February 28, 2020

Ms. Kathleen Theoharides
Chair, Transportation and Climate Initiative
Secretary, Massachusetts Executive
Office of Energy and Environmental Affairs
100 Cambridge St., Suite 900
Boston, MA 02114

Dear Chair Theoharides:

These comments are submitted by the National Association of Convenience Stores ("NACS"), the National Association of Truckstop Operators ("NATSO"), and the Society of Independent Gasoline Marketers of America ("SIGMA") (collectively the "Associations") with respect to the Draft Memorandum of Understanding ("Draft MOU") relating to the final Transportation Climate Initiative program ("TCI" or the "Program") design.[1]

The Associations' members are extraordinarily attuned and responsive to their customers' preferences. They are fuel-agnostic, governed by a loyalty not to a particular type of fuel, but to low and stable priced energy for their customers.

Successful environmental policies that have been designed to improve the emissions characteristics of transportation fuel have tended to harness the retail fuel industry's ingenuity and willingness to embrace alternative fuel types, provided their customers want to purchase such fuels. The Associations believe the final Program design should apply lessons gleaned from these policies' successes in recent years: consumer-focused, rules-based incentive and regulatory regimes that reward companies that make investments in bringing alternative fuels to market.

Unfortunately, the Draft MOU does not appear to apply any such lessons. It is structurally deficient in that it would lead to widespread evasion and enforcement difficulties. On top of this, the Draft MOU would inject substantial pricing and administrative complexities into the retail fuels market, without necessarily making alternative fuels (including electricity) more desirable for consumers than other fuels. Finally, and relatedly, the Draft MOU would not effectively "reward" fuel retailers who invest in bringing alternative fuels to market; instead, it would simply "punish them less" and potentially divert revenue raised in the name of improving the environment toward other, unrelated state priorities.

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[1] *See* Transportation and Climate Initiative, *Draft Memorandum of Understanding* (Dec. 17, 2019) *available at* https://www.transportationandclimate.org/sites/default/files/FINAL%20TCI_draft-MOU_20191217.pdf [hereinafter "Draft MOU"].

If finalized as proposed, the Program would represent a wasted opportunity as it will not achieve its stated goals. The Associations are eager to work with policymakers to help improve the Draft MOU so that it can better achieve TCI's stated objectives.

I. Introduction

a. About the Associations

The Associations represent approximately 90 percent of retail sales of motor fuel in the United States.[2] In 2018, the fuel retailing and convenience industry employed more than 2.36 million workers and generated $654.3 billion in total sales, representing approximately 3 percent of U.S. Gross Domestic Product.[3] Of those sales, approximately $412 billion came from fuel sales alone. Because of the number of fuel and other transactions in which the industry engages, fuel retailers and marketers handle approximately one of every 30 dollars spent in the United States. Fuel retailers serve about 165 million people per day—around half of the U.S. population—and the industry processes over 75 billion payment transactions per year.

Nevertheless, the convenience store and fuel retail industry is an industry of small businesses. Approximately 62 percent of convenience store owners operate a single store, and approximately 74 percent of NACS' membership is composed of companies that operate ten stores or fewer. Retailers want to be more competitive at retail because lower fuel prices drive increased fuel volumes and drive sales traffic in the stores. The businesses that the Associations represent and the customers to whom these businesses sell fuel are major stakeholders in TCI as outlined in the Draft MOU.

Members of the Associations sole objective is to sell legal products, in a lawful way, to customers who want to buy them. They believe it is best for the American consumer and America's industrial position in the world marketplace to have reasonably low- and stable-priced energy. The retail fuel market is the most competitive commodities market in the United States. Fuel retailers operate on tiny margins (around 2 percent or less) and are unable to absorb incremental cost increases without passing them on to consumers. Consumers see fuel retailers' price signs from blocks away or compare prices on applications on their cellular phones.

The retail diesel market, within which NATSO members operate most intensely, is extremely competitive and transparent because many of NATSO's members' customers – truck drivers and trucking fleets – are savvy and price conscious consumers of fuel. Truck drivers are often aware of retail fuel prices when they are 100 miles away from potential refueling sites, and fleets often use this information to direct drivers to specific retail sites in order to purchase the lowest-priced fuel available.

[2] NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,600 supplier companies as members, the majority of whom are based in the United States. NATSO currently represents approximately more than 3,000 travel plazas and truck stops nationwide, comprised of both national chains and small, independent locations. SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel.

