BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----In the Matter of---- PUBLIC UTILITIES COMMISSION Instituting a Proceeding to Investigate the Issues and Requirements Raised by, and and Contained in, Hawaii Revised Statutes 486H, as Amended.	DOCKET NO. 05-0002

DECISION AND ORDER NO. 21952

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DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

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Brooke K. Kane
for Chief Clerk of the Commission

ATTEST: A True Copy
BROOKE K. KANE
Administrative Director
Public Utilities Commission
State of Hawaii
Brooke K. Kane

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OF THE STATE OF HAWAII

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PUBLIC UTILITIES COMMISSION	Docket No. 05-0002
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DECISION AND ORDER

Executive Summary

By this order, under Hawaii Revised Statutes ("HRS") Chapter 486H (aka the Hawaii Gas Cap Law),[1] the commission sets forth: (1) the factors for determining the maximum pre-tax wholesale price of gasoline (aka gas price caps or gas caps); (2) the procedures for filing petitions and complaints with the commission; (3) the publication procedures for the commission

[1]During the 2002 legislative session, the Legislature enacted Act 77, Session Laws of Hawaii 2002, which established maximum pre-tax wholesale and retail prices on regular unleaded gasoline to be sold in the State of Hawaii (the "State" or "Hawaii"). In 2004, the Legislature enacted Act 242, Session Laws of Hawaii 2004 ("Act 242"), which among other things: (1) changed the baseline for determining maximum pre-tax wholesale gasoline prices by using the average of the spot prices for regular unleaded gasoline for the markets of New York Harbor, the United States ("U.S.") Gulf Coast, and Los Angeles; (2) extended the maximum pre-tax wholesale price limits to mid-grade and premium gasoline; (3) repealed the maximum pre-tax retail gasoline price; (4) established zones within the State and authorized the commission to adjust the maximum pre-tax wholesale gasoline prices in the various zones; (5) extended the effective date for the imposition of the maximum pre-tax wholesale gasoline price limit to September 1, 2005; and (6) appropriated funds, to be expended by the commission, to carry out the purposes of Chapter 486H and Act 242.

regarding the maximum pre-tax wholesale price of gasoline; and (4) the risks identified in implementing HRS Chapter 486H.

Under HRS § 486H-13(b), "the commission shall determine the maximum pre-tax wholesale price of regular unleaded, mid-grade, and premium gasoline . . . such that the maximum pre-tax wholesale gasoline prices reflect and correlate with competitive market conditions."

As described in greater detail below, to initially implement HRS Chapter 486H, the commission concludes that the following factors should be used in the HRS Chapter 486H maximum pre-tax wholesale price calculation: (a) the HRS Chapter 486H baseline price and location adjustment factor established by the Legislature; (b) the HRS Chapter 486H marketing margin factor established by the Legislature; (c) the HRS Chapter 486H Premium and Midgrade adjustments established by the Legislature; and (d) proposed zone price adjustments recommended by the commission's consultant, ICF Consulting, LLC ("ICF"), using, however the highest actual transportation costs rather than average transportation costs, as proposed by ICF (the Legislature did not establish zone price adjustments under HRS § 486H-13).

Although the commission has the discretion to use "more appropriate" factors or "otherwise determine" various factors under HRS § 486H-13, to-date the commission has not found sufficient justification to deviate from the factors established by the Legislature in HRS § 486H-13(b)-(g).[2] The methodology

[2]Although the commission in this order does not adopt many of the recommendations made by ICF, the commission greatly appreciates ICF's expertise and its efforts in preparing its report, "Implementation Recommendations for Hawaii Revised

adopted by the commission in this order constitutes its best efforts to address and mitigate some of the risks identified by ICF and the Parties and implement the current Hawaii Gas Cap Law on September 1, 2005, within the spirit and intent of the legislation.[3]

Statutes Chapter 486H, Gasoline Price Cap Legislation" ("ICF Report"), in a short period of time, and its assistance in the commission's investigation and efforts to implement HRS Chapter 486H. The commission notes that while the many of the Parties disagreed with the ICF's proposal in its Report, the Parties did not provide meaningful alternatives to the factors established in HRS § 486H-13(b)-(g).

[3]ACT 242, Hawaii Sessions Laws 2004 provides, in relevant part:

> During the 2002 legislative session, the legislature found that affirmative action was necessary to address the high price of gasoline in light of the strong tendency of the structure of the gasoline market in the State to perpetuate high and rising prices and the resulting supra-competitive margins realized by market participants. As a result, the legislature enacted Act 77, Session Laws of Hawaii 2002, which established maximum pre-tax wholesale and retail prices on regular unleaded gasoline to be sold in the State, on a self-serve basis.
>
> Since the passage of Act 77, the legislature has found that the problem of high gasoline prices is principally due to a lack of vigorous competition in the oligopolistic wholesale market, a phenomenon that was acknowledged in the testimony and unsealed documents in Anzai v. Chevron et al., and described in the study of fuel prices and legislative initiatives for the State of Hawaii, prepared by Stillwater Associates for the department of business, economic development, and tourism.
>
> The legislature has also found that there is competition at the retail level where there are approximately three hundred thirty-nine gasoline stations throughout the islands. Further, as stated on page 62 of the Stillwater Associates study, "Today,

service stations in Hawaii derive revenues not just from the c-stores (convenience stores) that first replaced the service bays, but from multiple sources, ranging from car rentals to fast food, and discount stores to car washes." Thus, through the sale of these other profitable products and services, many of these service stations have additional revenue sources to provide a means to compete vigorously for gasoline sales by accepting lower margins on gasoline in order to attract customers for gasoline, and thereby create opportunities for the sale of these other products and services, and vice-versa.

The legislature's findings on the lack of competition at the wholesale level and the existence of competition at the retail level are also supported by findings of fact made by the United States District Court in Chevron U.S.A., Inc. v. Cayetano, Civil No. 97-00933, in which the court found that "Hawaii's gasoline market is an oligopoly at the wholesale level but very competitive at the retail level."

To address the lack of competition at the wholesale level, instead of imposing limits on gasoline prices, the legislature would prefer a structural solution that would yield, foster, or promote a competitive market environment that will benefit consumers. But despite the criticisms levied at Act 77, no one has proffered such a structural solution, with the only "solution" often advanced being a repeal of Act 77 and thereby allowing the maintenance of the status quo.

The legislature finds that maintaining the status quo will continue to work to the detriment of the consumer welfare. Thus, after much deliberation, the legislature finds that there continues to be a need for affirmative legislative action in regards to gasoline prices. But rather than the means chosen and reflected in Act 77, the legislature finds that enhancing the welfare of consumers will be better achieved by fostering the opportunity for prices that reflect and correlate with competitive market conditions. Accordingly, the objective of this Act is to enhance the consumer welfare by fostering the opportunity for prices that reflect and correlate with competitive market conditions.

It should be clearly understood that the objective of this Act is not to guarantee lower gasoline prices. And in this regard, the legislature anticipates that, from time to time, there may indeed be situations where the actual pre-tax wholesale price of gasoline may be less than the maximum pre-tax wholesale prices of gasoline. This phenomenon should be expected, for nothing in this Act compels any manufacturer, wholesaler, or jobber to price up to the maximum pre-tax wholesale prices of gasoline.

