

COMMITTEE WORKSHOP
BEFORE THE
CALIFORNIA ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION

In the Matter of:)
)
Implementation of Assembly Bill 868) Docket No.
(Davis, Chapter 398, Statutes of 2007) 07-HFS-1
)
AB-868 Fuel Delivery Temperature)
Study)
_____)

CALIFORNIA ENERGY COMMISSION
HEARING ROOM A
1516 NINTH STREET
SACRAMENTO, CALIFORNIA

TUESDAY, DECEMBER 9, 2008

9:13 A.M.

ORIGINAL

Reported by:
Peter Petty
Contract No. 150-07-001

COMMISSIONERS PRESENT

James D. Boyd, Presiding Member

Karen Douglas, Associate Member

ADVISORS and STAFF PRESENT

Susan Brown, Advisor

Diana Schwyzer, Advisor

Gordon Schremp, Project Manager

Nicholas R. Janusch

ALSO PRESENT

John Siebert
Owner-Operator Independent Drivers Association
Foundation

Michael A. Flynn
LECG

Kevin Murphy
University of Chicago

Thomas Robinson
Robinson Oil Corporation

Jay McKeeman
Pacific Oil Conference
California Independent Oil Marketers Association
Petroleum Marketers Association of America

Judy Dugan
Consumer Watchdog
The Foundation for Taxpayer and Consumer Rights

Dale Boyett
Boyett Petroleum

Carl Boyett
Boyett Petroleum
Society of Independent Gasoline Marketers of
America

ALSO PRESENT

David Smith (via teleconference)
BP America, Inc.

Edmund E. Williams
Department of Food and Agriculture
Division of Measurement Standards
State of California

Kurt E. Floren, Agricultural Commissioner
Department of Weights and Measures
County of Los Angeles

John Eichberger
National Association of Convenience Stores

Ross Anderson (via teleconference)
Department of Agriculture and Markets
State of New York

Ernest J. Getto
Latham and Watkins, LLP

Ken Lake
Department of Food and Agriculture
Division of Measurement Standards
State of California

Tristan L. Duncan, Attorney
Shook, Hardy and Bacon, LLP

Prentiss E. Searles
American Petroleum Institute

I N D E X

	Page
Proceedings	1
Opening Remarks	1
Introductions	1,5
Presiding Member Boyd	1
Associate Member Douglas	4
Workshop Protocol	4
AB-868, Report Summary	8
Gordon Schremp, CEC	8
Afternoon Session	125
Stakeholder Presentations	126
LECG, Michael A. Flynn	127
Owner/Operator Independent Drivers Association, John Siebert	169
University of Chicago, Kevin Murphy	182
Public Comment/Discussion	214
Closing Remarks	223
Presiding Member Boyd	223
Adjournment	223
Certificate of Reporter	224

P R O C E E D I N G S

9:13 a.m.

PRESIDING MEMBER BOYD: Good morning, everybody. Welcome to the Energy Commission and this workshop on the staff draft report of the fuel delivery temperature study. This is a Transportation Committee workshop.

I'm Jim Boyd, Chair of the Transportation Committee, and Presiding Member of same. And to my immediate right is Commissioner Douglas, the Associate Member. To my left is my Advisor, Susan Brown. To Commissioner Douglas' right is her Advisor, Diana Schwyzer.

With those introductions, just a few comments on the workshop before I turn it over to the staff. This is billed as a Committee workshop, however it's a workshop to receive public input on the staff's draft fuel delivery temperature study report, which report is required by Assembly Bill 868.

So the purpose of the workshop today is to -- which was well indicated in the notice -- is to obtain public and stakeholder comment on the staff draft report. This is not a formal hearing; this is a workshop. So we solicit and request

1 free-flowing comment today as much as possible.

2 The makeup of this room makes it seem
3 more formal than we intended to be, but it is a
4 workshop.

5 The legislation, as you all know,
6 directed the Energy Commission, in consultation
7 with other agencies, including Food and
8 Agriculture and the Air Resources Board, to
9 perform hopefully a comprehensive study on fuel
10 delivery temperatures, their effects on gasoline
11 and diesel fuel volumes. And that was to include
12 a survey of retail fuel dispensers.

13 The legislation requires the Energy
14 Commission report back to the Legislature on our
15 recommendations, including any recommendations for
16 legislation, for legislative changes, if warranted
17 in this particular situation, on the issues -- or
18 I should say, one of the issues before us today is
19 the question of whether consumers of gasoline and
20 diesel fuel are being unfairly treated at the
21 pump.

22 Another question is would the potential
23 benefits to consumers of installing automatic
24 temperature control equipment at retail service
25 stations, or of establishing a new reference

1 temperature, would those benefits outweigh the
2 costs or potential costs to consumers, businesses
3 and to government agencies at all levels in the
4 said process.

5 So, our Committee is interested in a
6 fair and balanced consideration of the issues and
7 the options that were required in the legislation.

8 So, again, I say we're asking today for
9 comments on the staff's draft report issued on
10 November 26th, which presents their point of view
11 on the costs of potential benefits and which
12 report can, and undoubtedly will, be revised based
13 on input received at this workshop today.

14 Commissioner Douglas and I certainly
15 welcome your input today, but remind you that you
16 have the option also of submitting comments in
17 writing. And there's a deadline on written
18 comments of January 5, 2009.

19 The Committee will consider all the
20 information that's heard today, along with the
21 written submittals by all parties. And also then
22 consider any changes staff should make in their
23 draft staff report before the Committee, itself,
24 puts forth a recommendation to the full Commission
25 for the Commission's consideration.

1 Let me assure you that this Committee
2 takes its work seriously. We understand that the
3 results of the study being done in California can
4 certainly affect actions in other places, actions
5 taken by the states. Even actions taken at the
6 national level.

7 So, what we have to do here today and in
8 the immediate future is important to lots of
9 people in lots of places.

10 With that, I would ask if Commissioner
11 Douglas would like to make some comments. And
12 then we'll turn the workshop back to the staff and
13 Mr. Schremp will lead off. Commissioner Douglas?

14 ASSOCIATE MEMBER DOUGLAS: I just wanted
15 to briefly echo Commissioner Boyd in welcoming
16 everybody to the Committee workshop today. We
17 look forward to your comments. There's
18 considerable interest in this report, and I think
19 that's reflected in the participation we have
20 today. So we look forward to hearing from you.
21 Thank you.

22 PRESIDING MEMBER BOYD: Gordon, turn it
23 over to you.

24 MR. SCHREMP: Thank you, Commissioner
25 Boyd. Welcome, Commissioners, Advisors, ladies

1 and gentlemen and everybody online. I'm going to
2 cover a few housekeeping items before we get going
3 with my presentation.

4 First of all, I have a mandatory
5 statement to read. For those of you not familiar
6 with this building, the closest restrooms are
7 located outside these doors, slightly to your
8 left. There is also a snack bar on the second
9 floor, up the stairs under the white awning.

10 And lastly, in the event of an emergency
11 and the building is evacuated, please follow our
12 employees to the appropriate exits. So if you can
13 keep up with me --

14 (Laughter.)

15 MR. SCHREMP: -- I'll be going over to
16 Roosevelt Park across the street. It also says
17 please proceed calmly and quickly, again,
18 following the employees. Okay? Those are the
19 main housekeeping.

20 We also have some introductions. I'm
21 Gordon Schremp; I'm the Project Lead on this
22 study. I've been at the Energy Commission going
23 on 19 years now. I'm in the fuels and
24 transportation division.

25 I'd like to introduce a few other folks

1 that have been part of our team, because, after
2 all, this is a team effort. And if you could
3 please raise your hand.

4 And that would be Sherry Stoner over
5 there. And we have Gerald Zipay back here, raise
6 your hand. And Laura Lawson and Paul Deaver is --
7 he's hiding out in the back there. And Nick
8 Janusch. So those are all of the folks that have
9 been on the team; have been working toward getting
10 the product, multiple workshops, as well as the
11 staff document, you have before you.

12 So I want to thank them for all their
13 hard work, because, once again, without their
14 participation we wouldn't have a document for you
15 guys today.

16 Questions, I guess I'd question back to
17 the Commissioners, is how would they like to
18 handle questions. Would you prefer to have Q&A
19 while the presentation is going on, or hold
20 questions until the end of my presentation?

21 PRESIDING MEMBER BOYD: How would you
22 like it done? This is a workshop, and my first
23 reaction is to solicit interruptions. But, it's a
24 question of how comfortable folks are. I think in
25 a workshop setting if somebody has a question

1 based on something that was just said, that's the
2 time to ask the question, if you don't mind,
3 Gordon.

4 MR. SCHREMP: In fact, thank you,
5 Commissioner. That is actually our preference, to
6 be interrupted. There's a lot of material --

7 PRESIDING MEMBER BOYD: Something about
8 great minds --

9 MR. SCHREMP: Yeah. And I believe for
10 the court reporter purposes, questions would have
11 to be asked by coming to the center dais. Is that
12 correct? Yes.

13 So, --

14 PRESIDING MEMBER BOYD: You need to be
15 at a microphone, so feel free to leap up and race
16 to the most close microphone there to get your
17 question on the record.

18 MR. SCHREMP: And the sequence of
19 questions we'd like to take certainly is questions
20 from Commissioners or questions from the people
21 here in the audience. Questions from those online
22 on the WebEx. And those people are able to signal
23 they have a question by raising their hand
24 electronically.

25 And lastly, at certain junctures we will

1 open up the telephone lines for people that are
2 just phoning in to have a question. So we'll try
3 to do that periodically as we get to some natural
4 stops in the presentation.

5 So I think that about does it for how we
6 intend to proceed today. And just to echo the
7 Commissioner's comments, we look forward to your
8 input and, you know, we depend on your input
9 because, after all, all of you folks are in the
10 affected industry and representing consumer groups
11 that have a lot of expertise in your various
12 areas. So that's what we'd like to hear today
13 certainly.

14 Okay, hopefully everyone online can see
15 this slide, and everyone can hear me. I've
16 already introduced myself. We'll continue on our
17 merry way.

18 Here are the topics we intend to cover
19 today in their general headings. We'll go through
20 the temperature and density information. We'll
21 cover our benefit calculations. And we'll also
22 look at the cost of this program that we
23 anticipate under two different options.

24 We'll also look at what the cost/benefit
25 analysis results are. Let me do this, this little

1 dimmer. Can people see the screen okay here? All
2 right.

3 And then we want to talk about what the
4 circumstances might be for potential net benefits.
5 And that's if you change some of the assumptions a
6 little bit in the recurring costs. And then we'll
7 talk a little bit about permissive or voluntary
8 versus mandatory temperature compensation at
9 retail.

10 And then there's some other issues
11 associated with temperature compensation we want
12 to touch on. And then we'll talk about some next
13 steps, which I believe Commissioner Boyd has
14 already talked about in general terms.

15 A lot of you have been following this
16 issue for a number of years, and have been closely
17 following our progress on the topic as we
18 culminate it with this staff report.

19 But essentially the background for this
20 is liquids expand and contract. That's no
21 surprise. The petroleum industry recognizes this
22 and therefore they have a reference standard of 60
23 degree by which they consummate wholesale
24 transactions, to a large extent.

25 And earlier work has examined

1 temperature of fuel at retail locations. And the
2 earlier NIST studies, which we've talked about
3 before, show that there are some colder states, as
4 well as some warmer states. And California could
5 best be characterized as one of those warmer
6 states. And that meaning on average the fuel
7 temperature is above that 60 degree reference
8 level.

9 We use certain units of measure in the
10 study interchangeably. They're not meant to be
11 the same. We use them in their proper context,
12 but I'll just cover a little bit of vocabulary, if
13 you will.

14 Gross and net gallons are terms you've
15 heard, or U.S. gallons for gross, and you'll also
16 hear petroleum gallons for net. So gross gallon,
17 I think the main distinction is that that's 231
18 cubic inches regardless of temperature. So if
19 it's a warm fuel, 231; if it's a colder fuel than
20 60, 231. That's the gross gallon. That's the
21 type of gallon that's measured at retail in
22 California.

23 Net gallons are those transacted at
24 wholesale terminals are only 231 cubic inches at
25 60 degree Fahrenheit. There is a calculation, and

1 I'll get into this in a minute, that is undertaken
2 to determine what the value or the cost of the
3 load will be based on the temperature of the fuel
4 at wholesale, but not at retail.

5 And I think there's been at times
6 discussion about what temperature compensation
7 might be. It's in some ways almost changing the
8 size of the gallon being dispensed at wholesale --
9 I mean, excuse me, at retail.

10 And I think on the average that's
11 correct. It would be a larger gallon being
12 dispensed at retail on average. But I think the
13 distinction is -- the important distinction is
14 this is not simply as simple as a change to say
15 the metric system, where you make a permanent
16 change and the size of the gallon being dispensed
17 at retail.

18 Temperature compensation at retail would
19 result in a varying size gallon. The warmer it is
20 the larger the gallon as measured in cubic inches.
21 The colder it is, the smaller the gallon is,
22 measured in cubic inches. So it's not as simple
23 as going to, say, metric system.

24 And I think, as you would see in the
25 metric system, you would always have a fixed

1 quantity in terms of cubic inches because there's
2 no compensation for temperature variation.

3 And I'll talk a little bit about the
4 reference temperature example. And that is
5 changing the fixed quantity dispensed at retail
6 regardless of temperature. That's the Hawaii
7 example.

8 As I mentioned at wholesale there's
9 essentially a price adjustment, or final cost for
10 load adjustment. There's a loading of the truck
11 in gross gallons. There's a measurement of
12 temperature and there is a density value that is
13 either known or assumed for that loading event.

14 And then there's a calculation of what
15 the net gallons would have been. And then that
16 net gallon is multiplied by the posted net price.
17 And so you end up with a total cost for the load.

18 At retail temperature compensation would
19 not involve that type of calculation. Rather the
20 devices installed at retail would measure the
21 temperature and then adjust the quantity of fuel
22 being dispensed accordingly. If it's warmer, a
23 little bit larger, you know, units of gallons.
24 And if it's colder than 60, smaller.

25 And so the cubic inches will vary being

1 dispensed for the loading event. And so what's
2 being paid by the consumer is basically the net
3 gallons at that point. So that's a volume
4 adjustment.

5 So there is a difference in the
6 distinction between the two types of temperature
7 compensation.

8 There are -- temperature compensation
9 does exist at retail in other locations. In
10 Hawaii. This is one of the options examined in
11 the report, and that's a new reference
12 temperature.

13 Essentially in Hawaii they measured the
14 fuel temperatures and they determined or settled
15 upon an 80-degree reference temperature. And they
16 said, okay, well, what would be the size of the
17 gallon at 80 degrees. How much would it expand
18 to. And that's almost 234 cubic inches.

19 So that all the dispensers over time
20 were adjusted to dispense day-in and day-out 233.8
21 rather than 231. And so that's what was done in
22 Hawaii.

23 So is there still temperature variation
24 in Hawaii? Yes, there is. Sometimes it's warmer,
25 sometimes it's colder. But Hawaii is, I think,

1 more of a unique situation. It's a temperature
2 variation that's much smaller in Hawaii because of
3 its geographic scope is much more modest, as well
4 as the proximity of service stations to sea level.
5 There's no great geographic and change in altitude
6 as there is in California. So, I could see why
7 some people may have thought this was a good
8 approach to take.

9 In Canada there was permissive or
10 voluntary temperature compensation allowed at
11 retail. This was able to come about by
12 technological innovation in the late 1980s that
13 reduced the cost of the equipment and made it more
14 amenable to being installed at retail, retail
15 dispensers.

16 And the fuel in Canada on average is
17 colder than the reference temperature. And so
18 retailers, early on, say, well, I'll invest in
19 this equipment; it will change the size of the
20 gallon or liter being dispensed, and be slightly
21 smaller.

22 And so there were some early adopters,
23 and as well as there's some advantage of
24 dispensing a slightly smaller gallon.

25 There is no labeling requirement on the

1 big signs in Canada, but there is on the
2 dispenser. So consumers could become aware that
3 the temperature -- the service station had
4 temperature compensation by looking at the
5 dispenser, itself. There's a labeling requirement
6 in Canada.

7 Belgium, more recently, has passed
8 temperature compensation at retail, and is now
9 beginning to be phased in at their retail
10 stations. And that's for the existing stations.
11 All new stations, I believe beginning this year,
12 had to be temperature compensated at retail.

13 So we do have examples throughout the
14 world where temperature compensation has been
15 undertaken.

16 The objectives. The primary objective
17 is does temperature compensation for the two
18 options examined make economic sense. And that is
19 do the benefits for consumers outweigh the costs
20 to industry. Or do the costs outweigh the
21 benefits. And so that's what we're supposed to
22 look at.

23 And we examined those two options, we
24 called them, one is ATC retrofit and the other is
25 reference temperature, the Hawaii example.

1 And we have quantified benefits and
2 costs and then looked at them over time in the
3 cost/benefit analysis stream of ten years. So
4 what we'll present a little later in these slides
5 is the results of those findings.

6 And as Commissioner Boyd mentioned, the
7 final step is to actually provide a revised
8 Commission report to the Commission at a business
9 meeting for a vote on adoption.

10 Temperature. I'll transition into a lot
11 of the temperature work. Temperature sampling had
12 been going on between essentially April 2007
13 through March of 2008. The county sealers, the
14 individuals who inspect and certify, among other
15 things, that the fuel dispensed at retail is
16 properly calibrated. They were requested to, when
17 they make a normal visit to a location, to take
18 some temperature samples of fuel, as well as air
19 temperature.

