



August 1, 2013

Dave Edwards
Manager, Climate Change Reporting Section

Dr. Steven Cliff
Chief, Climate Change Program Evaluation Branch

California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: Comments to Proposed, Amended AB 32 Regulations

Dear Mr. Edwards & Dr. Cliff:

On behalf of the California Independent Oil Marketers Association (CIOMA) and California Service Station & Auto Repair Association, we are writing to provide comments on proposed amendments to AB 32's Mandatory Reporting Regulation (MRR). We are also providing our insights and concerns of the fuel supplier marketplace at this early stage of the AB 32 Cap-and-Trade (C&T) program. Our members are typically small independently owned businesses, which are involved in regional markets for RBOB and diesel fuel products all across the State of California. Our members are principally small fuel transactors, which have neither the resources nor the pricing power of its much larger trading partners, the refineries. Nevertheless, the small fuel transactors serve an important role in the fuel supply chain in several respects. As currently drafted, our members are exposed to multiple facets of AB 32 fuel regulations, which create numerous regulatory burdens and costs, including, MRR, cap-and-trade, low carbon fuel standard (LCFS) and others.

We anticipate AB 32 will dramatically change how the California fuel supply market operates. Our members are telling us they will likely stop their market involvement in transactions above the rack as a result of these new regulations. Even though our members are subject to more aspects of AB 32 than other industries, the current regulations does not provide the small fuel transactor with any industry assistance or other considerations while most other California industries have received up to 90% of direct/free allocations and other considerations. Given there are still roughly 18 months before C&T begins for fuel supplies, we would strongly urge additional evaluation of the fuel supplier marketplace, and how these AB 32 requirements will disrupt the California fuel market with potential long term adverse impacts on the California fuel supply chain and consumer choice.

Small Fuel Transactor Marketplace

Historically, small businesses are given flexibility, exemption or other considerations from local, state and federal regulatory programs recognizing their economic and resource limitations in meeting regulatory burdens. From our research, it appears that CARB has not fully considered the impact of AB 32 obligations on the small fuel transactor, including primarily the cost of carbon allowances. When dealing “above the rack” as position holder, even a small transactor can potentially be responsible for reporting well above 200,000 metric tons of CO₂e annually. At current allowance prices of \$15 per metric ton, this would equate to minimum compliance costs of \$3,000,000 per year, or exceeding \$20,000,000 for Compliance Periods 2 and 3.

It was commonly believed amongst our own membership, and others, that these AB 32 requirements were aimed at fuel refiners and importers, since they are sufficiently large and sophisticated enough to cope with the aspects of “fuels under the cap” requirements. These much larger business entities are in substantially better position (both financially and in market influence) to finance these AB 32 compliance costs through a combination of their own cash flow, cash reserves and/or pass these costs into the fuel price. The small fuel transactor has neither such resources, nor such a market position.

Fuel refiners and importers are “price makers” not “price takers”. They have more flexibility in establishing market-entry price points. Since the actual economic burden for this program will not be known until well after the gallons have been transacted, pricing flexibility is needed to allow inclusion of estimated cost into the pricing equation. Fuel refiners and importers typically deal with these more esoteric risks in their pricing calculations. Further, these larger companies have the financial resources and reserves to withstand incorrect assessment of their final obligation, and potential need to augment additional credit relinquishment.

Smaller transactors, on the other hand, are price takers, not price makers. They typically purchase gallons with wholesale price laid in, adding margin and expenses (like fuel taxes or fees) into their offering price. The inclusion of “estimated” expenses is well beyond their normal pricing structure and level of sophistication. And, they do not have the safety-net resources if they guess incorrectly on credit value at the time of redemption. Further, they are in a more highly competitive market position, and have higher “meeting competition” boundaries than price makers. This means they may, or may not, make profit on each tender they purchase and are therefore at greater risk if incorrect assumptions are made.

