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The Honorable Public Utilities Commission
of the State of Hawaii
Kekuanao'a Building, First Floor
465 South King Street
Honolulu, Hawaii 96813

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PUBLIC UTILITIES COMMISSION

Re: Participants for Docket No. 05-0002

To the Honorable Public Utilities Commission of the State of Hawaii:

Tesoro Hawaii Corporation, a Hawaii corporation ("Tesoro Hawaii") respectfully submits this letter in furtherance of the Public Utilities Commission of the State of Hawaii's ("Commission") investigation into the issues and requirements of Hawaii Revised Statutes ("HRS") Chapter 486H, as amended ("HRS 486H"), and the goals and objectives listed in Docket No. 05-0002. Specifically, Tesoro Hawaii is submitting the names of the entities in the local petroleum industry (attached hereto and incorporated herein as Exhibit A) whose activities fall within the nature and scope of this investigation outlined in Order No. 21525 (filed January 4, 2005) ("Order 21525") and who could provide helpful and valuable information that would assist the Commission in the development of a sound record in this proceeding.

BACKGROUND

On January 4, 2005, the Commission opened a generic docket to examine the issues and requirements raised by, and contained in, HRS 486H. HRS § 486H-13 established maximum pre-tax wholesale prices on gasoline to be sold in the State of Hawaii and tasked the Commission with determining the maximum pre-tax wholesale price of regular unleaded, mid-grade, and premium gasoline. [1]

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[1] HRS § 486H-13 provides in pertinent part as follows:

> 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.

In carrying out its duties, the Commission opened this generic docket. Order 21525 outlined the scope of the investigation which is summarized as:

(1) examining options as to a more appropriate
  (a) baseline or a more appropriate reporting service, if any;
  (b) location adjustment factor, if any;
  (c) marketing margin factor, if any;
  (d) mid-grade adjustment factor, if any;
  (e) premium adjustment factor, if any;

(2) determining the type of documents, data, and information the manufacturers, wholesalers, or jobbers must furnish to the commission to make a determination on zone price adjustments;

(3) determining the type 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;

(4) analyzing zone price adjustments to the maximum pre-tax wholesale regular unleaded, mid-grade, and premium gasoline prices and examining the effect, impact, and appropriateness on a zone by zone basis; and

(5) Identifying any further adjustments necessary to establish maximum pre-tax wholesale gasoline prices that reflect and correlate with competitive market conditions.

Order 21525 at 2-6.

In light of the nature and scope of this investigation and to assist in the development of a sound record in this proceeding, the Commission made the two Hawaii refiners (Tesoro Hawaii and Chevron U.S.A. Inc. ("Chevron")), and the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs ("Consumer Advocate") parties to this proceeding.[2] The Commission also retained professional consultants, ICF Associates, LLC, a consulting member company to ICF Consulting ("ICF"), to assist the Commission in its investigation in this matter. The Commission also stated that any "individual, entity, organization desiring to intervene as a party or to participate without intervention in this proceeding shall file a motion to intervene or participate without intervention not later than twenty (20) days from the filing of this order". Order 21525 at 6. On January 24, 2005, the period to file a motion to intervene or participate in this Docket expired. As of that time, only Shell Oil Company (Shell

[2] It is important to note that HRS § 486H-13 is applicable to manufacturers, wholesalers, and jobbers. Manufacturer is defined in HRS § 486H-1 as "every producer or refiner of petroleum products on January 1, 1992, or any subsidiary of that producer or refiner." Jobber is defined in HRS § 486H-1 as "every wholesaler of petroleum products." Wholesaler does not appear to be defined in the statute.

Oil") and Hawaii Petroleum Marketers Association ("HPMA") filed motions to intervene.[3]

DISCUSSION

Tesoro Hawaii is a Hawaii corporation that operates a 95,000 barrels per day petroleum refinery on Oahu. Tesoro Hawaii's principal product is jet fuel. Other petroleum products include diesel fuel, fuel oil, naphtha, asphalt, liquefied petroleum gas, gasoline, blendstocks and other petroleum products. As one of two refiners in Hawaii, Tesoro Hawaii has a substantial interest in being a party in this Docket and to see that the information acquired in this Docket presents a fair and accurate statement of the conditions of the petroleum industry, especially as related to HRS § 486H-13 et. seq., and to assist the Commission in a sound development of a record in this proceeding.