The legislature intends to keep a watchful eye on tendencies for the actual pre-tax wholesale price of gasoline to equal the maximum pre-tax wholesale prices of gasoline since such parity could well suggest that additional affirmative legislative action is needed. The possibility of the need for additional affirmative legislative action is not a sign of infirmities in the Act, but, rather, a recognition of the myriad options available to market participants to impair the consumer welfare.

In furtherance of the objective of this Act, the legislature finds that it should be sufficient to limit gasoline prices solely at the wholesale level and to not establish maximum pre-tax retail gasoline prices. The repeal of provisions in Act 77 relating to the setting of maximum pre-tax retail gasoline prices should allow competition to continue at the retail level.

Act 77 provided that the maximum pre-tax wholesale price was to be determined on a weekly basis, based on the average of the spot prices for regular unleaded gasoline for the markets of Los Angeles, San Francisco, and the Pacific Northwest. In furtherance of the objective of this Act, the legislature finds that a more appropriate basis for determining maximum gasoline prices to enhance consumer welfare is the use of the average of the spot prices for regular unleaded gasoline for the markets of New York Harbor, the United States Gulf Coast, and Los Angeles.

The legislature further finds that it is appropriate to set maximum pre-tax wholesale prices for mid-grade and premium gasoline to guard against unreasonable increases in the wholesale price of these grades of gasoline in the wake of the imposition of price limits on regular unleaded gasoline.

The legislature also recognizes that Hawaii, being a chain of islands with different demographics, populations, terminal and storage facilities, and economies of scale, contains different sub-markets and that it is necessary to identify these sub-markets by zones. Accordingly, the public utilities commission should have the authority to make any necessary adjustments to the maximum pre-tax wholesale gasoline prices in recognition of any unique attributes of these sub-markets that may have an impact on the prices. As a check on the zone price adjustments, however, and to ensure that the market conditions and attributes of the neighbor island markets are confronted and properly addressed, it is appropriate that further study be undertaken by the legislature through a legislative task force.

The purposes of this Act are to:

1. Change the baseline for determining maximum pre-tax wholesale gasoline prices by using the average of the spot prices for regular unleaded gasoline for the markets of New York Harbor, the United States Gulf Coast, and Los Angeles;
2. Extend maximum pre-tax wholesale price limits to mid-grade and premium gasoline;
3. Repeal the maximum pre-tax retail gasoline price;
4. Establish zones within the State and authorize the public utilities commission to adjust the maximum pre-tax wholesale gasoline prices in the various zones;
5. Establish a legislative task force to investigate the petroleum industry and its operations on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii;
6. Extend the effective date for the imposition of the maximum pre-tax wholesale gasoline price limit; and
7. Make an appropriation, to be expended by the public utilities commission, to carry out the purposes of chapter 486H and this Act.

I.

Introduction

A.

Procedural Background

By Order No. 21525, issued on January 4, 2005, the commission instituted an investigation to examine the issues and requirements raised by, and contained in, HRS Chapter 486H, as amended. By the same order the commission made Chevron U.S.A. Inc. ("Chevron") and Tesoro Hawaii Corporation ("Tesoro") parties to this docket. Pursuant to Hawaii Administrative Rules ("HAR") § 6-61-62, the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs ("Consumer Advocate") is an *ex officio* party to any proceeding before the commission. By Order No. 21579, issued on February 2, 2005, the commission granted Shell Oil Company's ("Shell") and Hawaii Petroleum Marketers Association's ("HPMA") motions to intervene in this proceeding.[4] By Order No. 21669, issued on March 1, 2005 the commission approved in part and modified in part the Parties' Proposed Stipulated Protective Order.[5] By Order No. 21670, issued on March 1, 2005, the commission also set forth the commission's regulatory schedule for this proceeding.

[4]On January 24, 2005, HPMA and Shell filed timely motions to intervene in this proceeding pursuant to Hawaii Administrative Rules ("HAR") § 6-61-55.

[5]By letter dated March 8, 2005, HPMA, among other things, objected to the modifications in Order No. 21669, specifically paragraphs 16 and 17 of the protective order. By letter dated March 9, 2005, the commission, among other things, addressed HPMA's objections.

From February 2, 2005 through April 15, 2005, the commission conducted its discovery of the issues of this docket. On February 2, 2005, the commission issued information requests to the Department of Business, Economic Development and Tourism ("DBEDT"). On February 16, 2005, DBEDT filed its responses to the commission's information requests.[6] By letter dated February 24, 2005, the commission requested that the Parties, excluding the Consumer Advocate, respond to the commission's information requests.[7] By letter dated February 24, 2005, the commission requested that Sause Bros., Inc., and Smith Maritime, Ltd., respond to the commission's information requests. On March 24, 2005, the Parties filed their responses to the commission's information requests.[8] On March 28, 2005, Sause Bros., Inc., filed its responses to the commission's information requests.[9] On March 29, 2005, the commission issued

[6]By letter dated February 10, 2005 and filed on February 11, 2005, DBEDT requested a five (5)-day extension to February 16, 2005, to answer the commission's information requests. By letter dated February 14, 2005, the commission approved DBEDT's request. By letter dated May 23, 2005, filed on May 24, 2005, DBEDT submitted its comments on ICF's Report.

[7]By letter dated March 2, 2005, the commission clarified PUC-IR-8.

[8]On March 3, 2005, Shell filed a letter requesting an extension until March 31, 2005 to submit its responses to the commission's information requests. On March 8, 2005, HPMA and Tesoro filed separate letters requesting an extension until March 31, 2005 to submit their responses to the commission's information requests. By letter dated March 9, 2005, the commission, among other things, extended the Parties' deadline for responding to the information requests until March 24, 2005.

[9]Smith Maritime, Ltd., did not respond to the commission's information requests. On March 9, 2005, Sause Bros., Inc. sent an e-mail message requesting an extension of time, until March 21, 2005, to respond to the commission's information requests. By letter dated March 9, 2005, the commission granted

supplemental information requests to the Parties, excluding the Consumer Advocate. On April 1, 2005, the Parties filed their responses to the commission's supplemental information requests. On April 5, 2005, Shell filed its second response to PUC-IR-23 and Amended Response to PUC-IR-1. On April 6, 2005, Chevron filed its supplemental response to the commission's information requests.[10]

On April 10, 17, 24, and May 1, 2005, the commission published its notice of public meetings statewide. On April 15, 2005, ICF submitted and filed its report. On April 19, 2005, ICF presented its report to the Hawaii State Senate and the Hawaii State House of Representatives.

From May 2, 2005 through May 12, 2005, the commission held public meetings in each of the eight (8) zones identified by the Legislature in HRS Chapter 486H.[11] On May 18, 2005 through May 20, 2005, the commission held technical meetings with ICF and the Parties.[12] On May 27, 2005, the Parties separately filed their information requests to ICF. On June 17, 2005, ICF filed

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Sause Bros., Inc.'s request. On March 22, 2005, Sause Bros., Inc. requested an extension of time to file its responses to the commission's information requests. By letter dated March 22, 2005, the commission granted Sause Bros., Inc. an extension of time, until March 24, 2005, to respond to the commission's information requests.

[10]Supplemental attachments to PUC-IRs-1, 6, 16, & 17.

[11]The commission accepted oral and written testimony at the hearings through e-mail and letters to the commission.

