Gas price spikes disguise real problems with California market

Too few companies own too many refineries and the obstacles to bringing in out-of-state supplies in an emergency are too great.

Price spikes tend to seize the attention of the public and political leaders, even though they're rare and typically short-lived. Above, a driver fills up in Alhambra. (FREDERIC J. BROWN, AFP/Getty Images / October 10, 2012)

By Michael Hiltzik
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Gasoline price spikes, such as the event that drove the average gallon in California to a stratospheric $4.67 in October, create two types of frustration.

There's the immediate frustration of seeing the price at the pump soar almost overnight to a figure that could buy you 10 Hostess Twinkies (in a non-panicking market, that is). Then there's the longer-term frustration that arises from the recognition that very little can be done to protect the California consumer from future spikes, and that very little has been done to address the bigger issues with the state's gasoline market. Those issues are that too few companies own too many refineries and the obstacles to bringing in out-of-state supplies in an emergency are too great.

"Instead of holding hearings every time there's a spike," says Severin Borenstein, co-director of the Energy Institute at UC Berkeley's Haas School of Business, "we need to address the scarcity and competitive issue."

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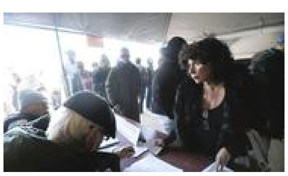

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There's little question that the California gasoline market operates as an island. There are pipelines connecting the state's refineries to points in Nevada and Arizona, but they operate in one direction — sending gasoline out, not bringing it in. The state's mandated anti-pollution fuel formulation is a further isolating factor.

Together, these conditions account for prices higher than the U.S. average of about 18 cents a gallon, according to the California Energy Commission. (Higher gasoline taxes account for an additional 20-cent differential over the national average.) They also make California vulnerable to market manipulation by opportunistic refinery operators or traders.

Theoretically, that is — there's no actual evidence of how often this has happened, or whether it contributed to the October spike. A hearing this month called by state Sen. Mark Leno (D-San Francisco) failed to produce any solid evidence of collusion among refiners or of unilateral actions to push prices higher.

But Leno observed in a written statement that "we still have more questions than answers about what makes gas prices spike in this state, and what might be done about it," adding that his hearing was "not the end but the beginning of a legislative conversation." And on Tuesday six West Coast U.S. senators, including California's Dianne Feinstein and Barbara Boxer, called on the Justice Department to investigate "possible market manipulation and false reporting by oil refineries which may have created a perception of a supply shortage" in October.

The California Energy Commission believes that the October price spike can be entirely explained by the confluence of a pair of unexpected refinery outages — one caused by a fire in August at Chevron's Richmond facility in the Bay Area, and the other by a power blackout that took ExxonMobil's Torrance refinery offline in October at a time of historically low statewide gas inventories.

Especially after the Torrance blackout, refinery operators responded to the outages by cutting off supply to independent gas retailers so they could be sure of serving their own branded gas stations. The action set off a ripple effect through the wholesale and retail markets in a "normally progressing price spike," Gordon Schremp, a fuel analyst at the California Energy Commission, told me.

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If the ExxonMobil refinery outage had not happened, he says, "we would have never had that price spike." Because the Chevron outage had drained slack out of the market supply, the spike turned into the state's worst in 15 years.

Price spikes tend to seize the attention of the public and political leaders, even though they're rare and typically short-lived.

Since 1999, the California Energy Commission counts eight major price spikes in California (leaving aside those related chiefly to the worldwide price of crude oil). Most resulted from unanticipated refinery problems such as fires, or major market disruptions such as the spike caused by Hurricane Katrina in 2005, and persisted for a matter of days.

Even the October spike, which lasted about a month, had a relatively small economic effect overall. As Borenstein observes, the excess price peaked at nearly 50 cents a gallon, but averaged closer to 25 cents over the entire period. In a market that consumes more than 40 million gallons a day, that created an excess cost of $320 million, according to California Energy Commission figures. In the aggregate that isn't chicken feed, but it amounted to about $8.40 per Californian for the entire month

"People who paid it weren't happy about it, and the people who got the money made out," Borenstein says. "But in the great scheme of all the costs of living in California, the price spikes are not in the top 10 of problems."

The chief drawback of the occasional spike, even one as severe as October's, may be that it diverts attention from a more fundamental problem with the California gasoline market — it's in the hands of a shrinking cadre of refinery owners, which may be about to shrink further if federal regulators approve a proposed acquisition of BP's Carson refinery by Tesoro Refining and Marketing. The deal would give Tesoro 27% control of California gasoline production capacity, making it the state's largest refiner.

Tesoro has said it would divest its small Wilmington refinery, if antitrust regulators insist. That would still leave it with more than 21% of the state's refinery capacity.

The deal would further concentrate what is already an oligopoly of refinery ownership. Today the state's five largest refiners (including BP) account for 65% of capacity. Combined with some of the other anti-competitive features of the California market, that opens the door to what economists charitably call "market power" and others might think of as manipulation.

As Robert McCullough, a Portland, Ore., energy consultant, observed in a report he presented at Leno's committee hearing, California has "a limited number of refineries, no ready access to gasoline supplies outside the West Coast, and very little market data." Under the circumstances, the ability of a few producers to take advantage of conditions such as a refinery fire or blackout to drive prices higher "is likely to exist."

McCullough contends that some public refinery data suggest that the owners may have exaggerated the impact of their shutdowns, presumably to create market pressures to drive up gasoline prices. (The refinery industry and the California Energy Commission say he's misinterpreting the data.) McCullough, whose contention inspired Tuesday's call by the six senators for a federal investigation, says tighter regulatory oversight of the refinery industry is essential.

"No specific agency has regulatory authority over oil and gasoline markets," he says. "No specific agency accumulates data on West Coast markets in sufficient detail to provide a check on the exercise of market power." The price spike of October, as well as a smaller spike in May, "demand investigation."

Borenstein says one way to address the state's vulnerability to tight supplies is to grant an automatic waiver of gas formulation rules allowing any company to bring in nonconforming gas by paying a surcharge. Set it high enough — say 25 cents a gallon — and there would be no incentive to import such fuel except in a really severe spike — the October event would barely qualify. The waiver would be used only rarely, but it would have the added benefit of discouraging price manipulation, which would only trigger a flood of out-of-state gas, driving prices back down.

He also says it's incumbent on antitrust regulators such as the Federal Trade Commission, which is reviewing the Tesoro-BP deal, to be especially attentive to the impact of such refinery mergers. "I'm sure they are looking at exactly the question of what the economies of scale are of letting them merge, versus the market power issues of having fewer players in the market."

Michael Hiltzik's column appears Sundays and Wednesdays. Reach him at mhiltzik@latimes.com, read past columns at latimes.com/hiltzik, check out facebook.com/hiltzik and follow @latimeshiltzik on Twitter.

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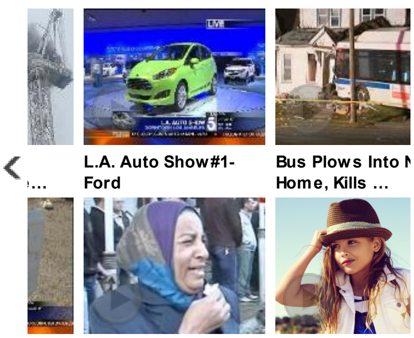

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