



Written Statement of the
National Petrochemical & Refiners Association

delivered by
Bob Slaughter
President, NPRA

before the
House Committee on Energy and Commerce

concerning
The Boutique Fuels Reduction Act of 2006

June 7, 2006

Washington, DC

Chairman Barton, Ranking Member Dingell, and members of the Energy & Commerce Committee, NPRA, the National Petrochemical & Refiners Association, appreciates this opportunity to present its views on the subject of boutique fuels and, more specifically, on draft legislation entitled the “Boutique Fuels Reduction Act of 2006.” Our testimony today will concentrate on emphasizing the realities and dispelling certain myths that surround the debate about boutique fuels. We will also discuss the factors impacting the current and projected transportation fuels supply and the specifications which refiners have already met or will be obligated to meet. I am Bob Slaughter, NPRA’s President. As you know, NPRA is a national trade association with 450 members, including those who own or operate virtually all U.S. refining capacity, as well as most of the nation’s petrochemical manufacturers with processes similar to those of refiners.

HOW WE VIEW THE BIG PICTURE

NPRA fully understands the impact that higher than usual gasoline and diesel prices are having on the nation’s consumers. We congratulate the Committee for holding this and other hearings regarding the current transportation fuels market. NPRA believes that the discussion that results will help separate fact from fiction in this important policy area.

We hope that the Committee will keep in mind that there are no short-term solutions to problems that have been building for over a decade. As we stated in our May 11th testimony before the Committee: “Rather than engaging in a fruitless search for questionable quick-fix solutions, or even worse, taking actions that could be harmful, we urge Congress, the Administration, and the public to exercise continued patience with the free market system as the nation adjusts to a volatile global energy market. The nation’s refiners are working hard to meet rising demand while complying with extensive regulatory controls that affect both our facilities and the products we manufacture.”

OUR VIEW OF THE PROPOSED LEGISLATION

Congressional interest in “boutique fuels” is understandable. There is little doubt that fungibility of fuel is related to supply. However, NPRA is concerned that boutique fuels have been taken out of perspective and identified by some as a primary cause of the current transportation fuels market. We would make three key points: 1) We believe that boutique fuels use resulted from a collision between the need for more state/local emissions reductions and shortcomings in the federal RFG program; 2) It appears unlikely that any change affecting boutique fuel requirements or other fuel specifications will affect the supply situation this summer, and 3) Congress must try to avoid the law of unintended consequences which often afflicts its forays into energy legislation. And while Congress considers this legislation, the U.S. refining industry must and will continue to do its job of optimizing the production and distribution of gasoline and other petroleum products this summer.

Regarding the specific subject of this hearing, NPRA believes that the Committee draft is a reasonable and modest approach to the boutique fuels issue, representing the absolute limit that policymakers should consider this year. We do suggest that it would be wise to add four additional items: 1) to include in the definition of boutique fuels all state ethanol and biodiesel mandates, as well as CARB fuel; 2) to require EPA to make a finding on the impact of state biofuel mandates and CARB fuel on fuel supply fungibility and air quality; 3) to require a study of the impact of a 1-3 fuel national fuel slate on concentration and competition in the U.S. refining industry, and 4) to determine the impact of this bill on the average consumer costs for gasoline, compared to the current system. Beyond that, action on this delicate subject should await completion of the reports mandated by the recent EPACT legislation. Given those reservations, NPRA offers its support for the limited bill drafted by the committee.

BACKGROUND

In past testimony before this and other Congressional Committees, NPRA pointed out that the prime factor increasing the number of fuel blends throughout the nation was The Clean Air Act Amendments of 1990 provision that requires certain areas to use federal reformulated gasoline (RFG). As you know, RFG containing a 2% by weight oxygenate was required in the most heavily polluted areas of the country. Historically, the primary driver leading local areas to opt for boutique fuels was emission reduction needed to attain the 1-hour ozone NAAQS. These areas often sought to avoid RFG when considering fuel controls, due to concerns about 1) its cost, and/or 2) the presence of MTBE or ethanol. As states developed their specific State Implementation Plans (SIPS) to address their particular air quality concerns, some (who were not required to use RFG) realized that they could achieve significant reductions in air emissions by using a low-RVP conventional gasoline, while avoiding the perceived problems associated with RFG. These states usually adopted low-RVP conventional gasoline programs only after consultation with refiners, the environmental community, and other stakeholders. The new fuel requirements went into effect only after approval by EPA. The upshot? Areas adopted boutique fuels only when they offered comparable emissions reductions at a reduced cost to consumers, and many stakeholders and regulators were involved in the process.

WHAT IS A BOUTIQUE FUEL?

