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"Reduction in the Number of Boutique Fuels"

Mr. Chairman, and Members of the Committee, I appreciate the opportunity to come before you today to testify concerning draft legislation on boutique fuels. This is a topic of great interest to the Administration. The Department of Energy has been working closely with the Environmental Protection Agency on this issue for several years. More recently, since the enactment of the Energy Policy Act of 2005, we have continued to collaborate with EPA to fulfill the many provisions of the Act affecting motor fuels including the boutique fuel requirements. On April 25, 2006, the President addressed boutique fuels in his *4-Point Plan to Confront High Gasoline Prices* directing Administrator Johnson to establish a Task Force to "confront the large problem of too many localized fuel blends."

Background on the Fuel Distribution System

The U.S. petroleum supply system comprises major refinery centers on the East, West, and Gulf Coasts, as well as some in the upper Midwest. Gasoline, diesel, heating oil and other petroleum products leave these refineries and enter a long and complex network of pipelines that distribute the products throughout the country. Pipelines move different products in separate batches, one right after the other. The separate products are then deposited in separate terminal tanks near to where they will be consumed. Tank trucks pick up the products from the terminals and deliver them to retail outlets, consumer businesses, and even homes in the case of heating oil. This production, distribution and storage system was designed to carry a limited number of fuels, but as fuel types have increased, the industry has accommodated the changes in various ways. For example, at many terminals where premium, midgrade, and regular gasoline were once stored, midgrade gasoline storage was eliminated, and blending equipment was added to combine the appropriate volumes of premium and conventional gasoline into tank trucks or at retail outlets when midgrade gasoline was needed.

Variations in fuel types have strained the distribution and storage systems and have contributed to price spikes when the supply system has been disrupted. The number of distinct fuels being used in areas distant from supply sources has strained the motor-fuel distribution system. Concurrently, these systems have also been challenged by the large

growth in U.S. gasoline and diesel demand and limited expansion of pipeline capacity and product storage. The collective result of all of these factors has been an increasingly sensitive fuel-supply system that has little room for error. Any supply problem can create a localized motor-fuel shortfall with consequent price spikes.

To date, fuel type proliferation has generally been an exacerbating problem to supply flexibility and potential supply problems. However, today's high gasoline prices are not the result of boutique fuels. Boutique fuel problems arise most often during supply disruptions such as a pipeline break or the recent hurricanes. In general, it may be worthwhile to limit or reduce the number of fuel types that can be used to meet local environmental requirements. Moving to fewer fuel types would tend to reduce strain on the distribution system. However, depending on what specific fuel types were required, there is a potential to increase challenges for the refinery sector. The consequences of requiring a generally cleaner fuel (for example, gasoline with a RVP of 7 lbs. instead of 7.8 lbs.) are not limited to higher fuel cost but also include loss of gasoline blending components that can be used during the peak gasoline season. Consequently, if reducing the number of boutique fuels that can be used to meet State Implementation Plans results in a regulatory regime that requires more low-RVP gasoline, this could reduce the availability of gasoline in the short term and thus offset any advantages gained by having fewer boutique fuels. Given the complexity of the fuel system and the factors cited above, then, thoughtful and informed solutions are needed

Fuel Harmonization Involves other Issues besides Boutique Fuels

The Energy Policy Act of 2005 (EPAct) recognized that the fuel harmonization issue is larger than the "boutique fuels" required by State Implementation Plans. Section 1541 will help limit the proliferation of these boutique fuels. This section is discussed in some detail by my EPA colleague. Section 1541 also requires that the Department of Energy and the Environmental Protection Agency submit a report to Congress in August of this year. This study shall be to determine how to develop a Federal fuels system that maximizes fuel fungibility and supply including that which results from a proliferation of boutique fuels and to recommend to Congress what legislative changes are necessary to implement such a system. Section 1509 requires a more broadly defined "Fuel Harmonization Study" that reflects all fuel requirements and requires a broader range of issues to be considered than the Section 1541 report. As defined in EPAct Section 1541, boutique fuels are those distinct fuels required by States to meet their State Implementation Plans. These fuels are a subset of the broader number of distinct fuel types, which will be addressed in the Section 1509 study. This study is due to Congress in June 2008.

State Biofuel Programs

In considering the broader question of fuel harmonization, it will also be important to consider the role of biofuels. As you know, the Administration has long promoted biofuels to achieve reduced oil imports and alleviate fuel-supply problems. We supported the national Renewable Fuel Program in the EPAct. In doing so, we strongly

endorsed the flexibility provided by the credit and trading program and considered it to be an essential part of the proposed Renewable Fuel Standard.

