

# RECENT DEVELOPMENT

## GASOLINE PRICES AND THE ENERGY POLICY ACT OF 2005: THE DECOUPLING OF GASOLINE PRICES FROM THE PRICE OF CRUDE OIL

### I. INTRODUCTION

Americans are ready to accept that the price of gasoline is related to the price of crude oil.<sup>1</sup> Crude oil is the raw material from which gasoline is made; it makes sense that if the price of crude oil increases by five percent, then the price of gasoline would increase proportionally, or possibly a little more because the energy required for refining might be derived from crude oil.

Americans are also ready to accept that the price of crude oil can be volatile<sup>2</sup> because it is based on factors that are, by definition, unstable. Political unrest in Iraq, Nigeria, and Venezuela; decisions made by the countries affiliated with OPEC; unexpected demand growth in China and India; decline in the value of the U.S. dollar; and uncertainty and fears based on the war against terrorism in the Middle East all understandably contribute to price volatility.<sup>3</sup>

Americans are not ready, however, to accept increases in gasoline prices that have far outpaced the increases in the price

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1. Scott Horsley, *Q&A: High Gas Prices*, NPR.ORG, Apr. 27, 2006, <http://www.npr.org/templates/story/story.php?storyId=5365439>.

2. Forbes.com, [http://www.forbes.com/static\\_html/oil/2004/oil.shtml](http://www.forbes.com/static_html/oil/2004/oil.shtml) (last visited Nov. 8, 2006) (showing the price of crude oil from 1861 to 2005).

3. CARL E. BEHRENS & CAROL GLOVER, CONG. RESEARCH SERV., GASOLINE PRICES: POLICIES AND PROPOSALS 1 (2005) [hereinafter BEHRENS & GLOVER I], <http://fpc.state.gov/documents/organization/48803.pdf>. This issue brief are regularly updated. See, e.g., *infra* note 4.

of crude oil.<sup>4</sup> This trend is caused by a decoupling of the gasoline and oil markets.<sup>5</sup> While the price of crude oil directly affects the price of gasoline, it is now not the only major factor affecting prices.<sup>6</sup> A perfect example of gasoline price decoupling is the gasoline price spike after Hurricane Katrina. The increase in gas prices outpaced the increase in crude oil prices so rapidly that the Senate passed a bill expediting the investigation of price-gouging following Hurricane Katrina,<sup>7</sup> and the House passed a bill with provisions requiring the FTC to define price gouging and penalize violators.<sup>8</sup> Decoupling of gas prices from the price of crude oil in the past few years suggests factors other than the high price of crude oil are now affecting gasoline prices in the U.S.

A number of factors have contributed to the decoupling of gasoline prices from that of crude oil. First, U.S. demand for gasoline has increased as economic growth has resumed in the past few years.<sup>9</sup> Second, domestic refining capacity has declined in both the number of refineries and refining capacity, and the refining industry has cut costs by operating with lower inventories, making them less able to meet unanticipated demand.<sup>10</sup> Third, gasoline markets have fragmented because of regional air regulations.<sup>11</sup> Fourth, U.S. oil companies have imported gasoline to meet increasing demand, as opposed to expanding existing refinery capacity or building new refineries.<sup>12</sup> Finally, refineries have complied with environmental regulation, adding expense to the final product.<sup>13</sup> Refineries in the U.S.

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4. CARL E. BEHRENS & CAROL GLOVER, CONG. RESEARCH SERV., GASOLINE PRICES: NEW LEGISLATION AND PROPOSALS 10 (2005) [hereinafter BEHRENS & GLOVER II], <http://fpc.state.gov/documents/organization/56862.pdf>. This document is an issue brief, which the Congressional Research Service regularly updates. This specific issue brief culminated in a CRS Report. CARL E. BEHRENS & CAROL GLOVER, CONG. RESEARCH SERV., GASOLINE PRICES: NEW LEGISLATION AND PROPOSALS (2006), available at <http://fpc.state.gov/documents/organization/69485.pdf>.

5. ROBERT PIROG, CONG. RESEARCH SERV., OIL INDUSTRY PROFITS: ANALYSIS OF RECENT PERFORMANCE 6 (2005), available at <http://fpc.state.gov/documents/organization/51075.pdf>.

6. *Id.*

7. Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006, H.R. 2862, 109th Cong. § 525 (2005) (as reported in public print).

8. Gasoline for America's Security Act of 2005, H.R. 3893, 109th Cong. § 402 (2005) (as referred to Senate committee after being received from the House).