[3] All data points in Section I.A can be found in *NACS, State of the Industry Annual Report (2018)*.

Fuel retailers and marketers are the consumer-facing side of the transportation fuels sector and they compete every day for consumer business. As such, when policymakers consider any energy or environmental policy, they should look to fuel marketers as being a proxy for the consumer in any policy discussion. When policymakers want to encourage increased investment in and consumption of more environmentally friendly alternative fuels, they must keep in mind this fundamental market reality: motorists do not purchase products because fuel retailers sell them; fuel retailers sell products because their customers want to purchase them. When buying motor fuel, consumers – from families traveling in passenger cars, to national trucking fleets, to cities and municipalities – very reliably purchase the least expensive product available.

b. Partnership with Policymakers

In this respect, fuel retailers are invaluable partners for policymakers whose objectives include increasing consumption of alternative fuels. The market is extraordinarily capable of efficiently and expeditiously bringing the lowest-cost fuels to market. Conversely, it is stubbornly reluctant to consume more expensive alternative fuels. Although one might view this as an obstacle (because the lowest-cost fuels are not necessarily policymakers' most desirable fuels), it should be considered an asset: a nimble, sophisticated industry that is able to adapt to clear policy signals and provide customers the fuels that they want. Therefore, any entity aspiring to create a program that improves the emissions characteristics of motor fuel should include a combination of financial inducements and regulatory signals such that it makes economic sense for consumers to purchase the fuels that policymakers want them to consume. Retailers will invest in selling whatever fuels consumers prefer.

Savvy policymakers have, for the most part, understood this relationship between fuel marketers and American consumers. This is evident in how Congress developed incentives for ethanol, biodiesel, and other biofuels via programs such as the Renewable Fuel Standard ("RFS"). When Congress enacted the RFS approximately 20 years ago, the Associations were <u>not</u> advocating for policies to replace gasoline and diesel with biofuels. Nonetheless, Congress recognized that if it created the right incentives to make biofuels cost-competitive with petroleum-based fuels, consumers would gravitate toward biofuels and the market would be forced to respond. No matter how people feel about ethanol and biodiesel, the incentives that Congress created have led to the displacement of a significant amount of petroleum-based fuels with renewables since the early 2000s.

c. Fundamentals of Successful Climate Policy

The Associations recognize that the states participating in TCI are attempting to create a regional policy to address the changing climate. The Associations believe successful climate policies at the federal and state level tend to share a number of fundamental characteristics and, as such, encourage policymakers to keep these in mind. Specifically, these policies should:

- provide clear signals to market participants to engage in behavior that lawmakers have decided is beneficial for society at-large;
- provide certainty to market participants;
- do <u>not</u> mandate a specific solution or outcome, but establish rules-based environmental standards combined with economic inducements to prompt the market to find the most efficient solution;

- ensure consistent application of the law across state lines to provide certainty, and minimize complexities and costs for market participants;
- do not demonize a particular industry, instead working with stakeholders to produce the desired change;
- consider all of the costs (e.g., social, environmental, etc.) that are associated with a particular policy objective and lay those out clearly for market participants and U.S. consumers;
- strengthen, rather than weaken, the transportation sector by ensuring any revenues raised are dedicated to transportation infrastructure; and
- harness existing infrastructure to better enable customers to gravitate to the fuels and vehicles they choose.

II. TCI Framework

The Associations' members are focused primarily on how TCI, as drafted in the MOU, will impact the downstream fuel market and the customers served by the associations' members on a daily basis. As drafted, TCI proposes to require that entities that sell "Affected Fuels"[4] ("TCI Suppliers") must obtain and surrender credits to "Participating Jurisdictions" ("TCI States")[5] to demonstrate compliance with the program. Affected fuels sold by the TCI Supplier, will be subject to TCI regulation.

Affected fuels enter commerce in a particular state from bulk storage facilities located at a refinery or a terminal remote from a refinery. Thus, the relevant point of inquiry is, as recognized by the Draft MOU, the loading rack of bulk product terminals. Fuel is delivered from terminal racks[6] into trucks. Trucks then deliver the fuel directly to a retail outlet for sale to a motorist, or transport it to other businesses within the supply chain. Title to fuel may pass through multiple entities before the fuel is finally sold to a consumer. The ultimate destination of a particular gallon of fuel being transported is often not known by its title-holder and/or transporter while the fuel is in transit. In fact, fuel could move to a different state (or multiple different states) and have multiple different interim owners prior to reaching the destination where it will be sold to an individual consumer.