[12]On May 12, 2005, the Parties submitted their proposed schedule of the individual technical meetings with ICF. By Order No. 21822, the commission amended the regulatory schedule established by Order No. 21670 to be consistent with the Parties' May 11, 2005 stipulation.

separate responses to the Parties' May 27, 2005 information requests. By letter dated June 22, 2005, the commission provided the Parties with copies of the public comments received by the commission. On July 1, 2005, the Parties filed their statements of position ("SOP"). On July 11, 2005, Shell and HPMA filed rebuttal statements.[13]

By letters dated July 15, 2005, pursuant to HRS § 486H-13(n), the commission chair submitted a report to the Governor, the House Speaker and the Senate President, notifying them that the commission had been informed that there may be significant conditions that may adversely impact gasoline consumers in the State of Hawaii as a result of implementing the Hawaii Gas Cap Law on September 1, 2005.[14]

B.

Issues

The issues in this docket include, but are not limited to:

1. Examining the effect, impact, and appropriateness of the baseline price as defined in HRS § 486H-13(c), as amended, and examining options as to a more appropriate baseline or a more appropriate reporting service, if any.

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[13]By letter dated and filed July 11, 2005, Tesoro informed the commission that it will not file a rebuttal position statement. On July 11, 2005, the Consumer Advocate informed the commission that it would not file a rebuttal statement of position. Chevron did not file a rebuttal statement of position.

[14]The significant conditions that may adversely impact gasoline consumers are outlined in Section D, below.

2. Examining the effect, impact, and appropriateness of the location adjustment factor established by HRS § 486H-13(d), as amended, at \$.04 per gallon, and examining options as to a more appropriate location adjustment factor, if any.
3. Examining the effect, impact, and appropriateness of the marketing margin factor established by HRS § 486H-13(e), as amended, at \$.18 per gallon, and examining options as to a more appropriate marketing margin factor, if any.
4. Examining the effect, impact, and appropriateness of the Midgrade adjustment factor established in HRS § 486H-13(f), as amended, at \$.05 per gallon, and examining options as to a more appropriate Midgrade adjustment factor, if any.
5. Examining the effect, impact, and appropriateness of the Premium adjustment factor established by HRS § 486H-13(g), as amended, at \$.09 per gallon, and examining options as to a more appropriate Premium adjustment factor, if any.
6. Determining the types of documents, data, and information manufacturers, wholesalers, or jobbers must furnish to the commission to make determinations on zone price adjustments. HRS § 486H-13(h), as amended.
7. Analyzing zone price adjustments to the maximum pre-tax wholesale regular unleaded, Midgrade, and Premium gasoline prices and examining the effect, impact, and

appropriateness on a zone by zone basis. HRS § 486H-13(i), as amended.

8. Determining the types of documents, data, and information necessary for the commission to determine whether the manufacturer, wholesaler, or jobber is complying with any requirement imposed or rule adopted, pursuant to HRS Chapter 486H. HRS § 486H-13(j), as amended.

9. Identifying any further adjustments necessary to establish maximum pre-tax wholesale gasoline prices that reflect and correlate with competitive market conditions. HRS § 486H-16(c), as amended.

ICF was retained by the commission to review and evaluate the issues and requirements raised by, and contained in, HRS Chapter 486H, as amended. ICF was specifically asked to address the issues, as defined above, and prepare a report to the commission. Considering, among other things, information filed by the Parties in their respective responses to the commission's information requests, ICF developed the ICF Report, filed on April 15, 2005.

II.

Discussion

A.

HRS Section 486H-13[15] Factors Should Be Used to Calculate the Maximum Pre-Tax Wholesale Price for the Sale of Gasoline

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[15]HRS § 486-13 provides:

§486H-13 Maximum pre-tax wholesale price for the sale of gasoline; civil actions. (a) Notwithstanding any law to the contrary, no manufacturer, wholesaler, or jobber may sell regular unleaded, mid-grade, or premium gasoline to a dealer retail station, an independent retail station, or to another jobber or wholesaler at a price above the maximum pre-tax wholesale prices established pursuant to subsection (b). The commission shall publish the maximum pre-tax wholesale prices by means that shall include the Internet website for the State of Hawaii.

(b) On a weekly basis, the commission shall determine the maximum pre-tax wholesale price of regular unleaded, mid-grade, and premium gasoline as follows: the maximum pre-tax wholesale price of regular unleaded gasoline shall consist of the baseline price for regular unleaded gasoline, plus the location adjustment factor, the marketing margin factor, and the zone price adjustment, and for mid-grade and premium gasoline, the applicable mid-grade and premium adjustment factor, such that the maximum pre-tax wholesale gasoline prices reflect and correlate with competitive market conditions.

(c) The baseline price for regular unleaded gasoline referred to in subsection (b) shall be determined on a weekly basis and shall be equal to the average of:

(1) The weekly average of the spot daily price for regular unleaded gasoline for Los Angeles;

(2) The weekly average of the spot daily price for regular unleaded gasoline for New York Harbor; and

(3) The weekly average of the spot daily price for regular unleaded gasoline for the United States Gulf Coast;

as reported and published by the Oil Price Information Service for the five business days of the preceding week; provided that the commission, in its discretion, may determine a more appropriate baseline or a more appropriate price information reporting service.

(d) The location adjustment factor referred to in subsection (b) shall be $.04 per gallon or as otherwise determined by the commission and shall thereafter be subject to adjustment pursuant to section 486H-16(a).

(e) The marketing margin factor referred to in subsection (b) shall be $.18 per gallon or as otherwise determined by the commission and shall thereafter be subject to adjustment pursuant to section 486H-16(a).

(f) The mid-grade adjustment factor shall be $.05 per gallon or as otherwise determined by the commission and shall thereafter be subject to adjustment pursuant to section 486H-16(a).

(g) The premium adjustment factor shall be $.09 per gallon or as otherwise determined by the commission and shall thereafter be subject to adjustment pursuant to section 486H-16(a).

(h) For purposes of this chapter, the State shall be divided into the following zones:

(1) Zone 1 shall include the island of Oahu;

(2) Zone 2 shall include the island of Kauai;

(3) Zone 3 shall include the island of Maui, except the district of Hana;

(4) Zone 4 shall include the district of Hana on the island of Maui;

(5) Zone 5 shall include the island of Molokai;

(6) Zone 6 shall include the island of Lanai;

(7) Zone 7 shall include the districts of Puna, south Hilo, north Hilo, and Hamakua on the island of Hawaii; and

(8) Zone 8 shall include the districts of north Kohala, south Kohala, north Kona, south Kona, and Kau on the island of Hawaii.

(i) The commission shall establish zone price adjustments to the maximum pre-tax wholesale regular unleaded, mid-grade, and premium gasoline prices on a zone by zone basis.

(j) Every manufacturer, wholesaler, or jobber, upon the request of the commission, shall furnish to the commission, in the form requested, all documents, data, and information the commission may require to make its determination on zone price adjustments. Any person who refuses or fails to comply with a request for information by the commission shall be subject to a fine of up to $50,000 per day. Each day a violation continues shall constitute a separate offense.

(k) The maximum pre-tax wholesale gasoline price imposed by this section shall take effect on September 1, 2005, notwithstanding the lack of the adoption of rules pursuant to this section.