9. BEHRENS & GLOVER II, *supra* note 4, at 3; see also Energy Information Administration, U.S. Department of Energy, <http://www.eia.doe.gov/emeu/steo/pub/gifs/Slide14.gif> (last visited Nov. 6, 2006).

10. BEHRENS & GLOVER II, *supra* note 4, at 3.

11. *Id.*

12. *Id.*

13. *Id.*

cannot make enough gasoline to satisfy American demand, and this insatiable appetite of for gasoline is now a significant factor adding to the price of gasoline.<sup>14</sup>

## II. HOW HAS CONGRESS ADDRESSED DECOUPLING?

Congress considered major energy legislation for three years before the current gas-price crisis.<sup>15</sup> The legislation culminated in the Energy Policy Act of 2005 (“EPAAct”).<sup>16</sup> This section examines the provisions of the EPAAct affecting gasoline, discusses how these provisions might affect gas prices, and emphasizes that the provisions of the EPAAct suggest that Congress, at best, has only indirectly mitigated the decoupling of gas prices.

### A. Issues Considered in Passing the Energy Policy Act of 2005

One of the issues Congress considered in the passage of the EPAAct was the regulation of gasoline additives.<sup>17</sup> Regulation of gasoline additives relates back to the Clean Air Act Amendments of 1990, which require oxygenation of gasoline by use of ethanol or methyl tert-butyl ether (“MTBE”).<sup>18</sup> Over time, many refiners chose MTBE as the preferred oxygenate because it was less expensive than ethanol, it was easier to transport, and it was easier to mix with gasoline.<sup>19</sup> Unfortunately, MTBE caused contamination of drinking water, and this contamination led to numerous lawsuits against refiners of MTBE.<sup>20</sup> The 108th Congress responded to the MTBE lawsuits by proposing provisions that lifted the oxygenate requirement mandated in the Clean Air Act,<sup>21</sup> mandated the use of other renewable fuel additives such as ethanol,<sup>22</sup> and created a “safe harbor” provision

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14. *See id.*

15. *See, e.g.*, Energy Policy Act of 2003, H.R. 1644, 108th Cong. (2003) (as reported in the House); Energy Policy Act of 2004, H.R. 4503, 108th Congress (2004) (as received in the Senate from the House); BEHRENS & GLOVER I, *supra* note 3, at 6.

16. BEHRENS & GLOVER I, *supra* note 3, at 6 (citing Energy Policy Act of 2005, H.R. 6, 109th Cong (2005)); Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) (codified as amended in scattered sections of 42 U.S.C.).

17. BEHRENS & GLOVER I, *supra* note 3, at 7.

18. ROBERT L. BAMBERGER & CARL E. BEHRENS, CONG. RESEARCH SERV., ENERGY POLICY: COMPREHENSIVE ENERGY LEGISLATION (H.R. 6) IN THE 109TH CONGRESS 3 (2005), available at <http://fpc.state.gov/documents/organization/50805.pdf>.

19. *Id.*; *see also* Derek Nagel, *Not Quite Off the Hook: Why There Should Be A Legislative Solution For MTBE Contamination Without a Safe Harbor For MTBE Producers*, 1 ENVTL. & ENERGY L. & POL’Y J. 319 (2006).

20. BAMBERGER & BEHRENS, *supra* note 18, at 3.

21. H.R. 6, 108th Cong. § 17101 (2003) (as introduced in the House).

22. *Id.*

for companies being sued over contamination by MTBE.<sup>23</sup>

The 109th Congress also addressed the fuel economy of automobiles.<sup>24</sup> Although Congress considered several measures for fuel efficiency, no new corporate average fuel economy (“CAFE”) standards were ultimately allowed into the EPAct.<sup>25</sup> A provision to raise the goal CAFE standard for passenger automobiles to thirty-three miles per gallon over the next ten years was one of the longest surviving fuel efficiency provisions, but was ultimately defeated in the House.<sup>26</sup> Despite not changing fuel economy standards, Congress did authorize \$2 million annually for rulemaking and studies by the National Highway Traffic Safety Administration.<sup>27</sup>