20 The Division of Measurement Standards
21 has provided us with that dataset. We have used
22 the dataset to do the analysis and come up with
23 some statewide averages, as well as some
24 variations in temperature that one might see at
25 retail.

1 And although not all the counties had
2 data representation, the counties that did were,
3 in large part, the main consuming areas in the
4 state for fuel. So that's why those counties are
5 about 85 percent of the gasoline sales or gasoline
6 demand, and thus 78 percent of diesel fuel. So I
7 think an overwhelming sample representative of the
8 state from a consumption perspective.

9 Three types of temperature measurements
10 were taken. The air, the fuel stored underground
11 in underground storage tank, and the fuel that
12 came out of the nozzle.

13 Now, we talk about nozzles, we talk
14 about prover. The prover is essentially the
15 receptacle that the fuel goes in out of the nozzle
16 that the sealers will use to determine if pumps
17 are properly calibrated, by the amount of fuel
18 that they measure and they compare to the
19 reference marks.

20 So the prover temperatures were
21 essentially, you take five gallons out of the
22 dispenser, then you take another five gallons and
23 that's where you take the temperature from.

24 So only about 20 percent of the time
25 they would take a temperature when they made a

1 visit. And there were no temperatures taken for
2 mid-grade gasoline, 89 octane. And that's because
3 in most locations there is no underground storage
4 tank holding mid-grade because mid-grade is
5 normally created by blending premium and regular
6 grade at the nozzle. There are no mid-grade
7 samples.

8 And we assumed, for the sake of this,
9 for gasoline purposes, that 6 percent of the
10 gasoline contained ethanol, when we did this.

11 This slide is just meant to show you the
12 three different temperature locations. The air
13 temperature is here. That's not the exhaust from
14 the diesel truck, that's an air temperature.
15 Prover out of the dispenser and the underground
16 storage tank.

17 We did not obtain data in this
18 collection process from tanker truck deliveries
19 because it would only be a coincidence the tanker
20 truck would be there when the sealer was making
21 their normal rounds. So, we do not have that
22 information at this point.

23 Here are the results of not only the
24 earlier NIST work in these white boxes up here, an
25 average of almost 75 degrees statewide. And then

1 we have some averages from the dataset over the
2 period I mentioned, April 2007 through March 2008.

3 You'll notice that the temperatures are
4 lower. And I also have this line of arithmetic
5 mean. We're just taking all of the temperatures,
6 adding them up and dividing by the number of
7 temperatures. There is no attempt to adjust for,
8 well, that temperature's from a county that has a
9 large demand for gasoline, and that temperature's
10 from a county that has a very small. Are they
11 weighted the same? No, they're not.

12 So we actually re-weighted the
13 information and that's why you see in these yellow
14 boxes the average statewide temperature on a
15 weighted basis. It's 71.1 for regular. A little
16 bit higher for premium. And a little bit higher
17 for diesel fuel. And we believe this has
18 something to do with the steadily increasing
19 density of the fuel.

20 The coldest temperatures on average
21 statewide were always in January. And as you can
22 see, a little below the reference standard of 60
23 for regular premium gasoline. And in August, the
24 warmest time of the year for fuel and ambient
25 temperatures, over 82 degrees at a minimum. So a

1 large fluctuation, but on average 71 degrees year-
2 round.

3 This just graphically represents the
4 month-to-month variation, the rise up through peak
5 in August, and then decline to low point in
6 January. And as you can see, the difference
7 between sort of the hierarchy, if you will,
8 regular is usually the coldest temperature;
9 premium is a little bit warmer; and diesel is the
10 highest.

11 These are just some more numbers.
12 They're in your report. We just want to
13 illustrate the fact that some locations, some
14 counties had some pretty high average
15 temperatures. From those, 80, almost 90 degrees
16 in Riverside County for July, actually not even
17 August. And some counties have pretty cold
18 temperatures, Amador County 43 degrees in January.

19 And then there's some -- I'm sorry, 50
20 degrees in Butte County for the average. Lowest
21 recorded temperature 43 degrees in Amador County
22 and 102 degrees was the highest.

23 Now, some of you have looked through the
24 dataset. We saw some datapoints that didn't make
25 sense. Not very many, less than two dozen. Those

1 are documented in our report in the appendix,
2 which piece of information we felt should have
3 been tossed out. There are only a couple of
4 those. I think one was a 4 degree temperature
5 that we thought was an oversight, especially I
6 think it was in May. So don't know, cryogenic
7 storage of gasoline is probably expensive. So we
8 threw that one out. But we detailed what we did
9 so that way people could replicate what we did
10 with our arithmetic and weighted averages.

11 Same sort of thing for diesel, just
12 usually a little bit warmer. But colder
13 temperatures are a little bit higher and the
14 warmer temperatures are even a little bit higher.
15 92 degrees for the month in Fresno in August,
16 pretty warm on average. And 107 degree
17 temperature in Riverside in July for diesel fuel.
18 So that's pretty high.

19 As I mentioned, not all of the counties
20 had representation, but the dominant consumption
21 average for the state did have temperature
22 representation for fuel.

23 And so staff looked at is there a
24 relationship between what the temperature is just
25 on a daily basis, and what the fuel temperature is

1 at retail.

2 And so looking at the analysis, doing
3 statistical analysis, which, of course, is also in
4 -- the results of that are in the report -- we
5 believe that there is quite a strong relationship
6 between the average ambient temperature and the
7 fuel temperature, the fuel dispenser or fuel
8 prover temperature.

9 About 76 percent of the temperature
10 variation for regular gasoline -- and 87 percent
11 for regular and 76 for diesel is explained by this
12 relationship.

13 So using that relationship we then
14 populated the rest of the counties and months that
15 had missing data. And actually the average, as I
16 showed you on the previous couple slides, are the
17 result of having populated all the counties with
18 that information.

19 And so, like I said, 15 percent of the
20 gasoline demand in those counties was estimated.

21 Yes, can you come up to the microphone,
22 please?

23 MR. ROBINSON: Just a quick question,
24 you can repeat it. Were any of the tanks that you
25 sampled aboveground tanks, or were they all

1 underground?

2 MR. SCHREMP: Question asked from the
3 audience, were any of the storage tanks
4 aboveground tanks, or were they all underground
5 storage tanks. We believe they were all
6 underground storage tanks that were sampled. But
7 if there's some information that someone has now,
8 or wants to provide to us following the workshop,
9 we'll attend to that comment in the report. But I
10 think that's our belief.

11 But, yeah, that's a good question, Tom,
12 especially with regard to a very warm temperature
13 in say, Riverside County of almost 107 degrees.
14 Was that an aboveground tank sitting out in the
15 sun. So, but I believe they were underground
16 storage tanks.

17 These next two slides were just meant to
18 illustrate sort of how close the estimation is for
19 multi temperatures to actual data. And so this is
20 Alameda County. And so you look at the slide and
21 you go, well, the predicted temperature looks like
22 it's a little bit warmer. So does your
23 relationship show it's a little bit warmer. Well,
24 yeah, for Amador County. But for Los Angeles
25 County it shows it's a little bit colder. So this

1 just goes to show that it's sometimes a little bit
2 above, sometimes a little bit below depending on
3 the county where we have the actual data for that
4 county.

5 We also looked at does the temperature
6 vary extensively from the point of being in the
7 underground storage tank to being dispensed at the
8 nozzle. In the summer does it warm up a lot; in
9 the winter does it cool down a lot. You know,
10 what kind of variation do you see there.

11 In the data you'll see that there are
12 temperature differences because they go to the
13 service station, will take a sample of underground
14 tank and do the prover almost nearly at the same
15 time. And so we've seen differences of up to 20
16 degrees. So that's a pretty wide variation.

17 But actually when you start looking at
18 the data, pairing those up together, you go, well,
19 most of those differences are fairly small; 70
20 percent are within plus or minus 3 degrees. And
21 about 95 percent are within plus or minus 7
22 degrees, as illustrated by this histogram.

23 So you can see these three slides or
24 these three sets of data, instances in the middle,
25 that's 70 percent all within plus or minus 3

1 degrees. So there's a very tight grouping. You
2 do have some outliers, yes, but predominately day-
3 in and day-out, month-in and month-out the fuel is
4 quite close to what the underground storage tank
5 temperature is. The variation is not that much.

6 Diesel fuel, there is -- I guess the
7 groupings are a little bit flatter and spread out
8 just a little bit more; they're not as tight a
9 grouping. But still predominately 85 percent are
10 within plus or minus 7 degrees. So it's a very
11 tight grouping, so not an extreme amount of
12 variation occurring in any particular month or
13 day.

14 Fuel density is, I think -- the reason
15 we care about fuel density is fuel density is used
16 to determine how much a liquid will expand or
17 contract depending on changing temperature. And
18 they use fuel density to preprogram software for
19 the devices in Canada. So they have an assumed
20 density for gasoline, one value; and they have an
21 assumed density for diesel fuel, one value.

22 And so we looked at, well, would that
23 value be appropriate for use in California. Would
24 multiple values be appropriate for use in
25 California. So that's why we wanted to look at

1 density, and how much that would matter.

2 And so this result compares the
3 California gasoline average is pretty close to
4 about the U.S. average. And the Canadian, I point
5 out, the reference standard that they use is the
6 very far low end of the density range actually in
7 Canada, about .73 mg/liter. So this is -- or
8 g/liter, excuse me -- this shows the dispersion of
9 density from high and low, as well as the
10 averages. And shows the Canadian values outside
11 the band, sort of outside the low end.

12 And then for diesel fuel the Canadian
13 reference standard is pretty much smack in the
14 middle between U.S. and California averages.
15 California diesel fuel is slightly less dense than
16 USEPA diesel used in 49 states. But looks like
17 the Canadian average is pretty much right in the
18 middle.

19 So, those two fuels, density for diesel
20 fuel seems that's an appropriate level to use
21 because it's sort of right in the middle of the
22 average. The density for gasoline seemed to be a
23 bit low.

24 We also looked at other densities and
25 this was in the context of essentially alternative

1 fuels. The Legislature required us to look and
2 consider what will be the potential impacts of
3 increasing renewable fuels, as well as the low
4 carbon fuel standard being considered by the
5 California Air Resources Board, being developed, I
6 should say, that regulation.

7 And staff's take on that is that the
8 concentration of low-level renewable fuel blends
9 in gas and diesel will both rise over time. And
10 the total amount of ethanol and total amount of
11 biodiesel or renewable diesel will increase for a
12 couple of different reasons.

13 The renewable fuel standard, the
14 national standard, is driving the increasing use
15 of ethanol in California and other parts of the
16 United States. That's one driver.

17 The low carbon fuel standard is
18 anticipated to result in increased use of
19 renewable fuels. That's another driver to
20 increase those concentrations.

21 So staff looked at that obligation, if
22 you will, from the legislation as what would
23 happen if those fuels increased. And so this is
24 really a density issue.

25 So, I think for blends up to 10 percent

1 of ethanol you can come up with one gasoline,
2 average gasoline, quantity. But it should be at
3 10 percent. But if there is going to be
4 temperature compensation at retail, and there are
5 sales currently of E-85, and we anticipate those
6 will increase, that there should be a different
7 density designation certainly for E-85. And that,
8 as well, goes for B-100, or 100 percent biodiesel,
9 pure biodiesel, because the densities are
10 sufficiently different from that of gasoline or
11 from diesel fuel in general.

12 I believe in Canada right now they allow
13 to B-20 with the same density as diesel fuel. In
14 fact, they have no different density standard for
15 B-100. And so you use that same one for those
16 locations that might have that.

17 MS. BROWN: Gordon, can I ask a
18 question?

19 MR. SCHREMP: Yes, Susan.

20 MS. BROWN: What, in general, would be
21 the impact of increasing ethanol volumes in
22 gasoline on volume and temperature?

23 MR. SCHREMP: Not quite sure what
24 happened to temperature. I'm sure there might be
25 some slightly different behavior that ethanol

1 might have as a higher concentration of ethanol
2 because of ambient temperature.

3 But probably pretty close to gasoline.
4 Certainly the density of the fuel will change and
5 the energy content, or I guess the fuel economy
6 one might experience will change.

7 For example, E-85 fuel, on a gallon of
8 E-85 versus a gallon of gasoline say with 6
9 percent ethanol, there's about at least a 25
10 percent drop in fuel economy for that gallon of E-
11 85.

12 And so there's a fuel economy
13 difference, but that's how it's reacting in the
14 engine, if you will. But the temperature might
15 not vary that much.

16 But certainly because the density is
17 different, much different than E-85, if you were
18 to use the gasoline density when you did a volume
19 correction factor, it would be incorrect.

20 MS. BROWN: So in general you can't say
21 there's an upward trend in volume or a downward
22 trend, as ethanol volumes increase over time --

23 MR. SCHREMP: Sorry, I didn't answer
24 your question specifically. Yes, with regard to
25 the use of ethanol, ethanol use in California is

1 rising, has been rising. This year it's going to
2 be above 6 percent. Next year we think the amount
3 of ethanol in California on average will be over 9
4 percent, and close to 10 percent in gasoline.

5 So, yes, ethanol concentration is
6 rising. And that's, at this time, driven by the
7 renewable fuel standard, or RFS, on the federal
8 level. But in the future those levels could go up
9 higher, Susan, as a consequence of the low carbon
10 fuel standard, which has not yet been finalized.
11 So we don't quite know yet.

12 MS. BROWN: And the same question for
13 biodiesel. As we get higher blends of biodiesel,
14 do we have a sense of how the volume sold will be
15 affected, or the size of the volume sold will be
16 affected? Sounds like we don't.

17 MR. SCHREMP: Not associated with the
18 low carbon fuel standard. And right now I don't -
19 - the biodiesel blends are sort of mixed in with
20 the renewable fuel standard obligations, and
21 that's another way of meeting them. I don't have
22 an answer for you right now, but we can get one
23 for you, because of the RFS.

24 But I think the trend will be the same,
25 Susan. There will be a continued increase in the

1 use of also biodiesel in California.

2 PRESIDING MEMBER BOYD: Gordon, we're
3 beginning to drift from the main theme here by
4 referencing the low carbon fuel standard. And you
5 did say that possibly that could have an effect on
6 the volume of ethanol blended into gasoline.

7 But, as I understand it, under current
8 ARB regulations there is a 10 percent cap because
9 of criteria air pollutant concerns. And it seems
10 to me highly unlikely that in the near term
11 California will be changing that cap.

12 So, it does seem to me worrying about
13 anything above E-10 is not something we have to
14 spend a lot of time on in the near term, anyway.

15 MR. SCHREMP: That's correct,
16 Commissioner Boyd. There is an effective cap for
17 criteria pollutant purposes, vehicle warranty
18 purposes. USEPA has been conducting some work on
19 looking at low level blends that are higher than
20 10 percent, how might they affect tailpipe and
21 evaporative emissions. How might they affect wear
22 and tear on the engine, the operation of the
23 engine. I believe the E-15 and E-20 levels.

24 And so will there be a higher cap
25 possibly in the future, we don't know. So if

1 California does use more ethanol than say an
2 average of 10 percent, that would have to be
3 accomplished by increased sales of E-85 until that
4 cap is raised. That's correct, sir.

5 Moving on to costs. And these costs, we
6 expect that society, if you will, of the universe
7 that would be affected by these costs are retail
8 station owners. And the costs fall into how we
9 have broken them down, three primary categories.

10 There is an initial cost of the
11 equipment. It's going to require a certified
12 technician to install and make sure the equipment
13 is operating properly. And we've anticipated that
14 there'll be financing required. I don't know if
15 you can get any now anyway, that's a whole other
16 matter.

17 But those are the three main components.
18 So if you look at that, we've estimated in the low
19 side \$102 million statewide, one time. And \$123
20 million on the high side, one time, initial cost.

21 And so if you portion that out and want
22 to measure that in terms of gallons of gasoline
23 and diesel fuels, about five- to seven-tenths of a
24 cent for one year. That's the initial cost. Now,
25 I'll talk a little bit -- I have a little slide on

1 each one of those.

2 The reference temperature, the Hawaii
3 example, does have a cost. And that cost is to go
4 into the field and make an adjustment to that
5 dispenser. So, it's now permanently dispensing a
6 slightly larger quantity, 232.7 cubic inches
7 rather than 231. So that would take a technician
8 to go in the field.

9 And so we had a labor estimate of about
10 \$8 to \$24 million for one year. So those are the
11 initial cost estimates.

12 The fuel dispensers, to retrofit one
13 requires a different type of retrofit kit
14 depending on the attributes of the dispenser. So
15 how many fuels does it dispense? Does the
16 dispenser blend mid-grade or have a dedicated mid-
17 grade tank?

18 And so, as I mentioned earlier, 70
19 percent of the outlets in California, as far as we
20 can tell, blend mid-grade at the dispenser. And
21 about 11 percent of the retail outlets have at
22 least one mechanical dispenser. So there are
23 still some mechanical dispensers out there. But
24 over time those are being slowly replaced.

25 So, this table illustrates what the

1 estimated equipment costs are. Now, earlier on in
2 our work, and in fact, something that caused us to
3 stand the amount of time to do the analysis was we
4 were endeavoring to identify exact make and model.
5 Because early on our study that is how the
6 dispenser retrofit kits were priced, make and
7 model.