(l) Any manufacturer, wholesaler, or jobber who knowingly violates any requirement imposed or rule adopted under this section, except for subsection (j), shall be subject to a civil penalty, for each violation, equal to three times the amount of the overcharge or $250,000, whichever is greater, and shall be liable for the costs of the action and reasonable attorney's fees as determined by the court. Within two years from the date the commission obtains actual knowledge of the violation, the commission may institute a civil action in a court of competent jurisdiction to collect the civil penalty, the costs, and attorney's fees. In the case of ongoing violation, the two-year period shall start from the date of the last violation. The commission may refer any such action to the attorney general as it deems appropriate. As used in this subsection, "overcharge" means the number of gallons of gasoline sold, times the wholesale

1.

The HRS Chapter 486H Baseline Price and Location Adjustment Factor Should Be Used

ICF recommended that the baseline price of gasoline contained in HRS § 486H-13(c) should be modified from the U.S. Mainland price points (Los Angeles, New York Harbor, and the U.S. Gulf Coast) to reflect what ICF believes are the most likely alternative source points for gasoline into Hawaii - the Far East and the Caribbean markets.[16] ICF also recommended using Platts price information reporting service instead of the Oil Price Information Service. ICF further recommended that the location adjustment factor proposed in HRS § 486H-13(d) be modified from a

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price at which the manufacturer or jobber sold regular unleaded, mid-grade, or premium gasoline to a dealer retail station, an independent retail station, or another jobber or wholesaler, less taxes assessed, less the maximum pre-tax wholesale price established pursuant to subsection (b).

(m) The commission shall have the power to determine the extent to which a manufacturer, wholesaler, or jobber is complying with any requirement imposed or rule adopted under this section, including the power to compel a manufacturer, wholesaler, or jobber to submit documents, data, and information necessary and appropriate for the commission to determine such compliance. The commission may use data collected by the department of business, economic development, and tourism pursuant to chapter 486J, as well as obtain the assistance of that department in determining such compliance.

(n) The commission shall report to the governor and the legislature, in a timely manner, on any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State.

(o) The commission shall adopt rules pursuant to chapter 91 as may be necessary to implement this section and section 486H-16. [L 2002, c 77, pt of §2(1); am L 2004, c 242, §3]

[16]See, ICF Report at 17-19 (ICF proposes using Platt's Singapore price quotes as a proxy for the Far East and Platt's U.S. Gulf Coast waterborne price less 1 cent per gallon ("cpg") as a proxy for the Caribbean).

fixed four (4) cpg to a factor that varies weekly based on the freight market for gasoline cargoes.[17] Together, ICF's recommended baseline and location adjustment factors are intended to represent the cost of delivering gasoline to Hawaii. This "import parity" price would be calculated on a weekly basis and is intended to reflect the cost an importer would need to pay to import gasoline into Oahu to compete with the local gasoline supply.[18]

The commission concludes that it should initially use the HRS Chapter 486H baseline price and location adjustment factor to implement HRS Chapter 486H rather than ICF's recommended import parity price for a number of reasons.

First, both the HRS Chapter 486H and ICF's recommended factors are not based on actual costs. Instead, the factors serve as a virtual import parity price, which reflects a hypothetical cost an importer would pay to import gasoline into Oahu to compete with local gasoline supply. ICF recommends changing the HRS Chapter 486H baseline price, stating "realistically there is little if any likelihood that cargoes would ever move from any of these sources [Los Angeles, New York Harbor, and U.S. Gulf Coast] into Hawaii and that U.S. Mainland markets do not represent a true alternative, or market source for gasoline for Hawaii."[19] However, ICF has also indicated that its import parity price requires a number of assumptions, since there

[17] See, ICF Report at 26.

[18] See, ICF Report at 2.

[19] See, ICF Report at 17.

is no ongoing merchant activity where product is actually imported.[20]

Second, there is no available data for prices of gasoline produced and sold in the Caribbean.[21] ICF concedes that there is no available published Caribbean pricing for gasoline.[22] Instead, ICF recommends using a U.S. Gulf Coast price less one (1) cpg as a proxy for the Caribbean prices. However, ICF did not collect specific transaction prices in the Caribbean to compare to the ICF recommended pricing for the Caribbean.[23]

Third, ICF has not estimated and does not know the additional expenses that would be incurred if backhauls[24] from Hawaii were either not available or had to be arranged.[25] ICF does not believe the Honolulu adjustment assumes a "paying backhaul."[26] The Platts freight rate quotes for the Caribbean and Singapore markets to the U.S. West Coast represent quotes from actual freight transactions.[27] Some of these may or may not

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[20]See, ICF Report at 23.

[21]See, ICF's Response to CHEV-IR-13.

[22]Id.

[23]Id.

[24]In distribution, when a ship has delivered goods to an outlying point, it will be forced to return empty to its home base unless a customer can be found, near to the delivery point, who requires a load to be transported back (ie "backhauled") to the original base, or somewhere near it.

[25]See, ICF's Response to CHEV-IR-16.

[26]See, ICF's Response to CHEV-IR-15.

[27]Id.

reflect backhaul opportunities from the U.S. West Coast.[28] ICF states that backhaul opportunities may be limited and states that there was insufficient information to gauge the costs of an empty backhaul.[29]

Fourth, ICF did not provide sufficient information related to the costs that would be incurred by Singapore refiners to produce gasoline that would meet U.S. specifications. ICF admits that the gasoline sold in the Singapore spot market is different from the gasoline consumed in Hawaii.[30] ICF points out that gasoline produced in Singapore, Taiwan, and Korea can have quality characteristics that do not fully align with the U.S. or Hawaii conventional gasoline and that Far East refiners are, in general, producing U.S. grade gasoline on "an exception basis."[31] ICF has not made a specific calculation of the added or decreased costs of producing gasoline to meet Hawaii specifications.[32]

Finally, the factors recommended by ICF create more complexities and uncertainties, without providing the commission with any assurance that its factors would correlate better with competitive market conditions than the factors provided by HRS Section 486H-13(b). For example, ICF's recommendation for the baseline source price for gasoline does not consider the additional inventory carrying costs associated with importing

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[28] Id.

[29] Id.

[30] See, ICF's Response to CHEV-IR-12.

[31] See, Chevron's SOP at p. 15-16; see also, ICF Report at 18 and 24, ICF Report Exhibit 2.2.

[32] See, ICF's Response to CHEV-IR-12a.

gasoline into Hawaii in its import parity calculation.[33] ICF acknowledges that the additional volume of gasoline "on water" should be considered in the import parity assessment.[34] The Consumer Advocate agrees that the import parity price calculation should include an inventory carrying cost based on an additional three-week supply held "on the water." This cost would float with baseline prices, and would be about 0.35 cpg in today's market according to ICF.[35]

ICF's freight assumptions associated with product imports sourced in the Caribbean, which include an estimate of canal fees[36], also creates uncertainty.[37] Canal fees are subject to change, however, and ICF's recommendations did not provide for updating these fees in its report.[38] The Consumer Advocate recommends that the actual canal fees associated with Caribbean volumes should be reviewed and updated annually.[39]

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[33]See, Consumer Advocate's SOP at p. 20; see also ICF Response to TESORO-IR-12.

[34]See, ICF's Response to Tesoro-IR-12.

