

**TESTIMONY OF PAUL D. REID
ON BEHALF OF THE
SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA
AND THE
NATIONAL ASSOCIATION OF CONVENIENCE STORES
BEFORE THE SUBCOMMITTEE ON ENERGY AND AIR QUALITY
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES**

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Thank you, Chairman Boucher and Members of the Committee, for holding this hearing today and inviting me to testify. My name is Paul Reid. I am the Chief Executive Officer of the Reid Group, which is based in Lockport, New York. The Reid Group distributes Mobil, Sunoco, Citgo, Coastal, and unbranded motor fuels throughout Upstate New York and Northwest Pennsylvania.

I appear today on behalf of the Society of Independent Gasoline Marketers of America (“SIGMA”), where I serve as President, and the National Association of Convenience Stores (“NACS”), of which I am a member. SIGMA is an association of more than 250 independent motor fuel marketers operating in all 50 states. SIGMA members sell more than 30 percent of all motor fuels sold in the United States and supply more than 35,000 retail outlets across the nation. NACS is a non-profit trade association representing the convenience and petroleum retailing industry. This industry operates more than 145,000 retail locations and, in 2006, sold \$405.8 billion worth of motor fuels. Together, SIGMA and NACS members sell approximately 80 percent of all motor fuels in the United States.

Thank you for providing me with the opportunity to share our industry’s perspective on the current debate regarding the future of renewable and alternative fuels. I would like to begin

by assuring this Committee that petroleum retailers do not have a preference on which liquid motor fuels we sell, provided there is sufficient supply and consumer demand for those products. It is upon these issues of supply and demand that I will focus my comments today.

Before I begin, however, I would like to correct the record concerning some statements made regarding the composition of the retail motor fuel market during this Subcommittee's hearing on April 18, 2007. I believe it is critical for Congress to understand how the retail market place operates when considering policies that might affect it. It was mentioned by a witness at that hearing that only 18-20 percent of retail motor fuel locations are independently owned and operated. In fact, the composition of the retail marketplace is much more diverse than this.

Of the more than 165,000 motor fuel retail locations in the nation, refining companies only directly own and operate approximately five percent, and they are increasingly divesting their retail locations to focus attention further upstream. An additional 55 percent of all stores are owned and operated by independent businesses who have supply contracts to sell motor fuel under the brand of their supplying refiner. Hence, although they appear to be the retail location of the refining company, they are in fact independent. The remaining 40 percent operate without such branded supply contracts and choose to establish their own, private brand.

The Future of Renewable Fuels

Any discussion of the future of renewable and alternative fuels must begin by distinguishing the two. For example, the Energy Policy Act of 2005 established a renewable fuels standard ("RFS"), mandating that at least 7.5 billion gallons of renewable fuels be sold in the United States by the year 2012. The industry is well ahead of schedule in complying with

this mandate. Last year, the ethanol industry produced nearly five billion gallons, exceeding the four billion gallon target for 2006 as well as the 4.7 billion gallon target for 2007. By 2008, the standard requires blending of 5.4 billion gallons, which will easily be satisfied.

This feat is being accomplished through the widespread use of ethanol in concentrations up to 10 percent. You can find ethanol in most if not all gallons of reformulated gasoline and throughout conventional gasoline markets as a means to expand supply and boost octane.

Given the fact that industry is ahead of schedule, several Members of Congress have introduced legislation that will not only increase the mandate of the RFS, but also accelerate its introduction. Some legislation calls for the RFS to reflect a mandate of 8.5 billion gallons in 2008, expanding to 36 billion gallons by 2022. Another requires 10 billion gallons in 2010, growing to 35 billion by 2017. These are very ambitious goals, but we must ask ourselves if they are in the best interests of a nation so dependent on motor fuel supply.

The market is proceeding to offer renewable fuels ahead of the federally mandated schedule. There is no reason to believe that this will not continue in the absence of an increased mandate. However, if Congress feels compelled to accelerate this transition through a revised federal mandate, SIGMA and NACS call upon Congress to construct the revised program with the interests of consumers in mind.

Any increase beyond the existing RFS should be predicated upon a finding by the Secretaries of Energy, Agriculture, and Transportation that there will be sufficient supplies of renewable fuels available and sufficient distribution infrastructure to deliver that product to retail without placing an undue financial burden on consumers. If fulfillment of these preconditions cannot be assured, then the proposed increase should be delayed until conditions are sufficient to support its implementation. Further, such a decision should be made with enough lead time to

enable the petroleum industry to make necessary arrangements to accommodate the requirements.

SIGMA and NACS do not oppose the transition to a renewable fuels economy. We do, however, urge Congress in its decisions to be fully cognizant of the economic and consumer consequences associated with continuing mandates on the motor fuels business.