However, in order to accomplish these goals, other entities should be made parties to this Docket or at a minimum, be required to answer information requests from the Commission either voluntarily or by subpoena. Further, Tesoro Hawaii and the parties to this Docket should be allowed to review such information to ensure that the information presents a fair and accurate statement of the conditions of the petroleum industry, and offer other information to give a balanced approach to this Docket.[4]

As discussed below, representation by not only manufacturers is needed, but also, at a minimum, by individual wholesalers and jobbers as set forth in the statutory framework of HRS § 486H-13.[5] Within this framework, however, are subclasses of entities that have varying economic interests in the outcome of this proceeding. Moreover, the interests will also vary by island. One way to classify these interests is as follows:[6]

1. Manufacturers with refining capabilities in the State of Hawaii that sell gasoline in the State of Hawaii;
2. Manufacturers with refineries outside of the State of Hawaii or wholesalers where a manufacturer has an ownership interest in the wholesaler that sell gasoline in the State of Hawaii;

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[3] Tesoro Hawaii does not necessarily agree with the allegations in HPMA's Motion to Intervene. Nevertheless, Tesoro Hawaii believes that all parties affected by HRS 486H should be allowed to participate and therefore supports HPMA's Motion to Intervene. Tesoro Hawaii also supports Shell Oil's Motion to Intervene.

[4] Of course, any confidential information provided by any of the parties will conditioned upon and subject to the terms and restrictions of an appropriate protective order as necessary.

[5] For example, Order 21525 and HRS § 486H-13 both request that the Commission determine what documents, data, and information must be furnished by manufacturers, wholesalers, or jobbers. Yet, only two manufacturers were made parties to this Docket.

[6] A general discussion on the manufacturing and distribution of gasoline in the State of Hawaii is provided in Exhibit B.

3. Wholesalers who sell at wholesale in the State of Hawaii;
4. Jobbers in the State of Hawaii; and
5. Special classification (Lanai and Molokai).

The following is a brief discussion of each of the above classifications that sell gasoline in the State of Hawaii.

1. Manufacturers with refining capabilities in the State of Hawaii.

Tesoro Hawaii and Chevron are the only two companies that fall in the category of manufacturers with refining capabilities in the State of Hawaii. This category represents companies that produce gasoline from crude oil with refineries located in the State of Hawaii. This group sells the gasoline produced to other Manufacturers, Wholesalers, Jobbers and retailers. Other gasoline customers include commercial end users such as rental car companies, and government entities.

The outstanding characteristic of this first group is the significant capital investment (in the hundreds of millions of dollars) made by these companies in their respective refinery operations in the State of Hawaii. Not only does this investment include the refineries, but also the significant cost of the off-shore moorings used to unload the crude oil from oil tankers, other marine transportation infrastructure and resources to ship the products between our Islands, bulk storage terminals and many miles of pipelines to transport the crude oil as well as finished product between various facilities. This group is also unique in that it is the only group that imports crude oil, refines the crude oil into petroleum products such as diesel fuel, jet fuel, fuel oil, naphtha, asphalt, liquefied petroleum gas, gasoline, blendstocks and other petroleum products.

The cost structure of the Manufacturers with refineries will also be different from any other group as the gasoline produced is comprised of local costs and expenses such as labor and available materials, and as just described, is just one of many petroleum products that are produced and distributed as it is impossible for a refiner to produce only gasoline from crude oil. The significant capital investment by this group, the need to handle the broad range of petroleum products in addition to gasoline that are produced from a single barrel of crude oil, as well as the use of local labor and materials, should be major considerations in examining options as to a more appropriate baseline, location adjustment factor, marketing margin factor, mid-grade adjustment factor, and premium adjustment factor.

2. Manufacturers with refineries outside of the State of Hawaii.

This category, while similar to the first category as they both manufacture petroleum products, is different from the first category in several important respects one of which is that that these manufacturers did not make a capital intensive investment in Hawaii and thus either have to purchase refined gasoline from Chevron or Tesoro or bring in their own refined gasoline product from an out of state or foreign refinery (as opposed to manufacturing gasoline in the State of Hawaii themselves). This group is also

different from Wholesalers (discussed below) as obviously, being a manufacturer themselves, they do not have to rely on other manufacturers for gasoline.[7] The customer group for this category is principally the same as the manufacturers with refineries in the State of Hawaii.

