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VALERO

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California Energy Commission
Dockets Office, MS-4
RE: Docket No. 09-IEP-1K
1516 Ninth Street
Sacramento, CA 95814-5512

CC VIA Email docket@energy.state.ca.us

Re: Valero Energy Corporation Comments on the Draft 2009 Integrated Energy Policy Report (IPER) Docket No. 09-IEP-1K

Commissioners,

Valero is submitting the following comments on the Draft 2009 IEPR. At the public workshop Commissioner Boyd asked for recommendations to address issues and make state policies work. While our comments address specific contents in the IPER, they also cover issues and recommended actions as requested.

Executive Summary

The draft 2009 Integrated Energy Policy Report should serve as a warning regarding the impacts of transportation fuel policy changes at both the state and federal level. Both the E10 and the B5 blend wall will limit the amount of 1st generation renewable fuels (ethanol and biodiesel) and 2nd generation renewable fuels (cellulosic ethanol) that can be blended into the gasoline and diesel pools. There is no near term solution to the blend wall issues.

The draft 2009 Integrated Energy Policy Report acknowledges the E10 blend wall issue but misidentifies the diesel blend wall as B20 instead of B5. This is important since the LCFS will apply to both the gasoline and diesel pools. The report projects the number of E85 vehicles, E85 pumps and E85 sales that will be required in California just to meet the U.S. EPA RFS2 regulations. The report does not project the additional E85 vehicles pumps and sales required to meet the LCFS. The E85 FFVs and E85 pump projections are overly optimistic. The concern drawn from this report is that obligated parties could have problems meeting the regulations, which could result in transportation fuel market impacts.

The IPER is quick to point out that the "disconnect" in the RFS and the RFS2 regulations between the obligated party and the required infrastructure at retail outlets. However, it does not mention that the same exists for the LCFS. There also is an additional disconnect between the

obligated party and the party that has title to gasoline and diesel at the truck rack before it is put into trucks. The party that has title at this point controls what, if any, renewable fuel is blended while the obligated party is the refiner or importer who may not have title to the fuel at the rack. Rather than using a direct obligation, both the RFS2 and the LCFS regulations are relying on market forces to provide an incentive for these mandates to work.

Comments on IPER Contents

Transparency

To truly understand the gasoline and diesel demand forecast, it would be extremely helpful to know the projected values of the underlying variables that are in the forecast such as VMT, CAFE and Ports-Container volumes and diesel demand. Essentially, projections for the forecast period for the variables analyzed in Chapter 2.

In addition, it would also be extremely helpful to know the assumptions (what regulatory regulations such AB 1493, ZEV, RFS2, LCFS) were included in all of the forecast scenarios.

E10 Blend Wall

The draft report does a good job in handling the E10 blend wall issue. More emphasis should be put on the multi-layered structure of the issue. The E10 blend wall is a multi-layer wall acting to limit increased ethanol use in different ways. The first layer is the U.S. EPA Sub-Sim regulations that prevent the blending of ethanol in levels above 10% in RFG, CARBOB, and Conventional gasoline. The second layer is the lack of an UL approved dispensing pump for blends with higher levels of ethanol. The third layer is the lack of coverage by OEM and extended warranty companies of blends above E10 for non-FFV's. The fourth layer is the high cost of adding another grade of gasoline at the retail level whether it be E15 or E85 (without warranty coverage, retailers will be highly unlikely to convert all of their pumps to one grade of gasoline that is above E10, they will need to add a tank and pump to offer two grades).

B5 Blend Wall

Unfortunately, the draft report identifies the biodiesel blend wall as B20 instead of B5. As with the ethanol blend wall, the multi-layered structure of the B5 blend wall needs to be emphasized. The B5 blend wall also is comprised of multiple layers. The first layer is the lack of approved underground storage and dispensing equipment for higher levels of biodiesel. The second layer is the lack of coverage by OEM and extended warranty companies of blends above B5. The third layer is the high cost of adding another grade of diesel at the retail level such as B20 (without warranty coverage, retailers will be highly unlikely to convert all of their diesel pumps to offer one grade of diesel that is above B5, they will need to add a tank and pump to offer two grades). Since there are no biodiesel FFV's, the most likely outcome is that biodiesel will be

limited to B5 for the near term. CEC should update their LCFS analysis of future compliance based on a B5 blend wall, using recently released CI values for biodiesel and assuming that additional E85 is needed in the gasoline pool once the B5 blend wall is hit in the diesel pool. An additional analysis projecting a LCFS compliance case with a reasonable number of PHEV's to generate LCFS credits and lower the amount of E85 required would also be very useful.

Issues and Recommendations

LCFS Disconnect

There is a serious disconnect in the LCFS regulations. The obligated parties are refiners and importers. If a refiner or importer sells CARBOB or CARB Diesel to another refiner or importer, the LCFS obligation transfers to the buyer. However, if a refiner sells CARBOB or CARB Diesel to a distributor, the LCFS obligation does not transfer. In this case the obligated party is responsible for the LCFS standard but has no control over what, if any, fuel with a low Carbon Intensity (CI) is added at the truck rack by the distributor. The CEC should bring this disconnect to CARB's attention.

E10 and B5 Blend Wall Issues (Regulatory, warranty, vehicles, rack and retail infrastructure)

This is actually a complex set of multiple problems. Unfortunately, Valero is not aware of any near term solution to these issues. However, we believe the CEC should keep in mind the following observations:

1. Refiners own only a small fraction of the retail outlets in California.
2. Refiners cannot legally force owners of branded retail outlets to install the tanks and pumps required for E85, or additional grades to enable sales of higher blends of ethanol or biodiesel.
3. Retail station owners and operators may not have the funds for installing additional tanks and pumps.

We also recommend that the CEC evaluate whether the Pavley regulations could potentially be working against the RFS2 and the LCFS regulations in the near term, when the most likely means of compliance will be the additional use of ethanol in the gasoline pool.

These issues need a lot more work and study by the CEC. We strongly recommend additional careful analysis to ensure that actions taken in California do not negatively impact a delicately balanced transportation fuel market. Your work in this area is appreciated.

Sincerely,

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