8 But recent developments by the industry
9 that produces these devices has gone, like I say,
10 evolved in the direction of universal retrofit
11 kits. And the universal kits are priced according
12 to how many fuels you dispense and if you blend or
13 not.

14 So that, later one, made our work a lot
15 easier. So then we just had to make sure we
16 identified all these appropriate attributes for
17 all nearly 10,000 locations in California.

18 So those are the average equipment costs
19 values we used for this analysis.

20 The labor component. We looked at a low
21 range of \$60 and a high range of \$70. We refer to
22 these as fully loaded rates. The technician does
23 not receive this wage. But that's of a sufficient
24 level to pay for insurance benefits, and overhead
25 for the company. So those are the rates we've

1 used, and if people have some input please let us
2 know if there is some better information out
3 there, what we should use instead.

4 We talked to the people who do
5 installation work. And we came up with
6 essentially two technicians that work as a team
7 most of the time doing this work. And if they're
8 pretty good at doing this, it could be as low as
9 an hour and a half to do a dispenser. And if
10 they're just starting out, four hours a dispense.

11 So, those are the two. So we used the
12 low wage rate and the least number of hours to get
13 our low estimate for labor. So then you'll see
14 that about \$8 million to \$24 million to retrofit
15 all the dispensers. So you put that in terms of
16 per station, it's less than \$1000, up to \$2500.

17 We also recognized that in some
18 instances technicians traveling to the more rural
19 locations of the state may require overnight
20 stays. And so we've included some additional
21 travel expenses. But as you can see, relative to
22 the \$8 million, we have an additional \$300,000
23 that's actually embedded in there. And the \$24
24 million, almost three-quarters of a million. So
25 it's not a lot, but there is some -- there was

1 some consideration about additional travel
2 expenses.

3 There's a question in the audience.

4 MR. McKEEMAN: Jay McKeeman, California
5 Independent Oil Marketers Association. It's our
6 understanding that the technicians get paid for
7 the time that they're traveling. So it's not just
8 a hotel stay. It may actually increase the total
9 cost of the labor involved for rural stations.

10 MR. SCHREMP: Okay, so essentially the
11 time they leave the shop, if they're in the local
12 area doing work during that day, until they get
13 back.

14 So the question is would that result in
15 increasing those rates, or is that certainly
16 captured in the overhead. So, if you guys have
17 some information on sort of what they charge, that
18 would be helpful.

19 MR. McKEEMAN: I think it's the hourly
20 rate that -- really I'm focusing on the rural
21 stations. For rural stations it would not just be
22 travel costs that are increased, it would be labor
23 costs that would be increased, as well, for the
24 rural stations.

25 MR. SCHREMP: So, in fact, if you're

1 traveling say four hours to a distant location, or
2 six hours, that's all on the clock, --

3 MR. McKEEMAN: Right.

4 MR. SCHREMP: -- besides what we
5 essentially have as overnight expenses on that
6 last bullet?

7 MR. McKEEMAN: Right. I've got one more
8 question, too, if that's okay? We earlier, at
9 junctures in these workshops, talked about
10 permitting costs. Did you take a look at whether
11 change-out of temperature compensation, or, you
12 know, temperature correction equipment would
13 require a permit, either from the local air
14 pollution control district or the CUPA?

15 MR. SCHREMP: We had no indications from
16 AQMDs that that would trigger a new permit for the
17 site. There is a higher fee associated with an
18 inspector coming and certifying the device is
19 properly working. But I know that's not what
20 you're asking, Jay.

21 MR. McKEEMAN: Okay, but you did ask the
22 question to --

23 MR. SCHREMP: To some of the AQMDs, the
24 large ones. And do you know of other AQMDs
25 that --

1 MR. McKEEMAN: I just was wondering if
2 the question was asked, that's all.

3 MR. SCHREMP: Yeah. Yes, we have
4 another question from the audience.

5 MS. DUGAN: Question, yeah. Judy Dugan
6 from Consumer Watchdog. When you're talking about
7 the mechanical pump stations, the rural stations
8 and the low-volume stations all having these
9 higher costs, there's so much overlap between
10 rural, mechanical and low-volume stations, what
11 happens to these calculations of per-station cost
12 if you remove, say the 15 percent lowest volume
13 stations from this?

14 And this is something we've discussed
15 throughout giving a pass or a much longer
16 timeframe, or some other benefit to these stations
17 that are generally serving unserved areas and have
18 a low volume of pass-through.

19 MR. SCHREMP: I think we've mostly, if
20 not partially, addressed that, Judy, when we
21 looked at --

22 MS. DUGAN: Yeah, I saw the partial
23 addressing of it.

24 MR. SCHREMP: Yeah -- potential stations
25 that might be at risk to closure. And that was in

1 the context of impacts on fuel availability for a
2 community.

3 So the other aspect of, say, a more
4 urban center where there are some stations that
5 have low through-put or predominately higher
6 mechanical dispenser costs, we did not look at
7 those locations as being, quote, at risk, as we
8 did the rural locations. Because in those
9 settings, the community would still have an
10 adequate source of fuel available to them if there
11 were some stations that they've closed. But we do
12 recognize that sort of the disproportionate burden
13 that might be on those locations because of their
14 lower through-put and use of mechanical
15 dispensers.

16 But we didn't completely address it in
17 terms of identifying those at risk in the urban
18 areas, no.

19 MS. DUGAN: Well, just I'd like to see,
20 these outliers add so much per capita per station
21 cost to your calculations, that if you were to
22 remove the bottom 15 percent, I mean I have some
23 other issues with the cost calculations, but I
24 think John is trying to discuss them.

25 But I would like to know what that would

1 come to. How much percentagewise that would take
2 down the per-station cost.

3 MR. SCHREMP: We could certainly look at
4 that calculation, Judy. I guess the question --
5 would you then be suggesting what would happen to
6 those 15 percent of the stations if ATC were
7 mandated. Would they be --

8 MS. DUGAN: Personally I don't care if
9 they ever switch. The ones that are mechanical
10 pumps are, when they finally change them over,
11 probably going to get pumps that are capable of
12 ATC anyhow, if we make them the standard.

13 I mean it's something that in many ways
14 would cure itself over time. But frankly, the
15 lowest 15 percent of input per station isn't
16 something that we couldn't live without in terms
17 of ATC.

18 MR. SCHREMP: Okay, like I said, we can
19 certainly look at how the numbers would change if
20 we did remove, say, a certain portion from the
21 calculation.

22 MS. DUGAN: Great, thanks.

23 MR. SCHREMP: You're welcome. I think
24 I'll transition, if we have no more labor cost
25 questions. We made an assumption that the monies

1 used to purchase the equipment and have the
2 equipment installed would be obtained through
3 short-term business loans.

4 In the high case the loan is paid back
5 in one year, and in the low case those loans pay
6 back over a three-year period of time.

7 We looked at a range of interest rates.
8 That's discussed in the financing section of the
9 report. Between 4 and 9.5 percent. On top of
10 that we added a 2 percent of loan value fee for,
11 you know, points and closing costs for the loan.

12 So, we effectively have an interest rate of 6
13 to 11.5 percent for our low and high.

14 And so we take that into consideration
15 in looking at an additional amount of money for
16 financing, about \$10 to \$13 million a year --
17 sorry, \$10 to \$13 million one year. But in the
18 low estimate we prorated those financial costs
19 paid out over a three-year period of time. But we
20 show that in the report as a one-year total cost.

21 There are some recurring costs that
22 would be -- well, first of all, recurring costs
23 under the reference temperature option, there are
24 none. Recurring costs under the ATC retrofit,
25 there are three types of recurring costs. Higher

1 inspection fees on a yearly basis. Higher cost
2 for dispensers. And higher cost for maintenance
3 of the ATC equipment only that we believe would be
4 a consequence of ATC retrofit if it's mandated.

5 On a per-station basis, about \$500 to
6 \$1400 per year, each and every year. This is a
7 recurring basis. And if you prorate that over the
8 fuel, it works out to be a rather small amount,
9 two-hundredths to seven-hundredths of a cent per
10 gallon.

11 In special fees we believe that the
12 inspection process, when the county sealer goes to
13 certify the accuracy of the fuel-dispensing
14 device, will require a bit more time, about 10 to
15 20 percent increase in the time. So, if people
16 think that's too high, or too low, please let us
17 know.

18 And assuming that there's a cap on the
19 fee of \$1000, we're looking at \$100 to \$200 a year
20 increase per location.

21 The last bullet on the inspection fee is
22 the recognition that there is currently a cap in
23 that fee system of \$1000. And if ATC retrofit
24 were to move forward at retail, we believe that
25 that cap would have to be considered to be set to

1 a slightly higher level to make sure that those
2 additional fees could cover the cost for the
3 county sealers.

4 If you're installing a new fuel
5 dispenser or retrofitting a site and putting in
6 new dispensers, in a post-ATC retail world, you'd
7 have to buy one that's ATC ready.

8 So, staff looked at -- considered that
9 as being, well, the cost of that would essentially
10 be the higher incremental cost of the equipment.
11 The labor is already captured in the device as
12 it's assembled at the factory, so there's no labor
13 component to that.

14 We do have an estimate of 500 to 550 new
15 dispensers per year in California. We have had
16 some people give us feedback on that number,
17 doesn't that appear to be rather low. Well, yes,
18 it does appear to be low, but these are actually
19 over the last two years those were sort of the
20 rate of new dispensers that were certified by
21 county sealers on a statewide basis.

22 But, yes, it does appear low to us. If
23 there are roughly 42,000 dispensers, and you're
24 say replacing 7 percent a year, which is, you
25 know, once every 15 years, you're going to be at a

1 rate that's about 3000 dispensers a year. Not 500
2 to 550.

3 So, it's possible that the reason the
4 number is so low based on the last two years worth
5 of data is that the upgrades may primarily
6 associated with the 1998 underground storage tank
7 regulations resulted in a lot of, I guess, newer
8 dispensers being installed. And so we're not at a
9 sort of a natural replacement rate yet. That
10 might be a higher percentage.

11 So, we'd be pleased for people to give
12 us some information on maybe what some new
13 dispenser or replacement dispenser numbers should
14 be in California. If you have some information
15 you can provide to us, that'd be great.

16 I think, at a minimum, we can look at,
17 on the high end, a number that is more reflective
18 of, say, a replacement rate of every 12 or 15
19 years, something to that effect. So please
20 provide some comment in that area.

21 And as a consequence of that, the
22 statewide cost, which is about \$900,000 on the low
23 end per year. For example, if you were at about I
24 think 2900 dispensers, that would go up to nearly
25 \$4 million. So it is a marked change in the low

1 estimate and would be a marked change on the high
2 estimate, as well.

3 So, please provide us some input in this
4 area for the recurring cost if you can, if you
5 have that kind of information. But we do
6 recognize that even though this is based on the
7 last two years of data it may be a low rate for
8 other reasons. Just not sure what those exactly
9 may be.

10 How we figure out maintenance is we
11 looked at -- we assumed that the equipment would
12 need some maintenance. The ATC components would
13 need some maintenance on a periodic basis.

14 And so the low end we assumed someone's
15 going out, 10 percent of the retail locations
16 require a visit. And that there's eight hours
17 spent by the technician; they replace 25 percent
18 of the ATC components at that location. So that
19 works out to be a failure rate of about 2.5
20 percent per year.

21 So is that high for that equipment? Is
22 that middle of the road, is that low? Too low?
23 Don't know. But we believe, you know, that's sort
24 of a conservative low failure rate for that.

25 On the high end we assumed basically a

1 fifth of the stations have a technician have to go
2 to every single year. And 16 hours is spent in
3 replacing half of the ATC components. So this is,
4 we think, a fairly high estimate. And that's
5 about \$11 million per year statewide as a
6 consequence. But it does imply a failure rate of
7 10 percent a year in the components. So that
8 would probably be considered quite high for
9 electronic components.

10 And keep in mind that these components,
11 at a minimum, will have a 12-month warranty, in
12 some cases 24 months. So if you see for the
13 manufacturer they don't want to be making service
14 calls on their own dime if you have high failure
15 rates. So they try to get the failure rate down
16 to a pretty low level.

17 So if people have some data they'd like
18 to provide that causes us to change these
19 estimates, please let us know.

20 Summarizing all these costs for retail
21 station owners, this is just a laundry list, if
22 you will, of the initial costs on the top four
23 lines. And the bottom three lines, the recurring
24 costs on an annual basis. So, up here these are
25 all one-time costs. Down here, annual basis.

1 Now, as I mentioned, the new dispenser
2 costs of \$905,000 a year statewide. If we use,
3 say, 2900 dispensers as the low end, then that's
4 going to go up to about \$4 million. So -- I think
5 about \$4.2 million. So that would rise rather
6 significantly if you're looking at a total of 4.4
7 anyway for that number.

8 So any information you folks could
9 provide would be helpful in that area.

10 The agencies, and in this case the
11 Division of Measurement Standards, they would have
12 some additional work if there was going to be some
13 ATC-related activities at retail, either on a
14 reference case basis or especially on ATC
15 retrofit.

16 And those have to do with there's a
17 development of regulations. They have to do what
18 we've been doing now, conduct public workshops so
19 they can take comment, write procedures. And so
20 that's all sort of a staff burden, if you will.
21 But we believe that's absorbable by the agency.
22 And if they don't believe so, they can jump up and
23 say something now.

24 Yes, we have a question here?

25 MR. BOYETT: Good morning, Gordon. Dale

1 Boyett, Boyett Petroleum. I think I can answer
2 your low dispenser question, the 500 to 550 for
3 the last couple years.

4 There's something called PCI compliance
5 which has to do with the encryption modules, the
6 card readers at the pumps. And Wayne and
7 Gilbarco, which are basically the two
8 manufacturers of dispensers, did not have one that
9 comes out till the first of next year.

10 Like we were going to order 24
11 dispensers last year, and we chose not to because
12 they were not going to be able to come without
13 this module in them. And it has to be replaced by
14 July of '10. So it would have been about a, I
15 think about 2500 a pump to go back and re-do them
16 for new pumps. So that might have a big factor.
17 So, we just started ordering dispensers again.

18 MR. SCHREMP: Thanks, Dale. We assumed
19 there was some reason that the numbers seemed to
20 be pretty low. So, yeah, that makes sense why you
21 might hold off and just wait a little bit longer
22 to do that. Thanks for your comment, Dale.

23 Back to the agency costs. I mentioned
24 that we believe there's some heightened activity
25 that DMS would have to undertake, and we believe

1 that's absorbable without additional funding or
2 people years.

3 There's also another program where they
4 certify equipment for use in California, fuel
5 dispensing equipment in particular in this case.
6 And we look at that as sort of a self-funding
7 program. Meaning the equipment manufacturer has
8 to pay to have that equipment reviewed and
9 certified. And that may include even field test
10 work for a period of time. And so if that's self-
11 funding, then that's certainly a cost by the
12 manufacturers in sort of a one-time basis for that
13 particular make and model.

14 So, summary, the agency costs on an
15 annual basis are something that -- since we don't
16 have a quantity, and I think we have a -- Nick has
17 a question online.

18 MR. JANUSCH: David Smith.

19 MR. SCHREMP: David? Are you live?

20 MR. SMITH: Gordon, can you hear me?

21 MR. SCHREMP: We can all hear you now.

22 MR. SMITH: All right. Is it okay if I
23 ask a question?

24 MR. SCHREMP: Yes. Dave Smith from BP,
25 right?

1 MR. SMITH: That's right. Do you know
2 how long it takes to install ATC devices, and did
3 you consider whether it was appropriate to
4 consider like lost sales that would result during
5 the installations?

6 And as you were talking about approval,
7 did these things, do the devices, do they already
8 have like UL approval for various fuels? Or do
9 they need that or -- well, -- two questions.

10 MR. SCHREMP: Okay, I'll take sort of
11 how long. Yes, we talked to some people that do
12 this kind of work, Dave, and as I mentioned
13 earlier, it's usually a two-man team operation.
14 And if they're pretty fast and efficient and they
15 have essentially the manifolds are pre-drilled for
16 the temperature probe, it's about an hour and a
17 half per fuel dispenser. That's you're looking at
18 like maybe three products on each side, kind of
19 typical dispenser.

20 Longer can be up to four hours. So
21 that's sort of -- we did look at the time. So if,
22 in fact, they're working on a dispenser at a site,
23 and that fuel dispenser is out of commission for
24 an hour and a half, or say four hours, I suppose
25 there could be some lost sales for that particular

1 location.

2 But, you know, we did not quantify that
3 because it would be only one of the dispensers and
4 only a short period of time. So, I guess, in
5 theory, at some locations that are, you know, very
6 active during the day and essentially has somebody
7 at a dispenser almost all the time, I mean I'm
8 sure there are some examples of places like that.
9 Yeah, there could be an effect on that particular
10 location's business. But I think on average the
11 effect would be quite small. But, no, we did not
12 quantify that.

13 Back to your approval of the devices
14 that are ATC capable or ATC retrofit kits, if that
15 case might be. I believe they have to meet all
16 Underwriter Laboratory regulations when they go to
17 DMS for approval. Unless I see someone -- no?
18 Yes?

19 MR. WILLIAMS: That's a separate
20 process.

21 MR. SCHREMP: Oh, Dave, I'm hearing that
22 that would be a separate process for the
23 Underwriter Laboratory would have to issue its own
24 certification for a particular device. So, a
25 separate process is the answer to your question.