Congress addressed a number of other issues during the passage of the EPAct. Provisions of H.R. 6 allowed the federal government to accept royalties in the form of oil instead of cash on leased federal property and lower or terminate royalties on leases in the Gulf of Mexico.<sup>28</sup> H.R. 6 provisions also relaxed regulatory requirements for hydraulic fracturing and construction of exploration and production facilities and amended the system for leasing and permitting of federal lands for oil and gas development.<sup>29</sup> Congress considered provisions for exploring and developing the Alaska National Wildlife Refuge (“ANWR”)<sup>30</sup> and lifting the moratorium on oil and gas leasing in the Outer Continental Shelf (“OCS”)<sup>31</sup> but neither was included in the EPAct.<sup>32</sup> Finally, Congress included provisions in H.R. 6 amending the Refinery Revitalization Act to ease regulatory requirements for construction of new refineries in areas of high

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23. H.R. 6, 108th Cong. § 17102 (2003) (as introduced in the House); BAMBERGER & BEHRENS, *supra* note 18, at 4.

24. See BEHRENS & GLOVER II, *supra* note 4, at 8–9.

25. *Id.*; Energy Policy Act of 2005, Pub. L. No. 109-58.

26. See BAMBERGER & BEHRENS, *supra* note 18, at 9; BEHRENS & GLOVER II, *supra* note 4, at 9.

27. BEHRENS & GLOVER II, *supra* note 4, at 9; Energy Policy Act of 2005, Pub. L. No. 109-58.

28. H.R. 6, 109th Cong. (2005); BEHRENS & GLOVER I, *supra* note 3, at 9–10.

29. H.R. 6, 109th Cong. (2005); BEHRENS & GLOVER I, *supra* note 3, at 9–10.

30. BEHRENS & GLOVER II, *supra* note 4, at 8. While ANWR provisions were too controversial for the Energy Policy Act of 2005 and were dropped, the ANWR issue has been revisited through proposals for the 2006 budget. *Id.* at 8, 11 (citing S. Con. Res. 18, 109th Cong. (2005)).

31. BEHRENS & GLOVER II, *supra* note 4, at 9. While provisions lifting the moratorium in the OCS were too controversial for the Energy Policy Act of 2005 and were dropped, the OCS issue was revisited in a proposed bill that never reached the House floor. *Id.* at 9.

32. *Id.* at 8–9.

unemployment.<sup>33</sup>

### *B. The Congressional Disconnect*

Assuming that decoupling has existed for some time, Congress must have knowledge of this phenomenon. The spike in gasoline prices would not have been so drastic if this phenomenon had not been waiting for its opportunity to exploit American gasoline consumers. However, issues considered during passage of the EPAct seem to demonstrate that Congress places little importance on minimizing the decoupled price of gasoline.<sup>34</sup> The issues addressed seem to relate mostly to increasing domestic production of oil and gas and not decreasing refining costs or increasing refining capacity. The royalty changes mentioned above leave companies with lower production costs, not lower refining costs, and relaxing regulatory requirements in the construction of oil and gas production facilities does not create financial or regulatory incentives to build new or more efficient refineries.

Further, amending the system of permitting federal lands for oil and gas development does not help the refining industry because permitting issues still exist for refineries.<sup>35</sup> Congress could specifically look at avoiding a repeat of the permitting debacle of Arizona Clean Fuels (“ACF”) in Yuma, Arizona.<sup>36</sup> After applying for a permit in 1999 for a different site, ACF withdrew its application in 2004 and applied for the Yuma site in 2005.<sup>37</sup> The EPA granted a permit in 2005, and ACF is still waiting for an air permit from the Arizona Department of Environmental Quality.<sup>38</sup> Many good reasons may exist for the delay in obtaining permits, but each delay adds to the decoupling of gasoline prices from crude oil prices because refining capacity will inevitably lag at least a few years behind the change in demand.

Allowing drilling in the ANWR also fails to remedy inadequate refining capacity. Even though provisions concerning ANWR in the EPAct were dropped, the Senate budget resolution that opens ANWR to oil and gas leasing development<sup>39</sup> marks a

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33. H.R. 6, 109th Cong. (2005); BEHRENS & GLOVER I, *supra* note 3, at 10.

34. The choice of issues also questions whether Congress has recognized that there is a decoupling problem.

35. See PIROG, *supra* note 5, at 15 (“The permitting process has been identified by some as an impediment to refinery investment in the United States.”)

36. *Id.*

37. *Id.* at 16.

38. *Id.*

39. S. Con. Res. 18, 109th Cong. (2005).

significant step toward allowing drilling in the ANWR. However, access to oil and gas in ANWR is irrelevant to decoupling—allowing drilling would not affect the decoupling of gasoline prices from crude oil because the supply of crude oil does not impact refining capacity.

