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BUSINESS

Refinery Woes Stall Gasoline Price Drops

In Midwest, West Coast, pump prices don't reflect skid in crude oil

Many drivers in California are saving less than 10% on gasoline this summer compared with about 25% for most U.S. drivers. A gas station in Encinitas, Calif., earlier this month. PHOTO: MIKE BLAKE/REUTERS

By Alison Sider

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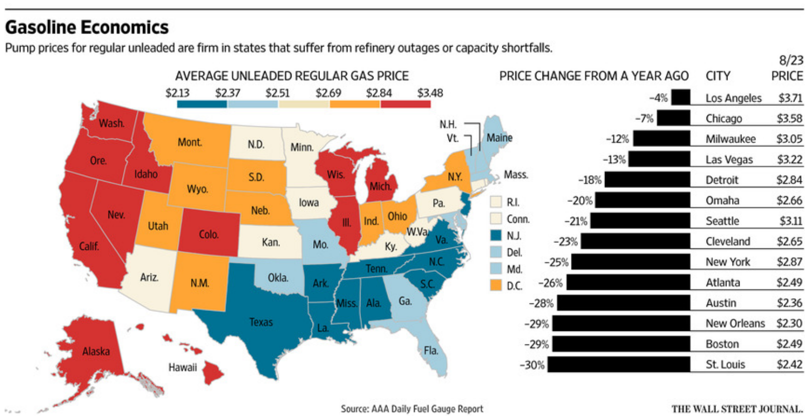
U.S. oil prices briefly dropped below $40 a barrel on Friday—hitting a six-year low that adds to pressure on pump prices for Labor Day road trips. But cheap gasoline isn't a sure bet everywhere.

Even as most drivers around the country are spending 25% less on fuel than they did a year ago, California drivers have missed out on the gasoline price windfall because of refinery outages. Many drivers in the state are saving less than 10% on gasoline this summer. In Los Angeles, where a gallon of regular unleaded averages $3.71, some stations are charging nearly $5 a gallon.

Production woes are spreading to other parts of the country, including the Midwest. That has kicked up prices in cities including Chicago, exposing how vulnerable some regions are to any interruption in fuel production. Refinery operators elsewhere warn they must shut down big fuel-making factories from Illinois to Texas for several weeks this fall for much needed repairs.

"Gas prices are not as low as they should be because of unexpected problems at major refineries and strong demand from drivers," said Michael Green, a AAA spokesman. The group says the nationwide average could fall to $2 a gallon this year, but only if there are no more production hiccups.

The national average for a gallon of regular unleaded was $2.60 a gallon this weekend—down from nearly $3.45 at this time last year, according to AAA. Lower fuel prices have spurred U.S. drivers to take to the road, burning more gasoline, and fuel-makers have been operating their plants at unprecedented rates to keep up.



Last week U.S. plants processed nearly 17 million barrels of crude every day—a 540,000 barrel a day increase over this time last year, according to the Energy Information Administration.

As refiners struggle to churn out enough fuel to power the resurging U.S. economy, any interruption to making gasoline can have an outsize impact on prices, said John Auers, a refinery consultant at Turner, Mason & Co.

"Everything has to be up and running at a high utilization because of supply and demand," he said. "When you do have something go wrong, you're going to see a price spike."

Higher fuel prices hit Chicago last week after BP PLC's massive refinery in nearby Whiting, Ind., the biggest fuel factory in the region, was forced to partially shut down due to leaky pipes. Prices at the pump in the metro area skyrocketed by more than 60 cents a gallon, though they have since dropped slightly, according to AAA's Daily Fuel Gauge Report.

Higher prices have spread across the Midwest, with gasoline rising 32 cents last week to an average $2.79 a gallon, the largest weekly increase seen in the area since Hurricane Katrina cut off supply links from the Gulf Coast back in 2005, according to the U.S. Department of Energy.

Supplies also are getting tight along the U.S. East Coast as a large fire broke out at a Delaware City refinery on Friday and operational problems cut into fuel production at plants in New Jersey and Pennsylvania, according analysts.

After running full-tilt for more than a year, American refineries appear to be hitting their limits, said Sandy Fielden, an analyst at energy market researcher RBN Energy LLC.

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"Refiners have been running plants hell-for-leather to take advantage of strong margins," he said. "It stands to reason that if you run any sophisticated plant harder and faster than normal—you are bound to end up breaking something."

The U.S. hasn't built a major new refinery since 1977, but capacity expansions and small plant additions in recent years have delivered the equivalent of a 380,000-barrel-a-day refinery.

Scheduled outages will stretch from late August into October, and a wide swath of the Midwest may pay elevated prices, according to energy analysts at Morgan Stanley.

> **Higher downtime will drive product shortages both in the midcontinent and Midwest.**
>
> —Morgan Stanley

Far more refineries in the region are scheduled to go down for maintenance than in prior years, the bank said, and work to overhaul plants could keep energy companies from making nearly 20 million gallons of fuel every day that they normally do.

BP's Whiting refinery, which is running at less than half capacity, could remain hobbled for at least a month and maybe as long as two months. More plant shutdowns nearby could affect more markets, including repairs at Exxon Mobil Corp.'s Joliet refinery near Chicago and downtime at Marathon Petroleum Corp.'s large Illinois refinery 150 miles east of St. Louis, Mo., according to analysts.

"We believe higher downtime will drive product shortages both in the midcontinent and Midwest," Morgan Stanley said, adding that oil stocks in the Cushing, Okla., storage hub could build during this time, which would push down oil prices even further.

That is great news for refiners if not drivers, the bank said, because energy companies will make higher profit margins on the fuel they make and buy cheap oil to store for later.

Not every state will get hit with higher prices. Gasoline prices historically drop in the fall, as people drive less and refiners start making winter-grade gasoline, which is cheaper to produce.

But California gasoline prices have remained stubbornly high because of strict pollution controls aimed at reducing smog. It is difficult to find any refinery in the U.S.—or the rest of the world—that can make gasoline clean enough to burn there. The few that do, located in Asia or Europe, are a 20-day ocean journey away, making fuel imports expensive.

California's biggest problem stems from a February explosion that hobbled an Exxon Mobil refinery in Torrance, which makes 10% of the state's gasoline. In September local air pollution regulators will consider a request by Exxon Mobil to restart the plant using old equipment that is out of compliance with current pollution regulations. If it gets approval—not a sure thing—the refinery's gasoline unit could run at about 65% of its full capacity.

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