1 So, I don't know how long that process
2 is. If it's longer than the process to certify
3 equipment through DMS, you know, that might be an
4 adjustment in our timeline. So, no, Dave, we did
5 not look at the UL approval process as a separate
6 track or a, you know, a consecutive track or a
7 concurrent track. We did not look at that.

8 But if you have some information, or
9 anybody else does, on the UL process and how long
10 that might be for equipment, we'd appreciate to be
11 able to look at that.

12 Anything else, Dave?

13 MR. SMITH: No, Gordon, thank you very
14 much.

15 MR. SCHREMP: You're welcome.

16 PRESIDING MEMBER BOYD: Gordon,
17 question. Do we know if there are already
18 certified pieces of equipment in existence?

19 MR. SCHREMP: There is a --

20 PRESIDING MEMBER BOYD: Ready to
21 install, so to speak.

22 MR. SCHREMP: There is a -- we
23 understand there's a ATC-ready fuel dispenser make
24 and model that's already been approved by Division
25 of Measurement Standards. I believe it is just

1 one -- are there more at this -- just the one.

2 And I don't know if there are any of
3 those ATC-rated make and models of that particular
4 have actually been installed. And --

5 PRESIDING MEMBER BOYD: Is this one
6 device compatible with all dispensers, or is it
7 for a particular type of dispenser?

8 MR. SCHREMP: It's, I think, as Dale
9 mentioned, you know, a lot of dispensers sold are,
10 say Gilbarco's. And it's a Gilbarco make and
11 model. So they would essentially purchase that
12 make and model that already has temperature
13 compensation capability.

14 PRESIDING MEMBER BOYD: Are these made
15 domestically, or --

16 MR. SCHREMP: I don't know where
17 Gilbarco produces their fuel dispensing equipment.
18 I don't know. So I don't know if there may be, I
19 think, Kurt, do you want to come up to the
20 microphone, please, or ask -- go ahead.

21 MR. BOYETT: Hi, Gordon. Carl Boyett
22 representing Society of Independent Gasoline
23 Marketers of America. We've been waiting for a UL
24 approval on anything selling more than 10 percent
25 ethanol for two years now. Underwriters

1 Laboratory has not approved anything.

2 So, certainly for E-85 it would be
3 fairly iffy at this point.

4 MR. SCHREMP: And, Carl, that is for E-
5 85 dispenser you're waiting for UL?

6 MR. BOYETT: It's anything over E-10,
7 they're certified up to E-10. But if you go to E-
8 11, which basically this year the United States is
9 going to E-10.6 overall. You know, people are
10 selling it but they just don't -- they use their
11 UL approval.

12 MR. SCHREMP: Okay. Thank you. Yes,
13 Kurt?

14 MR. FLOREN: Good morning, Gordon. Kurt
15 FLoren, Director of Weights and Measures for Los
16 Angeles County.

17 Just to briefly answer that last
18 question, Gilbarco's operations are located in
19 North Carolina. And they are, in fact, fabricated
20 there.

21 MR. SCHREMP: Thank you, Kurt.

22 PRESIDING MEMBER BOYD: Thank you.

23 MR. SCHREMP: Unless there are any other
24 questions, we'll continue on with recovery of
25 expenses is how we've couched this part.

1 Staff believes that, and this is
2 important, I mean certainly important concept with
3 regard to the cost/benefit analysis results. But
4 the staff believes that the California retail
5 stations do operate in a very competitive
6 environment. And that they do endeavor to pass
7 increased expenses through to their customers
8 regardless of what those expenses might be. Say
9 higher wage rates; higher rents for your property;
10 a new regulation say of enhanced vapor recovery.
11 Things of that nature.

12 So, there is an endeavor to pass those
13 increased expenses through to customers by raising
14 prices on goods that they sell. And those are
15 both fuel and nonfuel items.

16 And the reason it's important to keep
17 this in mind is because that has to do with how we
18 believe the industry would react in aggregate to a
19 change in temperature compensation at retail.

20 So we'll -- I'm sure there's
21 presentations after mine that will touch on this,
22 as well as questions -- right now.

23 (Laughter.)

24 MR. ROBINSON: Thank you, Gordon. Tom
25 Robinson. I appreciate you recognizing that we do

1 have a competitive industry. And I was just
2 questioning does staff really believe that the
3 Twinkie buyers are going to be able to subsidize
4 these costs. And I think maybe even more
5 importantly, aren't they also consumers? I mean,
6 so effectively it's consumers that in some shape
7 or form will pay for it.

8 MR. SCHREMP: Yeah, Tom. I think staff
9 and some of the commenters will probably quibble
10 and not necessarily just on semantics about, you
11 know, can be recovered in nonfuel items and fuel
12 items. You know, we certainly have an opinion on
13 that, with that regard.

14 But I think in terms of your reference
15 to society, certainly that's what this analysis
16 is. We look at society, and society in this
17 context is all the retail station owners and
18 operators, and all the consumers that go to those
19 locations. Primarily those are fuel consumers,
20 but they buy nonfuel items at these locations
21 predominately.

22 So, that's our society we're looking at.
23 And you're right, you know, we look at the -- we
24 believe that the costs or the expenses will be
25 passed along to that society collectively.

1 And so I think with regard to is it all
2 on fuel, is it some on fuel and some on nonfuel,
3 that gets into, I think, more into some of the
4 other types of things we looked at. But it
5 doesn't change the fact that the impact is on
6 society. But that's an important distinction to
7 make.

8 This is, in part, one of the issues that
9 Judy raised earlier. And we are concerned that if
10 there is, in fact, an ATC mandated at retail that
11 there could be some stations, especially in rural
12 locations, that may have a disproportionate
13 economic challenge. And this could be sort of the
14 straw that breaks that camel's back.

15 So we want to be sure that if, in fact,
16 something does move forward that there be some
17 consideration to how to address those kinds of
18 locations.

19 And it's couched in rural terms because,
20 as I mentioned earlier in response to Judy's
21 comment, that in the urban locations this is about
22 fuel availability for consumers.

23 And so stations come and go, especially
24 in the very urban station-dense area. And
25 consumers will certainly notice that their

1 favorite station is no longer there. They'll
2 transition to another station. And that's
3 certainly, you know, unfortunate news for someone
4 who loses their business there, of course. But
5 the fuel is still available for the community.

6 But in a rural location you may have one
7 or two stores and that's it. So, if there's a
8 loss to that store, then what does the community
9 do for fuel.

10 So we understand those situations do
11 come up. We understand that those stations close
12 for other reasons, and those kinds of hardships
13 are incurred by certain types of communities,
14 meaning I have to travel much farther or plan my
15 fuel purchases more carefully.

16 But we want to look and see, okay, how
17 many stations might that be. And in the report
18 you'll see a figure of no more than 450. And this
19 was basically one or two locations in a community.

20 Now, so we have since looked at those
21 individual stations and whittled down the number,
22 if you will, by concluding, well, yes, there might
23 be a couple stations right just in that community,
24 but two miles away in the other community there
25 are plenty of stations.

1 So, we've removed some of those, what we
2 had deemed at-risk stations from that list. And
3 Jay has a question here. And so right now we're
4 no more than 200, and that might be slightly
5 revised down just a little bit before we release
6 the next version of the report.

7 But we just wanted to let you know the
8 figure in the report now is not going to be 450.
9 It's 200 right now.

10 Yes, Jay.

11 MR. McKEEMAN: Jay McKeeman, CIOMA. The
12 location of these service stations, did you use
13 your database on reporting of service stations
14 to -- this is important information that I haven't
15 seen teased out of a lot of information that I've
16 been working with.

17 And it's actually pretty important
18 information for a whole other issue, which is
19 enhanced vapor recovery. And I'm just wondering,
20 I'd like to talk to you and find out where this
21 data came from. But could you just answer
22 generally where it came from?

23 MR. SCHREMP: Yeah, I'd be happy, Jay.
24 We primarily used, well, primarily used a survey
25 mechanism. We have an annual survey requirement

1 of the Commission, our E-15 survey, all retail
2 station operators, owners/operators, must fill out
3 an annual survey. So one page has lots of
4 different information they provide.

5 We used that predominately. We also,
6 because we don't have a hundred percent compliance
7 yet, fairly high, though, I think close to over 80
8 percent compliance. We did use information from
9 other sources, a list of locations by county
10 sealers as another main source. And I think in
11 some cases maybe an AQMD. But that was not very
12 much information from them.

13 So, I think primarily the E-15, and then
14 some county sealers to construct our database of
15 nearly 9700 locations.

16 MR. McKEEMAN: Okay, thank you very
17 much.

18 MR. SCHREMP: You're welcome. So when
19 we looked at these, what we characterize as at-
20 risk stations, we said, well, you know, what would
21 it take, and this is sort of in part addressing
22 Judy's question and concern, what would it take to
23 say fund those locations.

24 And so we said, well, you know, be a
25 little bit over \$2 million for the 200 stations.

1 And that would, if you put a fee, for example, on
2 fuel sales for six months, the fee could be as low
3 as two-hundredths to three-hundredths of a cent
4 for six months would generate sufficient monies
5 for this program to retrofit those locations.

6 So that's just an example of how that
7 could be addressed. And, once again, if ATC were
8 to be mandated at retail. That's the only time
9 you would look at that.

10 MR. SIEBERT: Gordon?

11 MR. SCHREMP: Yes.

12 MR. SIEBERT: John Siebert, OOIDA.
13 Another option would be to just ignore them at no
14 cost.

15 MR. SCHREMP: Thank you, John.

16 Okay, now I'm going to continue on with
17 potential consumer benefits. And certainly
18 there's been, I think, a lot of discussion about
19 this issue, certainly in the press over the last
20 couple of years. And we tried to be clear on how
21 we interpret, you know, these potential benefits.

22 And we know that how the devices work;
23 you'll get a little bit more larger size gallon,
24 as measured in cubic inches in California. That's
25 really how it works.

1 So the net impact of that is, well, then
2 I didn't buy as many gallons over the year if I
3 went back in time and did this. And then we have
4 price elasticity response, all that kind of stuff.
5 But, ignoring that because it's small in this
6 context. You end up buying fewer gallons, fewer
7 units, I should say, because they're down to net
8 units.

9 So, good, I got a bigger gallon and I
10 didn't buy as many, and so I saved that money.
11 Well, if, in fact, the price of that, the posted
12 retail price of that gallon didn't change. Well,
13 we believe it will change. We believe that
14 because the industry is competitive; the industry
15 is currently profitable. We believe it will
16 remain profitable over the future. That they'll
17 endeavor to recover those, I guess, we refer to as
18 a revenue shift, for lack of a better phrase.
19 They'll attempt to recover that.

20 So, what will be retained by the
21 motorist we think collectively from a societal
22 perspective will essentially net out. It won't be
23 anything. There'll be a complete recovery over
24 the long term. And so we'll talk about that, and
25 I know some speakers have different opinions on

1 that. But we'll get to that.

2 So, that comes into play when we look at
3 the cost/benefit analysis of what those potential
4 benefit streams are over the years. And then
5 compare them to the cost stream over the year.

6 So this is just a quantification of
7 those units, or the process we went by to see how
8 much larger the gallon would be, and how that
9 shifts from gross to net with resultant fewer
10 units sold. Different units, fewer units.

11 And that, I think, is quantified at 136
12 million, I call them gallons there, you can call
13 them units. They're net gallons. And that's over
14 the study period, April 2007 through March 2008.
15 So essentially go back in time for the equipment
16 and what would happen. And the value of that is
17 contingent upon what the average fuel price is at
18 the time. So change the answer.

19 You know, at the time we started doing
20 this study I think the average fuel price for the
21 study period is over \$3.20. At the time we were
22 doing the study this summer people thought that
23 price was too low. And I guess now they think the
24 price is too high. So that's all in a very short
25 period of time.

1 Yes. There's a question?

2 MR. EICHBERGER: John Eichberger with
3 the National Association of Convenience Stores.
4 Looking at this number in today's market we sell
5 gross gallons. We price based on gross gallons.

6 To calculate \$438 million, am I right to
7 assume that the staff used the calculated sale of
8 net gallons based on temperature compensation sold
9 at the average gross price charged last year? So
10 selling net gallons at gross prices yielded you
11 the \$438 million during the study period, is that
12 correct?

13 MR. SCHREMP: Actually we looked at how
14 the equipment would have operated in terms of
15 dispensing additional larger gallons as measured
16 in cubic inches, what those additional cubic
17 inches would have amounted to. And valued those
18 additional cubic inches that would have been
19 received by consumers.

20 MR. EICHBERGER: Based upon the average
21 price charged over the study period?

22 MR. SCHREMP: Of the gross gallon, yes,
23 that's --

24 MR. EICHBERGER: Which was a gross
25 price.

1 MR. SCHREMP: That's correct.

2 MR. EICHBERGER: So I'm not quibbling
3 with your 136 million gallons estimate on the
4 temperature compensation effect. I'm just
5 pointing out that when you calculate net gallons
6 multiplied by gross price, you're mixing two
7 measurement standards, which can create a
8 incorrect estimation.

9 MR. SCHREMP: I think the economic
10 valuation was on the additional cubic inches that
11 would have been received as benefit. I'm just
12 pointing out that another way to look at that is I
13 would have purchased fewer units. And so the unit
14 calculation is exactly the same as the valuation
15 calculation.

16 MR. EICHBERGER: Assuming no change in
17 price.

18 MR. SCHREMP: Assuming no change in
19 price.

20 MR. EICHBERGER: Okay, we'll talk about
21 that later. I just wanted to put that out.
22 Thanks.

23 MR. SCHREMP: Thank you, John. So as
24 you can see from these figures, most of the change
25 from going to ATC to retail would be on the

1 gasoline side, and no surprise. That's the
2 predominant fuel sold in California. And that's
3 why the gallons are much larger because the
4 temperature increase is somewhat similar.

5 So, what portion of this revenue won't
6 be successfully recaptured? Well, I already sort
7 of let that cat out of the bag and said we believe
8 that the industry collectively will be successful,
9 over the long term, in recapturing that, sort of
10 that revenue shift.

11 So, yeah, I'll get my larger gallon,
12 larger in terms of cubic inches. But I'll, in the
13 end, pay for that essentially by paying both a
14 higher price for fuel and likely a higher price
15 for some nonfuel items.

16 So as collectively, as a society, it
17 will essentially balance out, zero out from that
18 perspective. So I know people have a lot of
19 comments.

20 There'll be variations during the summer
21 months. Certainly it's a little bit bigger in the
22 summer months. In the winter months it's pretty
23 close in some locations to the 60-degree
24 reference, so there's not much change between the
25 gross and net.

1 Yes, Judy.

2 MS. DUGAN: Is this right now our only
3 opportunity to comment?

4 MR. SCHREMP: Oh, no, there'll be --
5 Judy, there'll be a period -- the question was is
6 this the only opportunity to make comment.

7 No. This is one of the opportunities.
8 There'll be some presentations following mine that
9 people in the audience can also comment on those.
10 There'll be a public comment period after that
11 time and people can come up and talk about
12 anything they want, including what's been
13 discussed here. Or even have their own prepared
14 remarks. So there are multiple opportunity, Judy,
15 to come up.

16 MS. DUGAN: Then we won't impede you at
17 this moment.

18 MR. SCHREMP: Okay, thank you. So we do
19 talk about here that even though our staff's
20 assumption is that there'll be success in sort of
21 the industry as a whole as sort of recapturing,
22 making themselves whole in terms of this revenue
23 shift, this isn't, you know, it's not precise.

24 They don't know exactly what the
25 temperature is at any given moment. They don't

1 know exactly what the temperature is being
2 dispensed for every transaction at a retail
3 station. It's imprecise.

4 But, in general, there's a recognition
5 that they'll see a change in the revenue stream
6 and they'll compensate to address that. And in
7 the long run they'll be successful.

8 So, as a society we think that's why
9 there's basically none of these expected consumer
10 benefits from the slightly large size unit that
11 will be -- or they'll pay for that essentially.

12 There is another type of benefit that's
13 been valued for this publication. And we refer to
14 it as information asymmetry. There is a
15 discussion in the report, and as well as a
16 economic discussion of how the benefit was
17 calculated in the appendix that you're welcome to
18 read through.

19 But essentially this is almost, it's
20 correcting an inefficiency in the marketplace, if
21 you will. Right now consumers don't have perfect
22 knowledge on the temperature of the fuel and how
23 that might affect the posted price.

24 They certainly have gasoline -- retail
25 gasoline is one of the most transparent

1 commodities there are in terms of pricing because
2 everyone can see the big signs and that's the
3 final price. No adders on top of that.

4 But variations in temperature do exist
5 seasonally, and certainly do exist even in smaller
6 geographic locations on any given day.

7 And so if consumers had better
8 information on temperature they could make a more
9 informed decision and likely purchase a slightly
10 less expensive gallon if they were shopping just
11 bottom line for price.

12 Yes. We have a question back here.

13 MR. MURPHY: Kevin Murphy from the
14 University of Chicago. I looked at your appendix
15 and I -- it wasn't clear to me exactly which
16 variation you did the calculations for. Is that
17 the average difference between the net gallon
18 price and the gross gallon price? Or is that the
19 variation over the year? Or is that the variation
20 across stages? Because any one of those could
21 have been used to calculate the number that you
22 did.

