CORRECTING THE RECORD ON REFINERY CLOSURES

Committee on Energy and Commerce, Democratic Staff

Republicans in the House claim that environmental and health protections are to blame for recent refinery closures in the United States. Speaker John Boehner has repeated claims that "extremely challenging regulations" for U.S. refineries are linked to rising gasoline prices.[1] Energy and Commerce Committee Chairman Fred Upton said the refineries are closing in part due to their "regulatory burden."[2] Nonpartisan energy experts, the Congressional Research Service, and the owners of the refineries themselves all paint a very different picture: decisions to expand refineries along the Gulf Coast and close others on the East Coast are based on market factors such as oil prices, consumer demand, and competition, not environmental regulations.

EAST COAST MARKET CONDITIONS, NOT REGULATIONS, CAUSED REFINERY CLOSURES.

U.S. demand for gasoline and other finished petroleum products has declined. According to the Energy Information Administration (EIA), U.S. consumption of motor gasoline fell in 2011 and is projected to continue to decline.[3] Demand for refined petroleum products has fallen most dramatically on the East Coast, declining by 13% since 2007.[4] A spokesman for Valero said that it is "very difficult to compete" in the East Coast market but "if there was demand for product there, those refineries wouldn't close down."[5]

As a result, the refining industry has excess capacity. U.S. refineries had more than two million barrels per day of excess refining capacity in 2011, squeezing profit margins.[6] According to the Congressional Research Service, East Coast refineries have been particularly unprofitable due to reduced refinery capacity utilization.[7] Overall, refinery utilization along the East Coast fell from 93% in 2005 to just 68% in 2011.[8] Along the Gulf Coast, refineries with excess capacity can produce refined petroleum products for export. But this option is not practical for East Coast refineries because of their source of crude oil.

East Coast refineries process more expensive crude oil. According to EIA, East Coast refineries have been idled or put up for sale "due to poor economics."[9] One cause is that East Coast refineries, including the refineries in Pennsylvania, are designed to process costly light sweet crude oil. This places them at a competitive disadvantage to more complex refineries that can process heavier crude oil, which is cheaper. Aaron Brady at IHS Cambridge Energy Research Associates says that East Coast refineries have been particularly vulnerable to market conditions because "they are buying crude at very high prices, but they have to sell gasoline in a very competitive market, which is shrinking."[10]

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[1] Office of the Speaker of the House, *As Gas Prices Soar, "Extremely Challenging" Regulations Making Things Worse for Refineries* (Mar. 20, 2012) (online at www.speaker.gov/blog/?postid=285767).

[2] Statement of Chairman Fred Upton, Committee on Energy and Commerce, *The Fiscal Year 2013 EPA Budget*, 112th Cong. (Feb. 28, 2012).

[3] EIA, *Short-Term Energy Outlook* (Mar. 6, 2012).

[4] EIA, *Petroleum & Other Liquids: Product Supplied* (online at www.eia.gov/dnav/pet/pet_cons_psup_dc_nus_mbbl_m.htm) (accessed Mar. 23, 2012).

[5] *Gulf Coast working to fill a fuel void in Northeast*¸ Houston Chronicle (Jan. 8, 2012).

[6] EIA, *Petroleum & Other Liquids: Refinery Utilization and Capacity* (online at www.eia.gov/dnav/pet/pet_pnp_unc_dcu_nus_a.htm) (accessed Mar. 23, 2012).

[7] Congressional Research Service, *Rising Gasoline Prices 2012* at 5 (Mar. 1, 2012).

[8] EIA, *Refinery utilization rates react to economics in 2011* (Mar. 20, 2012).

[9] *Id.*

[10] *Philly-area refinery closures would be severe hit*, Associated Press (Oct. 2, 2011).

SUNOCO CITES "DETERIORATING REFINING MARKET CONDITIONS."

On September 6, 2011, Sunoco announced plans to sell its refineries in Philadelphia and Marcus Hook, Pennsylvania, citing their "unacceptable financial performance."[11] In December, Sunoco idled its refinery in Marcus Hook "due to deteriorating refining market conditions."[12] Sunoco's CEO noted that the "outlook for both motor fuel demand and refining margins remains weak" and warned that it would idle the Philadelphia refinery by July 2012 if a buyer isn't found.[13] In an "open letter" to the Pennsylvania community, Sunoco listed three market factors that forced the company to close or sell its refineries: expensive crude oil, declining demand for gasoline, and overcapacity in the refining sector.[14] The company did not cite environmental regulations as a factor.

In the company's February 2012 10-K filing, Sunoco noted that some of its U.S. and global competitors have expanded or added new refining capacity, hurting the company's competitive position.[15] Sunoco also explained that its competitors are larger and may be "more flexible in responding to volatile industry or market conditions," such as "sharp changes in crude oil costs."[16] In particular, Sunoco stated that its refined product margins declined sharply in 2009 "in response to weak demand attributable to the global recession."[17] Although the margins improved a bit in 2010 and 2011, they "deteriorated significantly in the latter part of 2011," particularly along the East Coast.[18] Sunoco included a general discussion of the company's potential environmental compliance costs in the 10-K, as is required by law, but Sunoco's 10-K filing <u>never</u> linked these potential costs to its decision to shut down the Pennsylvania refineries.