Similarly, lifting the moratorium on oil and gas leasing on the OCS does not improve refining capacity. Even if this proposal had succeeded in the EPAct,<sup>40</sup> lifting the moratorium on drilling on the OCS would increase supply of crude oil as would drilling in the ANWR, but would not influence the decoupling effect of gasoline from crude oil.

Fuel economy is an area in which Congress could address gasoline price decoupling by controlling consumer demand for gasoline. Higher fuel efficiency standards in American's automobiles will reduce consumer demand for gasoline. The 109th Congress rejected through the EPAct fuel efficiency standards as a means to control rising gas prices. However, a continued decoupling of the price of gasoline from the price of crude oil may lead future congresses to consider fuel efficiency requirements as a more important means for reducing demand for gasoline, thus controlling prices.

### *C. As Good As It Gets—The Indirect Approach*

Despite turning a seemingly blind eye to the effect of refining capacity on gas prices, Congress has indirectly attempted to minimize the decoupling. First, the issues discussed above relating to lowering oil production costs could be considered a method for freeing oil companies' money from production so that it can be applied to refining. Second, allowing amendment of statutes concerning alternative-fueled vehicles helps address consumer demand for gasoline. Third and potentially most effective, easing regulatory requirements for construction of new refineries would directly lower oil companies' cost of refining<sup>41</sup> and help to minimize the decoupling of gasoline. The lower cost of construction could translate into lower gasoline prices because oil companies could pass the savings onto consumers.

Finally, the legislation concerning gasoline additives indirectly affects the decoupling of gas prices even though Congress may not have had that intention. Refiners suggested that requiring ethanol in place of MTBE could lead to an increase

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40. See *supra* note 33 and accompanying text.

41. Making capital cost cheaper may be one way to lower the total cost.

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in gas prices because ethanol is harder to transport, harder to mix with gasoline, and more expensive to make.<sup>42</sup> They argue that this increased cost of oxygenating gasoline will increase the ultimate price of gasoline.<sup>43</sup> However, the MTBE provisions also reduce refining costs by protecting refiners from lawsuits. The safe harbor provision of the EAct provides protection for producers of MTBE from products liability lawsuits,<sup>44</sup> thereby reducing MTBE litigation costs.<sup>45</sup> Arguably this protection allows refiners to invest more into future refining capacity.

### III. WHY THE DISCONNECT?

Current consumer spending on oil as a percentage of gross domestic product (“GDP”) is not at the alarming level that it was in the early 1980’s.<sup>46</sup> See Figure 1.

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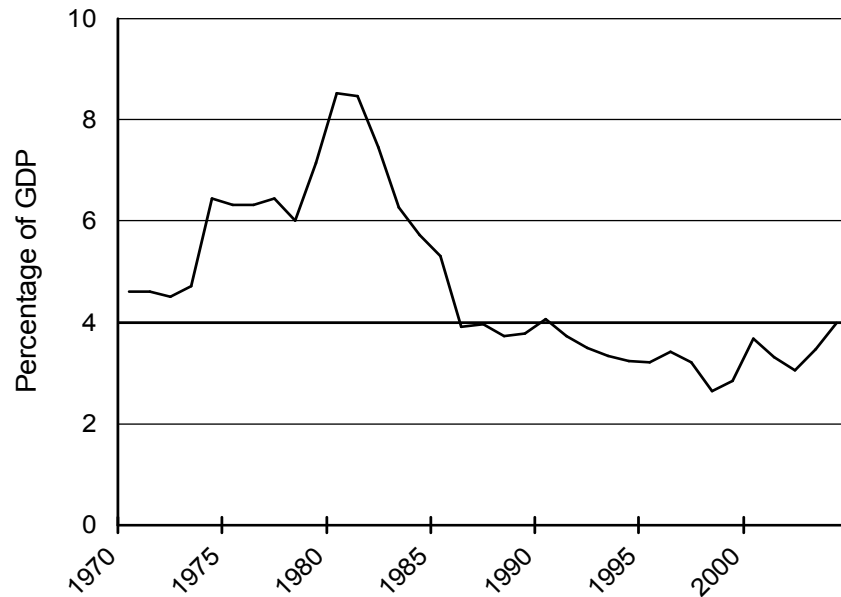
42. BAMBERGER & BEHRENS, *supra* note 18, at 3.

