UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

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OFFICE OF
THE ADMINISTRATOR

Memorandum

TO: Andrew Lundquist, Executive Director, NEPD Group

FROM: Tom Gibson, Associate Administrator

SUBJECT: Concerns with Chapter 8 of NEPD Report

Based on our review of the most recent drafts of the national energy policy report chapters, we continue to have concerns that I feel are significant enough to warrant bringing to your attention. Our concern is with the language and tone in Chapter 8, "Increased Production of U.S. Energy Resources."

EPA has provided comments regarding the language on oil refineries and fuel infrastructure and supply issues in past rounds of the document review process, but our concerns have not been addressed. In the latest draft, new language has been added which is even more problematic. Costs of compliance with environmental requirements are overstated, several inaccurate statements and opinions are presented as factual, and no citations are provided for many of these statements. We are very concerned that this language is inaccurate and inappropriately implicates environmental programs as a major cause of supply constraints in the United States' refining capacity. Such a conclusion, in our opinion, is overly simplistic and not supported by the facts.

We have submitted alternative language for the section on infrastructure in the oil industry, which is attached. We believe that this language provides a more accurate and balanced picture of the U.S. refining and distribution infrastructure.

Specific examples of our key concerns include:

Statements regarding refining capacity are oversimplified and misleading, and create the false impression that environmental regulations are the major cause of supply constraints.

According to EIA statistics, overcapacity existed from 1978 until 1993. This led to low return on investment and therefore, no financial incentive to invest in new refineries. Since 1978 refining capacity increased significantly at existing refineries to keep pace with demand. Data from the Oil and Gas Journal shows that from 1989 to 1999 domestic refining capacity increased 15% from efficiency improvements at existing refineries.

The bottom line is that the refining industry chose to increase output by utilizing under-used potential and by investing in more efficient technologies at existing facilities. In addition, since the mid-1990's, as facilities approached maximum output, it has become more profitable to import finished product rather than to build new refineries in the U.S. To draw the conclusion that environmental requirements are a primary cause of this trend is, to our knowledge, not supported by any study.

Estimates of the capital cost required to comply with environmental regulations are overstated, and are not cited.

A 1997 EIA publication, "The Impact of Environmental Compliance Costs on U.S. Refining Profitability" found that "although pollution abatement requirements reduced the rate of return to refining/marketing assets, these requirements appear to account for only a small part of the steep decline in the rate of return to U.S. refining/marketing operations in the 1990's." The report further notes that "pollution operating costs have been and continue to be a small part of the overall operating costs."

The document states that Tier 2 gasoline and diesel rules will require additional capital investments of $8 billion for gasoline and more than that for diesel. These numbers are inaccurate.

The correct data for capital investments is $4.5 Billion for Tier 2, and $5.3 Billion for Diesel, and these costs are spread over 9 years (per EPA's Regulatory Impact Analyses and Summaries and Analyses of Comments for these two rules). In addition, to fully put these rules into perspective, some discussion should be added regarding the substantial public health benefits that result from the production of cleaner-burning fuels.

Several misleading statements are made regarding new and potential regulatory actions.

For example, the document states that significant capital costs will likely be required to comply with a new driveability index, and with new toxics rules. In fact, EPA has no plans to set a standard for a driveability index, and the new toxics rule will require no new capital costs.

There is no evidence or documentation to support the effect of the transport of ultra-low sulfur diesel on delivery infrastructure claimed in the document.

EPA believes that with relatively minor changes and associated costs, the existing distribution system will be capable of adequately managing sulfur contamination during the transportation of 15 ppm sulfur diesel fuel, very similar to the way the distribution system optimized handling of 500 ppm sulfur diesel fuel in 1993. In addition, out-of-spec highway diesel fuel that does occur will be blended back into compliance at the terminal, as is done today, or will be put into the off-highway diesel pool. It will not be shipped back to refineries for reprocessing at substantial cost.

The statements regarding "boutique" fuel formulations and transmix fuels are inaccurate and misleading.

The draft language cites 50 unique fuel formulations. EPA disagrees with that figure. In addition to the federal requirements (conventional gas and RFG) there are 12 areas with State-run, summer-only low RVP programs and 11 areas with State-run winter-only oxy programs that are required by the Clean Air Act. (Many of the fuel formulations for these programs in each season are similar or identical.) States most often develop their clean fuels programs in cooperation with refiners who supply that area. EPA, when given authority, has set national fuel requirements.

EPA believes its Tier 2 and diesel rule will not result in any increased volume of transmix compared to today's levels. In addition, the interface (transmix) between diesel and gasoline that occurs today is sent back to the refinery and distilled into separate mixtures of gasoline and diesel. Those processes will not change.

Statements regarding coal generated electricity create the false impression that environmental regulations are the sole cause of the decrease in investment in new coal generation.

The section of Chapter 8 that deals with coal generated electricity is also more problematic than earlier versions. We are concerned that it gives the impression that environmental regulations alone are responsible for halting investment in new coal generation, when in fact it is but one of a number of factors. The section also does not recognize the important role that environmental requirements play in allowing coal to be burned while protecting public health.

We believe it is critical that chapter 8 of the Energy Policy document be edited to address these issues. Attached please find more detailed edits to chapter 8 that address our concerns. Please contact me if you would like to discuss these issues further.