CONOCOPHILLIPS CITES "SEVERE MARKET PRESSURE" ON EAST COAST.

On September 27, 2011, ConocoPhillips announced plans to sell its refinery in Trainer, Pennsylvania, idling it immediately and closing it permanently within six months.[19] ConocoPhillips noted that the "U.S. East Coast refining has been under severe market pressure for several years."[20] The company cited unspecified regulatory requirements as a factor in the refinery's closure, but only after "product imports" and "weakness in motor fuel demand."[21] A ConocoPhillips executive told reporters that the company decided to sell the plant instead of renovating it to make it more competitive.[22]

In the company's February 2012 10-K filing, ConocoPhillips reiterated the "severe market pressure" facing refiners on the East Coast.[23] The company noted that refining margins are dependent on the cost of crude oil and the sales prices for refined products, "both of which are subject to market factors over which we have no control."[24] ConocoPhillips specifically noted that cheaper, heavier crudes have been trading at a "deeper discount" relative to the lighter crudes refined on the East Coast.[25] In this market environment, ConocoPhillips stated that "product imports, weakness in motor fuel demand, and costly regulatory requirements" become key challenges.[26]

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[11] Sunoco, Inc., *Sunoco to Exit Refining and Conduct Strategic Review of the Company* (Sep. 6, 2011) (press release).
[12] Sunoco, Inc., *Sunoco to Idle Main Processing Units at Marcus Hook Refinery* (Dec. 1, 2011) (press release).
[13] *Id.*
[14] Sunoco, Inc., *Open Letter to the Community* (Mar. 1, 2012) (online at www.piersystem.com/external/content/document/3433/1322955/1/sunoco-inquirer-10.88x10.5.pdf).
[15] Sunoco, Inc., *Form 10-K* at 12 (Feb. 28, 2012).
[16] *Id*. at 13.
[17] *Id*. at 37.
[18] *Id*.
[19] ConocoPhillips, *ConocoPhillips Seeks Buyer for Trainer, Pa., Refinery* (Sept. 27, 2011) (press release).
[20] *Id.*
[21] *Id.*
[22] *ConocoPhillips looks to sell Pa. refinery*, Associated Press (Sept. 27, 2011).
[23] ConocoPhillips, Form 10-K at 42 (Feb. 21, 2012).
[24] *Id*. at 43.
[25] *Id*.
[26] *Id*.

HOVENSA CITES "WEAKNESS IN DEMAND" FOR PETROLEUM PRODUCTS.

On January 18, 2012, HOVENSA announced that it will begin shutting down its refinery in St. Croix, U.S. Virgin Islands, due to $1.3 billion in economic losses "caused primarily by weakness in demand for refined petroleum products due to the global economic slowdown and the addition of new refining capacity in emerging markets."[27] The company also noted that cheap natural gas had put the oil-fired refiner at a competitive disadvantage.[28] The company's CEO reiterated these points during testimony before the Senate of the Virgin Islands and dismissed a suggestion that an EPA order to install modern pollution controls was a factor.[29]

REFINERIES IN SOME PARTS OF THE COUNTRY ARE EXPANDING AND UPGRADING.

In 2011, U.S. refining capacity reached 17.7 million barrels per day, the highest level in at least 25 years.[30] In particular, Gulf Coast refineries have increased their capacity by more than one million barrels per day since 2000.[31] EIA notes that Gulf Coast refineries have been able to "use different types of crude oil to maximize production" and "cheaper sources of crude compared to the rest of the country."[32] More refinery expansions are underway. For example, Shell is expanding its Port Arthur refinery in Texas to more than double its capacity.[33] Valero Energy is investing billions to add new hydrocrackers to process heavy crudes at its refineries in Port Arthur and Norco, Louisiana.[34]

Similarly, BP is modernizing its Whiting refinery in northern Indiana to process heavier crudes. The company calls this modernization "essential to the long-term viability of the refinery" as "conventional supplies of the lighter crudes diminish, and are replaced by heavier crudes."[35] Sunoco and ConocoPhillips opted not to make a similar investment at their refineries in Pennsylvania.

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[27] HOVENSA LLC, HOVENSA Announces Closure of St. Croix Refinery (Jan. 18, 2012) (press release).

[28] *Id.*

[29] *Senators Grill Hovensa Officials*, St. Croix Source (Jan. 26, 2012).

[30] EIA, *Petroleum & Other Liquids: Refinery Utilization and Capacity* (online at www.eia.gov/dnav/pet/pet_pnp_unc_dcu_nus_a.htm) (accessed Mar. 27, 2012). EIA data only goes back to 1985.

[31] *Id.*

[32] EIA, *Refinery utilization rates react to economics in 2011* (Mar. 20, 2012).

[33] Shell, *Motiva Port Arthur Refinery Expansion Project* (online at www.shell.us/home/content/usa/aboutshell/projects_locations/port_arthur/) (accessed Mar. 27, 2012).

[34] *Valero Advances Port Arthur, St. Charles Hydrocracker Projects,* Bloomberg (Jan. 26, 2011).

[35] BP, *Refineries* (online at www.bp.com/sectiongenericarticle.do?categoryId=9030203&contentId=7055766) (accessed Mar. 27, 2012).