Consumer Watchdog

October 10, 2012

Attorney General Kamala Harris
Senior Assistant Attorney General Kathleen Foote
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RE: Acquisition by Tesoro Inc. of BP refinery, ARCO stations

Dear Attorney General Harris and Ms. Foote,

As we write you, the average price for California gasoline stands at $4.67 a gallon. That's a record high for the state and the highest price in the nation. We've just experienced a jump of 50 cents a gallon in a week.

Senators Diane Feinstein and Barbara Boxer are asking federal regulators to look into whether malicious trading schemes are the reason California consumers are paying record high prices. Historically, California refineries have tried to restrict supply, driving up prices. Recent supply disruptions haven't helped in a state that has only 14 refineries powering the world's eighth largest economy.

In this light, we urge you to stop the announced purchase of BP's large refinery in Southern California and its ARCO gasoline stations by refining company Tesoro. If the purchase goes through, the situation for consumers will only be worse. A California refining market that is already concentrated and uncompetitive will become a duopoly, with even higher retail gasoline prices and greater market control by the industry.

If the purchase goes through, Tesoro and Chevron will between them own nearly half of California's fuel refining capacity, including the three largest refineries in the state. The next two largest refining companies, Valero and Shell, would be a distant third even if combined. California's drivers and the state economy will pay the price for this merger at the pump. We ask you to halt it on antitrust grounds.

California's already low supplies of gasoline on hand—a major factor in the state's consistently higher pump prices than in the rest of the nation—are a product of refiners' refusal to build enough gasoline stocks to cushion market prices in the event of any emergency. For instance, the 28-cent-a-gallon jump in gasoline prices following the Chevron refinery fire was a direct result of low supplies of gasoline in the state when the accident occurred. Energy analysts at Stillwater Associates estimate the state's days of supply on hand at around ten days when the historical average for other states, which don't have California's isolation from outside supplies, is around 24 days.

California's major refining companies have historically tried to restrict and reduce the number of refineries and their output to increase their market control and profit margins:

- Whistleblower documents from the mid-1990s show deliberate attempts by Chevron, Texaco, Mobil, Shell and the American Petroleum Institute to reduce refinery capacity in the state and nationally. The companies blame competition and "excess" refining capacity for reducing their profit margins and discuss the need for refinery closures and buyouts to increase profits.[1]

- In 2004, Shell Oil sought to permanently shut, rather than sell, its Big West Refinery in Bakersfield, removing about 40,000 barrels a day of refining capacity from the California market. Only intense consumer protests and pressure from Attorney General Bill Lockyer resulted in Shell agreeing to sell rather than shut the refinery in 2005.[2]

- In a 2007 study, Consumer Watchdog found that refiners' "discretional refinery production drop" led to a gasoline price spike in May 2007 that rivaled the price effects of the 2005 Katrina hurricane

[1] Consumer Watchdog news release, *"Internal Memos Show Oil Companies Intentionally Limited Refining Capacity To Drive Up Gasoline Prices"* Sept. 7, 2005. Link to release and individual memos: http://www.consumerwatchdog.org/newsrelease/internal-memos-show-oil-companies-intentionally-limited-refining-capacity-drive-gasoline

[2] Consumer Watchdog News Release, Jan. 10, 2005. "Shell's Sale of Bakersfield Refinery Is Historic Victory For Motorists. http://www.consumerwatchdog.org/newsrelease/shells-sale-bakersfield-refinery-historic-victory-motorists

disaster on the Gulf Coast. Refineries in 2007 reaped record profits as a result, even as oil prices fell.[3]

California is almost entirely supplied with gasoline by the state's own refineries, with California-formula gasoline largely unavailable by domestic pipeline from other states. It is in refiners' self-interest to restrict production and supply, taking higher profits from selling less but more expensive gasoline. Tesoro's purchase of the BP refinery will intensify the ability of one or two companies to control output and supply.

Refining can be a volatile business, and even in California not every refinery is profitable in every quarter, no matter how much the industry suppresses supply. Oil producers like BP and Chevron offset occasional refining losses with oil production profits. Pure refiners like Tesoro and Valero cannot. This increases the likelihood that Tesoro would seek to further limit refining output in the state if it purchases the BP facility.

Tesoro has already indicated that it would merge functions of the BP refinery with those of the adjacent Tesoro refinery in Wilmington, CA. Such "streamlining" is highly likely to result in a permanent reduction in output disguised as a shutdown of "redundant" or aging refining units.

Ironically, Tesoro owns the Wilmington refinery only because Attorney General Bill Lockyer required Valero to sell it off in 2001 as a condition of approval for an earlier—and smaller--refining merger. Regulators said they would not allow Valero to have three California refineries. Yet if the Tesoro-PB merger is allowed, Tesoro would not only own three major California refineries, but would also become the biggest refiner on the West Coast.

In the retail gasoline market, especially in Southern California, the purchase of ARCO stations would also likely push Tesoro--which already controls Shell-branded Southern California stations, plus Tesoro, USA and Thrifty-branded stations statewide, to No. 1 in retail locations. Shrinking competition will almost certainly remove Arco as the state's largest lower-priced seller.

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[3] "The Katrina Syndrome," July 23, 2007, by Consumer Watchdog and analyst Tim Hamilton. http://www.consumerwatchdog.org/resources/KatrinaLessons2007.pdf (some users may have to cut and paste this link)

Consumer Watchdog has studied the market concentration in California's refining industry for more than a decade. We would be pleased to offer additional research or assistance to your office.

The conditions of the refining market in California today are even more stacked against consumers than in 2001. The state still has no authority over refinery output or supply. Refiners are not required to even report outages to regulators. Environmental and safety regulation of refineries is so fragmented that it is largely ineffective.

The number of operating refineries and owners has continued to shrink. Refiners' refusal to make safety and operational updates makes outages and accidents more likely, as with the entirely preventable Chevron Richmond blaze Aug. 13. Yet days of supply are in the teens, making every accident and outage a price-spike and profit opportunity.

Allowing Tesoro to purchase the BP refinery will only make the current untenable situation worse for consumers and the California economy. We urge you to forbid the purchase *in toto*.

Sincerely,

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