23 MR. SCHREMP: I think I'll have Nick
24 Janusch respond to that question, Kevin.

25 MR. JANUSCH: And so appendix R has a

1 figure that shows this, that weight loss. And the
2 shift is the bottom correction factor, and that's
3 the -- what we calculated as the average
4 difference.

5 MR. MURPHY: That's like the 71 versus
6 60 calculation. Okay.

7 Also just one quick comment is normally
8 half that figure would go to consumers and half
9 would go to producers, because some of it's kind
10 of the top half of the triangle and some is the
11 lower half of the triangle. So for consumer
12 benefits that really should probably be, given the
13 calculations you made, half that number.

14 MS. BROWN: Can I also ask a question on
15 that. You did quantify the consumer benefit of
16 this part, did you not, in the report? I didn't
17 see it on the slides. Can you elaborate further
18 on the --

19 MR. JANUSCH: Okay.

20 MS. BROWN: -- amount of the consumer
21 benefit?

22 MR. JANUSCH: When we calculated this
23 benefit of price transparency as \$3.2 million per
24 year. And the way we calculated it, and I have to
25 give sort of a mini-lesson in economics, but I'll

1 try not to use econ lingo and keep to English.

2 Anyways, information asymmetry implies
3 information about a product may not be equal on
4 both sides of the market. So you might be buying
5 something and you don't know exactly where you're
6 going to get it. And once you get it, you might
7 not be happy about it.

8 So, economists traditionally break down
9 three types of goods when talking about
10 information asymmetry. A search good, an
11 experience good and a post-experience good.

12 A search good is a good where a consumer
13 can observe the quality and characteristics before
14 consumption. An example of this would be a
15 college student trying to buy a notebook at a
16 university. They can look at the notebook; see if
17 it's colorful, they know exactly what they're
18 going to get.

19 An experience good is a good where the
20 quality is only observed during consumption. And
21 an example of this would be movie tickets. And
22 you might want to see a movie and you're not sure
23 exactly if you're going to like it or not, so you
24 can read newspaper articles and figure out the
25 quality involved.

1 And a post-experience good is a good
2 where consumption does not necessarily show the
3 quality of the good. An example of this would be
4 pharmaceuticals. And for those particularly, if
5 there are no third parties that will actually give
6 out that information or make that product more
7 transparent, then government intervention,
8 according to the textbook I cite, is necessary.

9 And because fuel is one of the many
10 goods that we consume every day, but we rarely
11 see; we can sometimes smell it. I would
12 characterize this as a post-experience good.

13 And so the way I calculated dead weight
14 loss. So, what happens with the information
15 asymmetry is consumers will, might over-consume
16 the goods that they're purchasing even though they
17 might, if they knew what the quality of the good
18 is.

19 And so this creates a inefficient
20 market. It creates a dead weight loss. And the
21 dead weight loss is the cost to society, and that
22 includes both retailers and consumers. And I
23 calculated that at \$3.2 million per year. And
24 that is basically under an assumption that -- and
25 this is an extreme assumption -- that retailers

1 are pricing the pricing fuel at net gallon price
2 and selling it at gross gallon price. I mean,
3 selling in gross gallons.

4 MR. SCHREMP: Was that a little bit more
5 than you wanted?

6 (Laughter.)

7 ASSOCIATE MEMBER DOUGLAS: Actually I
8 have a quick follow up question. The information
9 asymmetry is an issue, and I can see how -- to me
10 it seems like it's a more compelling problem if
11 there is significant variation of the fuel
12 temperature of fuel sold, say, by stations across
13 the street from each other, or in the same small
14 geographic location, as opposed to variations over
15 seasonally or between larger regions, such as
16 between Los Angeles and Tulare, for example.

17 And so I was hoping you could give us
18 some insight into how much of this variation is
19 this really within small areas?

20 MR. SCHREMP: The information we
21 received from --

22 MR. FLYNN: Gordon. May I ask one
23 question on that?

24 Didn't you say that to calculate your
25 information asymmetry benefit or the benefit from

1 ending that, that you were assuming that retailers
2 were pricing at net dispensing gross gallons?

3 MR. JANUSCH: Yes.

4 MR. FLYNN: Isn't that the opposite of
5 what you're assuming, or not the opposite, but
6 isn't it the case that you are assuming for the
7 remaining portions of your report that retailers
8 today are both pricing and dispensing in gross
9 gallons?

10 MR. SCHREMP: Actually I think it's
11 they're buying based on net gallon prices. They
12 are selling -- buying wholesale based on net
13 gallon pricing, --

14 MR. FLYNN: I'm talking about retail,
15 though, that's --

16 MR. SCHREMP: -- and retail they're
17 selling based on gross gallon.

18 MR. FLYNN: And pricing --

19 MR. SCHREMP: It's a gross --

20 MR. FLYNN: -- and pricing on gross
21 gallons.

22 MR. SCHREMP: Well, but --

23 MR. FLYNN: But I mean do you agree that
24 if that's not correct, then the price asymmetry
25 benefit for ending that dead weight loss is zero

1 because there's no difference between the prices.

2 MR. JANUSCH: Yeah, so under the
3 assumption that retailers are pricing gross and
4 selling gross there is no dead weight loss, there
5 is no benefit. But --

6 MR. FLYNN: Which is the assumption that
7 you maintain elsewhere in the report.

8 MR. SCHREMP: No, I -- I mean I think as
9 we've stated the purchase at wholesale, the
10 purchase is based on a net gallon price. The
11 purchaser can value the cargo or load of fuel any
12 way they want. They know what the gross gallons
13 are in the truck. They know what they paid for
14 it. They can value the cargo any way they want.
15 We understand that.

16 But they're buying net gallon posted
17 prices. So, I mean as to the valuation of the
18 cargo they can certainly do it any way they want.
19 But at retail they are selling gross units, each
20 retail transaction. And those posted prices for
21 the consumer are gross gallon prices.

22 MR. FLYNN: Okay.

23 MR. SCHREMP: So, yeah. So I think
24 there's, you know, there's net gallon posted in
25 evaluation calculation for the load of fuel. They

1 can certainly calculate the load of fuel with
2 those dollars to buy it by those gross gallons.

3 They can do that calculation, but
4 they're not buying gross gallons at wholesale.

5 MR. FLYNN: Right. But the information
6 asymmetry problem is entirely at the retail level,
7 is it not?

8 MR. JANUSCH: Yes.

9 MR. FLYNN: Okay. Thank you.

10 Yeah, I'm sorry. I'm Michael Flynn from
11 LECG. I'll be talking in just a little bit, but I
12 had not intended to address this section in my 20
13 minutes.

14 MR. SCHREMP: Thank you, Michael.
15 Commissioner Douglas, I will still get to your --

16 ASSOCIATE MEMBER DOUGLAS: Absolutely.
17 Take the comments first and then get to my
18 question.

19 MR. SCHREMP: Okay, thank you.

20 MR. ROBINSON: Tom Robinson, again. To
21 put it in perspective and see if I did my math
22 right, but it's seventeen-thousandths of a cent.
23 If I drive 12,000 miles a year, if my car gets 20
24 miles to the gallon, I buy 600 gallons. And is
25 the net impact to me 10 cents a year?

1 MR. SCHREMP: The impact is quite small,
2 yes.

3 MR. ROBINSON: So, I mean, the impact on
4 this to an average consumer would be about a dime?

5 MR. SCHREMP: I have to check that, but
6 if you have \$3 million a year, and you have 30
7 million drivers.

8 MR. ROBINSON: Well, that's what I came
9 up with, so -- you can check my math.

10 MR. SCHREMP: A dime is probably pretty
11 close to the mark. Yes, Kevin.

12 MR. MURPHY: Yeah, just a reference to
13 the question that Commissioner Douglas asked. I
14 mean this calculation doesn't have anything to do
15 with the variation across stations.

16 One could try to apply the same
17 methodology to do that, but the numbers calculated
18 here don't have anything to do with that
19 comparison. It instead is a comparison of the .75
20 percent difference or whatever you want to call it
21 between the 71 degrees and the 60 degrees, which
22 isn't the variation that occurs across stations,
23 which would be relevant for your question.

24 But the methodology, and again it would
25 be 5 cents rather than 10, because half of it

1 basically goes to the producer. So, we got to cut
2 that in half, so.

3 MR. SCHREMP: Commissioner Douglas, to
4 your question about variation in a particular
5 smaller geographic area, say in the intersection
6 of the temperature information for fuel that we
7 have in the database as part of the county sealers
8 sampling program, I don't think is sufficient to
9 do that comparison since we don't have the
10 physical location of the information. Other than
11 that of a county location.

12 We do understand that there is some
13 information that has been presented over this last
14 year, associated with the National Congress of
15 Weights and Measures. People have attempted to
16 look at temperature fuel variability on a given
17 day in a geographic region.

18 And so I have seen some information that
19 does suggest that there is variation on a given
20 day in a small geographic area, but we do not have
21 that information to do the analysis in California.

22 Now, I do have to add, though, that
23 there are instances where consumers are traveling
24 a significant distance because of their daily
25 commute. And they have options to fuel near their

1 place of residence before they go to work, near
2 where they work, and along the way.

3 And there are instances whereby you can
4 certainly, especially in southern California, look
5 at or even say, coming from the valley going into
6 the Bay Area, where there are temperature
7 variations that can be significant on any given
8 day in that kind of comparison.

9 But we are unable to quantify, say, the
10 number of potential consumers that might be
11 experiencing that large difference in temperature
12 variation on a given day.

13 ASSOCIATE MEMBER DOUGLAS: I'm not
14 convinced though that a consumer who commutes from
15 some cold mountain location into the valley and
16 back really loses out whether they buy their --
17 because of fuel temperature differentiation by a
18 decision to buy the fuel in the valley or buy the
19 fuel in the mountains.

20 You know, I can see how a consumer who
21 is attracted by lower prices on one side of the
22 street than the other would definitely lose out if
23 the difference in price is really reflective of
24 the difference of the temperature of the gasoline.

25 But, you know, do you see that

1 differently? I mean at least if we think that the
2 gross price reflects the actual volume being sold,
3 then the consumers buying fuel where the air,
4 where the ambient temperature and the fuel
5 temperatures are higher are not necessarily worse
6 off.

7 MR. SCHREMP: Well, I think it's, I mean
8 I think it's back to the comment of, you know, did
9 we perform this calculation evaluation. Yes. Did
10 we come up with a somewhat small number statewide?
11 Yes, we did. Is that number maybe double what it
12 should be? Possibly.

13 And therefore, if there was -- could you
14 see that number in the pricing at the pumps today?
15 No, you could not because those posted prices are
16 a tenth of a gallon -- excuse me, a tenth of a
17 cent per gallon.

18 So, we're talking about differences that
19 are even below that level to be noticeable. So,
20 it is a very small benefit calculation that has
21 been performed here. But would that make a
22 difference noticeable to the consumer? Not at the
23 level of pricing they have now to a tenth of a
24 cent, no.

25 ASSOCIATE MEMBER DOUGLAS: Thank you.

1 MR. SCHREMP: You're welcome. Kurt.

2 MR. FLOREN: Kurt Floren, Director of
3 Weights and Measures for Los Angeles County.

4 Commissioner, unfortunately the data
5 that was collected statewide did not track that
6 specific location information. But I can tell
7 you, in Los Angeles, and unfortunately I do not
8 have the data in hand with me, and it was on a
9 very limited basis.

10 But I did ask staff to monitor several
11 intersections specifically that had three or four
12 stations competing right on those intersections.
13 And this was very limited, I have to tell you.

14 But in evaluating that the largest
15 difference that we saw in the same grade directly
16 across the street from one another was 11 degrees.
17 So there is that difference that's approaching,
18 well, it's certainly over a half a percent
19 difference. And so you can do the math there.

20 If it's a \$3 gallon, a half a percent,
21 you know, is going to be a cent and a half, yes?
22 And so -- but I do need to make the point about
23 this commuting issue, and I've made it here
24 before.

25 And using Los Angeles County as an

1 example, we do have the high desert, Palmdale,
2 Lancaster. We have the San Fernando Valley. And
3 then we have the coastal region. And in our
4 county we do have many many residents that do
5 traverse those areas to commute every single day.
6 A couple hundred thousand people come down from
7 the high desert into the valley to work. And vice
8 versa.

9 And I am convinced that people make fuel
10 purchase decisions both near home and near work.
11 Rarely in between unless they're running out of
12 fuel.

13 But in the study that we did do, we did
14 see -- and again I don't have this data in hand,
15 but I know that we did see differences of the 20
16 degree variety from that high desert where it may
17 be 105, and the San Fernando Valley where it may
18 be 80 degrees or 75 degrees that day. And
19 similarly for those people moving from the valley
20 down to the coast, down to Santa Monica for the
21 day's work, it can be 60 degrees there.

22 There are those kinds of ranges. And
23 consumers do make purchase decisions between those
24 different marketplaces.

25 So we have this ongoing debate on what

1 is a marketplace. Is it a single intersection?
2 Is it a three-block radius? Or is it their day's
3 experience, whether they're near home or near
4 work?

5 And have to make the point that the
6 temperature compensation issue or the automatic
7 temperature compensation does do away with those
8 uncertainties. Thank you.

9 ASSOCIATE MEMBER DOUGLAS: Thank you for
10 that, that's really actually very interesting and
11 very helpful. One quick follow-up question. Do
12 you see -- before you run away back to your seat,
13 do you think that the variation that consumers in
14 that case experience really just impacts whether
15 they buy gasoline in one area as opposed to the
16 other because they believe it's cheaper? Or do
17 you think it actually impacts them in terms of
18 raising the fuel costs?

19 MR. FLOREN: Well, having been in the
20 weights and measures business, if you will,
21 personally for the last 23 years, and being a
22 consumer, myself, there is a phenomenon, I guess
23 is the best word for it, with fuel purchases
24 that's not seen in a lot of other commodities.

25 What I'm getting at is the simple

1 observation that people really do line up to save
2 2 cents a gallon on fuel. It seems strange they
3 won't drive across town to save 2 cents on a six-
4 pack of Coke, but they will line up to save 2
5 cents on a gallon gas.

6 And I believe it's reflected in the
7 report that the for instance when we were at \$3 a
8 gallon, and if there was a 15-degree difference
9 like I've just described, that translates into a
10 3-cent-per-gallon difference in value when
11 comparing the two.

12 And if a consumer is looking at two
13 competing stations that are only 2 cents apart,
14 and makes the 2-cent-less-per-gallon choice in
15 making the purchase he's doing so believing that
16 that's the better deal.

17 But if the temperature differences are
18 vice versa, that consumer will actually experience
19 a 1-cent-less-per-gallon receipt of value in
20 making that choice.

21 And that, in my view, is really the
22 bottomline about this entire issue.

23 MR. SCHREMP: We have two more people in
24 the audience. We're going to have some questions.
25 And then we have Ross Anderson on the phone who

1 will go third.

2 MS. DUGAN: Hey, Ross, it's Judy. Just
3 a followup on what Kurt said. This third level in
4 balance, a little bit more about that. When you
5 have that third level of imbalance and
6 information, information inequality, it means that
7 the consumer not only cannot find out the actual
8 value of the product, the gasoline, because of the
9 temperature of it, but they have no idea that they
10 don't know. This is a blinker over consumers'
11 eyes.

12 The value of taking off the blinkers and
13 giving people who will cross the street for a 2-
14 cent difference in the price of gas, the actual
15 information that they need to make that decision,
16 which is important in the way we conduct business
17 in a society like ours.

18 MR. MURPHY: I just wanted to follow up
19 because I think there was something said that was
20 not quite correct, which is it is true that there
21 is a value to information and the methodology that
22 they generally laid out a valid methodology for
23 assessing that.

24 But the statement that was made that
25 just looked at the price difference, because if

1 you look at their methodology it really matters,
2 not just the price difference, but how much
3 quantity changes.

4 And in fact, you know, that's why the
5 numbers come out so small, because you have like a
6 half a percent price difference, and it may be a
7 half a percent quantity difference. And you
8 multiply those two together. So that's .005 times
9 .005, which is actually .000025. And it's a
10 triangle, so take half of that.

11 And so you can see why the numbers come
12 out so small that they do. So you don't want to
13 say, well, it's half a cent cheaper here, it's a
14 half a cent more expensive there. You have to go
15 through the kind of calculations that they did.

16 And those numbers, once you run them
17 through the proper economic calculations, is what
18 comes out to be small. Not that there isn't a
19 value of information, but you really got to
20 quantify it, because the other things are real
21 costs. And we have to kind of put things apples
22 to apples in making our comparisons.

23 That's all I just wanted to add.

24 MR. SCHREMP: Thank you, Kevin. And
25 just a moment before we get to Ross online, I just

1 want to let people know here in the audience that
2 the three people who will be making presentations
3 after I conclude mine, copies of those
4 presentations are available out in the
5 entranceway. So I just wanted to let you know we
6 now have hard copies of all those presenters'
7 information.

8 Ross.

9 MR. ANDERSON: Thank you, Gordon. Just
10 I wrestled with this cost/benefit analysis in
11 trying to figure out what the dead weight loss
12 really meant.

13 And I'd just like you to -- just in
14 terms of a question. You estimated 117 million
15 gallons difference between net and gross for
16 gasoline, and another 19 for diesel fuel. Street
17 value, well over \$300 million. And yet your dead
18 weight loss is \$3 million.

19 Now my question is does that mean that
20 retailers are 99 percent efficient approximately
21 in getting to the correct gross gallon price for
22 use at retail?

