COMMENTS

OF THE

INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

ON THE PROPOSED

"TRANSPORATION & CLIMATE INITIATIVE
OF THE NORTHEAST AND MID-ATLANTIC STATES"

FEBRUARY 28, 2020

The Independent Fuel Terminal Operators Association ("IFTOA") hereby submits these comments on the proposed "Transportation & Climate Initiative of the Northeast and Mid-Atlantic States" ("TCI"). IFTOA is an organization representing companies that own and operate petroleum terminals primarily on the East Coast, importers, refiners, wholesale distributors and retailers. Accordingly, Members of the Association and their customers would be directly affected by the proposal.

The Association believes that reducing regional greenhouse gas emissions is an important goal. However, the TCI, as currently proposed, would not provide any direct reductions in greenhouse gas emissions. Unlike refiners, petroleum marketers are not able to reformulate petroleum products to reduce emissions. Similarly, petroleum marketers are not able to compel drivers to consume less product or to adopt alternative modes of transportation. <u>Petroleum marketers serve only as distributors of product</u>. They cannot reduce the emissions associated with transportation fuels.

The description of the TCI program in the Appendix that accompanied the draft Memorandum of Understanding ("MOU") sets out only the basic components of the program. It does not provide enough detail to enable the potentially regulated community to respond sufficiently to the proposal. Accordingly, IFTOA encourages TCI to release more information regarding the proposal as soon as possible. Once additional information is released, the Association plans to submit supplemental comments. Members of the Association believe that as currently envisioned, the TCI will substantially disrupt the distribution of motor gasoline and on-road diesel fuel in the region, will raise costs substantially for consumers and businesses in the Northeast and Mid-Atlantic, and will impose economic hardships on many individuals and companies dependent on these essential fuels.

For all of these reasons, TCI as proposed should not be adopted.

I. <u>Potential Adverse Consequences</u>

A. <u>Cost to Consumers</u>: TCI will establish an unnecessarily complex and costly program. It will <u>substantially raise the cost</u> of gasoline and on-road diesel to consumers and businesses. TCI projects that increases will range from 5 to 17 cents per gallon in the first year of implementation. There is no projection for later years, but the intent of the program is for costs to continue to increase. Such a program would create a hardship for many individuals or businesses who have no reasonable alternative to driving to work, school, or delivering goods.

B. Cost to the Economy: Economists knowledgeable about the petroleum industry have estimated that TCI would raise the cost of product between 10 and 20 cents per gallon under a range of scenarios. The region consumes about 700 million barrels of such products each year – resulting in a cost of between $2.8 and $5.6 billion annually. Such costs would contract the regional economy.

C. Price Variability: TCI suggests that the projected price increases for gasoline and diesel should not be a concern because "these increases are well within the range of historical variability." This assumption is incorrect. Petroleum prices certainly fluctuate for reasons such as a disruption or demand surge, but those increases are temporary. In contrast, increased prices due to TCI are permanent and are a continuing burden on consumers. Moreover, the costs of the TCI would be in addition to these traditional price fluctuations that would continue to occur at times in the market.

D. Disproportionate Adverse Effect: TCI hopes to raise petroleum prices so that consumers and businesses will change their habits and drive less. However, this approach will have a disproportionate and discriminatory effect on individuals in rural areas with no access to public transportation and low-income consumers in all areas of the region.

E. Lack of Uniformity: There is neither a guarantee that all of the jurisdictions in the Northeast and Mid-Atlantic region will participate in TCI nor that all will agree to adopt the same rules. The potential lack of uniformity would make transportation of products between participating and non-participating states burdensome, costly, and subject to uncertainty.

F. Small Emission Reductions: TCI assumes that greenhouse gas emissions from the transportation sector will decrease as a result of existing factors such as improved vehicle efficiency, more stringent CAFE standards, and the growth in the market for electric vehicles. At best, TCI would only reduce greenhouse gas emissions by a few percentage points below the already-anticipated reductions. Therefore, TCI would impose enormous costs but would yield only minor emission reductions.

G. Possible Loss of Product: Association Members are concerned that the adoption of TCI could result in the loss of supply. Some petroleum suppliers from outside of the TCI region may choose not to comply with costly and complex regulations imposed by the program. Rather, they could divert their product to other areas of the country where operations and compliance are easier. These actions could leave the region with pockets of product shortages resulting in operational disruptions and price spikes.

