# SB 509

**TESTIMONY OF CARLITO P. CALIBOSO**
**CHAIRMAN, PUBLIC UTILITIES COMMISSION**
**DEPARTMENT OF BUDGET AND FINANCE**
**STATE OF HAWAII**
**TO THE SENATE COMMITTEE ON ENERGY AND ENVIRONMENT**
**FEBRUARY 12, 2009**

**MEASURE: S.B. NO. 509**
**TITLE: RELATING TO GASOLINE.**

Chair Gabbard and Members of the Committee:

**DESCRIPTION:**

This bill proposes to amend Section 486H-13 (k) and (l), Hawaii Revised Statutes ("HRS"), to reinstate the maximum pre-tax wholesale price of gasoline if the Public Utilities Commission ("Commission") determines that the actual pre-tax wholesale price of gasoline exceeds the maximum pre-tax wholesale price of gasoline calculated pursuant to section 486H-13, HRS, for three consecutive weeks and reinstates the suspension of the maximum price limit when the actual pre-tax wholesale price of gasoline does not exceed the maximum limit for a period of three consecutive months.

**POSITION:**

The Commission would like to comment on a serious concern regarding this proposal.

**COMMENTS:**

- While the Commission defers to the Legislature on the general matter of suspending and reinstating the prohibition against selling gasoline above the maximum pre-tax wholesale price, the Commission believes that the proposal for an "on again, off again" maximum price, as presently proposed in this measure, would be an administrative nightmare for the Commission to implement and will cause confusion in the industry, the marketplace, and for consumers.

Thank you for the opportunity to testify.

WSPA

**Western States Petroleum Association**

February 12, 2009
4:00 p.m.
Senate Committee on Energy & Environment
Room 225

Re: SB 509 Relating to Gasoline

We are testifying in opposition to SB 509 on behalf of the Western States Petroleum Association ("WSPA"), a non-profit trade organization representing a broad spectrum of companies in the petroleum industry in Hawaii.

According to the Department of Business, Economic Development and Tourism ("DBEDT"), the cap previously cost Hawaii consumers close to $55 million. Fortunately, the legislature voted to suspend it. The petroleum industry has consistently opposed gasoline pricing caps over the years.

We have asked you for many years and ask you again now to reject the gasoline price cap. WSPA asks this because the cap and other "solutions" seem to be misguided efforts to address Hawaii's gasoline prices, while the real reasons prices, as repeatedly pointed out by consultants hired by the State, at times, are higher in Hawaii go unanswered.

Furthermore, the Public Utilities Commission issued a report to the Legislature dated November 2008. The report noted as part of its major conclusions about the Hawaii gasoline market, "the prices Hawaii consumers are paying for gasoline are determined by global gasoline markets, but influenced by Hawaii market conditions". Furthermore, the report concluded, "there do not appear any aberrant pricing activities by any of the reporting parties in Hawaii."

**High Taxes:**

Hawaii's gas taxes, at times over the years, have been the highest in the nation. In 2006, those taxes added nearly 60 cents to every gallon of gasoline purchased by consumers in Hawaii.

Presently, gasoline blended with ethanol as required by the state's ethanol blending mandate is exempt from state excise tax, but the legislature is considering proposals to suspend or eliminate the blending mandate, or the exemption, or some combination of both.

In addition, the House last week preliminarily advanced a measure that would increase the per barrel Hawaii Environmental Response Tax from 5 cents to $1 per barrel on petroleum products. Other proposals to increase taxes on gasoline and petroleum products which tend to increase prices at the pump are also under consideration.

**Anti-Consumer Regulations:**

Anti-competitive state regulations further add to the price at the pump according to the Federal Trade Commission. The FTC also attributes rent cap legislation and other government regulations with reducing the total number and quality of service stations, which results in higher product prices and inconvenience to consumers. Hawaii's current anti-encroachment legislation, also known as partial divorcement, creates further upward pressure on prices, according to the FTC.

**Higher Costs and a Small Market:**

Experts hired by DBEDT during Governor Cayetano's administration found that Hawaii gasoline dealers faced substantially higher fixed costs and lower sales volumes.

