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State attorney says legal price-gouging going on

Lawmakers may push bills to regulate fuel prices during upcoming session

Alaska legislators say they'll consider gasoline price-regulation or other actions, including state investment in a refinery, if refiners in Alaska don't lower gasoline prices.

"We're under tremendous pressure from our constituents to do something," Rep. Jay Ramras, R-Fairbanks, said in a legislative hearing Oct. 23.

Gasoline prices are dropping fast across the nation as crude oil prices fall, but they remain high in Alaska.

Ramras chairs the House Judiciary Committee, which held hearings on the fuel price issue in Anchorage.

At the hearing the state's lead attorney in an investigation on fuel prices told legislators that gasoline prices in Anchorage were as much as 90 cents a gallon higher than Seattle this summer and fall. On Oct. 24 regular gasoline sold for $3.51 per gallon in some Anchorage retail stations. On the same day gasoline prices averaged $3.08 per gallon in Seattle and $2.92 per gallon nationwide.

Prices were higher in small communities outside Anchorage. In Cordova, gasoline was selling for $4.93 per gallon. Residents of Kake, in Southeast Alaska, were paying $5.50 per gallon.

Ed Sniffen, head of the Department of Law's consumer protection division and lead investigator in the gasoline price inquiry, said he can find no explanation for the large price difference between Seattle and Alaska.

"Spreads like that raises anti-trust red flags," Sniffen told the Judiciary Committee.

It is possible that there is no illegal market activity and that the extended lag in price reductions results simply from the structure of the market, Sniffen said. He called it a "duopoly," or market domination by two suppliers.

Two refineries supply gasoline in Alaska. Tesoro Corp. is the state's main supplier, operating from its refinery near Kenai. Flint Hills Resources, a Koch Industries subsidiary, supplies gasoline to Interior Alaska markets from its refinery near Fairbanks.

Two other small refineries operated by PetroStar Inc., an Alaska company, make only jet fuel and diesel.

All of Alaska's fuel requirements except in the Southeast panhandle region are supplied by Tesoro and Flint Hills. Southeast Alaska is supplied by refineries in the Pacific Northwest.

Tesoro declined to appear before the committee, but Sniffen said he and other state investigators met with company officials in Anchorage on Oct. 22. Tesoro was cooperative in providing information, but Sniffen said he was unable to tell legislators what was discussed because of confidentiality agreements.

Flint Hills' Alaska public affairs manager Jeff Cook did appear before the committee but told legislators he couldn't answer detailed questions because of the investigation. Cook said Flint Hills supplies only 15 percent of the state's gasoline market and all of that is in Interior Alaska.

He also said new federal and state environmental requirements on fuels have imposed costs on the company's refinery, with an additional result that it is unable to produce as much gasoline as it did previously.

Ramras asked Econ One Inc., a consulting firm working for the state Department of Law, to analyze the effects of several legislative options, including price controls.

Other lawmakers aren't enthused about controls.

"Price controls can be very dangerous. The answer is to

increase competition," Rep. Bob Lynn, an Anchorage Republican, said in the meeting.

Rep. Les Gara, an Anchorage Democrat, said he favors either price regulation or a major state investment in one of two refineries serving Alaska so state officials will have a way to influence markets.

"If the state owns 51 percent of one of the refineries, we could decide to take a lower margin at certain times as a way of influencing behavior of the other refiner," Gara has said.

These ideas would obviously require a great deal more discussion, but Gara expects several legislators to introduce bills next spring.

There may be an opportunity for state investment in the Flint Hills refinery. The company is studying options for the plant, including selling it, because of poor financial performance. One of the problems is a high premium charged by the state for state-owned royalty oil supplied to Flint Hills.

Sniffen also told the legislative committee the state could act to induce new competition. When such a large price spread between regional markets exists, competitors typically rush new supply into that market to take advantage of higher prices.

That isn't happening in Alaska, Sniffen said, possibly because the gasoline market is small and the existing suppliers control storage and distribution.

"There might not be enough of an incentive for an entrepreneur to get into the market," Sniffen said.

Barry Pulliam, an economist with Econ One, agreed with Sniffen.

"In small markets the normal price discipline, the opportunity for competitors to bring product in from elsewhere, is often missing," he said. "It's a complex question but it's often difficult to get people to do it."

Hawaii's situation is similar to Alaska's in that the state is remote and has two refineries, and the market is relatively small. The price spread for gasoline between Hawaii and the West Coast is almost as high as in Alaska, Pulliam said.

California provided an example of what can happen when the opportunity to import competing supply is missing.

When the state of California imposed standards for gasoline formulation for environmental reasons, the price differences between California and Texas, for example, at times reached 50 cents to 60 cents per gallon even though it only cost 8 to 12 cents per gallon to transport fuel from the U.S. Gulf Coast to California. Because California imposed the special fuel standards and it wasn't made elsewhere, there was a supply restriction.

Ramras said the state could invest in bulk fuel tanks at Anchorage's port, which could then be leased to a competitor bringing gasoline to the state.

Sniffen said Alaska's toolbox to influence refiners is limited absent discovery of antitrust or illegal collusion, because the state doesn't have a price-gouging law. Refiners are free to charge whatever they think the market will bear.

"In theory, there is nothing preventing them from charging $10 per gallon," he said.

But price-gouging laws in other states, which could serve as a model for

Alaska, are typically linked to a natural disaster, such as a hurricane, and not to high crude oil prices. In those cases the state or other government entity must declare an emergency, which gives it powers to impose penalties if a marketer hikes prices unusually high compared with price levels prior to the event that triggered the emergency.

An alternative is for the Legislature to bring gasoline under state utility regulation that now covers telecommunications, electricity and natural gas sales, Sniffen said.

"That would work. It's a proven procedure," he said. The pitfalls with this are in the extended time needed for regulatory proceedings, he said.

Ramras said an option he wants to consider is to require refiners to maintain a certain spread between Anchorage and Seattle wholesale prices when crude oil prices exceed $100 per barrel, and to apply penalties if the spread exceeds those limits.

Sniffen said Flint Hills and Tesoro face challenges with their refineries. Flint Hills operates a topping plant near Fairbanks that can only make certain products from crude oil. Most of the output is jet fuel sold to airlines flying into international airports in Anchorage and Fairbanks. Flint Hills is capable of making only limited quantities of gasoline and diesel.

The refinery is also dependent on state-owned royalty oil delivered through the trans-Alaska oil pipeline, for which it pays a premium.

Tesoro's refinery near Kenai is designed to process light crude oil from Cook Inlet fields, but that supply is supplemented with crude oil from the North Slope and elsewhere. The refinery also has limited options for selling its residual oil, which amounts to about a third of production, and takes a loss on this, Sniffen told legislators.

Ramras said he doesn't want to "demonize" the refineries because he recognizes the problems they face. "Both of these plants are not models of efficiency," he said.

Sniffen cautioned legislators on price controls because of possible unexpected effects.

"In the worst case, one of the two refineries could close, leaving you worse off. There could also be effects on supply reliability," if the state moved aggressively to control margins. "Contracts for delivery to remote communities could be affected, for example."
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