H. Possible Supply Shortages: The proposed TCI program does not address situations that could result in other possible types of supply shortages. For example, assume that a terminal estimates that it will sell a certain volume of motor fuels during the year, and it obtains sufficient allowances to permit such sales. During the same time period, consumers seek to purchase a greater volume of motor fuels. A terminal operator could be forced to close its operations and hold off making those sales unless it could acquire the additional allowances. If the terminal found that none was available from either the TCI jurisdiction (through the TCI auction of allowances) or on the secondary market, supply shortages could occur causing economic harm to consumers.

I. Lack of Consumer Awareness: TCI is intended to increase the cost of transportation fuels for consumers, but general public awareness of the program is very limited. If participating jurisdictions intend to implement the TCI, consumers should be given full and detailed information about the proposal and its likely economic impact. Subsequently, they should be given a meaningful opportunity to provide input on the proposed program before it is adopted.

J. Timely Data/Establishment of Product Prices: It is not clear how the auctions and secondary market would establish the price of "allowances" in a timely manner, thereby enabling marketers to set prices for their motor fuels. Marketers operate on real-time data. Without such information, they could incorrectly price their products, incur substantial loses, and ultimately be forced out of business. These types of losses could lead to additional product shortages and harm to consumers.

K. Complex and Burdensome Regulatory Program: TCI would establish a new and complex regulatory program requiring substantial tracking of product, new reporting obligations, and third-party verification. The more complex the program, the more susceptible it will be to confusion, noncompliance, and possible manipulation.

The regulated community would need to hire additional staff or outside consultants to deal with such additional obligations as well as experienced traders who have knowledge about the operation of auctions. (Most facilities on the East Coast have little or no experience with trading on auctions). These obligations, in turn, would lead to increased compliance costs that once again would be passed on to the consumer.

II. Recommendations If TCI Is Implemented

For the reasons stated above, the Association believes that the proposed TCI program will not achieve meaningful greenhouse gas emission reductions and will only create a cumbersome and inefficient system. The jurisdictions in the Northeast and Mid-Atlantic should find a simpler and more effective way to reduce greenhouse gas emissions from the transportation sector.

However, if regulators in the participating jurisdictions decide that they must proceed with the TCI, the Association recommends the following:

A. Point of Obligation

In the Appendix accompanying the MOU, TCI proposes to impose the allowance obligation on "position holders" at a terminal rack. However, in many cases, the "position holder" will not know the ultimate destination of the fuel, and only those downstream companies who make the final sale into a TCI participating jurisdiction will have that information. Accordingly, The Association recommends that "State Fuel Suppliers" be defined as those companies that own the affected fuel (motor gasoline and on-road diesel fuel) at the time of delivery into a TCI jurisdiction for final sale or consumption within that jurisdiction.

Some regulators developing TCI have said that they are concerned about placing the "point of obligation" downstream of the terminal. Such action would force them to regulate a greater number of entities, and those downstream companies may not be sufficiently knowledgeable or sophisticated to take on the obligation of obtaining allowances and complying with the program. That is an incorrect assumption.

All such downstream marketers are licensed by the states/jurisdictions in which they operate. They comply with numerous regulatory programs including state and local tax regimes, regulations of their trucks or railcars, health and safety requirements, and complex hours of service regulations. These companies may be somewhat smaller than the "position holders" at a terminal rack, but they are not unsophisticated or without financial means. These companies, which on many occasions may be the retail arm of a larger company, have the knowledge and ability to comply with TCI allowance program. They are the only entities that actually know if the fuel loaded at a terminal was delivered into a TCI jurisdiction and consumed in that jurisdiction.

If TCI rejects the notion of imposing the allowance obligation on the downstream party, the TCI program would become far more complex than is currently envisioned, making compliance more difficult and costly. A two-prong system would be needed:

1(a). Position Holder: It would appear that the "position holder" at a terminal would be instructed to rely on the ultimate destination indicated on the bill of lading when calculating the number of allowances it would be required to obtain, even though it is a common practice for cargoes to be diverted to different locations to meet demand once they leave a terminal.