23 MR. SCHREMP: I don't think so, Ross. I
24 mean the information asymmetry discussion, I
25 think, is different than our valuation of consumer

1 benefits of receiving slightly larger sized units.
2 And that's, I think, the 136 million unit
3 difference that we talk about, is not the same as
4 the information asymmetry.

5 I don't quite get what you were asking,
6 Ross.

7 MR. ANDERSON: Okay. So, I was trying
8 to rummage through this as a noneconomist. You
9 know, I was trying to wrestle with what does
10 this -- the information asymmetry mean. And so
11 what you're talking about is this very small
12 little benefit of \$3 million out of a multi-
13 billion-dollar industry that we will improve by
14 making this change. Is that a correct statement?

15 Because, you know, I think the point is
16 when you look at tables 7 and 8 in your paper
17 there, the numbers are so negative, you know,
18 hundreds of millions of dollars in the red.

19 And can I assume that fixing information
20 asymmetry never drives those numbers to the plus,
21 never drives those numbers to where it would
22 benefit the consumer? Unless you can show, by my
23 calculation, that you have to have the information
24 asymmetry a dead weight of 3 to 20 billion, or \$20
25 million a year in order to drive that benefit

1 above the line into positive numbers.

2 MR. SCHREMP: And, Ross, we're going to
3 get to that in just a few minutes.

4 MR. ANDERSON: Okay.

5 MR. SCHREMP: And I will talk about a
6 circumstance whereby you could see a slightly
7 positive, you know, CBA result. I know you're
8 talking about -- and that would be in the
9 recurring years only, not in the initial year.
10 But I'll get to that and I'll talk about that.

11 MR. ANDERSON: Okay. Then I'm fine for
12 now. Thank you.

13 MR. SCHREMP: Okay, thanks, Ross. Oh,
14 and here we are. This is essentially what Ross
15 was referring to in the report. We have a couple
16 of tables, I think 6 and 7, and this is the low
17 estimate where we look at basically ten years. We
18 look at an initial year we refer to as year one,
19 and we have initial cost in the industry. So the
20 devices haven't been activated yet.

21 \$102 million, and so that's a large net
22 cost. And about .5 of a cent per gallon for that
23 year.

24 Then we have those recurring costs I
25 discussed, over \$4 million on the low side. And

1 we have those information asymmetry benefits, that
2 small amount. And, yeah, we've had some comment
3 about well, it's actually half that number. Okay.

4 And we've also had some input on the
5 recurring costs, maybe that's too low because of
6 the number of stations receiving new dispensers.
7 It's sort of an unusually low level right now.
8 But we'll go up to a more normal replacement rate
9 of maybe once every 12 or 15 years. So those
10 numbers could also change.

11 But for the numbers we have in the
12 report, if you do the comparison with benefits and
13 the costs, you do end up with net negative
14 numbers, I guess over \$1 million a recurring
15 basis. And that translates to a very small per-
16 gallon net cost of -- that's six-thousandth of a
17 cent per gallon. So, a million dollars, a lot of
18 gallons. You get a very small cent-per-gallon
19 valuation on that.

20 Now, looking on the high side, you see
21 that the initial cost is slightly higher for that
22 first year, .7 of a cent per gallon for the year.
23 And then you have higher recurring costs and you
24 end up with about \$10 million a year on a
25 recurring basis of net cost. And that's about a

1 sixth of a cent per gallon.

2 So, can you -- is there -- will
3 information asymmetry overcome those recurring
4 costs? No, they won't. But I'll talk about how
5 there could be some differences in terms of
6 changing the assumption on the recurring cost that
7 could end up with a slight positive. I'll get to
8 that in just a minute.

9 But essentially the CBA results are
10 looking at a negative result for society. So
11 almost no matter how you look at it you end up
12 with a negative result. And that's essentially
13 because -- sorry, in the reference temperature
14 it's -- sorry, let me go back to the reference
15 temperature of the two options.

16 The initial cost, I don't have a table
17 for it, is only for the first year. It's a small
18 amount of money; it's four to 13 hundredths of a
19 cent per gallon that first year before the
20 adjustment for the dispensing device. There are
21 no recurring costs, nor is there recurring
22 benefits.

23 Actually information asymmetry is a very
24 very very small part, and it's so small that we
25 didn't include that in here. So, you essentially

1 have, on a recurring basis, zero net cost on a
2 recurring basis. So, you have just the initial
3 year cost for the reference temperature example.

4 So, under what conditions could
5 potential net benefits be positive for all
6 consumers. These are in that society we talk
7 about, retail motorists essentially.

8 And that is using the numbers in the
9 report, recognizing that they will likely, based
10 on comments, they will be modified, that if you
11 change the assumption about what the failure rate
12 of the equipment is, it's not 2.5 percent; it's
13 actually about 1 percent.

14 Well, then that recurring cost amount
15 would be low enough that it would be slightly
16 below that of the information asymmetry valuation.
17 So you end up with, for society, a slight net
18 benefit. And by slight I mean \$40,000 a year
19 statewide. And that's two ten-thousandths of a
20 cent per gallon if you want to value it that way.

21 So, these are very small numbers no
22 matter how you look at them, on a recurring basis.
23 This is not the initial year, this is on a
24 recurring basis.

25 But, once again, based on some of the

1 feedback we're getting that the information
2 asymmetry number is a bit too high, and that
3 possibly the low recurring cost number is too low.
4 Then there's likely nothing you can do in the
5 assumptions to get to a positive on a recurring
6 basis.

7 So, yes, Carl.

8 MR. BOYETT: Gordon, Carl Boyett, SIGMA.
9 Does a 1 percent failure rate mean that they would
10 fail once in every 100 years?

11 MR. SCHREMP: The rate we're using that
12 that percent of the components that are failing
13 every year.

14 MR. BOYETT: Okay, so that means that
15 all of them, on average, would fail once every 100
16 years?

17 MR. SCHREMP: Yeah, I -- well, some
18 would --

19 MR. BOYETT: At 1 percent --

20 MR. SCHREMP: -- some would last as long
21 as that. Others --

22 MR. BOYETT: Well, 1 percent would be
23 the average, would be 100 years.

24 MR. SCHREMP: Yeah.

25 MR. BOYETT: I question that.

1 MR. SCHREMP: Well, I don't think that's
2 quite -- we're looking at --

3 MR. BOYETT: Well, if 1 percent failed
4 each year, then 100 percent of them would fail in
5 100 years.

6 MR. SCHREMP: I guess so, but I'm -- I
7 suppose that's right. I'm trying to think of
8 it --

9 MR. BOYETT: It just seems awful small
10 to me.

11 MR. SCHREMP: I think of it, it's back
12 to in how they manufacture the components and how
13 rigorous the components are manufactured to
14 withstand being out in the fuel dispenser box in
15 the heat and the cold. And to not have a failure
16 rate where they're having to go out in the first
17 12 to 24 months on their dime and repair that.

18 So, at some point there's a tradeoff
19 between how rigorous you build components to in
20 the standards so they can withstand a long
21 time --

22 MR. BOYETT: So maybe it means a 1
23 percent fail while it would be in warranty, and
24 the rest of them would be on us?

25 MR. SCHREMP: Yeah, yeah.

1 MR. BOYETT: Okay.

2 MR. SCHREMP: Yes, Kevin has a question.

3 MR. MURPHY: If you go down that road is
4 there a reason why you'd focus on the recurring
5 costs rather than include the upfront costs which
6 would still more than swamp the long-run benefits,
7 right? I mean presumably we want to consider all
8 the costs, both the upfront and the recurring
9 ones.

10 Also, I would question the idea of
11 whether the impact of a capital expenditure on
12 product prices would all show up in the year in
13 which the capital expenditure is made.

14 You know, somebody goes out and builds a
15 gas station, they don't say I got to charge enough
16 in year one to recover the cost of building my gas
17 station. That's factored in as a capital cost
18 component that's carried out over the life of the
19 equipment.

20 I would presume the market would lead to
21 that same effect here where you'd like to really
22 take that year one expenditure and push it out,
23 because that's how markets work, right? You don't
24 recover all the costs of a capital expenditure, in
25 this case it's going to last 100 years, in year

1 one. You're going to spread that out. In which
2 case I don't think even this change would change
3 the bottomline. But the net would still be
4 negative, so I just wanted to put that out.

5 MR. SCHREMP: Yeah, Kevin, you're right.
6 You know, there's no -- the only reason we're
7 talking about this recurring basis is, just to
8 give an example, where on a recurring basis you
9 could see a slightly net benefit result.

10 But, in recognition of some of the
11 information we received just today, that it's now
12 unlikely you can even see that on a recurring
13 basis.

14 But, you're right, overall you look at
15 the entire stream of years and you add up all of
16 those cost/benefit differences, and you total them
17 all up, net present valuation calculation, and
18 you're right, even with this assumption of
19 changing the failure rate, you would still be net
20 negative. That's correct, on the low case and on
21 the high case. So, you're right.

22 I think you'd have to essentially take
23 it out to some ridiculous number of years to try
24 to -- but I don't think, even at that small
25 number, you could do that.

1 But, you're right, so overall it would
2 be negative no matter what, when you add them all
3 up.

4 Yes, Judy.

5 MS. DUGAN: I know there'll be more
6 discussion of this, but the point is that I don't
7 think everyone is going to accept the fact that
8 100 percent of the costs will be recovered in a
9 competitive business like fuel market, that the
10 assumption you're making is that first, that no
11 cost will be absorbed elsewhere in the chain of
12 supply. That no costs will be absorbed by the
13 branded supplier of the fuels, especially true
14 with branded stations.

15 That no cost will be absorbed by the
16 brand in terms of switching out to pumps with
17 automatic temperature compensation. That the
18 assumption is that no costs will be absorbed by
19 the retailer. And that no costs will be absorbed
20 anywhere else along the line.

21 I think this is unrealistic in a
22 competitive business. I think that especially in
23 a vertically integrated business where there is a
24 high involvement and interest all the way up the
25 line of the supplier that there's every likelihood

1 that some of the costs can be absorbed by the
2 brand, both providing what are called image funds
3 for the switchover. And possibly in repricing, by
4 a fraction of a cent, their product.

5 Because there won't be transparency all
6 the way up and down the line. And the interests
7 of the brand is in keeping their retailers in
8 business.

9 MR. SCHREMP: Thank you, Judy. And we
10 did not consider looking at those expenses, even
11 on a recurring basis or in initial year as being
12 spread back up through the chain. No, we did not
13 look at that scenario in this analysis.

14 But I think we do talk about, and I'll
15 show it in just a few minutes, those slides about
16 profitability of the industry over time, and how
17 those profits have changed.

18 And so we are looking at a part of that
19 chain with that information. And that information
20 shows us that the industry is profitable, and the
21 profits do vary. But they predominately have been
22 positive. And we expect those to remain positive.

23 And that's been in the context of rising
24 expenses for wages, labor, equipment
25 modifications, credit card fees, you name it. And

1 yet there's still a profitability. So, somehow
2 the industry collectively is being able to pass
3 along those expenses, so to speak.

4 But the example that you gave, no, we
5 did not look further up the chain.

6 MS. DUGAN: I would hope that you would.
7 I mean the industry doesn't stop at the apron to
8 the gas station. There are relationships far up
9 the supplier line that would have an interest in
10 making this come out, you know, without damage to
11 the retailers.

12 And there are much higher profit levels
13 farther up the chain. When you get up to the
14 vertically integrated oil companies.

15 MR. EICHBERGER: Gordon, John Eichberger
16 with the National Association of Convenience
17 Stores. Just a point of clarification. Ms.
18 Dugan's comment about possibly the brand supplier
19 absorbing some of the costs associated with
20 retrofits, or providing some cost assessment, kind
21 of misunderstands the relationship between branded
22 suppliers and the branded retailers. There is no
23 love lost between the two whatsoever.

24 Any financial assistance that brands
25 provide the retailers is always recovered in the

1 contractual terms. There is controversy right now
2 regarding early termination of contracts, the
3 recapturing of the lost profits by the branded
4 supplier.

5 This is not a, hey, let me help you out,
6 here's some money, go forth and prosper. It is,
7 here is some money and now you're going to pay me
8 back with interest. And the terms of your
9 contract are going to be such that the branded
10 supplier is going to get theirs and then some.

11 So any assumption that there's some
12 benevolence on the part of the supplier to the
13 retailer is completely false within this
14 marketplace. Yes, it is competitive; yes, it is
15 integrated. But keep in mind the integrated oil
16 companies own fewer than 3 percent of convenience
17 stores in the nation.

18 The majority of retail locations are
19 independent owners and operators. More than half
20 have branded contracts that they pay for. They
21 pay a surcharge on every gallon they sell in order
22 to recover any type of financial assistance they
23 get from their suppliers.

24 So I just wanted to clarify that. Thank
25 you.

1 MR. SCHREMP: Thank you, John.

2 MR. BOYETT: Dale Boyett, Boyett
3 Petroleum. Probably the best way to help prove
4 John's points is that right now we have something
5 called EVR. That by April 1st it's an expense of
6 about \$50,000; has to be done by every station in
7 California.

8 And currently about 23 percent of the
9 stations are done. No fuel supplier is helping
10 anybody do that. And all these stations that are
11 not done will go out of business on April 1st.

12 So it is not the suppliers' problems, it
13 is not their interest. They would say, you take
14 care of your sector, retailers. And we have
15 living proof of that right now. We're in the
16 middle of it.

17 MS. DUGAN: And what's the cost per
18 station?

19 MR. BOYETT: It's about \$50,000 a
20 station. And 23 percent, I believe, is the number
21 by CARB as of what, December 1st?

22 MR. SPEAKER: November 1st.

23 MR. BOYETT: November 1st. And the
24 suppliers are not helping out one bit on any of
25 that, so. They have no interest in retail

1 problems.

2 MR. SCHREMP: Thanks, Dale.

3 MR. SIEBERT: Gordon, John Siebert. Are
4 you guys saying that you kill the golden goose?

5 MR. BOYETT: What?

6 MR. SIEBERT: You don't need retailers?

7 MR. BOYETT: We are retailers.

8 MR. SIEBERT: Yeah, the wholesalers
9 don't need retailers. The producers don't need
10 retailers? If you put them out of business
11 they're not going to be there for the wholesalers
12 to sell to.

13 Yes, you're going to take care of your
14 retailers.

15 MR. BOYETT: Not according to historical
16 examples.

17 MR. SIEBERT: So you put them out of
18 business.

19 (Parties speaking simultaneously.)

20 MR. BOYETT: There will always be
21 another retailer because there's always consumers.
22 But you have to look at past experience for a
23 lesson on future activities.

24 MR. SIEBERT: I'll read up on
25 Machiavelli.

1 MR. BOYETT: Probably a good idea.

2 (Laughter.)

3 MR. ROBINSON: I think everybody wants
4 to debunk this myth. We are 100 percent private
5 brander. One reason we are that is because we
6 look at the benefits that the majors provide the
7 brand suppliers and we think that they get over-
8 compensated for those benefits.

9 I think jumping to the conclusion that
10 they're trying to put us out of business doesn't
11 make any sense. The reality is that as we deal
12 with costs through mandates or whatever, it just
13 happens to be our challenge to take those costs to
14 the marketplace. And in a competitive market if
15 we're going to survive we have to be able to pass
16 those on to consumers.

17 So the majors, the branded suppliers,
18 the branded or unbranded suppliers, aren't trying
19 to put us out of business, but they're certainly
20 not subsidizing us to solve the various mandates
21 we deal with. And EVR is a good example.

22 MR. SCHREMP: All right, we'll continue
23 moving along here. And I'm sure I won't have any
24 comments on this. Could there be some
25 circumstances where some consumers could see a net

1 benefit? And in the construct I have here, we
2 believe so. But let's be clear. From a societal
3 perspective you'll still see a net cost.

4 So, in other words, can there be
5 circumstances in that society, in that group of
6 consumers, some winners and some losers? Yes, we
7 believe that can be the case. But, collectively,
8 still in that cost.

9 So, this is just -- this chart is just
10 meant to illustrate, well, under what changing
11 conditions could you see slight, you know, net
12 benefits as measured in cents per gallon. And
13 that has to do with the amount of the, I guess the
14 revenue shift recovery that occurs on the fuel,
15 nonfuel, you know, what ratio. And in what value
16 is the fuel being sold.

17 So, I guess now we're down in the lower
18 part of the \$2 a gallon range. And so under this
19 construct, if 95 percent of the revenue recapture
20 was just on fuel, and only a very small amount of
21 fuel, you see a very very small net positive under
22 this example.

23 If the revenue recapture was on 75
24 percent of the fuel and 50 percent on nonfuel
25 items, you could be at a little over a third of a

1 cent per gallon.

2 But recognize again that's for those
3 fueling events where there's only a purchase of
4 fuel. There's no subsequent purchase inside the
5 convenience store, which, in California and the
6 U.S., is about 80 percent of the fuel sales that
7 occur to retail.

8 So, this is just meant to illustrate
9 that those potential benefits for those fueling
10 events vary according to price and vary according
11 to how the station is trying to recapture that
12 sort of revenue shift that would occur if ATC was
13 put at retail.

14 So, but once again, from a net society
15 perspective it's still going to be cost no matter
16 how you look at it.

17 There's already been some discussion on
18 the industry. I just wanted to point out, and
19 this has to go toward staff's assumption of
20 profitability of the industry and the sustainment
21 of profitability into the future.

