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Hawaii Gas Caps Overview

- Hawaii has a long history of mistrust with the oil companies over the price of gasoline in the state.

- In 1998, the State Attorney General, Earl Anzai, filed an antitrust lawsuit against the major oil companies, including BHP (now Tesoro), Chevron, Shell, Texaco and Unocal.

- The AG announced that the suit would reclaim up to $2 billion from the oil companies for colluding on pricing and overcharging consumers.

- BHP & Tesoro settled early for $10 million because they wanted to consummate their pending merger.

- The remaining parties settled the anti trust lawsuit in March 2002 for $20 million.

- In Stillwater's opinion, this settlement reflected the fact that the market lacked vigorous competition and passed along the intrinsically high cost of doing business in Hawaii. No collusion had taken place.

- Because the settlement was far lower than the claimed damages, then Governor Ben Cayetano directed the Legislature to enact a price control bill. This bill included funding for a study of the issue.

- Late in 2002, Stillwater Associates was retained by the State to study the issues. Our team of experienced professionals went to Hawaii and interviewed more than 100 stakeholders, people involved in the issue, including legislators, government officials, refiners, jobbers, dealers, and logistic service providers.

- Stillwater Associates thoroughly studied the issues. In our report we pointed out that price controls have not worked in other markets. They typically lead to higher prices for consumers and poorer service. During the 1970's, U.S. gasoline price controls lead to shortages and long lines at service stations. In Canadian provinces, price caps failed to produce any measurable consumer advantages, but did lead to gaming of the formulae by market participants. Ironically, the caps also caused consumers to blame the local government rather than the oil industry for high prices at the pump.

- Our recommendation was that the price caps law not be implemented but that price reporting structures and analytical resources would be provided that would enable government agencies to adequately monitor profitability by segment. Most importantly, we recommended a look at the broader picture in terms of long term energy security for the state.

- The legislature rejected this recommendation. During the 2004 session, the law was modified to cap wholesale instead of retail prices, and set the implementation date for September 1, 2005.

- The current price cap formula is based on a weekly average of spot gasoline prices in Los Angeles, the Gulf Coast, and New York Harbor. This formula links Hawaii to the Mainland's more volatile markets. Added to the average are adjustments for transportation, marketing margin and other factors. Prices for the Neighbor Islands are adjusted above Oahu prices because of the higher costs to barge gasoline to these markets.

- Spot prices will be averaged from Wednesday to Tuesday. The new week's price will be announced on Wednesday for implementation the following Monday.

- Given these rules, two kinds of market distortions seem likely. Because the price is known on Wednesday and effective the following Monday, price conscious gasoline consumers will fill up on the weekend before a price rise. Conversely, they will wait until Monday if they know prices will fall. Today gasoline demand is fairly constant during the week, with Monday and Friday perhaps busier than Sunday or Wednesday. The gasoline distribution system is designed to meet this demand. If sales suddenly surge into one day or another, long lines could develop at stations. There is a chance that the gasoline delivery trucks will not be able to keep up, resulting in runouts at gas stations. This will be solved over time, but will add to the cost of doing business because the companies will have to buy more trucks and hire more drivers.

- Secondly, due to the way the regulations are written, there is a possibility that wholesalers on the Neighbor Islands (Kauai, Lanai, Maui, Molokai, and the Big Island of Hawaii) will not be able to economically supply their customers in remote areas. We expect that the State's Public Utilities Commission will address this issue to keep these firms in business. Of course, this will add to consumers' costs.

- Recent analysis by the Honolulu Advertiser points out that the gas caps formula, over the last year, would have been similar to actual market prices. Clearly the gas caps regulation is a solution looking for a problem.

- The key recommendation of the Stillwater report was to develop an integrated energy strategy that looked at fuel and energy in a coordinated fashion. Our major concern is that the narrow focus of the gas cap regulation completely ignores the larger issues of a global shortage of crude oil production and refining capacity, relative to demand. The gas caps issue diverts resources from the analysis and research efforts necessary to meet the state's growing energy needs.

- More information can be found at Stillwater Associates' website, www.stillwaterassociates.com