Many States are enacting biofuels programs. States should design their programs to consider the potential consequences on State and regional fuel supplies, especially during possible supply interruptions. States should also consider whether State mandates might work to undermine the flexibility provided in credit and trading system specified by EPAct to be incorporated into the federal Renewable Fuels Standard. An additional factor to be considered is that ethanol-blended gasoline cannot be commingled with other gasolines due to the adverse effect commingling has on vapor pressure.[1]

Fuel Islands

While reducing the number of boutique fuels would tend to reduce the burden on the distribution and storage system, it is also important to consider "fuel islands" that could be difficult to supply during a fuel-supply interruption. The fuel islands, by regulation, are limited in ability to draw supply from nearby surrounding counties due to the variations in product specifications.

Motor Vehicle Emission Technologies and Motor Fuels Have Changed

Following the successful implementation of the many fuel and vehicle programs required in the Clean Air Act, the US market is significantly different than it was in the late 1980s and early 1990s. Changes since 2000, such as the Tier II vehicle and low-sulfur gasoline program and the implementation of the RFS have further changed the national market. When the proposed second phase of the Mobile Source Air Toxics Rule is also considered, conventional gasoline emissions are being reduced to levels much closer to RFG emissions. There is reason to believe that the emissions consequences of RFG and low-RVP fuels in the changing Tier II vehicle fleet may be substantially different than those estimated in the early 1990s. Ongoing research could reveal important relationships between fuels and emissions that might point the way to a more harmonized clean fuel that is easier to produce and distribute.

Regulatory Stability

The motor fuel industry has, since the Clean Air Amendments of 1990, responded to a variety of regulatory initiatives including reformulated gasoline, low-sulfur gasoline and diesel fuel, changes in oxygenate requirements, shifts from ethers to biofuels and, as discussed above, the proliferation of boutique fuels to meet air quality standards. Over the last 9 months, natural disasters have constrained refinery output and, when combined with a strong economy and growing demand for U.S. transportation fuels, refiners are hard pressed to keep up with demand. The U.S. refining industry has announced plans to expand distillation capacity at existing refineries by over 1.5 million barrels per day by 2010. These plans often include increased capacity to use heavier crude oils and

[1] EPAct allowed for limited commingling of Reformulated Gasoline between June 1st and September 15th to consist of two 10 day periods. EPA has already implemented this provision by rule.

increased ability to produce clean light products. Consequently, the Department would encourage the Congress to consider the virtue of regulatory stability as a factor that could contribute to greater fuel supplies. An additional factor that should be considered is whether the current system of regulation could be enhanced by accounting for fuel supply and distribution issues in the development and approval of new fuel types.

Comments on the Discussion Draft Bill to Reduce the Number of Boutique Fuels

This bill would broaden the basis for granting fuel waivers and require the reduction in the number of approved boutique fuels, once a previous fuel ceases to be used. Another section of the bill would then change what fuels would be considered to be "approvable" as part of a State request for incorporation into its SIP. This section (Section III(b)) might have uncertain consequences on the resulting boutique fuel requirements by States. While it is possible that that it will produce fewer boutique fuels and no additional burden on refiners (even enhancement of fuel supplies), it is also possible that the resulting fuel requirements would be more stringent and adversely affect refiners' abilities to supply fuel. Due to the complexity of this issue it would be helpful to further review this section to better understand its possible consequences to help ensure that it achieves its desired outcomes. As indicated by my colleague from EPA, however, the Administration has not fully analyzed the legislation and is not offering a formal position on the legislation.

Administration Plans

The Administration is carrying out the boutique fuel requirements of the Energy Policy Act of 2005. In particular, the Department of Energy is moving forward on the Section 1509 and 1541 studies and reports discussed above. Collaborating closely with EPA we intend to employ detailed analyses of the refining industry, employ new methodologies to estimate the consequences of different supply scenarios and consult with industry and other stakeholders to produce findings and recommendations that could be of use to the Congress. The Boutique Fuel Task Force, described in some detail by my EPA colleague, is part of that process. DOE and EPA will be providing the Section 1541 report, focusing on boutique fuels (resulting from State Implementation Plans) on schedule in August of this year and will continue to study the broader issue of fuel harmonization as required by section 1509. DOE will continue to collaborate closely with EPA on all regulatory matters, especially the evaluation of any fuel-supply problems that may require fuel waivers.

Concluding Remarks

In conclusion, the Administration is focused on addressing our nation's energy challenges. The current gasoline market is being affected by numerous factors including rising demand, limited spare capacity, a number of planned regulatory changes this year and lingering problems from last year's hurricanes. We must address our energy challenge in a multifaceted manner by increasing supply, increasing refining capacity, and improving efficiency. The authorities provided in EPACT 2005 have laid out a sequential and thoughtful course to address the number of boutique and unique fuels. DOE is

committed to complying with these provisions. As indicated above, since the legislation is at an early stage in the legislative process and has not been reviewed by our normal interagency procedures, the Department of Energy does not have a position on the proposed bill. I would only add that I would like to thank the Committee for undertaking efforts to improve the Nation's fuel supply system and the Department of Energy stands ready to assist the Committee in consideration of these important National issues.