The California Association Representing Independent Fuel, Lubes and Convenience Store Interests

Questions for CEC Prices Hearing
CIOMA, October 13, 2015
Jay McKeeman, CIOMA VP of Government Relations

How does your business (or group members) fit into the fuel supply chain?
Refer to handout

How does it function under normal market conditions?

- *Our market segment essentially takes refined product and moves it to the customer. We can sell branded, unbranded, self-branded or blended products. A significant portion of the product our members engage in is unbranded or self-branded/blended product.*
- *During "normal" conditions there is usually sufficient supply of unbranded product to meet our members' and their customers' needs.*
- *In most cases unbranded product sets the base for petroleum pricing.*

With regard to the gasoline supply disruptions seen in the spring and summer of 2015:

- What is the impact on your business if there is a supply disruption like a major unplanned refinery outage? What changes to other parts of the supply chain impact your business? How do you adjust to those changes? (including a qualitative mention of price changes—e.g., higher, much higher.
  - *Since there is a tight supply of California-specific product in this market, and replacement loads are geographically distant, supply disruptions have significant consequences on unbranded supply. In very general terms unbranded fuel is the "leftover" fuel in the system; it is the first to be allocated by price or physical allocation. When allocation occurs, unbranded price goes up quickly and supply to unbranded customers can be restricted. We have seen recently that this can have dramatic upward price volatility.*
  - *Switching from winter to summer blend also can create impacts as the system is "purged" of winter blend fuel, making is susceptible to increased supply tightness.*
  - *Independent marketers have adjusted to this phenomenon over time – especially since the late 1990's when disruptions began having a demonstrable and fairly regular impact on the market.*

- Have the supply disruptions changed over time in their magnitude or nature?
  - *Not having kept a chart of such conditions I cannot statistically say they have increased but it is my general impression that such disruptions are increasing. I would like to make some observations about why that may be – many of these have been well-documented in numerous studies:*
    - *Unique California fuel specifications are at the base-level the cause for these situations.*