Pursuant to the MOU, a TCI Supplier will be required to possess and surrender to each TCI State in the program credits, at the end of a compliance period.[7] TCI Suppliers include two groups, "Position Holders" and "Enterers". Position holders – which often includes companies that also own retail fuel outlets – own affected fuel at a terminal as it is delivered across a terminal rack, for final sale in a TCI State. Enterers own affected fuel delivered for final sale in a TCI State from a facility outside of a TCI State. Enterers may not be regulated as a TCI Supplier if a position holder follows

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[4] *See* Draft MOU *at* 5. "Regulated fuels shall include the fossil fuel components of motor gasoline and on-road diesel fuel destined for final sale or consumption in a Participating Jurisdiction, upon removal from a storage facility (e.g., at a "terminal rack") in the Participating Jurisdiction, or, for fuel removed from a facility in another jurisdiction, upon delivery into the Participating Jurisdiction."

[5] *See* Draft MOU *at* 5. "[J]urisdictions that adopt a program consistent with the Model Rule and that complete the procedures needed to become a Participating Jurisdiction."

[6] A rack is a fuel distribution point—typically at a terminal—where fuel is supplied to a truck or trailer for distribution. It is called a rack because a truck pulls up to a loading rack to receive the blend of fuel from their suppliers to deliver to retailers.

[7] *See* Draft MOU *at* 3. The compliance period may be up to three years.

the regulation ascribed to them above, but there must be 'sufficient documentation'[8] supplied by the position holder on behalf of the enterer to demonstrate compliance.

III. Structural Challenges of the Program

The structure of the TCI as drafted does not make clear which fuel marketers will be subject to compliance obligations nor does it require each participating state to implement the program in the same fashion. Depending on how a state adopts and implements the rules relating to TCI, a business attempting to operate in one or more TCI States will be governed by various regimes even within the same program. In addition, there are several other challenges the Associations view as not only problematic but potentially disruptive to the implementation of the program should states adopt the model rule.

a. Regulated Entities

The structure of the TCI as outlined in the Draft MOU is exceedingly murky as to which fuel marketers will be subject to compliance obligations given the realities of the wholesale motor fuel market.

Northeastern states generally receive fuel that travels from a bulk storage facility, through a terminal rack, to its destination. Sometimes, the fuel continues to be sold further downstream until it reaches a retail outlet for final sale. The system described in the Draft MOU is dependent on what will inevitably be a complex tracking system where TCI fuel is tracked downstream until it reaches a final sale to a consumer in a TCI State. TCI Suppliers must hold sufficient documentation to ensure they demonstrate compliance. <u>It is unclear how they are expected to do so.</u> For example, the U.S. Energy Information Administration ("EIA") admits that it cannot identify the specific origin of gasoline sold at fueling stations, even if Association members sell branded gasoline.[9] The only way an entity knows it faces a compliance obligation is if that entity knows the ultimate destination of the fuel. This is nearly impossible.

b. Market Incentives and Revenue Diversion

The Associations' members are receptive to programs aimed to achieve climate goals so long as those programs are designed to encourage and incentivize the participation of the Associations' members. TCI, as drafted, is a punitive program that exacts a charge on the Associations' member businesses and customers without any incentive for members to innovate and bring to market fuels that achieve TCI's stated climate goals. In fact, as drafted, TCI generates revenue from fuel marketers and others and collects that funding in the state coffers of the TCI States. The Draft MOU does not require that those funds be used for climate reduction nor is there any effort to encourage states to partner with the impacted businesses and provide incentives for those businesses to deliver cleaner fuels at reasonable prices for the consumer.

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[8] Sufficient documentation is not defined in the Draft MOU.

[9] *See* U.S. Energy Information Administration, *Gasoline explained; Where our gasoline comes from* (Last updated December 3, 2019)*, available at* https://www.eia.gov/energyexplained/gasoline/where-our-gasoline-comes-from.php.)

TCI is, in essence, a "cap and invest" program," similar to California's cap and trade program. A critical difference, however, is that there is not in TCI States a direct monetary benefit associated with using alternative fuels (as there is in California via that state's low-carbon fuel standard "credits" that alternative fuels generate). It is easy, and short-sighted, for policymakers to simply impose strong and direct *negative* incentives for particular fuels; the critical, albeit more complicated task, is providing a *positive* incentive for using alternative fuels.