The Future of Alternative Fuels

As I mentioned, the discussion of renewable and alternative fuels should be separated because they involve very different requirements. The implementation of the RFS has been relatively seamless because the mixture of gasoline with up to 10 percent ethanol, or diesel with a small percentage of biodiesel, can be sold through existing fueling infrastructure to all consumers regardless of their vehicle type. It is upon this concept of infrastructure and vehicle compatibility that this Congress should focus when seeking to promote alternatives.

There are reported to be certain alternative fuels, such as renewable diesel or bio-butanol, that are believed to be completely fungible with the existing fuel supply and distribution system and compatible with the current storage infrastructure and vehicle fleet. Congress should be paying greater attention to such compatible alternatives than is currently being done. Introduction of such alternatives could prove to be seamless to the consumer and provide an immediate boost to our nation's energy sustainability.

This is not to diminish the value of existing alternative fuels and the roles they can play in the future of our motor fuels system. But with incompatibility comes increased marketing challenges. Products like bio-diesel blends above 5 percent and E-85 will contribute

significantly to our transportation economy, but they present significant challenges that this panel must understand.

To illustrate this issue and to discuss the challenges that face certain alternative fuels, I will be happy to present our industry views on E-85. Other alternative fuels proposals under consideration will present perhaps even more complex compatibility issues; we stand ready to assist the Committee in analyzing those barriers to consumer protection.

Cost to a Fueling Station to Sell E-85

The primary impediment to retailers converting a dispenser to E-85 is equipment compatibility. Because E-85 is more corrosive than regular gasoline or fuels with lower concentrations of ethanol, it requires equipment that is certified compatible with the fuel. At your April 18 hearing, it was mentioned that a retailer can convert a system to E-85 for as little as \$5,000.00. This is not very common. In fact, some retailers report having to sell E-85 at a loss in order to offer it for the same price as gasoline.

In preparation for this hearing, I have surveyed some of my colleagues in the industry to determine the range of costs that might be involved in a full conversion to sell E-85. Many of these stations have the newest equipment and, therefore, hold the best chance for existing equipment compatibility. I learned that newer steel tanks and fiberglass tanks were certified compatible with E-85. In addition, newer automatic tank gauges were listed compatible as were fiberglass piping systems. However, many would have to replace several of the ancillary fittings, including the submersible turbine pump, the overfill drop tube and others like flexible hoses, spill buckets, ball valves, and so forth. Moreover, hanging hardware, which includes conventional nozzles, swivels, breakaways and curb hoses would have to be replaced with nickel

plated units at an increased cost. For all of these conversions, including tank cleaning, I estimate the cost to be between \$8,000.00 and \$9,000.00.

Keep in mind, however, that this does not include converting the dispenser itself. The two dispenser manufacturers each charge an additional fee for E-85 compatible equipment -- \$8,000.00 for Dresser-Wayne and \$7,300.00 for Gilbarco. Thus, a typical E-85 dispenser can cost at least \$17,000.00 per unit, and often far more depending on regional variations.

It is conceivable to convert an existing dispenser, but this would require at a minimum replacing the meters, internal piping, filter inlets, compression fitting, control valves and seals, and any non-ethanol compatible sealants. I estimate such a conversion for these components to be in excess of \$5,000.00.

In short, to convert one of my newer stores to sell E-85, I would be facing an expense of something in the range of \$20,000, not including labor expenses. Assuming that a retailer can do such a conversion technologically, that's a bargain compared to the installation of an entirely new system for E-85.

I was recently quoted a price of \$75,000 to install a new E-85 system at one of my stations. Another member of SIGMA told me last week that he was quoted a price of over \$200,000.

Please keep in mind that the annual pretax operating profit for a convenience store in 2006 was just \$33,000. The infrastructure costs to install alternative fuel systems, therefore, are so substantial that ultimately consumers will have to pay the price.

In the Energy Policy Act of 2005, Congress provided for a tax credit to help offset the installation of alternative fueling infrastructure. This is helpful. In addition, many states have enacted their own incentive programs and Congress has been considering other legislation to

assist with the installation of alternative fuels infrastructure. While we support these initiatives, I would like to explain that cost is not the only impediment to retail availability of E-85.

If a retailer determines it makes economic sense to install an E-85 system, it is not necessarily feasible at every location. The requirement to dedicate an underground storage tank to the new fuel can be a limiting factor. Many stores operate only two tanks—one for regular unleaded and the other for premium. Mid-grade gasoline is often blended at the dispenser. Therefore, replacing one of these tanks is not an option. However, installing an additional tank may also be ruled out due to land availability or permitting restrictions. In short, some retailers may not be able to install a system to sell a distinct alternative fuel like E-85.

Finally, there is the fact that Underwriters Laboratories has not certified any dispenser to sell E-85. Until there is a certified dispenser, any retailer selling E-85 is at increased liability risk. Despite assurances by many local regulators to allow continued operation of existing facilities, retailers selling E-85 accept full liability for any problems associated with the dispensers. In fact, at least one equipment manufacturer requires customers to sign a waiver assuming all liability for these units. This is an important issue that must not be overlooked.