1(b). If a "position holder" could demonstrate that the fuel was ultimately not sold in a participating jurisdiction as indicated on the bill of lading, the "position holder" would receive some type of "credit" against the number of allowances it would need to demonstrate compliance. However, little thought has been given to this idea, and regulators have yet to propose any specific "credit" mechanism. In addition, the regulators have not proposed how a "wholesale distributor" or "jobber" (often a third-party carrier) picking up product at a terminal would communicate the ultimate destination of the affected fuel to the "position holder" at the terminal.

2. Enterer: If product were brought into a TCI jurisdiction for final sale or consumption from a terminal outside the jurisdiction, the "enterer" of that product – the owner of the product at the time of delivery for final sale –

would be responsible for the allowance obligation because that company would know the ultimate destination of the motor fuel.

B. Allowance Auctions

The Model Rule would provide for a shared auction platform. "State Fuel Suppliers" would bid for the amount of allowances needed to cover the volume of carbon dioxide emissions expected from the sale of motor gasoline and on-road diesel fuel. Participating TCI jurisdictions would establish a "minimum reserve price," below which allowances would not be sold. There would be a single auction each quarter for all participating jurisdictions.

Members of IFTOA strongly oppose the use of auctions because they create complex, burdensome, costly and unnecessary programs. TCI should adopt an alternative method of selling/distributing allowances. Each year, TCI should set the price for allowances and increase that price annually. No limit or cap should be set on the number of allowances a regulated entity could purchase. In this way, the program would achieve TCI's objective of raising motor fuel prices to consumers and businesses and force behavioral change. Moreover, such an approach would achieve the objective without requiring the establishment of a complex and very costly auction mechanism. In addition, by establishing a set price each year, the regulated community would know the cost of allowances and could price its commodities accordingly.

The use of an auction system would require each regulated entity to establish a new or expanded compliance team and would substantially increase the cost of compliance. A critical distinction between the Regional Greenhouse Gas Initiative ("RGGI") system and the TCI is that a utility operating within RGGI can minimize its allowance obligation by investing in new air pollution controls or other means to reduce GHG emissions -- thereby reducing its obligation to acquire allowances through an auction. The RGGI auction system incentivizes behavioral change by the regulated entity (the utility). In this case, petroleum distributors have no way of avoiding or minimizing their obligation through similar means -- they are simply intermediaries that deliver the fuel. Therefore, it is a mistaken assumption that the auction system would further the goals of the TCI program. The auction system would only cause price uncertainty for both petroleum distributers and consumers.

Under the RGGI auction system, all financially-qualified parties may participate in the auction, not simply obligated parties. This approach is based on the idea that a larger pool of bidders would ensure there is adequate liquidity in the TCI allowance market. However, there is concern among Members of the Association that permitting third-party entities to participate in the trading market could result in hoarding of allowances or other market manipulation. Members have not yet had sufficient time to fully consider this issue and plan to submit supplemental comments to TCI on this and other points regarding elements of the TCI program once further details have been made public.

C. Cost Containment Reserve

TCI has said that if a certain bid price is reached in an auction, an automatic additional set volume of allowances would be released for sale. Association Members require more information on the proposed auction system. They plan to submit supplemental comments on this point, but believe that the size of a Cost Containment Reserve should not be limited. If a trigger price is reached, obligated parties should be able to purchase as many allowances as they require to meet market demand.

D. Secondary Allowance Trading Market

TCI proposes to have a secondary trading market for allowances and to permit all financially-qualified entities to participate. This secondary market would provide an opportunity for the regulated community to meet its needs -- obligated parties would sell excess allowances or purchase additional allowances not acquired through the quarterly auction system.

The Association supports the creation of a secondary trading market for allowances, but, as stated above, will submit supplemental comments on whether non-obligated parties should be able to participate in such a market.

E. Reporting Requirements

The Model Rule would include an electronic emissions reporting system requiring the submission of substantial information about each regulated entity's activities so that TCI could audit the system.

The Association recommends that any forms developed for TCI should mirror federal, state or local forms obligated parties are already filing. This approach would minimize the amount of new information that must be collected and filed.

F. Business Confidential Materials

As Association Members understand, TCI would provide only limited "confidential treatment" to an entity's allowances. Specifically, TCI would treat the number of allowances held in an entity's "allowance bank" (allowances acquired) as confidential, but would make public the number of allowances a company used to demonstrate compliance with its obligations.