High costs create a barrier to new market entrants. According to University of Washington economist Dr. Keith Leffler, who testified on behalf of the State of Hawaii in the State's anti-trust suit against local oil companies, high barriers to entry that dissuade new competitors from entering the gasoline market in Hawaii include substantial fixed, or "sunk," costs.

And, according to the then-director of the DBEDT, economist Seiji Naya, Hawaii's isolated geography, which requires everything to be imported, creates natural barriers to entry into the Hawaii petroleum market. Dr. Naya testified in the State's anti-trust case that gasoline prices can be expected to be higher because the entry barriers to the market are higher. One of the higher costs involved in operating a gasoline service station (and refinery) is the higher real property expenses. The State of Hawaii Legislative Reference Bureau acknowledged the high land prices are a deterrent to petroleum industry expansion, as well as unrecoverable capital costs, environmental restrictions and the small market. Most recently, the Federal Trade Commission chimed in, acknowledging that "Hawaii's unusual land ownership regime [which makes] it difficult to obtain fee-simple ownership to land" may reduce the incentive to invest in station facilities.

Also, Hawaii's gasoline market is relatively small. As far back as 1990, the East-West Center concluded that it is no coincidence that Alaska and Hawaii have such high pre-tax gasoline prices, because both are small, isolated markets with correspondingly small refining industries – and that higher gasoline prices in Hawaii should not be surprising. The East-West Center Report remarked that competitors considering entry into the Hawaii market may weigh the costs against the possible benefits and decide that it would be a poor business venture – the then Hawaii gasoline market of 23,000 barrels per day was comparable to a medium-sized city, but requires marine facilities, terminals and a large local administrative staff that would not be needed to expand into a mainland city.

We are hopeful that DBEDT will explain in more detail why the gasoline price cap law fails to address the real reasons gas prices are higher in Hawaii. WSPA is here to add to the discussion what some of the experts have cited as the real reasons prices in Hawaii are high.

Unless these issues are addressed, no "solution" to Hawaii's higher gasoline prices is likely to be effective, and consumers will suffer from a repeat of Hawaii's unfortunate history with the failed gas cap.

ALOHA
Petroleum, Ltd.

LATE

**TESTIMONY TO THE**
**SENATE COMMITTEE ON ENERGY AND ENVIRONMENT**
**ON**
**SB 509 RELATING TO GASOLINE**
**By**
**Richard Parry**
**President and Chief Executive Officer**
**Aloha Petroleum, Ltd.**

Chair Gabbard and Members of the Senate Committee on Energy and Environment, I am Richard Parry, President and Chief Executive Officer of Aloha Petroleum, Ltd.

Aloha opposes SB 509 which mandates the PUC to reinstate the gas price caps if actual pre-tax wholesale gas prices exceed the price caps for 3 consecutive weeks and suspends the price caps when the actual pre-tax wholesale gas prices don't exceed the price caps for 3 consecutive months.

This legislation is fundamentally flawed and totally unnecessary.

1. Study after study and experience after experience have shown that an artificial system of price controls doesn't work. Hawaii's own experience with gasoline price caps was a problem – remember the long lines at gas stations when the price was about to rise, and the vehicle run outs when the price was about to fall; remember the public outrage when prices changed every week, sometimes dramatically. Look at your own studies, look at independent studies - it doesn't work.

1132 Bishop Street, 17th Floor • Honolulu, Hawai'i 96813
P.O. Box 500 • Honolulu, Hawai'i 96809 • Telephone (808) 522-9700 • Facsimile (808) 522-9707
www.alohagas.com

2. The state has imposed significant reporting requirements on the petroleum industry. We have to report all sorts of information on pricing, sales, inventories, margins and costs; frankly, it is a major nuisance and expense for jobbers and distributors like Aloha to have to do it. The state also requires that the PUC report annually on that information provided by the oil companies. The two PUC annual reports prepared to date - - based on its professional consultant's findings - - both point out no wrongdoing by the industry and no unreasonable behavior or profits. They point to no reason whatsoever to re-instate price caps.
3. This concept of temporarily re-instating price caps shows a total lack of understanding of how the Hawaii gasoline market works. Just look at recent experience - - the Hawaii market doesn't move as quickly as mainland markets, either up or down. Consequently, by imposing temporary price caps the legislature would structurally change the way the market prices, making the market much more likely to move quickly with other markets, *i.e.,* the same as we saw when the price cap was in full force.
4. Aloha strongly believes the formula used to calculate the price in the law that is currently on the books is fundamentally flawed and was never properly vetted by the Hawaii legislature before its passage because the amended law would be immediately suspended. See our detailed comments in the attachment. For that pricing formula to be reinstated by the PUC would be a major problem.

