California State Senate

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OVERSIGHT HEARING

California Energy Commission Update to the Legislature on Implementation of SBX1 2 (Chapter 1, Statutes of 2023) Transportation Fuels

1020 O Street, Room 1200
Tuesday, May 7, 2024
9:00 a.m.

BACKGROUND

On the heels of record-setting gasoline prices in 2022, on December 5, 2022, the opening day of the 2023-24 Legislative Session, 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 California Energy Commission (CEC) and the California Department of Tax and Fee Administration (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).

In addition to calling for the special session, on the same day, SBX1 2 was introduced with the Governor's proposal for a Petroleum Windfall Profits Penalty policy which at the time prescribed the profit margin cap approach (though with blanks for the actual numbers) and with the intent to adopt future legislation to require the CEC to conduct assessments and other actions. Subsequently, this committee held an informational hearing on February 22, 2023 to discuss the Governor's proposal and hear from expert perspectives, including 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), on methods to address gasoline price spikes, high gasoline prices, gasoline supply, and related issues.

On March 20, 2023, SBX1 2 was amended eliminating the prescribed profit margin cap approach (instead authorizing the CEC to adopt a profit margin cap), and intent to adopt subsequent legislation. The bill incorporated additional elements, including details on the membership of an expert advisory committee and required reporting to the legislature, among other requirements. The amended version of SBX1 2 was voted on by both houses and signed by Governor Newsom on March 28, 2023.

More than a year later since SBX1 2 was enrolled into law, today's committee oversight hearing is intended to provide members of the committee the opportunity to hear about the efforts to implement the many elements of the law, ask questions about any challenges and opportunities, and areas that need further attention or where there may be concerns. Most importantly, members will want to understand whether the efforts to implement SBX1 2 are driving towards addressing gasoline price spikes and higher gasoline prices, as intended. As noted in the SBX1 2 findings and declarations:

> Fundamental change is necessary to prevent future extreme price spikes and price gouging by oil companies, which are entitled to a reasonable return but are not entitled to reap exorbitant profits at the expense of Californians, many of whom rely on gasoline as an essential commodity or who are impacted by the increased cost of goods and services that results from the gasoline price spikes, even as the state begins to transition away from dependence on the fossil fuels that are destroying our climate.

About SBX1 2

SBX1 2 incorporates several policies to address gasoline supply and pricing. The main elements of the new law are the authority for the CEC to establish a maximum gross refining margin and penalty, a new Division of Petroleum Market Oversight, an Independent Consumer Fuels Advisory Committee, expanded reporting requirements by industry participants, CEC ability to impose refinery maintenance and turnaround requirements, annual report on gasoline prices, a transportation fuels assessment, and transportation fuels transition plan. Each element is described below:

Maximum gross refining margin. The law authorizes the CEC to establish a maximum gross refining margin and penalty on gasoline sold by refiners in the state, which is the maximum amount of the gross gasoline refining margin excluding state program costs (essentially a refiner's profit). If the CEC establishes the maximum margin, the CEC must establish a penalty for exceeding the maximum margin and requires the penalty to be a percentage of the amount the refiner exceeds the maximum margin, to be tiered and increase with the amount the refiner's gross margin exceeds the maximum gross margin. The CEC is authorized to adjust the margin and the penalty to ensure a sufficient, affordable, and fairly priced supply of gasoline is available to Californians. Requires the State Auditor, by no later than March 1, 2033, to complete an audit and performance review of the maximum margin and penalty. If the Auditor finds the policy is not working to address price spikes and stabilize the gasoline fuel supply market, the CEC is required to cease implementing the policy within 180 days after the Auditor's report.

Pursuant to SBX1 2, the CEC is prohibited from establishing a maximum margin and penalty, unless the CEC finds that the likely benefits to consumers outweigh the potential costs to consumers. Requires the CEC to consider, at a minimum:

a) Whether it is likely that the maximum margin and penalty will lead to a greater imbalance between supply and demand in California transportation fuels market than would exist without the maximum margin and penalty.

b) Whether it is likely that maximum margin and penalty will lead to higher average prices at the pump on an annual basis than would exist without the maximum margin and penalty.

c) Whether case-by-case exemptions from the maximum margin will be sufficient to ensure that individual refiners have an opportunity to demonstrate the need for a greater margin before they make decisions about production.

New Division of Petroleum Market Oversight (DPMO). SBX1 2 establishes DPMO within the CEC, and requires DPMO to be led by a director appointed by the Governor, subject to Senate confirmation, and specifies that DPMO operates with authority independent of the CEC's authority. Among the duties of the DPMO, the division has the duty to provide guidance and recommendations to the Governor and the CEC on any issues related to transportation fuels pricing and transportation decarbonization in California. Pursuant to the statute, DPMO is provided with the ability to subpoena witnesses and require by subpoena any books, papers, records, or other items.

