

COMMENTS
OF THE
INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

ON THE PROPOSED

“TRANSPORTATION & CLIMATE INITIATIVE
OF THE NORTHEAST AND MID-ATLANTIC STATES”

November 5, 2019

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 would be directly affected by the proposal.

The proposal is based on an overly simplistic model of the petroleum industry’s distribution system. It does not accurately reflect all of the permutations of transactions and traditional movements of petroleum products from the refinery/import gate to the ultimate end-user. Capturing those volumes would result in a complex and cumbersome system. Tracking of product to the ultimate end-user is not currently done by the petroleum industry and could prove to be impossible. In addition, the proposed Initiative would impose significant increased costs on the regulated community. They, in turn, would be passed on to consumers and businesses in the region and would likely have adverse effects on the region’s economy. Members of the Association believe that the proposed program is unworkable and should not be adopted.

I. Potential Adverse Consequences

A. Cost of the program: No one yet knows the cost of the TCI. Nevertheless, as it has been preliminarily proposed, it appears that the program could result in difficulty in moving product, possible disruption of supply operations or loss of supply, inefficiencies, and substantial increased compliance costs. These increased costs are essentially a tax – raising prices at the pump and thereby negatively impacting individuals and commerce.

B. Difficulty Moving Product: TCI would establish a legislative/regulatory framework for the program. However, under TCI each state would adopt its own regulations to implement the Initiative. There is no guarantee that there would be uniformity among the states. Adoption of different standards and rules would make the transportation of product from one state to another burdensome and costly.

In addition, tracking each sale to determine if the product sold is to be consumed within the state would be unmanageable. No such tracking is currently done by the industry, and companies would have to create entirely new systems for this purpose – a costly and complex process.

C. 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.

D. 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 would 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 were available from either the state (through auction) or on the secondary market, supply shortages could occur causing economic harm to consumers.

E. Cost of Allowances: It is not clear how the auctions and secondary market would establish the price of “allowances” in a timely manner to enable a marketer to set the price for its motor fuels. Without that information, marketers could be significantly disadvantaged – pricing their product based on outdated, inaccurate information.

F. Reduction of Greenhouse Gas Emissions: The TCI, as currently proposed, would not provide any direct reductions in greenhouse gas emissions. Unlike refiners, petroleum marketers are not able to reformulate product to reduce emissions. Moreover, petroleum marketers are not able to compel drivers to consume less product. Petroleum marketers serve only as distributors of product. They cannot reduce or offset the emissions associated with transportation fuels.

G. 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 regulated community would need to hire additional staff or outside consultants to deal with such additional obligations. 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 its objectives and will only create a cumbersome and inefficient system. The states of the Northeast and Mid-Atlantic should find a simpler way of reducing greenhouse gas emissions from the transportation sector. The proposed TCI is not workable.

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

A. Point of Obligation

1. Prime Supplier

While the Association understands that no decision has been made, documents explaining the TCI proposal have indicated that participating states are inclined to employ the Energy Information Administration (“EIA”) definition of “Prime Supplier” to

designate the obligated parties required to obtain allowances to cover sales of motor fuels. Use of the “Prime Supplier” model would not be an effective approach. Prime Supplier is the point of obligation only for a federal reporting system. It is not a comprehensive regulatory regime. Companies move in and out of prime supplier status because the “Prime Supplier” designation is based on specific sales activity in a given month. It would be very difficult, time-consuming, and costly to track each sale to verify which entities are prime suppliers in each state and therefore subject to the TCI program. Because the point of obligation would be subject to regular changes within the distribution system, use of a system based on “prime suppliers” would lead to inaccuracies and unintended non-compliance. Such a system should not be adopted.

2. Federal Motor Fuels Excise Tax

If there must be a TCI, the states should adopt a system that mirrors the existing federal excise tax program applicable to sales of gasoline and on-road diesel. This system has been in place for more than 25 years, and it is well understood by the regulated community. Petroleum terminals are registered with the Internal Revenue Service (“IRS”). If product moves from one registered terminal to another registered terminal, there is no tax. Tax is imposed when the product crosses the terminal rack (the distribution platform) and flows into a truck. The taxpayer is the “position holder” – the party responsible on the terminal’s books for storage of the product at the facility. In most cases, this entity is the owner of the petroleum product immediately before it goes over the terminal rack. In addition, the IRS has established regulations and rulings about which parties are obligated to pay the tax in a number of situations, including when product is exchanged among petroleum marketers.