In examining options as to a more appropriate baseline, location adjustment factor, marketing margin factor, mid-grade adjustment factor, premium adjustment factor, this group is different from the Manufacturers with refineries as these entities do not have the large capital investment in Hawaii. Moreover, their cost structure for producing gasoline will depend on the location of their refineries, which, for example, if they had refineries in foreign countries they may be in a position to produce gasoline at a lower cost due to their labor cost and other costs which may be lower than equivalent costs in Hawaii.

Shell Oil and its subsidiary Equilon are the principal companies in this category.

3. Wholesalers.

Wholesalers in this class have the volume purchasing ability and facilities to purchase gasoline directly from Tesoro Hawaii or Chevron or to import gasoline from any of the other manufacturers. Product is delivered into the terminals by either pipeline and/or barge. Wholesalers have ownership or joint ownership in at least one terminal and may have terminaling agreements with other Wholesalers and/or manufacturers throughout the State of Hawaii. This class sells to retailers and also own stations carrying their company brand name. Other customers include commercial end users, rental care companies, and government entities.

Aloha Petroleum, Mid-Pac Petroleum, LLC[8], and Fuel Supply Inc. (U.S. Restaurant Properties) are the principal Wholesalers in Hawaii.

4. Jobbers.

Jobbers are generally smaller companies that do not own terminal facilities or otherwise have infrastructure to import gasoline. Jobbers usually own tanker trucks that go to the load racks at the terminal facilities to makes purchases from the Manufactures or Wholesalers. The Jobbers customer base generally consists of smaller accounts that the Manufactures or Wholesalers will not deliver to due to small quantities or the

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[7] Manufacturers who do not have local refining facilities often resemble wholesalers to the extent that they do not import their own product.

[8] Mid-Pac is a unique within Wholesalers as they are indirectly owned in part by Singapore Government linked corporations that also own an interest in a petroleum refinery and other petroleum assets so they could arguably be considered a hybrid of the second and third classification. See http://info.sgx.com/listprosp.nsf/4f925e50089e98bf48256dad001425f5/bb5a315063b1a5b948256f27002dd500?OpenDocument for the annual report for the K-1 Ventures Limited that is the parent company of Mid-Pac.

requirement to pump into storage tanks or vehicles at the customer's site. Some jobbers may own gas stations or cardlocks (self service stations for commercial customers) and also provide product to other gas stations.

In considering the options as to a more appropriate baseline, location adjustment factor, marketing margin factor, mid-grade adjustment factor, premium adjustment factor, this group has a different interest than the other groups as they are generally the last group to receive product at wholesale and sell product at wholesale to the retailers as discussed in more detail below.

There are a number of jobbers on Oahu, Maui, Kauai and the Big Island including, B&E Petroleum, Inc., Diamond Head Petroleum, Inc., Fuelman, Inc., Garlow Petroleum, Inc., Leeward Petroleum, Inc., Akana Petroleum, Inc., Hawaii Petroleum, Inc., Maui Oil Company, Inc., Maui Petroleum, Inc., Kauai Petroleum Co., Ltd., and Senter Petroleum, Inc. Even though many of these Jobbers may belong to the HPMA, depending on how HPMA responds to information requests, these Jobbers may still provide valuable information and insight independent of HPMA as many of the Jobbers may have interests diverse from each other, such as information pertaining to location adjustments and marketing margins as many of them operate in separate zones.

5. Special classification (Lanai and Molokai)

Lanai, which is serviced by Lanai Oil Company, Inc., and Molokai, which is serviced by Island Petroleum, Inc., are in a unique situation that requires separate consideration. They are the only companies that service their respective island. They do not manufacture or import their product but instead buy it from Wholesalers or Manufacturers much like Jobbers. Moreover, also like Jobbers, the volume purchased by them is small. But they are different from Jobbers in some very important aspects. For example, Lanai Oil owns its own infrastructure and barges gasoline into its tanks on Lanai. Thus, Lanai Oil Company, Inc. and Island Petroleum, Inc. should be in a separate classification.