22 So, convenience stores are the
23 predominant means of selling fuel in the United
24 States, and in California, about 80 percent.
25 There are hyper marts like CostCo. And you have

1 some car lots that actually have some retail
2 sales, and fuel-only outlets are those stations
3 that only sell fuel. There are some still
4 around. The nice stations with the
5 attendant are -- those are all out of business, as
6 days gone past.

7 The pre-tax profits for the national
8 levels are about \$33,000 a year over the last ten
9 years. But they do range from a low of under
10 \$20,000 -- and this is on a per-station, per-year
11 basis pre-tax profits -- and up to a higher level.

12 So you do see there's fluctuation. I'm
13 sure if we looked at other industries we'd see
14 other types of fluctuations that have to do in
15 large part with the strength of the economy or the
16 weakness of the economy.

17 Looking at the margins, gross profit
18 margins, fuel, the low line, has been declining.
19 And the instore, the nonfuel items sold, have been
20 somewhat stable, but declining these last three
21 years.

22 And so this shows you that there are
23 various profit margins depending on the type of
24 commodity being sold, and that there are some
25 trends here.

1 We are not assuming that the motor fuel
2 trend, for example, will continue declining down
3 to that of zero, following this trend line out.
4 We're assuming the industry will remain, as a
5 whole, profitable moving forward, like it has in
6 the past.

7 This just looks at the per-gallon
8 margins on fuel. And I think, in some part, this
9 goes to, well, expenses, capital expenses, well,
10 that can only be, say, recovered in fuel alone.

11 Well, okay, if that's the case, then I
12 would expect to see these margins going up over
13 time to capture, you know, only get higher rents,
14 recaptured in fuel. Only get higher wages. Only
15 get enhanced vapor recovery, which hasn't
16 occurred. And only get higher credit card fees
17 only on the fuel.

18 We believe that the industry, and this
19 being the retail station industry, has the
20 flexibility to try to recover all sorts of
21 increased expenses through both fuel and nonfuel
22 good sales. And not limited solely to looking at
23 fuel trying to recover those costs.

24 But further, we believe the industry
25 will be successful in passing along these expenses

1 in the long run. Yes, some stations, as John
2 mentioned, might go out of business. New ones
3 will come in. And even collectively in the United
4 States and California even see a gradual decline
5 of stations relative to the number of consumers,
6 meaning stations are selling more fuel on average
7 per location, fewer stations, more through-put.
8 So that's certainly been a trend that also could
9 continue.

10 Voluntary versus mandatory. This has
11 been an issue. This is certainly the case in
12 Canada. Permissive or voluntary is the way it is
13 in Canada right now. You're not mandated to do
14 that, but if you do temperature compensation at
15 retail in Canada, you have to abide by the rules
16 and regulations and procedures in that country.

17 But in California permissive or
18 voluntary ATC at retail is permitted. You are
19 allowed to have ATC at retail. As far as we know
20 no one has installed and activated those types of
21 dispensers. But it is possible.

22 Staff has concluded that if permissive -
23 - well, staff has concluded that there need to be
24 adequate, I think, safeguards, I guess is the best
25 way to say it, for consumers that all of the

1 different aspects of temperature compensation at
2 retail be attended to, and say, you know, maybe a
3 neater regulatory package.

4 We understand that from DMS has many
5 standards, temperature compensation is something
6 used at retail for other fuel types, gasoline and
7 diesel fuel. They are very familiar with
8 temperature compensation for those fuels.
9 Procedures for testing those devices, and
10 regulations for how long you can have temperature
11 compensation operational, 12 months at a time at a
12 minimum each time. You can change that.

13 So there are many of this laundry list
14 of items on here that DMS either has current
15 regulations or the tools at their disposal to
16 address this. But not all of them yet, and not
17 certainly in a neat package.

18 So I think from staff's perspective and
19 our conclusion that permissive shouldn't be
20 allowed until there is more of that for larger,
21 more complete package, that permissive not be
22 allowed. But there's differences of opinion on
23 that certainly, but it shouldn't be taken that
24 staff has concluded that permissive ATC retail
25 should not be allowed. We're not making that

1 conclusion. We're just saying that there needs to
2 be a sufficient number of, I guess, primary
3 consumer safeguards before that happens.

4 So, there's a question here?

5 MR. GETTO: Yes. Ernie Getto from
6 Latham and Watkins. The first statement on this
7 slide that permissive voluntary use of ATC devices
8 in California is permitted because it's not
9 specifically prohibited, we feel is erroneous.

10 California law clearly prohibits
11 voluntary ATC at this time. We think that legal
12 conclusion is beyond the scope of the mission of
13 the Energy Commission in doing this draft report.

14 And rather than belabor the record now
15 we're going to file a short memorandum with the
16 Commission laying out this view. But it is
17 erroneous. Thank you.

18 MR. SCHREMP: Well, I don't know if
19 anyone else wants to respond. I believe that this
20 issue came up during the spring, I think. And I
21 think a request was made to DMS to prevent, I
22 think emergency regulations to prevent the
23 application of ATC at retail.

24 Is that -- that's correct. So I think
25 this issue surfaced at the time. And I believe

1 DMS concluded that there's nothing prohibiting ATC
2 at retail. Is that right?

3 MR. WILLIAMS: That's correct.

4 MS. DUGAN: What is the cite of
5 California code for that? I'm talking about that
6 it's forbidden, when you said --

7 MR. GETTO: Well, ATC, as described in
8 the report, when implemented would (inaudible) --

9 MR. SCHREMP: Could you come up to the
10 microphone, please?

11 MR. GETTO: -- would provide a variable
12 gallon at retail. And California law is clear. I
13 mean there are many provisions in play here, but
14 one is the California law is clear that a gallon
15 is defined as 231 cubic inches exactly,
16 irrespective of temperature.

17 So, on its face ATC would permit or
18 would have variable gallons being dispensed
19 contrary to California law. And were a dealer to
20 do that, he or she could be subjected to criminal
21 penalties in the state.

22 MS. DUGAN: What's the cite on that?

23 MR. GETTO: I can give you that. I'll
24 send you my memorandum --

25 MR. SCHREMP: I think, Jay, before you

1 go --

2 (Parties speaking simultaneously.)

3 MR. SCHREMP: Jay.

4 MR. McKEEMAN: Jay McKeeman, California
5 Independent Oil Marketers Association. We did not
6 retail Latham and Watkins, but we agree with their
7 analysis.

8 On page 8 of the report basically
9 establishes what California law stipulates. And
10 in the third bullet it says, defines the unit of
11 gallon as 231 cubic inches exactly. So I think
12 that that's the cite that they're relying upon.
13 And that's the one that we went to when we thought
14 there was a problem.

15 MR. WILLIAMS: That's true.

16 MR. SCHREMP: So I guess we'll wait to
17 see your information and address it at that future
18 time.

19 There are -- oh, --

20 MR. SIEBERT: I'll just jump up.

21 MR. SCHREMP: John, identify --

22 MR. SIEBERT: John Siebert.

23 MR. SCHREMP: Thanks.

24 MR. SIEBERT: With OOIDA. You're asking
25 for legislation to ban it. What's the inertia

1 cost of having it banned by legislation because
2 you're going to have to overcome something that
3 has been -- even if we have sufficient standards,
4 when would we know that we had sufficient
5 standards to overcome something that's permitted
6 now, but which you're recommending be banned?

7 MR. SCHREMP: I think there are a number
8 of, as I characterized it, there's not, I guess
9 I'd say, a clean section in the immense
10 regulations one can go to to read about, okay,
11 here's all how to provide, abide by to sell ATC
12 compensated fuel for gasoline and diesel fuel.

13 And they're not clearly defined sets of
14 procedures for, say, weights and measures
15 officials to go out and check calibration on such
16 a dispenser at this time.

17 It doesn't mean that DMS is unaware of
18 how they would do that. It doesn't mean that DMS
19 does not know what portions of their existing
20 regulations that they can refer to that would also
21 apply to retail ATC application of gasoline and
22 diesel.

23 So, we're not suggesting that there's an
24 outright ban. We're just saying that
25 clarification and identification of all those.

1 And does that take a new regulation to put them
2 all together? I don't know the answer to that.

3 But, it's say, not as clean as it is in,
4 say, some other -- say Canada where it's pretty
5 clear what the regulations are and you can go find
6 those.

7 So I think we're not suggesting that
8 there's an outright prohibition period in the
9 discussion. We're saying there needs to be
10 additional information and clarity with regard to
11 how one would do that. And recognizing that we
12 believe that it is a permissive now.

13 MS. DUGAN: You're clearly calling for a
14 law to forbid it. That is your recommendation,
15 right?

16 MR. SCHREMP: Unless these items are --
17 so, if that's --

18 MS. DUGAN: But who would --

19 MR. SCHREMP: -- unclear, we will change
20 that. Yeah. Yes, Ken.

21 MR. LAKE: I just wanted to make a point
22 of clarification. Ken Lake with Measurement
23 Standards.

24 There are regulations that specify that
25 packaged petroleum products are sold at 231 cubic

1 inches at 60 degrees. And as well as other
2 liquids are at 68 degrees and refrigerated liquids
3 are at 4 degrees C.

4 That is in regulation, and it's also in
5 the national model regulations. So, I'm not sure
6 that that conflicts with law, but it seems like
7 there is a precedent not to establish it at
8 whatever temperature it happens to be.

9 There's also consideration against fraud
10 by artificially heating fuels to expand their
11 volume and sell them for an inflated gallon would
12 obviously be an area of concern. So I'm not sure
13 it's that cut and dried. I'm not an attorney, but
14 our legal staff can probably respond to that
15 issue.

16 MR. SCHREMP: So it sounds like we'll
17 certainly be revisiting this topic in the report.
18 So, another comment?

19 MS. DUNCAN: Yes. This is Tristan
20 Duncan with Shook, Hardy and Bacon. We share the
21 legal conclusions articulated by Latham and
22 Watkins, and to the point that the prior speaker
23 just made.

24 The maxim that you're relying on, which
25 is if it's not specifically permitted, it's

1 prohibited. I mean if it's not expressly
2 prohibited then it's permitted is not actually
3 applicable in the temperature compensation
4 context.

5 And the reason is is because that maxim
6 applies only when you have a statutory scheme that
7 is silent on temperature compensation entirely.
8 And as your speaker just pointed out, because
9 temperature compensation already is permitted,
10 both the wholesale level and for propane and in
11 other levels of the energy field, that maxim
12 doesn't apply.

13 Instead, the maxim that says if it is
14 specifically permitted in one area of the scheme,
15 it necessarily must be interpreted to be excluded
16 where it is silent.

17 So, in this situation where you have
18 temperature compensation silent at the retail
19 level, that has to be construed as a prohibition,
20 not permission. Otherwise you aren't doing
21 justice to the legislative intent. The
22 legislative intent is expressed in the statutory
23 scheme, as a whole. And you have to read the
24 statutory scheme as a whole, and you have to
25 construe the silence at the retail level as a

1 prohibition, not permission.

2 And so the point we make in our memo
3 that we also will be presenting to the Energy
4 Commission is that you are relying on an in-
5 applicable maxim for interpreting the correct law.
6 And that the appropriate rule of statutory
7 construction is actually prohibition.

8 And so our point would be you don't need
9 to amend the statutes to have an express
10 prohibition. It already exists. And the
11 California Supreme Court hasn't construed
12 California law that way. And so we'll give you
13 some California Supreme Court precedent, as well.

14 Thank you.

15 MR. SCHREMP: So I guess making it --

16 PRESIDING MEMBER BOYD: Gordon, I think
17 there's a lot on the record on this point. I
18 think there's no question now that staff is going
19 to have to consult its own attorneys. So, I think
20 we should let this question lie at that point. We
21 have it in the record now. We will be receiving
22 written comments, and maybe more possibly as a
23 result of this discussion.

24 But I do think you have to turn to your
25 own attorneys now for interpretation. Let's move

1 on. We're an hour behind schedule already.

2 MR. SCHREMP: Very well. There are some
3 other issues. If ATC were to be mandated at
4 retail, and I'm going to cover three main areas.
5 There's a longer laundry list in the document you
6 can look at.

7 But it's basically labeling, will be the
8 compliance schedule, if ATC were to go into effect
9 at retail. And what about other types of fuels
10 besides gasoline and diesel fuel that we've been
11 discussing for this point in time.

12 So, if ATC is required at retail
13 stations staff concludes that the information
14 being displayed on the dispenser would be
15 sufficient, and you wouldn't need information
16 displayed on the big sign. Why? It's required
17 everywhere.

18 If there's a voluntary or permissive
19 system in California, then staff believes that
20 large signs would provide sufficient information
21 to consumers of whether or not that particular
22 station actually had temperature compensation.

23 So, that's essentially some of the labeling
24 issues out there.

25 Printed receipts. There is no

1 requirement in Canada for anything. And the staff
2 has concluded that a message should be an option
3 to put onto the receipt, but trying to put more
4 information like, here's the exact gross gallons,
5 here's the exact net gallons, here's the
6 temperature, that kind of information is
7 increasingly difficult to obtain.

8 It has to do with the software
9 manufacturers of the ATC devices, and the software
10 for the point of sale devices.

11 Over time it's possible that those kinds
12 of softwares can work together so that kind of
13 information could be put onto a printed receipt.
14 But at this time that would be a very expensive
15 proposition to try to attempt that.

16 And, once again, in Canada where they
17 actually have temperature compensation, they do
18 not require that kind of information on the
19 receipt.

20 Compliance schedule. There are various
21 simply three main aspects. There would be
22 legislation that would obviously have to be
23 written up, approved and signed into law. There
24 are Division of Measurement Standard regulations
25 and guidance documentation that would be

1 developed. Those are workshops.

2 And then there is modifications to the
3 existing dispensers, themselves, over some period
4 of time. Because there are 10,000 locations.

5 So we talk about the compliance schedule
6 for reference temperature because it contains
7 those three steps. But it does not contain a step
8 where you have to approve certain devices for use.
9 Obviously because we're just making modifications,
10 minor modifications to existing dispenser. That's
11 about 18 to 24 months.

12 For ATC at retail the anticipated
13 compliance schedule is a bit longer, one might
14 say. About five to six years. And this, in fact,
15 is a bit shorter time period than has been
16 discussed at the National Conference on Weights
17 and Measures.

18 There are a number of discrete steps in
19 here. And a lot of these take time for regulation
20 development, and a lot of time would be expended
21 for manufacturers to obtain certification for
22 their devices.

23 And then you got to put the devices in,
24 and when you would turn them on would they be
25 activated right away or not. That's in the

1 report. We talk about that and address that.

2 So, it's not a quick process if that's
3 where, you know, the state actually ends up going.
4 It is a rather lengthy process.

5 There are other transportation fuels we
6 looked at. Aviation fuel, staff concluded, should
7 not be part of an ATC retail requirement due to
8 the disproportionately greater use of mechanical
9 and more expensive devices of a much lower
10 through-put on average, that those aviation fuels,
11 that would be aviation gasoline primarily, jet
12 fuel sold at retail and some military fuel.
13 Obviously probably exempt for federal reasons.

14 And also bunker fuel clearly is not sold
15 at retail, so that would not be part of an ATC at
16 retail obligation.

17 Last slide. There are some next steps.
18 We have proposed comments be submitted to us until
19 through December 19th. And if the Commissioners
20 want to modify the time to submit comments, you
21 know, they'll certainly let us know.

22 We will have a revised document at some
23 point that we will then release to the public.

24 The next step, as we have laid out here,
25 is to go to a full business meeting. And I think

1 we're looking at a target of February 11 in 2009.

2 And those are on a Wednesday.

3 And so will certainly be mailing out a
4 notice in January. And we have a revised report
5 that would go to that meeting.

6 We anticipate that following adoption
7 that the report will be then delivered to the
8 Legislature and the Governor's Office. The
9 report, as directed by legislation, will contain
10 recommendations at that point.

11 So, Jay.

12 MR. McKEEMAN: Jay McKeeman, California
13 Independent Oil Marketers. In your notice on the
14 meeting today it says comments would be accepted
15 until January 5th. So I'm wondering, is that a
16 change in the --

17 PRESIDING MEMBER BOYD: That's what the
18 notice says, Gordon.

19 MR. SCHREMP: Oh, --

20 (Laughter.)

21 MR. McKEEMAN: I'm a stickler, okay.

22 MR. SCHREMP: Well, I guess -- since
23 that's what the notice says, I guess that's -- I
24 guess we're bound by that, I suppose.

25 PRESIDING MEMBER BOYD: Well, the

1 Committee can talk about it.

2 MR. SCHREMP: Well, I think -- we've
3 received a lot of information. We'll receive more
4 with the subsequent speakers today. We hope
5 people will endeavor to provide us their comments,
6 you know, suggested as whatever they might, as
7 quickly as they can.

8 Staff will have to take that. We have
9 to work with the Committee. We have to work to
10 provide a revised document. So there will be some
11 work there. So we're just -- but thank you for
12 pulling that out. Okay.

13 That concludes my comments. And do the
14 Commissioners have any questions at this point,
15 or --

16 PRESIDING MEMBER BOYD: You caught us in
17 the middle of a discussion. Your question was did
18 we have any more comments, I believe?