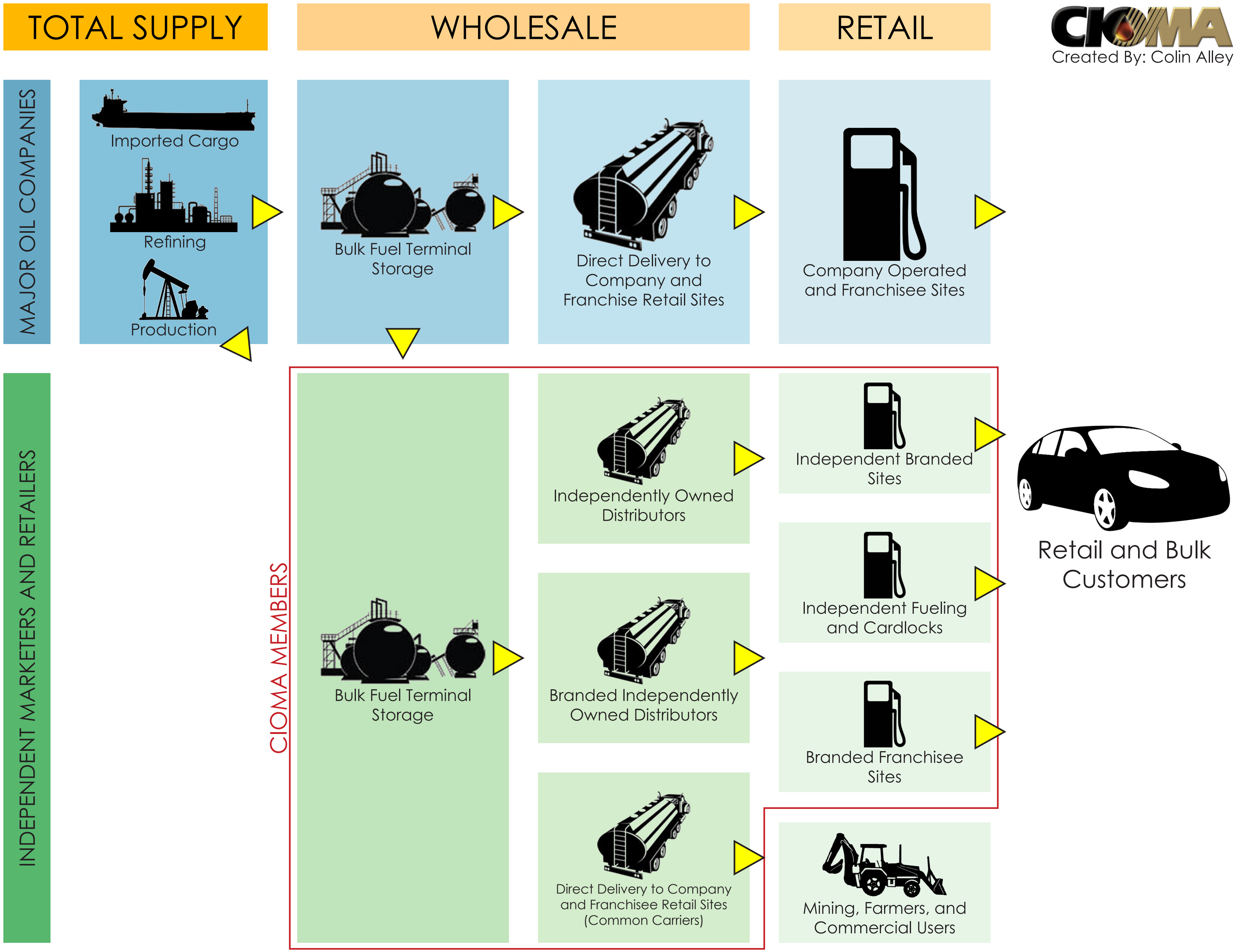
- *Isolation from quick and dependable alternative supply exacerbates the price and supply problems.*
- *As California moves to a more diverse liquid fuel supply condition, this may add additional complications and supply tightness. For example, if California becomes dependent of low-carbon-intensity Brazilian ethanol, weather or other factors may interfere with delivery of that fuel, creating similar tightness problems. Also supply tightness of more exotic fuels could lead to export of base fuels refined in California to avoid penalties in the LCFS program.*
- *Cap & Trade, Fuels Under the Cap (FUtC) may be leading to tightening of unbranded supply in the general course of business. I do not have any statistical evidence but a number of our members who trade "above the rack" are obligated parties in the FUtC program, We have detailed how this may affect small fuel providers' ability to withstand risk in the "pay it forward" Cap & Trade obligation payment system. We have tried to get these small suppliers (mainly unbranded fuel suppliers) disengaged from the program without success.*
- *Sending strong supply reduction mandate signals or significantly complicating provision of sufficient fuel quantities upon refiners may cause them to adjust their business planning strategies to examine alternative refining and supply scenarios with adverse consequences to the market.*

- Do you have any future expectations of disruptions and in what time frame—weeks, months, during planned turnarounds?
  - *Independent marketers have adapted to uncertainties in the marketplace and will continue to do so – that's how they survive. However, risks become higher and the capital requirements for operation continue to increase. For example, in addition to Cap & Trade capitalization, marketers are having to spend significant amounts for diesel truck upgrades. Permitting costs are ever-increasing. Vapor recovery systems are increasingly expensive to maintain and may need additional investment due to equipment design issues. The state's underground storage tank program also may bring significant additional expense for tank upgrades in the near future.*
    With these competing demands for limited resources, independent marketers have increasing challenges in making ends meet. And they have decreasing capacity to cover high fuel costs during price spikes.
    The fact that California seems bent on electrifying transportation energy (which has limited engagement for our members) also gives next-generation marketers pause in deciding to pursue this ever-challenging market sector.
- What could lessen or minimize the impact of the disruptions on your segment of the supply chain? These could be activities of other segments or activities of your own segment. Very specific points or broad generalities are perfectly acceptable. Any other relevant points we should know about to understand supply/demand imbalances in the California gasoline market?
  - *Removing small, independent fuel marketers from the Cap & Trade FUtC program may bring more liquidity into the unbranded market.*
  - *Allowing "time-out's" on fuel specifications, or shifting to lesser standards which can increase California refining output should be seriously considered.*
  - *Although there may be some minor health consequences in such abeyances, especially if criteria pollutant controls are involved, that impact must be weighed against the higher fuel costs*

which likely means shifting of discretionary income away from such things as optional health care expenses.

In the case of GHG emission reductions, shifting out of compliance requirements for short periods should have no material effect on health consequence.

- *As a litmus test, assure state emission reduction goals provide for a robust and competitive marketplace, which will encounter upheavals but react quickly to find the correct supply/demand balances.*



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