INTEREST IN THIS DOCKET

As briefly discussed above, each of these five classifications have a different perspective and different interests in the matters to be investigated in this Docket. Due to these differing perspectives, each category will be able to provide different types of information to assist the Commission in its investigation. The key to the information that may be provided in any given situation depends on not only what category a particular party occupies but on what island a party is physically located and whether the party is a purchaser or seller of gasoline. The relationships can be shown in the following chart where an "X" indicates a possible transaction point between the purchaser and seller of gasoline.[9]

[9]Please note that the chart does not take in the true complexity of these relationships such as exchange agreements, location differences, capital structure of the companies, market penetration of any particular company or brand, just to name a few.

SELLERS OF GASOLINE	PURCHASERS OF GASOLINE: Manufacturers with refinery	Manufacturer without refinery	Wholesaler	Jobber	Retailer	End User
Manufacturer with refinery	X	X	X	X	X	X
Manufacturer without refinery		X	X	X	X	X
Wholesaler			X	X	X	X
Jobber	X				X	X
Retailer						X

There are several interesting observations relating to these relationships. First, in gathering information for this Docket, the information provided needs to consider whether a particular entity is a purchaser or seller of gasoline. For example, a Wholesaler will be a purchaser when buying from a Manufacturer but that same Wholesaler will be a Seller when selling wholesale to a Jobber.

Second, the impact of the various adjustments will vary depending on the number of parties in a chain of transactions from the manufacturer to the end user. The longest purchase relationship is a situation where a manufacturer purchases gasoline from another manufacturer and then resells it to a wholesaler who sells it to a jobber who sells it to retail. The shortest purchase relationship is a direct sale from a manufacturer to the end user (such as a tour bus company). Not surprisingly, Manufacturers can sell to a wide variety of customers. The Wholesalers and to a lesser extent Manufacturers without Hawaii refining facilities, however, have greater latitude when it comes to purchasing gasoline. What is not shown is that Wholesalers and Manufacturers without Hawaii refineries can purchase from any of the manufacturers whereas the Manufacturers with significant refinery investments are more likely to use their own product in order to attempt to obtain a return on that investment.

Third, by requiring the participation of many parties, the Commission can obtain a better picture of the industry. Many of the Manufacturers, Wholesalers and Jobbers are customers of each other. Thus, as a practical matter, it is in the interests of the industry to obtain information directly from the parties with respect to their respective businesses as the cost structures are going to vary from, for example, a Wholesaler selling directly to retail as opposed to a Jobber who has to purchase product from a Wholesaler first before selling to retail. In addition, the Commission will have the benefit of both sides of the transaction and associated costs structures and should use other information provided by the other parties to confirm or modify such information.

In summary, Tesoro Hawaii has a substantial interest to see that a sound record is developed in this proceeding. In order to accomplish these goals, other entities should be made parties to this Docket or at a minimum, be required to answer information requests from the Commission either voluntarily or by subpoena. In addition, the parties to this Docket should be allowed to review such information to ensure that the information presents a fair and accurate statement of the conditions of the petroleum industry and offer other information to give a balanced approach to the Docket.

If you have any questions, please do not hesitate to contact me. Thank you for your time and consideration in this matter.

Sincerely,

RUSH MOORE LLP
A Limited Liability Law Partnership

Craig I. Nakanishi
Attorney for
Tesoro Hawaii Corporation

cc: Chevron U.S.A. Inc. (Albert Chee, Jr.)
Division of Consumer Advocacy

EXHIBIT A

Classifications of Necessary Parties

Manufacturers who refine and distribute within the State of Hawaii

Chevron U.S.A. Inc.
Tesoro Hawaii Corporation

Manufacturers who only distribute in the State of Hawaii

Shell Oil Company (Equilon Enterprises, LLC)

Wholesalers who sell at wholesale in the State of Hawaii

Aloha Petroleum, Ltd.
Fuel Supply Inc. (United States Restaurant Properties)
Mid-Pac Petroleum, LLC

Jobbers

Oahu

B&E Petroleum, Inc.
Diamond Head Petroleum, Inc.
Fuelman, Inc.
Garlow Petroleum, Inc.
Leeward Petroleum, Inc.

