

# Looking past the Texas oil company stereotype in Prop 23 fight

By Chris O'Brien  
Mercury News Columnist  
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In fighting Proposition 23, the ballot measure that would all but kill California's landmark environmental legislations, opponents have settled on a fairly simple narrative:

Evil Texas oil companies are invading California!

This story line is driven by the fact that two San Antonio-based companies, Valero and Tesoro, have donated about \$5.6 million of the \$7.8 million that the Yes on 23 campaign has raised, according to state campaign finance records.

That investment earned them a blistering tirade from Gov. Arnold Schwarzenegger during a recent appearance at the Commonwealth Club:

"Texas oil companies have descended upon California to overturn a California law," he said. "Valero and Tesoro are in a conspiracy. Not in a criminal conspiracy, but a cynical one about self-serving greed. Does anyone think in their black oil company hearts that they want to create jobs?"

Beyond this overheated rhetoric, I was still left wondering: Who are these companies? And of all the petroleum-related businesses in the U.S., why are these two going all-in on this campaign?

Before I answer, I should say that I am absolutely against Proposition 23. I detest California's system of propositions and usually abstain from voting on any of them. This time I'm making an exception to vote against Proposition 23.

I'm also predisposed to be suspicious of any energy company that hails from Texas. Like many Californians, I still remember the role Houston-based Enron and other energy bandits played in orchestrating the state's deregulation crisis early last decade.

That said, let's understand what these companies are not. They are not "big oil," a term that typically refers to Exxon Mobil, San Ramon-based Chevron and BP. In fact, those companies are sitting this campaign out.

Tesoro and Valero are more like medium-size oil. And unlike a corporation such as Chevron, which is a large, integrated company that does everything from exploration, drilling, refining to selling, Tesoro and Valero are primarily in the refinery business. They buy oil from other

companies, refine it and then sell the product to somebody else. They are what is known in industry jargon as "independent refiners."

And right now, that's a terrible business.

In 2009, with the recession slowing gas consumption, Valero's revenue dropped to \$68.1 billion from \$119.1 billion in 2008 (Exxon Mobil, the country's largest oil company, took in \$311 billion in 2009, by comparison). Tesoro's revenue fell to \$16.9 billion in 2009 from \$23.8 billion. Things have picked up during the first six months of 2010, but it's still grim.

Compounding their troubles is the fact that the U.S. has far too much refinery capacity. This surprised me, because oil industry rhetoric usually claims that gas prices are high in part because it's so hard to build new refineries. In fact, it's just the opposite, said Morningstar analyst Allen Good.

"That's a complete fallacy," he said. "The fact of the matter is that over the past 25 years, while nothing new has been built, refiners have continually invested in expanding capacity of their current facilities. There's no need for extra refineries."

Good's take is supported by a number of financial presentations Tesoro and Valero have filed with the Securities and Exchange Commission. For instance, a presentation made last month by Valero CEO and Chairman Bill Klesse to a Barclays Capital conference includes slides that refer to the "Rationalization of Industry Capacity," meaning they are expecting many refineries to either shut down or reduce their output.

The slides also note that one of Valero's strategic priorities is to "continue to lower costs." By lowering costs, Valero hopes to remain as competitive as possible.

The last thing either needs, from a business standpoint, is to have to spend hundreds of millions of dollars investing in new equipment that might cut emissions but also raise their costs without generating more revenues.

But that's exactly what they would need to do to comply with the new California environmental regulations under assault by Proposition 23 because refineries tend to be particularly big sources of the kind of emissions targeted by the new rules. And unlike larger oil companies like Chevron, where refining is only a small chunk of the larger business, the costs fall harder on pure refinery businesses like Tesoro and Valero.

But wait, it gets worse. While these companies are based in Texas, a big chunk of their business is in California.

Both companies have two major refineries in California. And together, they employ about 4,000 people in the state and paid about \$100 million in state taxes last year, according to Valero spokesman Bill Day.

"We're a significant part of California's economy," Day said. "And it's important that California's economy recover from the recent downturn before these new regulations go into effect. To us, it was common sense to support something like Prop. 23."

To sum up: Both companies are getting hammered by the economy, squeezed by overcapacity in their industry, and have a huge footprint in California. Not surprisingly, Day said the companies were not pleased by the governor's remarks.

"I know that there is going to be rhetoric like that thrown around in a campaign season," Day said. "I can imagine that Prop. 23 opponents are getting desperate. But it's disappointing to hear the governor talk like that."

None of this changes the fact that I think these companies are on the wrong side of this issue. And let's face it, their involvement has made them irresistible targets. Heck, if you can't demonize a Texas oil company, you're probably not much of a political consultant.

But consider this a warning to opponents of Prop. 23. If you believe your own rhetoric, if you accept the caricature you're creating of the big, bad Texas oil companies bankrolling this measure, I think you and others risk underestimating your opponents.

Because for these two companies, this issue is not just about ideology. It's business, and not just simple greed.

Expect them to wage a tenacious fight to the very end of this campaign. They are the most dangerous kind of opponent: They believe they are fighting for their lives.

Contact Chris O'Brien at 415-298-0207 or [cobrien@mercurynews.com](mailto:cobrien@mercurynews.com). Follow him at [Twitter.com/sjacobrien](https://twitter.com/sjacobrien) or [www.facebook.com/ChrisOBrienJournalist](https://www.facebook.com/ChrisOBrienJournalist).