Demand: The Critical Chicken-and-Egg Factor

As I mentioned previously, retailers will sell whatever products their customers want to purchase. However, the number of flexible fuel vehicles (“FFVs”) on the market remains relatively small, limiting the potential market for sales of E-85 fuel. In addition, the number of those driving FFVs who realize they can purchase E-85 and choose to do so is even smaller. Some contend that the lack of E-85 use in FFVs is due to the limited availability of the product. This is the classic chicken and egg problem -- which should come first, supply or demand?

Predictably, retailers believe demand should precede supply. Let me explain why this approach makes sense for public policy as well.

Owners of FFVs have the ability to purchase either gasoline or E-85, without any affect on their vehicles. However, when a retailer chooses to sell E-85, the commitment is not as flexible. To offer E-85, as I have explained, requires a significant, long-term economic investment. In addition to the up-front conversion costs, the retailer is dramatically changing his business model.

Although there are some multi-hose dispensers with blender pumps selling E-85, most E-85 is sold through single-fuel dispensers. A typical gas station operates four dispensers, each providing two fueling positions. If E-85 replaces one of these dispensers, the retailer is effectively reducing his fueling positions by 25 percent. Therefore, unless consumer demand for E-85 is sufficient to ensure no reduction in customer traffic, retailers stand to lose valuable sales. It is important to realize that retailers generate most of their profit from inside the store sales. Therefore, a reduction in customer traffic to a location can dramatically affect overall store performance.

Consequently, it makes sense that retailers would be hesitant to make such an investment until there is sustained consumer demand in their market. Meanwhile, the drivers of FFVs are not denied the opportunity to purchase fuel because they have the option to buy gasoline. Hence, the chicken should come first. And, in fact, it is.

The auto manufacturers are increasing their production of flexible fuel vehicles. As more and more of these vehicles enter the market, demand for E-85 could potentially increase and change the economic calculations for retailers, resulting in more E-85 fueling stations in the nation.

Consumer Price Sensitivity

Another very important factor for this Committee, and indeed this Congress, to consider is that of price. Few other issues attract as much attention from consumers, the media, and Congress as does the price of gasoline. For retailers, the recent increase in wholesale prices have forced retail prices higher and with that comes the fear that lawmakers at the state level and here in Washington will consider legislation to curb retail price increases.

I mention this because the Congressional discussion about alternative and renewable fuels to date has focused on two issues: reducing America's reliance on imported energy resources and reducing emissions. Little attention has been paid to the cost at which these new fuels may be offered to consumers. Meanwhile, considerable attention has been paid to the price at which retailers sell gasoline. This disconnect must be corrected.

The transition to new fuels will not be without expense, and this expense will ultimately be borne by the consumer. But how much is too much? At what point will consumers reject the new fuel market because it negatively affects their personal economics? These are questions Congress must ask. Luckily, we have some indications today that can help guide Congress in this discussion.

NACS recently fielded a survey to assess consumer sensitivities to gasoline prices. This survey found that more than one-quarter of consumers will turn left across a busy intersection to save one penny per gallon and half of consumers will do so for three pennies. Additionally, one-quarter of consumers would drive 10 minutes out of their way to save three pennies. This indicates that consumers are extremely sensitive to retail gasoline prices. Retailers are then forced to compete on the basis of price differentials of a penny or two per gallon -- a very pro-consumer model.

What the NACS survey further reveals, however, is that what consumers say they will do and what they actually do is not always consistent. What real market data demonstrates is that while consumers want to promote a green economy, when they go to fuel their vehicles the only green that truly matters is the green in their wallets (or the balance on their credit cards, but we don't need to get into that issue today).

Consumers Are Not Paying Premiums for E-85

SIGMA and NACS have spoken with retailers throughout the nation who sell E-85, and we have learned that volumes of E-85 fall off dramatically when the price is not significantly lower (at least 20 cents per gallon) than gasoline. Some retailers, including one operating in Minnesota, report that the price differential to maintain volumes is actually closer to 40 cents per gallon. Unfortunately, it is not always possible for a retailer to price E-85 below gasoline.

Clearly, consumers have made the economic calculation regarding E-85 and they are demanding a benefit in price. Absent that benefit, they will follow their economic interests and purchase gasoline.

This is important for Congress and retailers to understand. Consumers act on the basis of their self-interest. Yes, they support a more independent and renewable energy sector, but only if it does not negatively affect them financially. Therefore, I urge this Committee not to ignore the economic interests of your constituents when considering legislation to promote alternative and renewable fuels.

Conclusion

The future of renewable and alternative fuels is a bright one, even without new government programs. As Congress considers policies to accelerate the market's transition, SIGMA and NACS encourage you to keep in mind the nature of the retail marketplace, remember the economic interests of your constituents, and provide safety valves to ensure minimal disruption to the system. Government mandates are antithetical to a free motor fuels marketplace and will only wind up harming consumers in the short run and beyond.

Again, thank you for the invitation to testify here today, and I will be happy to answer any questions which my testimony may have raised.