Big Island

Akana Petroleum, Inc.
Hawaii Petroleum, Inc.

Maui

Maui Oil Company, Inc.
Maui Petroleum, Inc.

Kauai

Kauai Petroleum Co., Ltd.
Senter Petroleum, Inc.

Special Classification

Lanai - Lanai Oil Company, Inc.
Molokai - Island Petroleum, Inc.

EXHIBIT B

Manufacturing and Distribution of Gasoline In Hawaii By Tesoro Hawaii

The gasoline used in Hawaii is either imported in its final processed form from refineries outside of the State of Hawaii or is processed by Tesoro Hawaii or Chevron refineries on Oahu from various crude oil stocks. The crude for Tesoro Hawaii originates in widely separated geographical areas such as Alaska in North America, Indonesia, Malaysia, Brunei, China and Vietnam in the Far East,and Saudi Arabia in the Middle East.

Refining Crude Oils into Gasoline

The first step for Tesoro Hawaii is to obtain crude oil for its Refinery. When crude oil arrives in Hawaii, it is brought onto Oahu from the off-shore mooring facility which is owned and operated by Tesoro Hawaii. Due to the substantial economies of scale obtained when shipping crude oil or petroleum products in large quantities, all of the crude oil and most of the petroleum products deliveries take place at the off shore mooring. Tankers, carrying loads of between 400,000 to 1,000,000 barrels of crude oil deliver their cargoes through this off-shore mooring facility into the Tesoro refinery.[10]

Once the crude oils are off loaded, the crude oils are processed through the refinery. The most basic refining process separates the crude oil into various components by heating the crude oil and putting the heated crude oil into a still and letting the different components boil off and so that they can be recovered as they condense at different temperatures. Various distillates such as kerosene and diesel fuel are extracted from crude oil through this boiling point separation process. Additional processing follows this initial crude boiling point separation process with the goal of changing the molecular structure of the initial processed product. This occurs through a variety of chemical reactions caused by variations in heat, pressure and vacuum conditions or by a catalyst which is a substance that increases the rate of a chemical reaction without being consumed in the reaction. Some of the resulting petroleum products resulting from this additional processing include jet fuel, naphtha, gasoline and blendstocks.

It is important to note that crude oils are unique and will produce different types of products with the varying characteristics. For example, with respect to gasoline, the characteristics of the gasoline produced depend on the type of crude oil that is used and the configuration of the refinery at which it is produced. Other ingredients may also be blended into gasoline that will impact its characteristics, such as ethanol.

Importing Gasoline

If gasoline used in the State of Hawaii is not refined here then it is imported either directly from another refinery or through an out of state wholesaler or distributor. The

[10] As a side note, Tesoro Hawaii has very strict rules, standards, and procedures for qualifying vessels that are allowed to discharge crude oil and petroleum products into its mooring facility. Tankers sometimes must wait for days until conditions are appropriate to off-load.

refined product is either brought in through the off-shore moorings, through Barbers Point Harbor or on rare occasion another marine facility such as Honolulu Harbor. The imported gasoline is stored at a terminal facility which generally consists of large storage tanks, pipelines and racks to load gasoline trucks.

Whether gasoline is imported or refined in the State of Hawaii, it is important to remember that gasoline is not a homogeneous product nationwide. Because of different Federal and/or state laws, gasoline may differ depending on location or climate. For example, gasoline produced in Hawaii, as a general rule, cannot be sold in California because of different specifications. Simply stated, gasoline produced for sale in one area may not be suitable for use in another area without a substantial change to its formulation and only if the refinery has the processing capability and sophistication to make such a formulation.

Distribution

Once crude oil has been refined into gasoline and the other petroleum products, or the gasoline has been imported into Hawaii in its finished form, the gasoline is transported by pipeline to the refiner's bulk storage facilities, bulk storage terminals owned by others or transported to Barbers Point Harbor for shipment to the neighbor islands. Once at the storage terminals, tanker trucks (that typically hold up to 9,100 gallons) will pull into the storage terminal facility and gasoline is then loaded into the trucks for delivery to individual retail gas stations. These tanks usually have several compartments allowing them to transport different grades of gasoline. When the tanker truck reaches a gas station, the truck operator unloads each grade of gasoline into the appropriate underground tanks at the station.