VALERO

January 24, 2012

Clerk of the Board
Air Resources Board
1001 I Street
Sacramento, California 95814

Sent by electronic transmission via ARB webpage

Re: **2012 Proposed Amendments to the Clean Fuels Outlet Regulation**
Comments of Valero Refining Company—California, Ultramar Inc, Valero Marketing and Supply Company, and Valero Renewable Fuels

Board Members:

Valero Refining Company – California and Ultramar Inc, together with Valero Marketing and Supply Company and Valero Renewable Fuels (collectively "Valero"), appreciate this opportunity to provide comments regarding the California Air Resources Board ("ARB") 2012 Proposed Amendments to the Clean Fuel Outlet (CFO) Regulation. Valero's refining entities in California own and operate two refineries in the state of California, with a combined throughput capacity of over 305,000 barrels per day. Valero is also one of the largest ethanol producers in the U.S, and is investing in renewable diesel and cellulosic ethanol projects at various locations.

Valero agrees with the comments offered by the Western States Petroleum Association (WSPA) regarding the CFO regulation and incorporates those comments as its own. Additionally, Valero is providing the following comments for your consideration.

1. **Refiners and importers should not be the regulated party under the Clean Fuels Outlet regulation.**

   In the December 16, 2011 draft revisions to the rule proposed to be renamed as the "Clean Fuels Outlet" regulation, ARB proposes to change the emphasis of the former "Clean Fuels Program" from facilitating market availability of various types of alternative fuels to focusing exclusively on zero-emission vehicles fueled by hydrogen and perhaps electricity. Further, ARB proposes to significantly shift the burden of the regulation by changing the "regulated party" under the regulation from the owners and operators of retail stations to refiners and importers of petroleum fuels. The effect of the proposed redefinition is to force refiners and importers to finance installation of infrastructure that will directly compete with

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their own core business and, if market saturation is as successful as ARB hopes it will be, eventually erode that business. As the nation's largest independent refiner and the second-largest producer of corn ethanol, Valero objects to being forced to fund its own demise, and would note in particular the following issues:

- ARB's staff report on the Initial Statement of Reasons (ISOR) for the 2012 Proposed Amendments to the Clean Fuels Program Regulation does not consider making the parties who will benefit from installation of CFOs—the auto manufacturers and the hydrogen suppliers—the "regulated parties." With this change, ARB proposes to make the parties that will bear the brunt of the economic impact of declining gasoline demand fund the CFOs. The rationale offered in support of making refiners/importers regulated parties is that "This amendment will ensure that those refiner/importers that have the largest stake in supplying gasoline to the California market have a commensurate role in developing the state's hydrogen infrastructure." The logic supporting this statement is not apparent, unless one takes the punitive view that having supplied gasoline to the California market is a misdeed that now must be remedied. It makes more sense for those who potentially stand to profit from the proliferation of ZEVs to be responsible for developing the infrastructure to fuel them, yet the ISOR does not even identify this approach as an alternative.

- Transfer of funds from the refining industry based on each participant's market share in that industry for the benefit of stimulating a competitive business amounts to exaction of funds from the refining/importing industry. In order to impose a new tax, ARB must first seek approval of two-thirds of the California Legislature, as provided by Proposition 26. In order to impose a new fee, ARB must show a nexus between the fee and the use of the fee.

- The economic impact discussion in the ISOR acknowledges that return on investment (ROI) is important in assessing the economic impact of the regulation. Leaving aside for the moment the adequacy of ARB's ROI projections, the ISOR does not explain the basis for the assumption that refiners/importers will be in a position to recoup any return at all if they are forced to pay for installation of equipment on property they neither own nor control. The ISOR assumes that branded dealers lease the real estate and equipment on which their stations operate from refiners. This is simply not the reality today. Nearly all branded dealers own their own property and equipment and are simply parties to branding and supply agreements. In fact, out of over seven hundred Valero-branded, wholesale-supplied retail outlets in California (which number does not include sites operated by a Valero affiliate), Valero has a real estate interest in only 19 of them, and fee title to only 10. To the extent Valero is compelled to fund installation of CFOs at branded stations that it does not own based on ARB's market-share formula for identifying the number of stations a particular refiner/importer must finance, coupled with ARB's ability to dictate the location of CFO outlets, Valero will not be making an "investment" in its own property at all. In that circumstance, Valero will receive no benefit whatsoever. Instead, Valero will be harmed to the extent CFOs result in reduced sales of the products provided under those supply agreements.