[35]See, Consumer Advocate's SOP at p. 20 (citing ICF's Response to Tesoro-IR-12). This as calculated with the following assumptions: London Inter-Bank Offered Rate ("LIBOR") rate: 4% (actual current 6 MO LIBOR rate is 3.540); Wholesale Gasoline Price: $1.50/gal; Time on Water: 3 weeks; Calculation: (3 weeks/52 weeks)*.04*1.50*100 = .35 cpg. (ICF's Response to Tesoro-IR-12).

[36]ICF adds 2.15 cpg to their freight assumptions from the Caribbean.

[37]See, ICF Report at 22.

[38]See, ICF's Response to HPMA-IR-5.

[39]See, Consumer Advocate's SOP at 21.

Therefore, based on the foregoing, the commission concludes that it should initially use the HRS Chapter 486H baseline price and location adjustment factor to implement HRS Chapter 486H rather than ICF's recommended factors.

Based on monthly data from September 1999 through November 2004, on average, ICF's baseline and location adjustment factor would be approximately 1.1 cpg less than the HRS Chapter 486H baseline and location adjustment factor. For the eleven months through November 2004, ICF calculated that its baseline and location adjustment factor would be 0.8 cpg higher than the HRS Chapter 486H baseline and location adjustment factor.[40]

2.

The HRS Chapter 486H Marketing Margin Factor Should Be Used

ICF concluded that the various classes of wholesale trade (e.g., bulk, rack, and dealer tankwagon ("DTW")) cannot be regulated under one (1) common margin.[41] In addition, ICF recognized that there can often be multiple wholesale transactions prior to delivery to a service station and concluded that the wholesale price must be high enough to cover the cost of the product and the cost of marketing.[42] In its analysis, ICF

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[40]See, ICF Report at 25, Exhibit 2.11. From September 1999 to November 2004, the overall average for (1) the proposed 486H baseline price plus location adjustment was 88.70 cpg; and (2) the ICF proposed basket price and estimated historical freight from Singapore and the Caribbean was 87.60 cpg.

[41]See, ICF Report at 2.

[42]See, ICF Report at 2, 29-34.

relied on U.S. Mainland margins. ICF calculated an average DTW margin based on its selected benchmark areas on an annual basis and then doubled that margin to allow for flexibility in setting prices and responding to market conditions over the course of the year.[43]

The commission concludes that the ICF proposed class of trade approach is reasonable; however, the commission has concerns with the selection of the geographic locations used in creating the margins for the different classes of trade and the doubling of the average margins of the selected locations. Accordingly, the commission concludes that it should initially use the HRS Chapter 486H method of adding eighteen (18) cpg for the marketing margin to implement HRS Chapter 486H rather than ICF's recommended methodology. While the HRS Chapter 486H approach does not take into account the different classes of trade, the commission finds, that at this time maintaining the flexibility of marketers within one wholesale cap is preferable than creating a rigid price structure based on a questionable set of wholesale price caps in the various classes of trade. This conclusion is based on the following.

First, Shell, HPMA, and the Consumer Advocate generally support ICF's recommendation for marketing margin adjustments for certain classes of trade, but disagree with the method of creating the various caps for the specific classes of trade.[44]

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[43]See, ICF Report at 42-43.

[44]HPMA supports multi-layered marketing margin adjustments for bulk, DTW, and branded rack, but not unbranded rack. See, HPMA's SOP at 3; see also, HPMA's Rebuttal SOP at 5-6. The Consumer Advocate recommends that the margin cap on the bulk

The commission generally concurs with this analysis. Specifically, ICF has proposed caps on marketing margins based on estimates of U.S. Mainland margins.[45] The commission concludes this could be a reasonable approach; however, ICF uses different benchmarks for its different proposed gas caps. ICF bases its proposed branded rack cap on an average of rack prices in eight (8) cities in eight (8) states.[46] Its proposed unbranded rack cap is based on unbranded rack prices in five (5) cities in five (5) states.[47] In determining the proposed caps for DTW prices, ICF uses state-level DTW prices in five (5) states (not the same five (5) states where the five cities used for unbranded rack prices are located).[48]

Second, the Parties questioned the selection of various benchmark markets, which were limited to certain markets with wholesale rack pricing markets, and also to areas served by conventional gasoline.[49] ICF could have identified U.S. markets

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class of trade should be eliminated, as agreed to by ICF. See, Consumer Advocate's SOP at 21. Shell states that ICF correctly identified a significant flaw in the original law, whereby there is no provision for the multiple channels of distribution that exist in the marketplace, but further states that ICF's recommendation contains errors and flaws that will create unintended consequences at the expense of consumers. See, Shell's SOP at 10-11.

[45]See, ICF Report at 29-47.

[46]See, ICF Report at 35-40.

[47]Id.

[48]See, Chevron's SOP at 18.

[49]See, Shell's SOP at 13.

that have significant dealer operated networks[50] or included markets with divorcement laws similar to Hawaii.[51] Moreover, consideration should be given to the impact of temporary competitive allowances,[52] cash discounts,[53] real estate costs and rent caps.[54]

Third, ICF's "doubling factor" methodology does not appear to be based on any objective rationale. ICF calculates an average DTW margin based on its selected benchmark areas on an annual basis and then doubles that margin to allow for flexibility in setting prices and responding to market conditions over the course of the year.[55] The commission finds that this doubling factor methodology is not supported by any credible data or information in the record. HPMA recommends that the doubling factor should be tripled in recognition of the questionable nature of ICF's average data and the need to ease in to such a dramatic and invasive regulatory scheme.[56] The Consumer Advocate recommends a rolling-average U.S. Mainland margin that provides for a more real-time reflection of U.S. Mainland margins, but

[50]See, ICF's Response to Shell-IR-45 (ICF concurs with the general statement that DTW price comparisons "would have been more meaningful to the present analysis if the comparison markets were selected where significant dealer operations existed.")

[51]See, ICF's Response to Shell-IR-45 ("Maryland and/or Virginia would have been appropriate alternatives to examine").

[52]See, ICF's Response to Shell-IR-40 and HPMA-IR-9 and 13.

[53]See, ICF's Response to Shell-IR-39.

[54]See, ICF's Response to Chev-IR-33.

[55]See, ICF Report at 42-43.

[56]See, HPMA's SOP at 3.

also provides consumers in Hawaii with some protection from the seasonality/volatility that exists in U.S. Mainland margins and mitigates the risk associated with the "doubling" approach proposed by ICF.[57] These are all creative approaches that could be reviewed and considered in more detail subsequent to the September 1, 2005 implementation date.

Finally, the commission agrees with HPMA's caution that if some recommendations are adopted and not others, it could make matters worse for the jobber industry as a whole (e.g., if the commission adopted HPMA's recommended rack margin adjustment and ICF's recommended DTW margin adjustment).[58] Accordingly, the commission concludes that at this time, maintaining the flexibility of marketers within one (1) wholesale cap is preferable to creating a rigid price structure based on a questionable set of wholesale price caps in the various classes of trade. However, the commission also finds that we should continue to study and refine the class of trade approach through this docket or collaborative groups beyond the implementation date of September 1, 2005.

Based on yearly data, from 1999 through 2004, on average, ICF's DTW margin cap would be approximately 1.6 cpg less than the HRS Chapter 486H marketing margin factor. Based on 2004 data through November, ICF calculated a DTW marketing margin cap

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[57]See, Consumer Advocate's SOP at 22-23.