Establishes the Independent Consumer Fuels Advisory Committee (ICFAC). SBX1 2 creates the ICFAC within the CEC, consisting of six members appointed by the Governor, one member appointed by the Speaker of the Assembly, and one member appointed by the Senate Committee on Rules. Statute requires the ICFAC to advise the CEC and DPMO and provides ICFAC with access to all the information provided to the CEC and DPMO, and requires confidentiality.

Expanded reporting requirements by industry participants. SBX1 2 revises, recasts, and expands the existing reporting requirements to the CEC to, among other things:

a) Require pipeline operators and operators of ports through which refined gasoline is imported to annually report their capacities for all pipelines and ports used to transport refined gasoline.

b) Require all importers of refined products and renewable fuels via marine vessel to submit reports to the CEC, as specified.

c) Require non-refiners that commercially trade in gasoline, gasoline blending components, diesel fuel, or renewable fuel inventory to submit weekly reports to the CEC.

d) Require refiners and non-refiners that consummate spot market transactions to submit a daily report to the CEC containing certain information for each transaction occurring in the preceding day, as provided, and require refiners to report maintenance activities, both planned and unplanned, to the CEC, as provided.

e) Requires refiners to notify the executive director of the CEC of all plans to undertake turnaround and planned maintenance, and to include specified information, including the drawdown of inventory levels of gasoline and gasoline blending components controlled by the refiner and at other storage locations.

f) Requires the operators of refineries to report additional information, including the net gasoline refining margin per barrel of gasoline sold in that month. Requires the CEC to post on its internet website certain information related to the net gasoline refining margin.

Refinery turnarounds and maintenance. SBX1 2 authorizes the CEC to impose requirements governing the timing of turnaround and maintenance for refineries developed through consultations with the Labor and Workforce Development Agency, labor and industry stakeholders.

Annual report on the price of gasoline. SBX1 2 requires the CEC, in cooperation with the CDTFA, to submit a report to the Legislature, by March 1st of each year that includes a review of the price of gasoline in California and its impact on state revenues for the previous calendar year. Pursuant to the legislation, CDTFA is authorized to request from any person certain records required to be maintained and any records in the person's possession, custody, or control that the CDTFA deems necessary to facilitate the report or to assist the CEC.

Transportation fuels assessment. SBX1 2 also requires the CEC, on or before January 1, 2024, and every three years thereafter, to submit an assessment to the Governor and the Legislature that identifies methods to ensure a reliable supply of affordable and safe transportation fuels in California. The CEC is required to use reasonable means necessary and available to seek and obtain information from any sources for purposes of preparing the assessment. The CEC may impose a civil penalty if a person fails to timely provide information necessary for preparing the assessment.

Transportation Fuels Transition Plan. SBX1 2 also requires the CEC and the California Air Resources Board (CARB), on or before December 31, 2024, and taking into account the assessment, to prepare a Transportation Fuels Transition Plan to explore how to ensure the supply of petroleum and alternative transportation fuels is affordable, reliable, equitable, and adequate to meet the demand.

Implementation of SBX1 2

For ease of reference, the table below summarizes some of the key activities/actions within SBX1 2 and their current status.

Table on Implementation Status of SBX1 2

Element/activity	Due Date	Status
Maximum gross refining margin.	No required due date	CEC held two workshops (November 28, 2023 and April 11, 2024). March 27, 2024 – CEC released Request for Information to solicit input on whether and how to structure a margin and penalty. (Responses were due by May 3) CEC plans to make a decision by end of the year.
Annual report on the price of gasoline	March 1, and every March 1	Released Friday, May 4 (attached)
Transportation fuels assessment	January 1, 2024, and every three years	Draft assessment released April 12, 2024. (attached) May 3 - Presented at CEC-CARB joint agency workshop. Final report expected this summer.
Transportation Fuels Transition Plan	December 31, 2024	May 3 - CEC-CARB joint agency workshop introducing the Transportation Fuels Transition Plan. Working group currently being assembled, first meetings in late Q2. Final plan expected by end of the year.
New Division of Petroleum Market Oversight (DPMO)	No specific date.	New director was appointed by the Governor in August 2023, and confirmed by the Senate Committee on Rules on April 24. Pending a Senate Floor vote for confirmation. DPMO is currently hiring six positions; two investigative counsel roles tentatively filled by

		candidates currently serving as assistant district attorneys. DPMO has sent two letters to the Governor and Legislature regarding gasoline prices. (attached)
Establishes the Independent Consumer Fuels Advisory Committee	No specific date, but is required to inform shaping of margin and penalty.	Speaker of the Assembly and Senate pro Tem each appointed their respective appointees in 2023. Governor's Administration has not appointed remaining six members.
Expanded reporting requirements by industry participants	Daily, weekly, monthly, and annual reporting requirements on industry participants	CEC is collecting data. Some concerns about lack of standardization and updates to forms.
Refinery turnarounds and maintenance	No specific date.	CEC plans to hold workshop this month to review draft regulations. CEC intends to adopt regulations at the July business meeting.