It would be a major mistake to re-instate price caps in any form, and the form proposed would be a total disaster. Please don't pass this bill.

Thank you for the opportunity to testify in opposition to Senate Bill 509.

## Attachment

## Problems with the Price Cap Formula

As you recall in 2006, over our opposition and the opposition of many industry participants, including the PUC's own consultant, that legislature amended the price cap formula to: (1) add the Singapore spot daily price for regular unleaded gasoline in determination of the Baseline price, with the lowest three of the four average geographic prices averaged for the State Baseline price; (2) eliminate the location adjustment factor; and (3) reduce the marketing margin factor to 14 cents.

Other than to artificially lower the price caps, there was no stated justification for any of these changes to the price cap law. At that time, Aloha Petroleum opposed the addition of the Singapore spot daily price for regular unleaded gasoline in determining the Baseline price because, as reported by the PUC's consultant, gasoline produced in Singapore has significantly higher sulfur and benzene levels than gasoline sold in Hawaii or the U.S. Therefore, Singapore is not a suitable market to use in the law's Baseline because Singapore-refined gasoline is not a product that can be used in Hawaii or anywhere else in the United States. Furthermore, the use of the Singapore gasoline market as well as the other Baseline markets is highly inappropriate because these markets deal with conventional gasoline as opposed to "reformulated" gasoline needed to blend with ethanol as we are required to do in this State.

Use of the spot daily price for Singapore gasoline would also require that both the location adjustment factor and the marketing margin adjustment factor be increased to account for increased freight costs and the additional costs that would be incurred by Singapore refiners to produce gasoline meeting the gasoline specifications for use in Hawaii. The changes to the price cap law in 2006 make no adjustment for these very real cost differentials and greatly increase the risk of market dislocations and other unintended consequences.

Instead, the price cap law eliminated the location adjustment factor altogether. The location adjustment factor was meant to address the freight cost to get refined products to Hawaii from the three mainland markets originally used in the Baseline. The Oahu zone adjustment was meant to recognize the cost and value provided by terminalling, storage, trucking and distribution activities on Oahu. Therefore, these adjustments had a designed purpose and were an attempt to reflect actual values for services provided by industry participants.

The price cap law's elimination of the location adjustment factor makes absolutely no sense at all. Indeed, the PUC consultant itself stated that "the location factor proposed [of 4 cents] was extraordinarily low based on all historical information" and recommended using even a higher number. Aloha Petroleum also opposed the reduction of the marketing margin factor because there was also no justification for this change. Simply ignoring the realities of the marketplace will undoubtedly have serious unintended consequences.

Finally, the price cap law fails to consider the economic consequences of the state-mandated ethanol-blending and the potentially dire consequences if Hawaii refiners begin to export gasoline out of Hawaii or if one or both refineries close as a result of the reinstatement of this flawed law. Price controls in a market economy do not work and any attempt to reinstate this faulty law will only produce additional unintended harmful consequences.

**From:** mailinglist@capitol.hawaii.gov
**Sent:** Tuesday, February 10, 2009 11:15 PM
**To:** ENETestimony
**Cc:** BJB@hawaii.rr.com
**Subject:** Testimony for SB509 on 2/12/2009 4:00:00 PM

Testimony for ENE 2/12/2009 4:00:00 PM SB509

Conference room: 225
Testifier position: oppose
Testifier will be present: No
Submitted by: Brian Barbata
Organization: Individual
Address:
Phone:
E-mail: BJB@hawaii.rr.com
Submitted on: 2/10/2009

Comments:
Chairman Gabbard, Vice-Chair English and Committee members:

I was shocked when I noticed that the Legislature was seriously considering reviving the infamous "Gas Cap". This was the laughing stock of the year a couple of years ago, and it backfired horribly. Why would you want to give it another try? All it does is tell everyone (including competitors) what the price is going to be in a few days, and everyone either hoards gasoline or runs on fumes until the price changes. You know it won't lower gasoline prices, and may well increase them. Coming off of $5 gasoline finally, and into a deep recession, it is hard to conceive of why anyone would want to make another unknown experiment like this by dabbling in one of the most complicated industries on earth. You might like to keep things simple, but it's not always possible.