[58]See, HPMA's Rebuttal SOP at 4.

of 15 cpg, 3 cpg less that the 18 cpg HRS Chapter 486H marketing cap.[59]

3.

The HRS Chapter 486H Premium And Midgrade Adjustments Should Be Used

The Adjustment factors proposed in HRS §§ 486H-13(f) and (g) are 5 cpg and 9 cpg for Midgrade and Premium gasoline, respectively. ICF recommends adding Midgrade and Premium adjustment factors for Bulk and Rack classes of trade as well.[60] ICF also recommends that these adjustment factors should also be reviewed and updated annually.[61]

Based on the above marketing margin discussion and the same concerns regarding the selection of the geographic locations used in creating the Midgrade and Premium adjustment factors, the commission concludes that it should use one Premium and one Midgrade adjustment and utilize the factors in HRS §§ 486H-13(f) and (g), for the Midgrade and Premium adjustments, respectively, to initially implement HRS Chapter 486H.

Based on 2004 data: (1) the ICF Midgrade adjustment factor would be 1.4 cpg higher than the HRS Chapter 486H Midgrade adjustment factor; and (2) the ICF Premium adjustment factor

[59]See, ICF Report at 43, Exhibit 3.18. [14.4 + 17.6 + 19.6 + 14.8 + 17 + 15]/ 6 = 16.4. The HRS Chapter 486H marketing margin is 18 cpg.

[60]See, ICF Report at 3, 49-58.

[61]Id.

would be 1.1 cpg higher than the HRS Chapter 486H Premium adjustment factor.[62]

4.

ICF's Proposed Zone Price Adjustments, Using the Highest Actual Transportation Costs Should Be Used

HRS § 486H-13(i) requires the commission to establish zone price adjustments, on a zone-by-zone basis, to transport gasoline from the source base of Oahu to specific zones. The legislation did not provide the factors for the various zone price adjustments.[63]

HRS § 486H-13(h) divided the State into eight (8) zones which included: (1) Zone 1 - the island of Oahu, (2) Zone 2 - the island of Kauai, (3) Zone 3 - the island of Maui, except the district of Hana, (4) Zone 4 - the district of Hana on the island of Maui, (5) Zone 5 - the island of Molokai, (6) Zone 6 - the island of Lanai, (7) Zone 7 - the districts of Puna, south Hilo, north Hilo, and Hamakua on the island of Hawaii; and (8) Zone 8 -

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[62]See, ICF Report at 56-57, Exhibits 4.8 and 4.11. Exhibit 4.11 shows the 486H-13 Factors: Midgrade Adjustment Factor = 5.0 and Premium Adjustment Factor = 9.0. Exhibit 4.8 shows the ICF recommended DTW: 2004 Midgrade adjustment factor = 6.4 ; 2004 Premium adjustment factor = 10.1. ICF noted in technical meetings that the Exhibit 4.11 DTW numbers were wrong and should be those reflected in Exhibit 4.8.

[63]The commission is not aware of any report prepared by a legislative task force pursuant to Hawaii Sessions Laws 2004, Act 242, § 7. Shell argues that the legislative task force must be convened and fulfill its duties pursuant to Act 242 § 7 prior to the implementation of the Hawaii Gas Cap Law, Shell's SOP at 4-5, 26-40; however, a plain reading of HRS § 486H-13(i) requires the commission to establish zone adjustments, independent of the duties of the task force.

the districts of north Kohala, south Kohala, north Kona, south Kona, and Kau on the island of Hawaii.

Based on information provided by the Parties, ICF recommended determining the zone adjustments by generally using an average cost of barge, terminal, and trucking costs to the eight (8) different zones.[64] The commission believes that applying an average cost concept means, among other things, that service providers with low volume and small delivery size areas, i.e., jobbers that service rural "mom and pop" retailers, would be especially vulnerable.[65]

First, ICF specifically acknowledges that: "[t]here may be some unique situations (similar to Hana on Maui) in which small jobbers or distributors have few outlets which are in a high-cost-to-deliver regions, and the [commission] may wish to consider some exceptions or further adjustments."[66]

Second, the commission received compelling testimony on this issue. For example, on Kauai, Roger Cable of Senter Petroleum, a Chevron jobber testified as follows:

> *There was no consideration given to outer island deliveries for independent service stations. The reason you didn't get much response on Oahu is because there are no jobber service stations on the island of Oahu. There are on the outer islands, and*

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[64]See, ICF Report at 61-62. The barging costs were based on data provided by the Parties and include an additional cost for losses, inspections, and demurrage of 0.7 cpg. Terminal costs include Oahu terminal costs in all outer zones. Trucking costs were estimated based on the range of high, low and/or average trucking costs supplied by Parties.

[65]See, ICF's Responses to HPMA-IR-34 and CA-IR-12.

[66]See, ICF Report at 75.

> *it's important for us to be able to serve these stations because they're not - they would not be served by the major oil companies.* This has been seen throughout the State that the major oil companies are focusing on stations that produce a significant quantity of volume, and the little mom and pop stations are gone.

Transcript of May 3, 2005, Kauai Public Meeting, at 21-22 (emphasis added). Testimony on Kauai was also taken from an independent service station owner in Princeville, Mr. Jeff Guest, who is a jobber-served dealer serviced by Senter Petroleum. Mr. Guest testified that the gas cap is "going to affect the jobbers considerably[,]" stating that "if I were in Senter Petroleum's shoes, I would stop delivering fuel to us." Id. Mr. Guest explained that if Senter Petroleum stops delivering fuel to him:

> Basically, I've got to go out and see if Chevron will deliver to us directly. Basically, Chevron stopped almost ten years ago delivering fuel to us, and Senter Petroleum stepped in and said, hey, we'll take care of you, you're a small-volume dealer, we'll get gasoline out to you. This law doesn't address any of that.

Id. at 25. Mr. Guest also expressed his concern that:

> from September 1st, we're going to be looking at a situation where, okay, how are we going to get gas out to our station if the jobber can't supply it. If I were a jobber, I would say - I don't think they're obligated to do it. I would stick to my wholesale accounts where I can have a fair market return on my product, you know.
>
> They're going to have to go out there and get gas out to me for 4 cents a gallon. You know, it's just - there's not enough money in there to deliver fuel out to the North Shore. *And we're being compared to a station in Lihue, which is 40 miles different - or not 40 miles. It's about a 40 to one-hour drive difference to - you*

> *know, there's even zones within Kauai that are - that need to be considered.*

Id. at 25 (emphasis added).

Finally, Mr. Guest also testified that "*there should be some considerations to zones within zones. I don't see how, like I said, a Lihue station can be compared to Princeville or Waimea station. And I think that should be something that should be looked at.*" Id. at 27 (emphasis added). Mr. Guest further stated:

> *Small mom and pop stations like mine may be out of business.* I've got 10 to 13 employees. Summertime, we'll have about 13 employees. Small business. Family owned. But, you know, there's other ways to make money on Kauai, I guess. But right now, I've been in the fuel business for 10 years and I've put a lot of money into my gas station, I'd like to see it survive.
>
> *The way I see this bill coming through, I'm going to be scrambling to survive. Economically, it doesn't seem feasible to me the way this bill is written to be a jobber-served gas station in a rural location and survive. It just doesn't seem feasible to me.* And I hope I'm wrong. I might have to - I'll go down with a fight, that's for sure, you know. So we'll see what happens ….