43. BEHRENS & GLOVER I, *supra* note 3, at 7.

44. *Id.* For additional information on the “safe-harbor” provision, see AARON M. FLYNN, CONG. RESEARCH SERV., THE SAFE-HARBOR PROVISION FOR METHYL TERTIARY BUTYL ETHER (MTBE) (2005), available at <http://www.ncseonline.org/NLE/CRSreports/05feb/RS21676.pdf>. See also BRENT D. YACOBUCCI, ET AL., CONG. RESEARCH SERV., RENEWABLE FUELS AND MTBE: SIDE-BY-SIDE COMPARISON OF H.R. 6 AND S. 2095 (2004), available at <http://www.ncseonline.org/NLE/CRSreports/04Mar/RL31912.pdf>.

45. See YACOBUCCI, ET AL., *supra* note 44.

46. EIA, State Energy Consumption, Price, and Expenditure Estimates (SEDS), United States, Prices and Expenditures 1970–2003, [http://www.eia.doe.gov/emeu/states/sep\\_prices/total/pdf/pr\\_us.pdf](http://www.eia.doe.gov/emeu/states/sep_prices/total/pdf/pr_us.pdf) (last visited Jan. 18, 2007) (see tbl. 1 for 2003 data); EIA, SEDS, United States, Partial Updates: Recent Years by Energy Source, Total Petroleum Prices and Expenditures, [http://www.eia.doe.gov/emeu/states/sep\\_fuel/html/pdf/fuel\\_pr\\_pa.pdf](http://www.eia.doe.gov/emeu/states/sep_fuel/html/pdf/fuel_pr_pa.pdf) (last visited Jan. 18, 2007) (see tbl. F9b for United States 2004 data); EIA, Annual Energy Review 2005, Financial Indicators, tbl. 3.5: Consumer Expenditures Estimates for Energy by Source 1970–2002, [http://www.eia.doe.gov/emeu/aer/pdf/pages/sec3\\_11.pdf](http://www.eia.doe.gov/emeu/aer/pdf/pages/sec3_11.pdf) (last visited Jan. 18, 2007); see also BEHRENS & GLOVER I, *supra* note 3, at 3, Fig. 4.



**Figure 1.** Total U.S. Petroleum Expenditures as Percentage of Nominal GDP, 1970–2004.

Discussions about energy policy and high gas prices are compared to the Iranian crisis of the early 1980s when spending on oil reached around eight percent of American GDP.<sup>47</sup> However, the fact that consumer spending on oil is not at the alarming level of the early 1980s does not mean the effect of high gasoline prices is necessarily less dramatic.

Until Hurricane Katrina, high gasoline prices were not as crippling as prices of earlier crises: there was no physical shortage of gasoline, and there were no lines at the pump.<sup>48</sup> During Hurricane Katrina, oil rigs in the Gulf of Mexico and refineries on the Louisiana coast shut down.<sup>49</sup> Not only was American supply of crude disrupted, but the supply of gasoline was disrupted as a result of the closed refineries.<sup>50</sup> This disruption led to a sharp spike in prices and short supply of gasoline, especially

47. See, e.g., BEHRENS & GLOVER II, *supra* note 4, at 4.

48. *Id.*

49. James R. Healey, *Storm Worsens Oil, Gas Problems*, USA TODAY, Aug. 31, 2005, [http://www.usatoday.com/money/industries/energy/2005-08-29-katrina-cover-1b-usat\\_x.htm](http://www.usatoday.com/money/industries/energy/2005-08-29-katrina-cover-1b-usat_x.htm).

50. *Id.*

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in areas hit by the hurricane.<sup>51</sup> Before Katrina, regulating the price of gasoline was not as pressing because Americans could afford the price increases.

Congress may not have felt a sense of urgency to address the decoupling issue prior to Katrina because it only had previous price crises as a comparison. However, one fatal flaw existed in their comparison: Congress did not take into account the extent of price decoupling in the U.S. gasoline market. The volatility of gas prices is no longer solely dependent on the volatility of crude oil prices.<sup>52</sup> Prices now depend on refineries' ability to immediately meet Americans' ever-increasing demand for gasoline.<sup>53</sup> Whenever the supply of gasoline is disrupted, Americans now see a great and immediate increase in price.<sup>54</sup> The lesson from Hurricane Katrina should be that Congress should take action to abate the effects of our own demand for gasoline. In particular, Congress should take into account the factors that affect the decoupling of gasoline prices from crude.<sup>55</sup>

#### IV. LEGISLATION ADDRESSING DECOUPLING SINCE THE ENERGY POLICY ACT OF 2005

The root cause of price decoupling seems to be lack of domestic refining capacity. Congress must find a way to increase U.S. gasoline refining capacity, whether it is from encouraging private oil companies to build new refineries or expanding existing refineries. While Congress has introduced a plethora of legislation aimed at giving tax credits or reductions to consumers and oil companies<sup>56</sup> (which largely ignores the decoupling problem), Congress may be on the right track with some bills.