DPMO sends letters regarding gasoline price increases

In September 2023, DPMO Director Tai Milder sent letters to the Governor and Legislature providing an interim update. The letter noted that the average price for gasoline was $5.78 per gallon, 25 cents higher than the previous week, and 52 cents higher than the previous month. DPMO cite three reasons for the higher gasoline prices: 1) an increase in global crude oil prices; 2) refinery maintenance events causing decreases in supply that "refiners did not adequately prepare for by increasing inventories and imports; and 3) an unusual spot market transaction on September 15, 2023 that has had an outsized impact on gas prices, causing prices to jump $0.50 per gallon. Director Milder suggested the situation highlighted "several market flaws that make California gasoline prices vulnerable to price spikes." These include: spot market volatility and its outsized impacts on prices, lack of spot market liquidity, inadequate inventories, of gasoline and blend stocks, and refinery undersupply during maintenance.

On September 27, 2023, Governor Newsom directed DPMO to identify "initial proposals" of potential spot market reforms. In addition Governor Newsom, as he had the previous year, directed the California Air Resources Board to allow for an early transition to winter-blend gasoline in order to quickly increase fuel supply. In January 31, 2024, DPMO sent a letter to the Governor outlining two policy options that can improve how California's spot market functions and help protect consumers. Specifically, DPMO recommended near-term options: 1) publishing a California spot market report and 2) establishing minimum inventory and resupply obligations on refiners. The CEC moved forward with adopting new spot market reporting requirements, utilizing the authority in SBX1 2, including utilizing emergency regulations. On March 26, 2024, the California Fuels and Convenience Alliance (CFCA) filed a lawsuit against the CEC for failing to observe the requirements of the California Environmental Quality Act (CEQA) and the California Administrative Procedures Act (APA) and other provisions of California law. The lawsuit remains active.

Background on gasoline prices and market in California

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 (April 29, 2024)
(Source: California Energy Commission)

	Branded	Unbranded
Distribution Costs, Marketing Costs, and Profits	$0.62	$0.72
Crude Oil Costs	$2.10	$2.10
Refinery Cost and Profit	$1.01	$0.91
State Underground Storage Tank Fee	$0.02	$0.02
State and Local Tax	$0.11	$0.11
State Excise Tax	$0.55	$0.55
Federal Excise Tax	$0.18	$0.18
Retail Prices	$5.17	$5.17

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 nine 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. The state's refineries process over 1.6 billion barrels of crude oil per day. In 2021, 88 percent of gasoline production was used in state and 12 percent was exported. These refiners produce transportation fuels that meet California standards, including the specially formulated gasoline to meet California's air quality standards mandated by the CARB, known as California Reformulated Gasoline Blendstock for Oxygenated Blending (CARBOB) 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. However, the gasoline sent to neighboring states and countries is not the CARBOB gasoline, and is, generally, less expensive to produce.

Unexpected disruptions and facility outages can result in reduced supply and price spikes. California has no ability to deliver gasoline into the state via pipelines, as the existing pipelines deliver gasoline and other refined fuels out of the state. Gasoline imports, generally, provide a smaller portion of overall supply. However, when needed, California imports gasoline via marine shipments, which can take three to four weeks to deliver and with prices that account for the additional costs of transporting via international marine vessel. 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 situation after the unexpected outage at the then-Exxon Mobil Torrance Refinery in February 2015 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.

California has a 40-plus year history of attempting to address gasoline prices. Most notably, following the 1979 energy crisis, when the nation (and much of the Western world) 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 required 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. The Legislature enacted PIIRA as an acknowledgement that the petroleum industry is "an essential element of the California economy and is therefore vital to the importance to the health and welfare of all Californians." The Legislature also stated that; "A complete and thorough understanding of the operation of the petroleum industry is required by state government to enable it to respond to possible shortages or other disruptions." 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. Since the passage of PIIRA, California policymakers have responded to significant gasoline price increases several times. *(See Background of Extraordinary Session Informational Hearing by this committee on February 22, 2023)*

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 required 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, the CEC declined to proceed with a rulemaking, citing the recently called First 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.

Other actions to address gasoline price volatility prior to SBX1 2. The Newsom Administration, including the CEC, 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 2022, 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."