- Refiner/importers such as Valero that do not own the property upon which the CFOs will be located will have no direct control over how the CFOs are to be operated. Valero-affiliated entities that own operate petroleum refineries in California do not even have indirect relationships through contractual arrangements with wholesalers, much less retailers. Thus, the extraordinarily detailed requirements in Section 2309(b) of the proposed regulation prescribing exactly where on the property the CFOs are to be installed and how they are to be operated (sufficient fuel storage, signage, how customers are to pay, lighting, daily maintenance of equipment, etc.) and the breakdown/repair provisions in Section 2311 are not only unreasonably prescriptive, but they are completely inappropriate to impose as requirements on refiner/importers. The only way refiner/importers will be able to have any influence at all over compliance with these provisions is indirectly, through entering agreements with retailers for "constructive allocation" of stations or through persuading affiliated corporate entities to request modification of their contractual relationships with branded retailers to have the retailers promise to fulfill these provisions. Independent retailers may be reluctant accept the increased liability associated with storing and dispensing hydrogen onsite, or refuse to agree to the intrusive operational provisions mandated by the proposed revisions to the regulation. Even if some retailers ultimately agree to allow their site to be used for CFOs, if they do not fulfill their contractual obligations, refiner/importers will be left vulnerable to enforcement under the regulation with no direct ability to comply.

2. **<u>The proposed enforcement remedies in the ISOR are inequitable and without sound legal basis</u>**.

The proposed revisions would make refiner/importers' willful failure to timely install CFOs subject to the penalty provisions of California Health and Safety Code (H&SC) Sections 43027 and 43208, and thus would provide penalties of up to a quarter-million dollars per day. This proposal raises several issues of equitable regulation and of legal sufficiency:

The proposed penalties for regulated parties and auto manufacturers are grossly inequitable. Under the proposed revisions, if vehicle manufacturers fail to meet their projections for production of hydrogen vehicles, the consequence to refiners and importers is that they will have been required to spend tens or hundreds of millions in sunk costs on installation of fuel outlets for which the demand turns out to be insufficient. Under the proposed revisions, the penalty for the vehicle manufacturers in this instance is a one-time fine of up to $35,000. In contrast, the proposed revisions would make a refiner/importer's "willful" failure to timely build a single fuel outlet subject to a penalty of up to $250,000 *per day*. The proposed revisions exceed the authority granted to ARB under H&SC Section 43027(a) based on the plain language of the statute, which does not reference imposition of daily penalties. Even if ARB recognizes that a penalty under Section 43027 should be a one-time occurrence, the quarter-million-dollar potential penalty for failure to install a single CFO on ARB's timetable represents a penalty over seven times that proposed for an auto manufacturer's penalty for misleading ARB and the public, as well as refiners and importers.

- The order-of-magnitude disparity noted above is particularly troubling given the vagueness of what constitutes a "willful" failure to install outlets timely. Under the proposed revision, the regulated party obligated to provide for installation of fuel outlets may have little or no direct control over where, when, and how the outlets are to be installed. If a regulated party has no option but to negotiate with a third party to install outlets to satisfy the refiner/importer's obligation, the third party is likely to leverage the fact that the regulated party is under the compulsion of a regulatory requirement, coupled with time pressure and a significant potential penalty, to demand commercially unreasonable terms. Based on the discussion in the ISOR and the language of the proposed regulation, it appears that ARB could regard the regulated party as willfully violating the regulation if it does not agree to this type of extortion.

