CEC). The summer-blend gasoline is designed to evaporate at a higher temperature than winter-blend gasoline so as to minimize its contribution to unhealthy ground-level ozone (also known as smog). However, the summer-blend gasoline is more expensive to produce and tends to be used for longer stretches of the year, given California's warm climate.

| Estimated Gasoline Price Breakdown and Margins (February 13, 2023) (Source: California Energy Commission) | | |
|---|---|---|
| | **Branded** | **Unbranded** |
| Distribution Costs, Marketing Costs, and Profits | $0.39 | $0.46 |
| Crude Oil Costs | $1.98 | $1.98 |
| Refinery Cost and Profit | $1.22 | $1.15 |
| State Underground Storage Tank Fee | $0.02 | $0.02 |
| State and Local Tax | $0.10 | $0.10 |
| State Excise Tax | $0.539 | $0.539 |
| Federal Excise Tax | $0.184 | $0.184 |
| Retail Prices | $4.43 | $4.43 |

**California gasoline fuels market is isolated.**

California's gasoline fuels market is geographically isolated from other locations in the U.S. that produce refined fuel products. California has 11 refineries that refine crude oil into gasoline fuel; the majority are located in and around the South Bay region in the Los Angeles Basin, some in the East Bay region of the Bay Area, and the smallest by volume produced is located in Bakersfield. These refiners produce transportation fuels that meet California standards, including the specially formulated gasoline to meet California's air quality standards, known as California Air Resources Board (CARB) gasoline. In addition to providing in-state supply, California refiners provide the majority of transportation fuels to neighboring states – sending the equivalent of 10 percent of California's consumption of gasoline to Nevada and Arizona via pipeline from Southern California. California refiners also export gasoline via marine shipments, including to western Mexico and Central America. The state's refineries process over 1.6 billion barrels of crude oil per day. In 2021, California was the seventh-largest producer of crude oil among the 50 states, and, as of January 2021, the state ranked third in crude oil refining capacity (according to the U.S. E.I.A.). Over the past 40 years, the source of crude oil has shifted so that foreign source of crude oil, which used to make up the smallest percentage in 1980, is now over 56 percent of the crude oil processed in California. In 2021, 88 percent of gasoline production was used in-state and 12 percent was exported. Gasoline imports, generally, provide a smaller portion of overall supply, as California has been characterized as a "self-sufficient" gasoline fuels market. However, when needed, California imports gasoline via marine shipments, which can take 3 to 4 weeks to deliver and with prices that account for the additional costs of transporting via international marine vessel.

**Unexpected disruptions and facility outages can result in reduced supply and price spikes.**

As a result of California's isolated gasoline fuels market, unexpected and unplanned disruptions on the system, including unplanned refinery outages, can impact the supply and often result in price spikes. This was the case after the unexpected outage at the then-Exxon Mobil Torrance Refinery in February 2015 which was due to an explosion of the facility that resulted in an extended outage. Gasoline prices were immediately affected, as prices increased $0.25 per gallon within a week of the outage. The tenuous gasoline supply system was further underscored just over a week ago. On Thursday, February 9th, a leak was discovered at a Kinder Morgan pipeline facility in Long Beach that feeds the majority of gasoline and diesel fuel to Las Vegas and much of the rest of the southern Nevada and parts of Arizona. The pipeline had to be shut down. The following day, Nevada Governor Joe Lombardo declared a State of Emergency and urged residents to refrain from panic buying. By Saturday morning, news reports showed hour-long lines of cars at Las Vegas gas stations, as residents rushed to fill up their gas tanks. The pipeline was brought on-line that afternoon and the emergency declaration is scheduled to expire within 15 days of the date it was issued.