Members, particularly privately-held companies, object to the release of information about the volume of allowances used by a company to demonstrate compliance. Release of such data could provide too much information to competitors about the company's sales volumes and points of sale. Provision of this type of information could place such a company at a competitive disadvantage. Therefore, information held by TCI on the number of allowances acquired by an obligated party and the number of allowances used to demonstrate compliance with the TCI program should be treated as "confidential" and not be made available to the public.

If the TCI believes that it must publicize information regarding allowances held and allowances used to demonstrate compliance, such information should be aggregated to avoid the disclosure of confidential business information.

G. Offsets

The TCI documents say nothing about offsets. As explained, the regulated community in the proposed TCI program are petroleum marketers. They do not operate refineries and cannot reformulate motor fuels to reduce carbon emissions. They also cannot compel drivers and businesses to drive less or purchase more fuel efficient vehicles thereby reducing carbon dioxide emissions from motor fuels. Unlike the regulated power plants under the RGGI program, the proposed TCI regulated community has no practical way in which to reduce its allowance obligations. Therefore, the Association recommends that TCI provide several specific acceptable offsets to reduce such obligations, and the Association will submit supplemental comments with offset proposals.

H. Exempt Sales

Under existing tax regimes, sales to federal, state and local governments or tribes are exempt from certain tax obligations. The Association recommends that sales to these same entities also be exempt from TCI obligations. Thus, if an obligated party sold fuel to such an entity, it would not incur an allowance obligation for that sale. Petroleum marketers are already charged with the responsibility of maintaining records of such sales for taxing authorities, and therefore could also maintain them for the TCI program.

I. Single Jurisdiction

The petroleum industry would have great difficulty following rules developed by individual jurisdictions. A patchwork of regulations would impose a substantial burden on the regulated community. Even though TCI hopes that all participating jurisdiction will adopt a Model Rule, they are not compelled to do so. Accordingly, the Association recommends that the participating states in the Northeast and Mid-Atlantic and the District of Columbia form a "single TCI jurisdiction." A single jurisdiction would minimize some of the problems with the proposed program. A single set of rules would be applied, allowances would fungible for compliance, all reporting would be uniform, and individual jurisdictions could still decide for themselves how the revenues raised would be spent.

III. Conclusion

For the reasons stated above, the Association recommends that jurisdictions in the TCI region not adopt the proposed plan for reducing greenhouse gas emissions in the transportation sector. The proposed program would be overly complex, lead to inefficiencies, operational difficulties, and possibly significant and disruptive supply problems. Further, the TCI's own modeling analysis shows that the program would not be an efficient way to achieve meaningful greenhouse gas emissions reductions.

If, however, jurisdictions in the Northeast and Mid-Atlantic decide they must proceed with TCI, then it should be modified as suggested to:

1. Impose the "point of obligation" on the downstream marketer delivering the product for final sale at a location within a participating jurisdiction;

2. Eliminate the use of auctions to sell and distribute allowances and instead adopt a system where TCI sets the annual price for allowances and increases that price each year. There should be no limit on the number of allowances an obligated party could purchase;

3. If TCI continues to include an auction system, then obligated parties should be allowed to purchase as many allowances as they choose if a price trigger is reached and allowances are released from the Cost Containment Reserve;

4. Establish a secondary trading market where obligated parties can buy or sell allowances;

5. Have reporting obligations mirror existing regulations and forms so that obligated parties do not need to collect and file information already being submitted to government agencies under other programs;

6. Treat allowances held in an obligated party's "allowance account" and the volume of allowances used to demonstrate compliance as "business confidential" and do not make them available to the public.

As noted above, the potential regulated community does not have enough information on the proposed TCI program. TCI should release its draft Model Rule and allow interested parties to provide far more detailed comments before anything is adopted.

It is clear that the TCI jurisdictions are trying to raise petroleum product prices so that such increases will change driving behavior and reduce greenhouse gas emissions. However, as currently proposed, it appears that the TCI program would cause major disruptions in the petroleum distribution system and would likely cause loss of supply and shortages, thereby crippling the regional economy. If adopted, the proposed system should be modified to make the program consistent with the existing distribution system.

As stated above, the Members of Association plan to discuss TCI in more detail, and based on available information provide supplemental comments on key elements of the proposal.