Because the federal excise tax system is well understood by the industry and has already addressed many issues relating to the distribution of motor fuels and application of such taxes, it could be adopted for use in the TCI. It would ensure greater accuracy of volumes and far better compliance than a program based on the EIA’s reporting program for “prime suppliers.”

3. First Enterer Into a State

In addition to sales from the terminal rack, there are circumstances in which product is trucked into a state or entered by other modes of transportation. To capture those volumes, a state would have to impose the allowance obligation on the “first enterer,” assuming that the product is to be consumed in the state. The first enterer will only know where the fuel is to be consumed if that marketer is making the sale directly. If the first enterer sells the fuel to a third party, it will have no knowledge of the destination of the product. Therefore, states participating in the TCI should require by regulation that such buyers provide the first enterer with the state of destination/consumption.

However, the TCI regulatory program should not impose a requirement that obligates a first enterer to track the destination of a cargo. The tracking of product would impose an intolerable compliance burden on these businesses.

Accordingly, a reasonably efficient system would combine both the federal excise tax model using the “position holder” at a terminal and the “first enterer” system for product brought into a state without moving through a terminal in that state – again without requirements that result in the tracking of each sale.

B. Uniformity and Fungibility of Allowances

As indicated, if different states within the TCI region adopt different rules of implementation, there would be operational problems associated with moving product throughout the region. Therefore, if the states decide to move forward with the Initiative, TCI should develop a model rule for use by all of the participating states. Unless there is regulatory uniformity, supply problems could develop and consumers and businesses would suffer. In addition, fungibility of all allowances from all participating states would enhance the proposed trading program.

C. Publication of Real Time Data on Allowance Prices

It is essential for petroleum marketers to know the cost of each element associated with their product so that they can properly establish their selling price. Therefore, TCI should establish a website showing in real time the cost of allowances. Only with access to such information in a timely manner can marketers operate efficiently.

D. Confidentiality of Allowances Used to Demonstrate Compliance

Some regulators have told interested parties that the total volume of allowances held by obligated parties in their “bank accounts” would be treated as confidential while the volume of allowances used to demonstrate compliance each year (allowances held in their “compliance accounts”) would be made available to the public. This approach fails to recognize that competitors can derive a company’s sales volumes by reviewing the volume of allowances in these “compliance accounts.” While this information may be available from some public companies, it is generally not available from privately-held companies and could place such companies at a competitive disadvantage. Therefore, information about the amount of allowances held in both types of accounts should be considered “business confidential information” and not released to the public.

E. Reporting Obligations

In various documents and presentations about TCI, it was indicated that the program would require the submission of a substantial number of new reports from obligated parties. The petroleum industry is already overwhelmed with reporting requirements, and in most instances companies are forced to hire a team of employees to meet such obligations or retain outside consulting firms to fill this role. Both of these

options are quite costly. Therefore, if TCI were to impose reporting requirements, those reports should mirror other federal programs so that companies can simply duplicate the information already provided.

III. Conclusion

For the reasons stated above, the Association recommends that states in the TCI region not adopt the proposed plan for reducing greenhouse gas emissions in the transportation sector. The program would be complex, lead to inefficiencies, operational difficulties, and possibly supply problems.

If, however, states in the Northeast and Mid-Atlantic decide to proceed with the Initiative, then it should be modified as suggested to (1) use the federal excise tax program as the basis for a TCI system "point of obligation;" (2) develop model rules for implementation that all participating states would be required to follow; (3) publish information about the cost of allowances in real time for use by participants in the program; (4) treat all information about the volumes of allowances held by obligated parties and used by those parties to demonstrate compliance as "business confidential information;" and (5) minimize any reporting obligations by mirroring existing reports required by the federal government with which obligated parties already comply.

The Association recognizes the region's desire to reduce greenhouse gas emissions, but the TCI proposal is not the correct approach to achieving that objective.