Transcript of May 3, 2005 Kauai Public Meeting at 26-27 (emphasis added).

In Kona, Mark Leong, vice president and general manager of Hawaii Petroleum and for Maui Petroleum on Maui, who explained that:

> We [Hawaii Petroleum and Maui Petroleum] are a petroleum jobber here. We are not a refiner. We service - we are one of twelve jobbers in the State of Hawaii. We service a lot of the small accounts out there. We service stations down in Kealakekua, service stations up mauka, up here.

> *We service stations, small stations, that can't take a whole truck-and-trailer load.* And the PUC's come up with recommendations on locations and a set delivery cost.
>
> *How can we - what are we going to do? Are we going to tell the small stations that we're not getting paid enough to deliver gas to you? So you know what, we're not going to deliver gas to you today or tomorrow or next week. So we have a supply problem.*

Transcript of May 5, 2005 Kailua-Kona Public Meeting at 14-15 (emphasis added). According to Mr. Leong "We're not big oil. You guys are going to hurt the small jobbers, the small retailers. They won't be able to take fuel because we can't deliver it." Id. at 16.

Alec McBarnet, president of Maui Oil Company,[67] noted at the Hana Public Meeting that:

> we have service stations up in Keokea on the way to Ulupalakua. Harley and Florence Ching have operated that service station as a Chevron station for over 50 years, and they certainly are in a different zone within the zone than would be the zones if it was just in the Kahului area. I think Lahaina has to be considered another zone also because it's a different kind of delivery load and certainly Hanzawa's and Toma's up in Haiku are certainly kind of a delivery zone area also.
>
> I just - I don't think it's fair to attempt to say that their deliveries would be the same as the deliveries within the Kahului area … on Maui just like Kauai and the Big Island we have places that are in the zone that need zones within the zone.

Id. at 16-18 (emphasis added).

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[67]Maui Oil Company is based in Kahului and services Hana and other remote areas of Maui.

Testimony from a Hanzawa's Store,[68] representative echoed Mr. McBarnet's concerns, noting that:

> We are now faced with this impending wholesale gas price cap that although aimed at refiners, will inevitably affect all members and levels in this industry. Our concerns focus specifically on the possibility that our distributors may decide not to deliver gas supplies to rural areas like ours if they are held to a small margin that may not cover their expenses. Since we have no means to pick up gasoline ourselves, we will be forced to close our gas station. This will not only hurt our business and chance to recoup some of the funds spent on our renovation, but also all of the area residents who depend on us for their gas as they rush off to work or school.
>
> Let me tell you that I've lost sleep over this as I'm concerned for the future of my business. We are aware that this is a very complex issue with many variables to examine. While there are no easy answers, this gas cap may have serious consequences for small businesses like ours. Please don't let this be our demise.

Letter dated May 10, 2005 from Sally Daniells of Hanzawa's Store to the commission.

Accordingly, the commission is aware there is a risk that higher costs in areas on the neighbor islands and remote areas may lead to closure of service stations if the gas cap is implemented.[69] Further, there is also a risk that if gasoline marketers in the State find that, under the proposed caps, some distribution channels do not provide an economic return, they may

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[68]Hanzawa's Store, located in Haiku, Maui, is an independent service station selling gasoline for over 50 years.

[69]See, Shell's SOP at 3-4.

reduce or eliminate sales through those channels.[70] Furthermore, in a capped price environment, a wholesale marketer supplying a DTW account may see no way to cover its costs to service the account and may cancel the supply contract.[71] As a result, there is a high probability of service station closures in some areas due to supply cost issues, and there is a higher risk that remote locations might lose service.[72]

Therefore, based on the probable impact on the rural areas, the commission will use ICF's recommended zone price adjustments, further adjusted, however, to utilize the highest actual transportation cost for each zone, instead of the average transportation cost as proposed by ICF.

HRS § 486H-13(h) does not authorize the commission to create zones within a zone, or to provide exceptions. Unlike HRS § 486H-13 (c)-(g), which authorize the commission to modify and propose alternatives to the law, HRS § 486H-13(h) does not authorize the commission to modify HRS § 486H-13(h), or to add a zone within a zone, or provide exceptions to the established zones. Thus, based on the probable impact on the rural areas, the commission will use ICF's recommended zone price adjustments, utilizing, however, the highest actual transportation costs, in an attempt to minimize some of the adverse supply impacts to the rural areas. Accordingly, the modified ICF zone price adjustments are as follows: Zone 1:

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[70]See, Chevron's SOP at 36.

[71]See, Consumer Advocate's SOP at 13.

[72]Id.

Oahu 6.5 cpg; Zone 2: Kauai 13.6 cpg; Zone 3: Maui, except the district of Hana 20.4 cpg; Zone 4: The district of Hana on the island of Maui 28.4 cpg; Zone 5: Molokai 31.2 cpg; Zone 6: Lanai 40.3 cpg; Zone 7: The districts of Puna, south Hilo, north Hilo, and Hamakua on the island of Hawaii 21.3 cpg; Zone 8: The districts of north Kohala, south Kohala, north Kona 23.2 cpg.

B.

Petitions and Complaints

Petitions pursuant to HRS § 486H-16[73] shall be made in compliance with HAR, Chapter 6-61, Rules of Practice and Procedure Before the Public Utilities Commission. Complaints[74], formal or informal, shall be made in compliance with HAR Chapter 6-61[75]. Moreover, all filings pursuant to HRS Chapter 486H shall be made in accordance with HAR Chapter 6-61.[76]

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[73]HRS § 486H-16(a) provides that "[a] manufacturer, wholesaler, or jobber may petition the commission to adjust the maximum pre-tax wholesale price of regular unleaded, mid-grade, or premium gasoline in the event of a change in the value of the baseline price of regular unleaded gasoline, the location adjustment factor, the marketing margin factor, the mid-grade adjustment factor, the premium adjustment factor, or zone price adjustment."

[74]HRS § 486H-13(m) provides, in relevant part, that "[t]he commission shall have the power to determine the extent to which a manufacturer, wholesaler, or jobber is complying with any requirement imposed or rule adopted under this section…"

[75]Compliance shall be initially monitored through the complaint system. The commission is aware that this may not be the most effective system, which is the only system that can be implemented before September 1, 2005.

[76]ICF made recommendations as to the types of documents, data, and information necessary for electronic compliance system for its proposal; however, since the commission will initially

C.

Publication and Effective Date of the Gasoline Price Caps

The commission will publish the first maximum pre-tax wholesale price for the sale of gasoline, pursuant to HRS § 486H-13(b), on its website, www.hawaii.gov/budget/puc, on August 24, 2005. These maximum pre-tax wholesale prices shall be effective from September 1, 2005 through September 4, 2005. The commission thereafter will publish the maximum pre-tax wholesale prices every Wednesday, to be effective the following Monday through Sunday. For example, the second publication will be published on August 31, 2005, which will be effective for the period September 5, 2005 through September 11, 2005.

The baseline price shall be computed using the spot prices of the five (5) business days prior to each Wednesday. In the event that a State holiday falls on a Wednesday, the commission will publish the maximum pre-tax wholesale price on the previous business day, using the spot prices of the five (5) business days immediately prior to the day they are published.

D.