**California has a 40+ years history of attempting to address high petroleum prices.**

*Petroleum Industry Information Reporting Act of 1980.* Following the 1979 energy crisis, when the Western World, including the United States, faced petroleum shortages and high prices, California established the Petroleum Industry Information Reporting Act of 1980 via SB 1444 (Holmdahl, Chapter 1055, Statues of 1980). Often referred to as PIIRA, the statute requires the CEC to collect and analyze specified data reported by petroleum industry companies on a weekly, monthly, and annual basis. The CEC analyzes the data to understand the operations of the petroleum industry in California. PIIRA was intended to provide California with sufficient oil pricing information to identify price and supply volatility before it resulted in oil shocks similar to those experienced in the 1970s. Under PIIRA's provisions, much of the data collected by the CEC must remain confidential as to specific entities in the market. The CEC utilizes the data to help establish public reports based on aggregated data. The confidentiality provisions of PIIRA are intended to encourage timely reporting and prevent companies from gaining access to pricing data that would allow them to manipulate the market.

*Attorney General Lockyer Report on Gasoline Pricing in California*. Since the passage of PIIRA, California policymakers have responded to significant gasoline price increases several times. Most notably, in 1999, following legislative informational hearing on the topic of recent gasoline price increases, the Legislature passed urgency legislation, SB 1131 (Burton, Chapter 956, Statutes of 1999) to fund the first-year costs of "investigating industry practices relevant to the production, distribution, and pricing of gasoline and diesel fuel" by the Department of Justice. The legislation, which was sponsored by then-California Attorney General Bill Lockyer, also authorized costs related to reviewing pending mergers between major oil companies. Following the passage of the legislation, Attorney General Lockyer established a Gasoline Price Task Force which met January through March of 2000. In May 2000, the Attorney General issued a report with gasoline supply proposals, including proposals to address price spikes and supply disruptions and others to address long-term imbalance between in-state supply and demand. These proposals include establishing a state gasoline reserve, study of pipeline connections to the U.S. Gulf Coast, expansion of in-state capacity and independent refineries, mandating inventory requirements, and other proposals. The report was further updated in 2004 when gasoline prices reached another record high.

*Petroleum Market Advisory Committee*. In 2012 a fire at the Chevron Richmond Refinery led to an outage that contributed to higher petroleum prices in California. Following reports that Californians experienced unusual price increases even while supply was increasing and crude oil prices decreased, several elected officials requested investigations into potential market manipulation. In 2013, the Legislature passed SB 448 (Leno) to investigate suspected fuel price manipulation and make recommendations to the Legislature to reduce price volatility. Governor

Brown vetoed the bill and directed the CEC to work with the Attorney General to develop a plan for responding to petroleum price volatility. In 2014, the CEC established the Petroleum Market Advisory Committee (PMAC) to provide expertise on factors leading to price increases and strategies for addressing price volatility. In the midst of the PMAC's efforts, in February 2015, an explosion at the Exxon Mobil Torrance refinery resulted in the shutdown of the facility and subsequent sudden increases in California fuel prices, renewing concerns about fuel price volatility. In response, the Senate Committees on Transportation and Housing and Energy, Utilities, and Communications held an oversight hearing on the issue of gasoline price spikes. In September 2017, the PMAC issued its final report noting "several gasoline market anomalies that appeared to be new trends in California," including increasing retail margins and retail price differentials between California and the U.S. average, and increasing price differences among gasoline retail brands. The PMAC also explored various policy options for addressing gasoline price volatility, including some that had been explored in the earlier Attorney General report. Ultimately, the committee members "did not reach agreement that any of the policy options would appropriately address price volatility in California." Many of the members noted the lack of sufficient staffing resources and access to data, among the challenges that hampered their efforts.

*CEC Analysis on Gasoline Prices in California.* In 2019, Governor Newsom asked the CEC for an in-depth analysis of the causes of the increased differential between national and California gasoline prices. The CEC issued a preliminary report in May 2019, noting that the differential had increased to as high as $1.00 per gallon in April 2019. The CEC found "an unexplained residual price increase over the last five years." After further examining the possible causes, the CEC concluded, "the primary cause of the residual price increase is simply that California's retail gasoline outlets are charging higher prices than those in other states." The CEC noted that branded retailers had increased the retail margins "far beyond their competitors". The CEC also noted it lacked the expertise to investigate whether competitors fixed prices or employed false advertising practices and deferred to the expertise of the California Department of Justice. In 2020, the Attorney General filed lawsuits against two international commodities trading companies, SK Trading and Vitol, for exploiting the 2015 refinery explosion by engaging in market manipulation to artificially inflate the spot market price for refined gasoline. The lawsuit is currently pending.