With a TCI-style cap-and-invest program, obligated parties pay state governments via an auction for the credits they need to hold. The states then invest the auction proceeds in alternative fuel production, logistics, storage, etc., as *the states see fit.* Private companies would need to apply for funds, and only then (assuming funds are available and directed appropriately) can such companies pass along benefits to customers. This will not be an effective inducement for anyone to purchase alternative fuels. It will prolong and ultimately make less likely consumer acceptance of alternative fuels.

c. Compliance Evasion

Once entities recognize that enforcement regimes will be unable to identify the ultimate destination of fuel (and therefore which parties are subject to obligation), businesses with relative market power as well as bad actors will take advantage of that system flaw. The Draft MOU imposes an "economic rent" at the rack, which is the same location motor fuel excise taxes are collected. If TCI were designed as a simple tax assessed on all fuel at the rack, the Program could be implemented similarly to the gasoline excise tax. However, given that not all fuel will be subject to the economic rent, there will inevitably be an effort to evade this cost. The mechanics of diesel excise tax collection exemplifies this threat and the ways that the government has addressed those challenges. On-road diesel is subject to the motor fuel excise tax whereas off-road diesel is not. As diesel leaves the rack the fuel remains clear if the excise tax has been paid. If the tax has not been paid, and the fuel is therefore determined to be for off-road use, the fuel is dyed red. That this tracking regimen was put in place underscores the pervasive desire for bad actors to avoid costs associated with their product. If the enticement is present for individuals to evade the diesel excise tax system, it stands to reason that a similar incentive to evade the TCI cost burden will exist as well.

It may be tempting, therefore, to take the diesel model, apply it to TCI, and dye fuel not being sold in the TCI States. The problem with that solution returns to the structural challenges of the program at large. Because TCI impacts fuel based on where the fuel is sold and not for what purpose, and the final destination of fuel is not known when it leaves the rack, dyeing non-TCI State fuel is not an option. In addition, the multiple state jurisdictions will make enforcement and compliance an added challenge. Fuel may travel in and out of TCI States (more than once) before reaching its final destination. Tracking this across multiple states will not be possible.

Given the lack of clarity in the proposal and the costs added to product, the incentive to avoid these costs will be high. Large suppliers of fuels with sophistication and bargaining power will attempt to structure sales and transfers of fuels such that smaller and less powerful companies bear the brunt of any compliance costs. The result will be that the smallest businesses will suffer relative to their competitors.

Similarly, bad actors will try to cheat the system. The difficulty of tracking and loopholes created by the proposal will be exploited by bad actors who will not only rob TCI of the revenue it anticipates generating but ultimately will rob it of anticipated revenue from responsible actors. Businesses that make every attempt to follow the law and the Program will be required to price product higher than those evading compliance. Because consumers are extremely price conscious, the bad actor, offering lower priced product, will generate more business than the responsible actor. In doing so, the responsible actor will generate less income, sell less product, pay fewer taxes and retire fewer TCI compliance credits.

d. Pricing Product

The TCI Program as drafted discusses a three-year compliance term for retiring compliance credits. Even ignoring the structural flaws discussed earlier pertaining to the inability of a title holder to know the final destination of fuel, there is an added challenge for responsible businesses to price product to recover the cost of the added compliance burden. A three-year window to retire credits may mean entities will not know the value of the credit at any given time, which means that entity may be unable to price product such that it can recover the added costs.

In addition to the pricing challenges the compliance period presents, there could be additional factors that make pricing product very challenging for fuel retailers. For instance, as the overall allowance cap nears in a particular year, regulators may determine that additional credits should be made available to ensure fuel can still be sold in the state. The injection of those credits into the market at unknown times and in unknown amounts will likely distort the market for those credits and lead to additional pricing challenges for the industry.

IV. Conclusion

The Associations are encouraged by policymakers who take seriously the threat of climate change and craft policy designed to mitigate this threat for all Americans. As currently written, the Draft MOU suffers from various flaws that will hinder its ability to achieve its own goals. The Associations urge policymakers to work closely with its respective members to develop policies that are more consumer-focused and thus better able to achieve what should be mutually compatible objectives.

Sincerely,

Paige Anderson

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