Risks in Implementing HRS Chapter 486H

The Parties participating in this proceeding and the commission's consultant, ICF, have stated that there may be substantial concerns and risks associated with the implementation of the gas price caps as required under the Hawaii Gas Cap Law, effective September 1, 2005. These concerns and risks are set

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implement the HRS Chapter 486H factors and will initially monitor compliance through the complaint system, the commission will not adopt ICF's compliance proposal at this time.

forth in the record, and are included in the Parties' respective SOPs, filed on July 1, 2005, and Rebuttal Statements, filed on July 11, 2005, and in ICF's April 15, 2005 Report to the Commission.

The risks and concerns identified by the Parties and ICF include, but are not limited to:

(1) **Increased Risk of Gasoline Supply Shortages.**

Parties assert that gas price caps, by definition, constrain prices, and as a result, businesses operating under price caps may not be able to earn normal returns.[77] Under such conditions, gasoline supply shortages may occur, which could lead to product outages at particular stations.[78] In addition, there may be instances when the gas price cap formula's baseline price and the location adjustment factor are lower than a local refiner's export opportunity, making exporting gasoline more attractive to refiners than selling it in Hawaii.[79]

According to ICF, any outages at Hawaii's refineries may locally affect supply and inventory, but the gas cap would not change because Hawaii's problem likely would not impact the outside markets on which the gas price cap is based.[80] If imports are needed to make up the lost volume, the inability to raise

[77]See, Chevron's SOP at 34.

[78]Id.

[79]See, Consumer Advocate's SOP at 10.

[80]See, ICF Report at 76.

prices beyond the gas price cap may blunt economic replenishment and jeopardize supply.[81]

(2) **Increased Risk of a Refinery Closure.**

Parties state that the economic viability of the State's refiners would be threatened if they were unable to generate an adequate return on investment.[82] At that point, it would no longer make economic sense for them to refine gasoline on Oahu.[83] In addition, ICF notes that changes, including the ethanol mandate starting in 2006, which could require refiners to reduce gasoline production to manage supply, may push Hawaii's refiners to closely examine refinery profitability and sustainability.[84]

(3) **Increased Risk of Wholesale Marketers Deciding to Cease Operations.**

According to the Parties, if the proposed gas price caps do not cover wholesale marketing costs (including truck delivery for dealer tankwagon class of trade) and provide a reasonable profit margin, some wholesale marketers may choose to cease operations.[85] The consequences of this action would be a reduction of, rather than an increase in, wholesale competition in Hawaii.[86]

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[81] Id.

[82] See, Consumer Advocate's SOP at 11-12.

[83] See, Chevron's SOP at 34.

[84] See, ICF Report at 74.

[85] See, Consumer Advocate's SOP at 12.

[86] Id.

(4) **Increased Risk of Smaller, Remote Stations Losing Supply.**

Parties maintain that higher costs in areas on the neighbor islands and in remote areas on Oahu may lead to closure of service stations if the gas price cap is implemented.[87] Stated another way, if gasoline marketers in Hawaii find that, under the proposed gas price caps, some distribution channels do not provide an economic return, they may reduce or eliminate sales through those channels.[88]

(5) **Increased Risk of Reduced Investment.**

Recognizing that the petroleum industry is extremely capital intensive, from the cost of refineries to capital tied up in inventories and receivables and the cost of retail stations, Parties argue that to the extent a price ceiling is restrictive, it is likely to discourage investment.[89] One of the market implications of imposing a regulated price ceiling is reduced local investment if a better return can be obtained elsewhere.[90] Parties also claim that sellers may look to other sources of revenue that are not regulated (surcharges, credit processing fees, etc.), services previously provided may be reduced or eliminated (reduced delivery schedules, advertising and marketing programs may be eliminated, etc.), or investment at service

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[87]See, Shell's SOP at 3-4.

[88]See, Chevron's SOP at 36.

[89]See, Consumer Advocate's SOP at 14.

[90]Id.

stations, terminals or refineries may decline or no longer be viable at all.[91]

(6) **Increased Risk and Uncertainty Due to the Ethanol Blending Requirements.**

Compounding the uncertainty of the gas price cap impacts are State ethanol blending mandates that go into effect in April 2006. ICF noted that the impacts of ethanol blending are clearly a factor which may need to be considered by the commission in future gas cap administration.[92] It also expressed concerns, in response to an information request, that "the marketers, refiners, and consumers in Hawaii may be approaching a confluence of regulatory actions involving both the gas caps and ethanol which will likely create high business and capital investment uncertainty, as well as possible supply concerns."[93]

Several of the Parties have requested that the commission urge the governor to use her emergency powers to suspend the Hawaii Gas Cap Law under HRS § 486H-15. On the other hand, the Consumer Advocate states that "[t]he regulation of wholesale gasoline prices is a first in this country, and the risks outlined above are just that - risks. They are not certain to happen."[94] Nonetheless, all Parties agree that there are certain risks in implementing HRS Chapter 486H.

Accordingly, the commission will closely monitor the actual impacts of the Hawaii Gas Cap Law, as the commission is

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[91] See, Chevron's SOP at 36.

[92] See, ICF Report at 76.

[93] See, ICF response to HPMA-IR-38.

[94] See, Consumer Advocate's SOP at 26.

required to inform the Governor and the Legislature of any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State, pursuant to HRS Section 486H-13(n). In this regard, the commission notifies the Parties as well as all manufacturers, wholesalers, jobbers, and retailers of gasoline that they are to inform the commission of any breach of compliance of Chapter 486H, and any significant adverse impact of the Hawaii Gas Cap Law.

III.

Orders

THE COMMISSION ORDERS:

1. The following factors shall be used in the initial HRS Chapter 486H maximum pre-tax wholesale price calculation: (a) the HRS Chapter 486H baseline price and location adjustment factor established by the Legislature; (b) the HRS Chapter 486H marketing margin factor establish by the Legislature; (c) the HRS Chapter 486H Premium and Midgrade adjustments established by the Legislature; and (d) ICF's proposed zone price adjustments, using, however, the highest actual transportation costs by zone rather than average transportation costs as proposed by ICF, as more specifically described above.

2. Petitions, complaints, and all other filings relating to HRS Chapter 486H shall be filed in accordance with HAR chapter 6-61, as more specifically described above.

3. The commission will publish the first maximum pre-tax wholesale prices for the sale of gasoline, pursuant to HRS § 486H-13(b), on its website, www.hawaii.gov/budget/puc by

August 24, 2005. These maximum pre-tax wholesale prices shall be effective from September 1, 2005 through September 4, 2005. The commission thereafter will publish the maximum pre-tax wholesale prices every Wednesday, to be effective the following Monday through Sunday. In the event that a State holiday falls on a Wednesday, the commission will publish the maximum pre-tax wholesale prices on the previous business day, using the spot prices of the five (5) business days immediately prior to the day they are published.

4. The commission will contact the Parties by letter to establish the subsequent schedules and procedures in this docket, which shall include, but not be limited to: (A) adjusting the maximum pre-tax wholesale price formula or factors to include ethanol and (B) further refining ICF's recommended marketing margins by different classes of trade.

DONE at Honolulu, Hawaii August 1, 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By Wayne H. Kimura
Wayne H. Kimura, Commissioner

By Janet E. Kawelo
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Kevin M. Katsura
Kevin M. Katsura
Commission Counsel

05-0002.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21952 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: August 1, 2005