- Although the draft rule indicates that Health and Safety Code Section 43027(a) will be cited as the basis for any violation of the requirement to install CFOs, ARB cannot unilaterally expand its statutory authority through regulatory interpretation. H&SC Section 43025 states that "It is the intent of the Legislature in the enactment of this chapter to update the penalty provisions for *violations of fuel regulations* to ensure that the appropriate tools are available to effectively and fairly enforce state law." Further, the plain language of H&SC Section 43027 indicates that it applies to violations for sales of fuel that does not comply with applicable specifications. Subsection (a) reads as follows (emphasis added):

> *Any person who willfully and intentionally violates any provision of this part, or any rule, regulation, permit, variance, or order of the state board, pertaining to* ***fuel requirements and standards****, is liable for a civil penalty of not more than two hundred fifty thousand dollars($250,000),* ***and the prosecuting agency shall include a claim for an additional penalty in the amount of any economic gain that otherwise would not have been realized from the sale of the fuel determined to be in noncompliance.***

The language above makes it clear that the California Legislature intended Section 43027 to apply to violations of applicable regulations related to fuel quality. Requiring Valero to fund installation of CFOs is a way to fund installation of infrastructure to provide a regulated fuel, but these new requirements have nothing to do with meeting the requirements of ARB's fuel regulations. The California Legislature has not empowered ARB to impose a penalty of this magnitude for a violation of a requirement that is fundamentally different in nature than anything that existed when this provision was adopted.

3. **<u>The economic impact assessment in the ISOR does not adequately address impact on retailers or on refiner/importers.</u>**

- The ISOR does not address the potential consequences to retailers of displacing gasoline availability with CFO stations or on-site steam methane reformers. Most retail gasoline stations have little or no undeveloped surface available. During the peak hours before and after work and at lunchtime, the fueling positions at most retail stations are fully occupied and the limited parking spaces are full. If the hydrogen refueling equipment uses existing parking spaces, then in-store sales will decline. If the hydrogen dispenser replaces a gasoline dispenser, then not only will gasoline sales decline, but in-store sales will also decline, as there will be fewer hydrogen customers then gasoline customers. If the hydrogen dispenser is added to a fuel island, a car using it will prevent another car from using the gasoline pump next to the hydrogen dispenser. If an on-site steam methane reformer must be installed, this equipment would completely displace any space that could be occupied by an in-store retail customer. Thus, in any of these scenarios, gasoline and retail sales will decline, and retail service station owners will lose sales, revenue and profit. The economic impact of the proposed rule cannot be understood without quantifying these impacts.

- The economic analysis presented in the ISOR is based on numerous unfounded and unduly optimistic assumptions. For example, ARB assumes that technology advancements will result in a drop in the price of supplied hydrogen, although there is no basis for concluding what those advancements might be or why they would result in cheaper hydrogen. ARB assumes counterintuitively that station operators will be able to sell hydrogen at a higher price in later years to recoup their initial losses even though ARB also assumes that the number of stations will increase in subsequent years. If ARB's assumptions about the eventual profitability of hydrogen fueling outlets were correct, it would not be necessary to forcibly conscript participants in this market.

4. **The prescriptive requirements pertaining to CFO operation are overly burdensome and unrealistic.**

Sections 2309 and 2311 of the proposed regulation include numerous requirements that are overly burdensome and unrealistic, even if station operators remain the regulated party. For example, the requirement to notify ARB within four hours of dispensing equipment malfunction is unnecessarily burdensome and serves no purpose. Station operators' time would be better spent calling the repair company to service the equipment. The requirement to repair broken equipment within one month overlooks the fact that until market saturation is reached, equipment and contractors are not likely to be widely available, and therefore it is arbitrary to mandate an unreasonably short time for equipment to be ordered, fabricated, delivered, and installed. The detailed requirements pertaining to amenities, lighting, signage, and so forth are stunningly intrusive. Most or all of these requirements exceed ARB's statutory authority to protect air quality in California.

5. **The ISOR overlooks the environmental and safety impacts associated with hydrogen fuel manufacture and supply.**

The proposed CFO revisions will just raise cost to all California consumers with little or no benefit. There are still emissions when hydrogen is produced and electricity is generated, they just are not at the tailpipe. Further, the ISOR is dismissive of the risks associated with onsite hydrogen storage, fueling, and perhaps manufacture.

For the reasons discussed above and in the comments submitted by WSPA, Valero strongly urges ARB to refrain from moving forward with the proposed amendments to the Clean Fuel Outlet regulations. If you have any questions, please contact me at (210) 345-2922.

Sincerely,

John R. Braeutigam

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V.P. Strategic & Regulatory Development