First, the Gasoline for America's Security Act of 2005 provides for presidential designation of potential refinery sites on federal lands and military bases that are closing and sets up a process for coordinating authorization and related environmental review for construction of new refineries.<sup>57</sup> In short, the Act

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51. *Id.*

52. *See supra* notes 1–14 and accompanying text.

53. *Id.*

54. *Id.*

55. *Id.*

56. *See, e.g.*, Gasoline Price Stabilization Act of 2005, H.R. 3544 (2005) (as introduced in the House) (having various provisions creating tax credits for fuel efficient vehicles); Gasoline Price Relief Act of 2006, H.R. 5203 (2006) (as introduced in the House) (having general tax credit provisions); Gas Price Reduction Act of 2006, S. 2673 (2006) (as introduced in the Senate) (having provisions for the federal tax reduction on gasoline).

57. Gasoline for America's Security Act of 2005, H.R. 3893, 109th Cong. (2005) (as reported to the House).

would give refiners financial and bureaucratic incentive to build new refineries. The House passed the bill,<sup>58</sup> referred it to the Senate, and the Senate read and submitted it to the Committee on Energy and Natural Resources.<sup>59</sup>

Second, the Gasoline Availability Stabilization Reserve Act introduced in the House establishes an unleaded gasoline reserve having a total capacity of 20 million barrels. The Act gives the Secretary of Energy power to make decisions including plans for transportation of the gasoline in emergencies.<sup>60</sup> The bill is currently in the House Subcommittee on Energy and Air Quality.<sup>61</sup> Having a reserve of gasoline directly addresses price spikes in scenarios like Hurricane Katrina. The reserve is an extra supply of gas that takes the place of the refineries that go off-line during a hurricane, and it will act to at least mitigate price increases in emergency situations.

Third, the Strategic Gasoline and Fuel Reserve Act of 2005 establishes a gasoline reserve of 40 million barrels and a jet fuel reserve of 7.5 million barrels.<sup>62</sup> The bill is currently in the Senate Committee on Energy and Natural Resources.<sup>63</sup> Like the Gasoline Availability Stabilization Reserve Act in the House, this Act directly addresses the decoupling problem, especially in emergency situations.

## V. CONCLUSION

The current gasoline price volatility can be explained in great part by the phenomenon of price decoupling. No longer is the price of gasoline only dependent upon the volatile price of crude oil. Americans now must cope with their own demand and lack of increased refining capacity in dealing with gasoline prices. While the EPA takes steps in the right direction, United States energy policymakers must address the decoupling phenomenon, especially in light of Hurricane Katrina's

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58. The Library of Congress, THOMAS Home, Bills Resolutions, Search Results, <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:h.r.03893>: (last visited Dec. 17, 2006).

59. Gasoline for America's Security Act of 2005, H.R. 3893, 109th Cong. (2005) (as referred to the Senate Committee on Energy and Natural Resources after being received from the House). The Senate Committee on Environment and Public Works rejected a senate bill similar to H.R. 3893. Gas Petroleum Refinery Improvement and Community Empowerment Act, S. 1772, 109th Cong. (2005) (as introduced to the Senate); BEHRENS & GLOVER II, *supra* note 4, at 10.

60. H.R. 3792, 109th Cong. (2005) (as introduced in the House).

61. The Library of Congress, THOMAS Home, Bills Resolutions, Search Results, <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:h.r.03792>: (last visited Dec. 17, 2006).

62. S. 1794, 109th Congress (2005) (as introduced in the Senate).

63. The Library of Congress, THOMAS Home, Bills Resolutions, Search Results, <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:s.01794>: (last visited Dec. 17, 2006)

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magnification of the decoupling problem. Congress is moving in the right direction in addressing the decoupling of gas prices through the creation of gasoline reserves; however, the fraction of legislation actually addressing decoupling does question whether Congress views the American public's economic health as a priority over the economic health of private interests.

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