A great deal of attention has been given to national maps showing the varied gasoline specifications required across the nation. Those maps were prepared to explain two things: the logistical realities involved in serving gasoline markets, and the fact that certain areas have chosen a special fuel offering the most environmentally sound and economically justifiable approach to their specific clean air and consumer needs.

In the May 11th hearing before this Committee, Acting EPA Assistant Administrator for Air and Radiation, Bill Werhum, offered the following definition: “a boutique fuel is a unique fuel specification that is developed by a state or local air

pollution agency and approved by EPA as part of the State Implementation Plan (SIP) for the affected area. It is worth noting that boutique fuels do not include other clean fuel requirements, such as Federal fuel controls (e.g., reformulated gas, winter oxygenated fuels), California clean fuel requirements, and area-specific fuels required by state law for purposes other than air quality (e.g., Minnesota’s ethanol mandate)” (emphasis in the original) NPRA believes this is an incomplete definition of boutique fuels. It does not include California’s unique gasoline (CARB), RFG, nor mandated federal or state ethanol and biodiesel blends. These fuels walk, talk and act like all other boutique fuels, but they have not been defined as such frankly because of political considerations. Given the history of the past ten years, it seems unlikely that federal statutes will be permitted to recognize the truth about these political favorites. The latest evidence: EPA’s recent draft Boutique Fuels list does not include these fuels.

BOUTIQUE FUELS AND PRICE VOLATILITY

Much discussion has focused on the rare occasions in which events such as refinery outages, pipeline failures, or weather related circumstances arise, causing brief supply disruptions in limited geographic areas. In these instances, higher prices serve for a brief period to balance supply and demand while eliciting additional supplies from sources outside the affected area. It is important to note that gasoline meeting stricter specifications than those in the affected area can immediately be supplied to that area in nearly all cases. If the situation requires additional, focused actions, EPA responds by issuing fuel specification waivers. These waivers allow otherwise non-compliant fuel to be used until such time as the initial episode is corrected.

NPRA’s position continues to be that these waiver requests should be granted only when a high burden of proof has been met. EPA, in our opinion, has met this burden of proof before acting, and the system has worked. As a prime example, in the aftermath of last summer’s hurricanes EPA, with added authority provided to it by EPACT, worked closely with the entire fuels production, transportation, and distribution system to stretch the available supplies of transportation fuels in the affected area. The

system operates much the same way in an area using boutique fuels on the very rare occasions when supply problems arise.

EPACT restrictions on the total number of fuels currently allowed should even further reduce the frequency of the need for such actions—actions that are even now strictly episodic in nature. However, since boutique fuels were adopted because they were equally effective in reducing emissions but were cheaper, even the changes under EPACT may result in a higher average fuel price for affected consumers. Under EPACT, a substitute fuel seems to include a more stringent environmental specification. NPRA therefore suggests that Congress should direct DOE to perform such a cost comparison analysis to determine whether this is in fact the case. This analysis should include the economic impact that California's adoption of CARB fuel has had on consumers in that state due to increased fuel costs and supply problems.

FURTHER DISCUSSION OF A LIMITED FUEL MENU

The Committee draft represents a modest, do no harm approach to addressing the concern with the fuel formulations available throughout the nation. Limiting the number of low-RVP fuels that can be used, however, may do very little to reduce price volatility. History shows that the main regions of price volatility have been California and the Chicago-Milwaukee areas made themselves into "fuel islands" due to their own choices. In fact, other than the large area and overall large volumes of fuel involved, California fuel is a classic example of a boutique fuel, although EPA does not characterize it as such. Refineries outside of California have little or no incentive to make the investments necessary to provide California with additional supplies of CARB fuel on a sporadic basis. Chicago's reliance on ethanol as a blendstock for its RFG requirements, especially at the outset of RFG II implementation, was a major factor in fuel-volatility related problems in the early part of this decade. There have been brief problems in some parts of the country with low-RVP fuels, but far less often than has been the case with California and ethanol-blended RFG.

While the committee draft takes a more balanced approach to the boutique fuels debate and does not suggest adoption of a significantly reduced fuel slate, some propose

such an action. Reducing allowable fuels to a very limited (4, 5 or even less) number, as some have suggested, would require adoption of California RFG or Federal RFG. This result would occur since the obvious choice would be the "cleanest" fuel available, not the fuel with higher air emission potential. Adoption of such a strategy could very well reduce price volatility, but significantly increase the cost of gasoline manufacture.

Given current and anticipated requirements facing the domestic refining industry, an additional change to more stringent specifications at this time would undoubtedly be difficult and disruptive. Marginal refineries could be closed if the owners believe that better investments should be made elsewhere, since attractive alternative uses for scarce capital always exist. And imports could be more difficult to attract since additional investments would have to be made by importers to meet new specifications. In short, an "all RFG" or "all CARB" market would make it much more difficult for remaining refiners to produce compliant fuel than it is to produce a combination of RFG and conventional gasoline, and available imports could be affected.