My understanding is the Hawaii Legislature has been advised over and over by all manner of consultants and government agencies NOT to try this. Whose advice are you listening to? Vindictive anti-business people who are of the opinion that the oil companies are the root of all our problems? Please. We rely on you for better judgment than that. Why does Hawaii think it has to be the first and only state to attempt regulating gasoline prices? IT WON'T WORK!

Thank you for considering these comments.

**From:** mailinglist@capitol.hawaii.gov
**Sent:** Thursday, February 12, 2009 9:56 AM
**To:** ENETestimony
**Cc:** edsel@garlowpetroleum.com
**Subject:** Testimony for SB509 on 2/12/2009 4:00:00 PM

LATE

Testimony for ENE 2/12/2009 4:00:00 PM SB509

Conference room: 225
Testifier position: oppose
Testifier will be present: No
Submitted by: Edsel Eshima
Organization: HMPA
Address: Kakoi Street Honolulu, Hawaii
Phone: 836-1957
E-mail: edsel@garlowpetroleum.com
Submitted on: 2/12/2009

Comments:

HAWAII PETROLEUM MARKETERS ASSOCIATION
P.O. Box 500 • Honolulu, Hawaii 96809

LATE

**TESTIMONY TO THE**
**SENATE COMMITTEE ON ENERGY AND ENVIRONMENT**
**ON**
**SB 509 RELATING TO GASOLINE**
**By**
**Robert W. Fung, President**
**Hawaii Petroleum Marketers Association**

Chair Gabbard and Members of the Senate Committee on Energy and Environment, I am Robert Fung, President of the Hawaii Petroleum Marketers Association.

SB 509 requires the PUC to effectively reinstate the suspended gas price cap law. The Hawaii Petroleum Marketers Association opposes this bill because the significant amendments to the gas price cap law were never properly vetted by the legislature based on the understanding the amended law would be immediately suspended after its passage. To require the suspended law be reinstated three years later with no proper vetting of the amendments is disturbing.

As we all know, the proponents of the price cap law were clearly pandering to Hawaii's consumers with promises of cheaper gas prices based on an arbitrary, artificial and unrealistic price cap formula in total disregard to the adverse consequences to the Hawaii marketplace, industry participants and consumers. In support of this statement, we point to the words of the PUC's own consultant, ICF Consulting.

In testimony before this committee in 2006, ICF stated the following:

- ICF did not recommend the use of the Singapore gasoline spot market in the baseline without a commensurate and market-based adjustment for real freight costs.
- ICF did not recommend elimination of the 4 cents per gallon location adjustment factor, but rather, they recommended increasing the location adjustment factor to a market-based freight cost.
- ICF's estimation for the marketing margin factor was in line with the original price cap formula, and they did not recommend lowering the marketing margin factor.

So what did this legislature do before suspending the law? It adopted the exact opposite of ICF's recommendations without any justification:

- It adopted the Singapore gasoline spot market in the baseline <u>without</u> a commensurate and market-based adjustment for real freight costs.
- It eliminated entirely rather than increase the 4 cents per gallon location adjustment factor used in the price cap formula.
- It lowered the marketing margin factor used in the price cap formula.

Again, the Hawaii Petroleum Marketers Association opposes the reinstatement of the gas price caps because the legislature never properly vetted significant amendments to the gas price cap law before its suspension and because it is based on an arbitrary, artificial and unrealistic price cap formula without regard to the adverse consequences to the Hawaii marketplace, industry participants and consumers.

Thank you for the opportunity to testify in opposition to Senate Bill 509.