Example: Unbranded Fuel Impacts

One example of the potential disruption of the California fuel markets is in the area of unbranded fuels. While volumetrically unbranded fuel is not a significant quantity of fuel sold in the state, its importance to bulk fuel purchasers and unbranded outlets is a critical component of California fuel supply is hard to measure. Almost all of the diesel sold in this state is unbranded. It supplies bulk fuel purchasers such as agriculture, construction, truck fleets, local governments, emergency responders, backup electrical generation and industrial locations. Our members are the primary source of diesel in this state.

While only 10-15% of the gasoline sold in this state is unbranded, it is supplied to unbranded stations that typically set the floor for retail pricing. Any interference with the supply of unbranded fuel (diesel and/or gasoline) is likely to have dire consequences for a variety of state fuel consumers. Here are some ways CARB's GHG fuel regulations (including LCFS) could negatively impact unbranded fuel supply:

- Elimination of fuel suppliers above the rack – Our members who transact above the rack provide much of that fuel into the unbranded market. As previously stated in this letter, we are hearing the AB 32 regulations are providing compelling reasons for small fuel transactors to remove themselves from this part of the market. This is likely to have two implications. First, competition will diminish, allowing upward price creep. Second, it will place the unbranded supply in the hands of the refiners and importers. There may not be a business case to supply low-end priced fuel into the market, especially when fuel can be manufactured to other specifications, allowing export and avoidance of AB 32 obligations. This may create actual fuel shortages and result in significant price increases.
- Tight fuel supply for unbranded retail outlets – A number of our members supply unbranded fuel to unbranded service stations. The first question is whether AB 32 regulations will impede supply to these outlets by eliminating ratable supplies of unbranded fuel to the state's fueling terminals. The second question is whether the unbranded fuel will remain the low-cost fuel in the state. Last October we encountered a +\$1/gallon price spike in retail fuel prices due to the perceived lack of unbranded fuel in the market. When fuel supply becomes tight, unbranded fuel become the most volatile product and encounters the most significant price swings. This influences the rest of the market, well beyond the actual volume of unbranded fuel sold in the state. Further, if this creates insurmountable impacts for unbranded retailers, they will simply go out of business. What are the small business and loss of employment costs of this possibility?
- Possible elimination of fuel importers – Fuel importers have expressed to us significant concerns about remaining as a supplier in this state due to the high risk and uncertainty created by AB 32 regulations. These suppliers are substantial in the unbranded portion of the market. The worst-case scenario is that fuel exporters are frightened out of the market, and state refiners start exporting substantial quantities of fuel, leaving this state in a perpetually short fuel condition.

Additional Actions Regarding Small Fuel Transactor Is Needed

For all the reasons above and others, it is our continued belief that due to its location in the fuel supply chain, it makes abundant sense to exclude these small fuel transactors from MRR and cap-and-trade. There are logical and practical reasons to do so. No gallons will slip from coverage if the higher level title holders of the fuel becomes the obligated party. Further this would ease administration and reporting of obligations. And, it may save the market from serious competition reduction by elimination of significantly important competitors. Moreover, fuel refiners and importers (and possibly large terminal operators) are already in the best position to report these supplied fuels, finance the compliance costs and pass along

the regulatory costs into their products. It appears redundant for the small fuel transactor to do the same, when they all are purchasing their products from the same large trading partners, and do not have the position or resources to finance these compliance costs.

As a consequence, our associations strongly urge the ARB to further study the impacts of these AB 32 regulations on the small fuel transactor. As part of this additional analysis, we would urge evaluation of regulatory changes or other industry assistance such as limited exemptions, direct allocations, linkage between low carbon fuel standards with cap-and-trade, and possibly other considerations.

Our associations stand ready to engage with ARB on these issues, and provide the perspective of the small fuel transactor in the State of California. Thank you for your consideration.

Sincerely,



Jay McKeeman, Vice President Government Relations & Communications

cc: CIOMA Board of Directors
Cliff Rechtschaffen, Senior Advisor, Governor's Office
Richard Corey, Executive Director, CARB
Ms. Ellen Peter, Chief Counsel, Air Resources Board
Richard Bode, CARB GHG Inventory Branch