NEED FOR REGULATORY CERTAINTY

Refiners have made significant capital expenditures in order to comply with the requirements for existing fuel blends. These investments were made at a time when refiners also faced the additional regulatory requirements of Tier 2 gasoline sulfur reductions, preparation for implementation of ultra low sulfur diesel regulations for both highway and non-road applications, and implementation of the renewable fuel standard (RFS) in conjunction with the elimination of the 2% oxygenate standard for RFG. Further complicating this picture by adding new programs, or even eliminating existing ones, at this time will not benefit consumers. Last minute changes will increase uncertainty and upset reasonable expectations based on current law.

Also, failure to consider and balance supply implications, air quality impacts, and fuel choices together risks making the current situation worse, perhaps much worse. A precipitous reduction in the number of boutique fuel blends now (so that only the most environmentally stringent fuels would be left) would probably translate into reduced

supplies. This is because cleaner fuels require more crude to produce them, given the need for additional processing. This also adds cost to the ultimate product, which consumers who do not need these special fuels should not have to pay. NPRA is pleased, however, to see that Section (3)(B)(II)(aa) through (ff) provide for studies that are at least intended to prevent such occurrences. We are concerned, however, that they may not be effective.

BOUTIQUE OR NOT BOUTIQUE?

The Committee draft attempts to control the total number of boutique fuels as defined in section 211(c)(4)(C) of the Clean Air Act in an effort to minimize fuel marketplace volatility and maintain air quality gains. However, while the draft legislation focuses on the purely legal definition of boutique fuels, it expressly allows the proliferation of state mandated fuels using renewable additives such as ethanol and biodiesel.

The federal preemption provisions in the Clean Air Act preserve a rational motor fuel supply because states are precluded from unilateral adoption of unique specifications unless EPA grants a waiver. EPA explains the merits of federal preemption in the preamble for the federal RFG and anti-dumping final rules, which includes the following statements:

“The regulations proposed here will affect virtually all of the gasoline in the United States. As opposed to commodities that are produced and sold in the same area of the country, gasoline produced in one area is often distributed to other areas. The national scope of gasoline production and distribution suggests that federal rules should preempt State action to avoid an inefficient patchwork of potentially conflicting regulations.”

Because the draft legislation intends to improve fuel fungibility and alleviate adverse air quality impacts, it should also cover other fuels, such as state ethanol and biodiesel mandates—whether or not these fuels fall under the requirements of section

211(c)(4)(C) of the Clean Air Act. At the very least this legislation should require EPA to make findings regarding the impact of these mandated fuels upon fuel supply and fungibility and air quality.

FUELS OF THE (NEAR) FUTURE

It is clear to NPRA that implementation of current and proposed regulatory programs will tend to reduce existing “proliferation” of transportation fuels. For example, EPA published the Mobile Source Air Toxics Phase 2 proposal (71 FR 15804; 3/29/06). The primary feature is a proposed reduction in the average annual benzene content in all gasoline (conventional as well as RFG) to 0.62 vol%. This eliminates a current distinction between conventional gasoline and RFG in toxics control. In addition, recent repeal of the oxygen content requirement for federal RFG narrows the differences between winter RFG and winter CG and between summer RFG and summer 7.0 RVP CG. In addition, the average sulfur content of RFG and CG is identical because of the federal Tier 2 Gasoline Sulfur program. This means that areas requiring VOC and toxics emissions reductions may now be content with RFG or CG rather than a new boutique fuel.

NPRA believes that attempts to limit the number of viable motor fuels in various regions or even nation-wide beyond those already contained in EPACT may prove unnecessary. That is why we think that the draft proposal should be the outer limit of action taken on this issue. After all, why add substantial additional burdens on refiners when the objective of reducing fuel blends will most likely be met in a more rational way in the coming years?

CURRENT STUDIES

NPRA supports the EPA review process and the expansion of the scope of its analysis of boutique fuels in section 1541 of last year’s energy bill. Clean Air Act section 211(c)(4)(C) was amended by the Energy Policy Act of 2005 to give EPA and

DOE joint authority to review motor fuel control selections by states and require that both agencies consider the regional supply implications of such choices. EPA has expanded the effort to include a “Governor’s Task Force” to aid in this process. It seems to us not only premature but also wasteful to short-circuit this process by legislating additional limitations on boutique fuels before the studies are complete.

SUMMARY

NPRA’s members are dedicated to working cooperatively with government at all levels to ensure an adequate supply of transportation fuels at reasonable prices. But we feel obliged to remind policymakers that action should only be taken to improve energy policy in order to increase supply and strengthen the nation’s refining infrastructure. We appreciate the invitation to appear at this hearing and look forward to answering the Committee’s questions.