*Legislation to require more data of petroleum industry.* SB 1322 (Allen, Chapter 374, Statutes of 2022) requires the CEC to publicly post oil refining margins on a refiner basis for those refiners with more than one refinery in the state. Additionally, the bill expands the types of data that the CEC must collect on a monthly basis to include refinery-specific data, and extends existing confidentiality requirements to the data reported by the bill. While the CEC reports aggregated industry data on refining margins, it is based on self-reported data provided through the Oil Price Information Service (OPIS). SB 1322 requires specified refinery specific data regarding costs paid for crude oil, quantity of wholesale gasoline sold that meets California specifications and corresponding volume-weighted average prices, reduced by all applicable local, state, and federal taxes, separated by type of sale, and separate quantification of the volume-weighted fees or estimated valuations of costs embedded in all wholesale gasoline sales associated with the low-carbon fuel standard (LCFS) and associated with cap-and-trade cap-at-the-rack program. The Western States Petroleum Association (WSPA) petitioned for a rulemaking to provide clarification for some of the new reporting requirements in SB 1322. However, recently, the CEC declined to proceed with a rulemaking, citing the recently called extraordinary session as reason to not proceed with a rulemaking. Based on conversations with CEC staff, absent the rulemaking, the CEC is directing refiners to provide the required information to the best of their ability. However, questions remain as to the implementation of the bill. For example, as noted in the Senate Floor Analysis for the bill, it is unclear whether the largest gasoline refinery, Marathon Petroleum, will be providing the required reporting given the company aggregates data for both the Wilmington and Carson facilities as one refinery, and does not seem to have another refinery in the state. SB 1322 reporting requirements apply to refineries with more than one refinery in the state.

*More recent actions to address gasoline price volatility*. More recently, the Newsom Administration, including the CEC, have sent letters to oil industry executives and held an informational hearing on the issue of recent gasoline price increases, in particular regarding concerns about the record-setting price differential of $2.50 per gallon of gasoline between California prices and the national average. The correspondence occurred around the time some refineries were taken off-line for maintenance. When gasoline prices spiked in late summer/early fall, Governor Newsom, as previous Governors have at times done, directed CARB to make an early transition to winter-blend gasoline to help increase supply and also noted a desire for a special session of the Legislature to address windfall profits in the oil industry. On November 29, 2022, the CEC held an informational hearing on the California Gasoline Price Spikes, Refinery Operations, and Transitioning to a Clean Transportation Fuels Future. The hearing discussed possible causes of the price spikes, including concerns about the Mystery Surcharge – the price differential at the retailer end – and the need for more data to better understand the causes between branded and unbranded fuels. Additionally, the CEC staff relayed plans for a Fuels Transition Study, to “understand the impact of climate goals on the demand, reliability, safety, and affordability of petroleum fuels under a variety of scenarios.”

*Governor Newsom officially calls a Special Session of the Legislature.* On the heels of record-setting gasoline prices in 2022, Governor Newsom called for a Special Session of the Legislature:

> To consider and act upon legislation necessary to:
>
> a. Deter price gouging by oil companies by imposing a financial penalty on excessive margins, with any penalties collected to be returned to Californians.
>
> b. Empower the CEC and the CDTFA to more closely review and evaluate costs, profits, and pricing in the refining, distribution, and retail segments of the market for gasoline in California.
>
> c. Provide for greater regulatory oversight of the refining, distribution, and retail segments of the market to prevent avoidable supply shortages and excessive price increases.
>
> d. Make conforming changes to existing law consistent with paragraphs (a), (b), and (c).

The Governor formally issued a proclamation on December 5, 2022, the first day of the 2023-24 Legislative Session, when Senators and Assembly members were sworn into office. On that same day, SB2-1X (Skinner) was introduced containing the concept and general framework for the Governor’s Petroleum Windfall Profits Penalty proposal, but with an acknowledgement that the bill would need to be further developed, given the blanks on the proposed profit margins and the construct of the bill noting the intent for future legislation to operationalize aspects of the proposal.