19 MR. SCHREMP: Yes.

20 PRESIDING MEMBER BOYD: No. I think we
21 should move right smartly along to the agenda
22 since we're -- now, there is a problem. You say
23 in the agenda lunch time, but we have three people
24 scheduled to speak. Do you want to -- do any of
25 these folks have travel logistics problems if we

1 were to break now and come back in an hour?

2 Let's take a lunch break now, come back
3 in an hour. Give you 15 minutes to beat the
4 crowd.

5 (Whereupon, at 11:45 a.m., the workshop
6 was adjourned, to reconvene at 12:45
7 p.m., this same day.)

8 --o0o--

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 AFTERNOON SESSION

2 1:00 p.m.

3 PRESIDING MEMBER BOYD: You know where
4 to find Gordon anytime you need him.

5 MR. McKEEMAN: I do have his phone
6 number.

7 MR. JANUSCH: He'll be here in about a
8 minute.

9 MR. McKEEMAN: Okay. My name is Jay
10 McKeeman; I'm with the California Independent Oil
11 Marketers Association, and also today representing
12 the Petroleum Marketers Association of America.

13 I'm introducing Mr. Flynn today as a
14 person that brings some additional information to
15 the, quote, "hot fuels debate."

16 During our participation in the various
17 workshops, and our I need to define as the
18 Petroleum Marketers Association of America, the
19 National Association of Convenience Stores, SIGMA
20 and NATSO.

21 During our participation in the previous
22 workshops we were a little concerned that there
23 were some analytical paths that weren't being
24 explored quite thoroughly enough.

25 So we jointly retained Mr. Flynn and his

1 firm to take a look at gathering some additional
2 information. And his presentation today is
3 offered in the spirit of providing mortar between
4 the bricks.

5 We think the Energy Commission has done
6 an excellent job of correctly analyzing that
7 temperature correction is going to be a cost to
8 society and to the consumer. We might argue with
9 the definition or the articulation of slight in
10 the report; and that's basically what Mr. Flynn's
11 going to address.

12 But I do want to take this opportunity
13 to really compliment the Commission and the staff
14 for providing a level playing field for this
15 debate. One of the things that was seriously
16 missing in this discussion was a good solid
17 analytical treatise on temperature compensation.

18 There were allegations, counter-
19 allegations, benefit numbers being thrown around,
20 cost numbers being thrown around. And we believe
21 that the Energy Commission has really come up and
22 helped focus the debate on the appropriate issues
23 and the appropriate figures.

24 John Eichberger is up at the table from
25 the National Association of Convenience Stores.

1 Holly Alfano is up at the table with NATSO. And
2 I'll be sitting there.

3 We're there more to answer questions or
4 provide some, I guess, reality points, because
5 this discussion does tend to get into some serious
6 economic discussion. So if we believe there need
7 to be some touchstones provided, we'll chime in
8 with those. But basically it's Mike's
9 presentation, but feel free to ask questions of
10 any of us. Thank you. Mike.

11 MR. FLYNN: What I'd like to do -- thank
12 you, Jay. There was a couple of points that came
13 up; during the earlier presentation today that I
14 just wanted to touch on briefly, because I had
15 kind of a limited agenda of points that I wanted
16 to try and cover today.

17 I've been asked by the organizations
18 that hired my firm to put everything into a
19 whitepaper that will be made available to the
20 Commission; then I guess through the Commission to
21 everyone in the early January timeframe.

22 So what I'm talking about today are just
23 a few highlights from what is expected to be a
24 much longer and more comprehensive whitepaper.

25 But the two points I wanted to touch on

1 were, first, the question of the impacts on fuel
2 availability and pricing that would ensue if
3 retailers dropped out of the market.

4 Gordon discussed this as a potential
5 issue, but felt that it was -- its import was
6 limited to rural areas, or areas served by only a
7 handful of retailers at most.

8 And what I wanted to offer was that this
9 issue has actually been studied extensively by
10 economists who do study and analyze the petroleum
11 industry, and especially the retail end of it.

12 And what has been found repeatedly is
13 that the retail prices in a particular area are a
14 significant function of the density of stations in
15 that area. In other words, the more stations per
16 square mile there are in a particular community,
17 other things equal, the lower are retail prices.

18 And what this means, the practical
19 significance of it, is that losing any station has
20 a non-zero impact on retail prices. The size of
21 that impact does also depend on how many surviving
22 stations there are.

23 But if a station drops out of the market
24 that's not a problem confined to rural areas. It
25 would raise prices, like I say other things equal,

1 everywhere. And there's quite a literature on
2 that. And I expect to cite to it in the
3 whitepaper.

4 The second point, and the one that is
5 more central to my approach to the CEC Staff
6 report has to do with the speed by which retailers
7 pass through increases in their costs to their
8 retail prices or to their street prices, or pump
9 prices, whatever you want to call them.

10 And this is an issue that has received
11 considerable attention in the economics
12 literature. And it goes by a shorthand that also
13 has been picked up in government studies and
14 others. And that's the so-called rockets-and-
15 feathers debate.

16 And this is the shorthand reference to
17 the repeatedly studied and documented phenomenon
18 that when the costs of retailers, retail fuel
19 stores, go up, they pass through those costs to
20 their street prices with considerably alacrity.

21 And the question is at exactly what rate
22 does this normally happen. And as you may have
23 heard, in general the rule of thumb is that retail
24 street prices will go up like a rocket almost
25 instantly with any increase in especially fuel

1 prices, the wholesale fuel prices.

2 They come down a little more slowly as
3 competition at the retail level forces street
4 prices to subside.

5 But this phenomenon has been studied
6 extensively. If I can just offer a couple of the
7 economists who have written on it repeatedly,
8 Severin Borenstein, Rich Gilbert, who I've worked
9 with a lot, John Zyren and his colleagues at the
10 Energy Information Administration. And it's a
11 pretty well established and generally accepted
12 result in economics.

13 And the reason I harp on this is because
14 it's at the heart of what I think you now perceive
15 as the debate or the disagreement over how rapidly
16 retailers will be successful in, quote,
17 "recapturing" the revenue that in the initial
18 instance they would lose if they were required to
19 dispense fuel in net gallons, but continue to
20 charge their previous gross prices per gallon.

21 And I just want to highlight the fact
22 that this is not conjecture. It's been
23 extensively studied. And in the whitepaper I will
24 be referring to it.

25 My quick take on the CEC Staff report is

1 that, as others have said, the staff should be
2 commended for establishing that it's really
3 difficult to make a compelling economic case for
4 automatic temperature compensation.

5 And this is especially the case because
6 retail competition in fuel markets, and this is
7 competition that the CEC Staff report, itself,
8 acknowledges exists. They have said that the
9 retailers operate in a highly competitive
10 environment.

11 And this is significant, and it's a
12 touchstone for everything that I'll be saying
13 today, and also for the analysis generally of this
14 industry.

15 To an economist, highly competitive
16 doesn't mean the kind of flamboyant rivalry that
17 people think of when they see Hertz versus Avis,
18 or Coke versus Pepsi. That's not competition. In
19 fact, those are oligopolies that do earn supra-
20 competitive profits generally.

21 Competition, as economists understand
22 that term, means that the firms operating in such
23 an environment are unable to earn anything more
24 than a normal competitive profit.

25 What that means is that over the long

1 run their prices will be just equal to their
2 costs, where one of the costs is the return on the
3 entrepreneurship and the capital that are employed
4 in the enterprise.

5 But they don't earn excess profits. And
6 that's important because there's also another
7 point of departure in the CEC Staff report from
8 the kinds of writing and issues that got a lot of
9 this started. And that's the so-called hot fuel
10 ripoff controversy.

11 The alleged hot fuel ripoff profits are
12 excess profits; its supracompetitive profits that
13 allegedly retailers have been reaping from
14 motorists and consumers for decades, and secretly
15 hanging onto. And you can read the Kansas City
16 Star and elsewhere about how much per year, in the
17 billions, this supposedly amounts to.

18 It's important to recognize that the CEC
19 Staff report does not have any finding about any
20 such hot fuel profits or any excess profits
21 whatever. As I say, it acknowledges that the
22 retail industry is highly competitive, and a great
23 deal flows from that.

24 Because it's so competitive, and because
25 the market currently measures retail quantities in

1 gross gallons, and then prices them in gross
2 gallons, and because of the competition it is
3 unable to sustain any above-normal profit, there
4 really is no problem with the current performance
5 of the California retail fuel markets that needs
6 correction.

7 And in particular there is no problem
8 out there that requires the imposition of
9 automatic temperature compensation.

10 Net and gross systems of measurement are
11 equally valid. There's nothing inherently
12 superior about net measures over gross measures.
13 They each are valid alternative methods that can
14 be used to account for the same objective reality.
15 As long as you don't mix them, in other words try
16 to use units from one along with another to
17 describe a particular transaction or state of
18 affairs in the industry, there is no problem.

19 The main criticism I have with the CEC
20 Staff report is that it is predicated on the
21 unsupported and unsupportable assumption that were
22 ATC to be mandated as part of the ATC retrofit
23 discussed in that report, that retailers would be
24 willing and able to dispense fuel in net gallons,
25 but at their unchanged previous retail prices per

1 gallon. And I'm using gallon in quotes now,
2 because there's two different meanings of that
3 term.

4 So, because there are no hot fuel ripoff
5 profits, so-called, to be recaptured by the ATC
6 retrofit mandate, it must be the case that the
7 consumer benefits that are contemplated by the
8 staff report have to be gotten by a significant
9 reduction in retailer margins. There's no other
10 place they can come from.

11 And remember those margins are no more
12 than normally competitive to begin with. Nobody's
13 earning any super-competitive profits. You're
14 taking the return that a competitive firm needs to
15 stay in business.

16 And this next one I can touch on just
17 very very briefly. It is possible that the
18 estimate of the cost of the ATC retrofit in the
19 staff report is understated. But that's not a
20 main topic of my concentration.

21 But it is important to notice that the
22 \$438 million annual benefit that the staff report
23 suggests, at least initially, in the short and
24 medium term, will be extracted from retailers,
25 actually is greater than their total profit. And

1 I'm now relying on the figures in the CEC Staff
2 report, itself.

3 It finds that the average convenience
4 store has profits of about 33,000 a year. Take
5 the 438 million annual benefit contemplated by the
6 staff report, divide it by the 9700 retail stores
7 in California, and you get a figure that's over
8 \$45,000 a year.

9 And just comparing those two figures you
10 can see the incredible problem with the suggestion
11 that retailers would acquiesce or even be able to
12 acquiesce if they wanted to, to the switch to net
13 gallons for measurement, but retaining their pre-
14 existing prices per gross gallon.

15 This next slide is really just a setup,
16 but it's trying to illustrate that the net and
17 gross systems really account for the same
18 objective reality. And they just do so
19 differently.

20 And what I suggest, just look at the
21 section for a hot climate. And this, and
22 following examples, all start with a retailer
23 receiving a load of gasoline at wholesale that in
24 every instance will be measured in gross gallons.
25 And we're assuming they fill up the tank wagon at

1 8000 gallons.

2 But because of temperature compensation
3 the number of net gallons that the retailer
4 receives will be less than that, as you see. And
5 that's because of the different size in column C
6 of the two measures measured in cubic inches.

7 Now, that load of gasoline, and this is
8 going to be repeated in following examples, is
9 assumed to cost the retailer \$23,000. This is a
10 made-up number, but it's a realistic number.

11 And so from that, depending upon whether
12 he wants to measure it in terms of gross gallons
13 or net gallons, a dealer knows his implicit cost
14 per gallon for that load. And that's his cost.
15 That's the kind of cost that he has to be able to
16 cover if he wants to be able to stay in business
17 in the long run.

18 And in these examples I'm always
19 assuming that the retailers target margin is
20 \$1000. I'm not vouching for exactly that number,
21 but it is in the ballpark; it's about 12.5 cents
22 per gallon, something like that.

23 So that the retailer's target sales
24 revenue from this particular load of gasoline is
25 24,000. From that it follows that there is a

1 target retail price or street price that he needs
2 to achieve in the long run if he wants to say in
3 business.

4 Now, I'm not saying that he can set his
5 price at that value and hit the mark exactly.
6 That's not the way competition works. Retailers
7 can exist for awhile below that figure; at other
8 times they will have margins that exceed it. But
9 this is the long run target that they need to
10 achieve.

11 And just by doing the arithmetic, you
12 see in this simple example that the retailer's
13 target street price per gallon, gallon in quotes,
14 differs depending upon whether he is thinking
15 about his inventory in net gallons or in gross
16 gallons. And it's that arithmetic fact that
17 matters in the following examples.

18 I'm not sure how, to tell you the truth.

19 (Pause.)

20 MR. FLYNN: Doesn't seem to be behaving
21 for me. Okay, I apologize, but I understand that
22 these slides will be posted at the CEC website, as
23 well.

24 The important thing to realize, and this
25 is just building on the previous example, is that

1 the consumer benefits anticipated by the staff
2 report would come about through a significant
3 reduction in retailer margins.

4 Because essentially what the ATC
5 retrofit would accomplish, at least in the short
6 run, perhaps medium term as viewed by the staff
7 report, is that retailers would dispense, quote,
8 gallons that are 233.4 cubic inches rather than
9 the smaller 231 cubic inches they had been
10 dispensing before. So that's a change.

11 But the CEC Staff report expects,
12 looking at column F, that retailers will do so by
13 continuing to charge that \$3 per gallon that was
14 the competitive price for a gross gallon. And the
15 consequence of that is that they would be unable
16 to earn that target \$1000 in margin because they
17 have fewer gross gallons to sell. That's what it
18 means to have a net gallon, rather than a gross
19 gallon.

20 And so rather than being able to
21 generate \$1000 in dealer margin, that margin
22 would, in this instance, this example, falls by
23 about 25 percent. And it's this mechanism that is
24 at the heart of the scenario in the CEC Staff
25 report.

1 So, just summarizing, the CEC Staff
2 expects that somehow retailers will continue to
3 price as they did for gross gallons, but dispense
4 the larger net gallons.

5 And it's important to realize that this
6 is different from the hot fuel debate, which
7 claims that retailers have these secret supra-
8 competitive profits that can be clawed back by an
9 appropriately nuanced public policy.

10 There's no hot fuel profits here. It's
11 coming straight out of the revenue stream that a
12 retailer needs to survive. Because the staff
13 report acknowledges, and I'm now repeating, that
14 these guys operate in a highly competitive market.

15 And because they are in a highly
16 competitive market their prices are not generating
17 any of the hot fuel profits that are at issue in
18 those other cases. And the CEC Staff report gets
19 whatever consumer benefit it is able to achieve by
20 assuming that retailers would acquiesce in an
21 increase in their cost that is greater than their
22 total profit.

23 Let me move through this one very
24 quickly. The first point is I have no better
25 information. The second one actually is my bad

1 because I went through the CEC Staff report too
2 quickly and didn't notice that, indeed, they do
3 have an estimate for that issue.

4 But what I want to draw your attention
5 to is the third item. There has been another
6 state level official estimate of the cost of
7 mandating automatic temperature compensation. And
8 it's one that apparently was done by the State of
9 Missouri in 2006. And it was referenced very late
10 in the Government Accountability Offices report
11 that came out in September of this year.

12 And I confess that that's all I know
13 about it. I and my staff have gotten in touch
14 with the State of Missouri asking for the details
15 of this particular finding, namely that the State
16 of Missouri estimates that it would cost \$341
17 million to implement automatic temperature
18 compensation in that state, a state that has 4300
19 retail stores.

20 The answer we got back is that they
21 aren't providing any details, but they stand by
22 that estimate, whatever that means. And perhaps
23 the CEC Staff would be able to get more specific
24 information, because I think it's important. The
25 reason it's important is that if that Missouri

1 estimate is valid, it strongly suggests that the
2 total cost in California of an ATC retrofit would
3 be more in the neighborhood of \$700 million,
4 rather than the much lower estimate currently
5 provided by the CEC Staff, slightly above 110
6 million.

7 Let me go through this one very quickly
8 because I've already given away my punch line.
9 And that is that the CEC Staff report, itself,
10 acknowledges that the pre-tax profits, mind you,
11 of convenience stores in California average less
12 than about 33,000 over the past several years.

13 And at the same time that 438 million in
14 benefits distributed over the 9700 retailers in
15 California comes to the annual average of \$43,000
16 a year that would have to be transferred from each
17 retailer to that retailer's customers for that
18 \$438 million-a-year benefit to be realized.

19 And I've looked at this number long and
20 hard, and the only thing that I can conclude is
21 that is a lot of Twinkies that have to be sold, or
22 a hugely increased price of gasoline at these
23 retail stores.

24 I think this one is -- we can go through
25 very quickly. The critical issue in the CEC Staff

1 report, however, is what they mean by the long
2 term. Because they concede that in the long term
3 retailers will successfully recapture all of that
4 revenue.

5 But I have been unable to find in the
6 staff report exactly what that long term means, or
7 how it's defined, or when it starts. And that's
8 important. But even more important is the fact
9 that economists are unanimous, I'll say, you know,
10 virtually unanimous, that at the level of retail
11 gasoline stores, if you have an increase in
12 wholesale prices per gallon because of a refinery
13 incident, because of military action in the Middle
14 East, or what-have-you, just think about your own
15 experience all of the times that prices at the
16 pump skyrocketed very quickly because of some news
17 event or some refinery catching fire in
18 California.

19 And ask yourself, how long did it take
20 for that incident reported in the news to show up
21 at the pump. And it's not months, it's certainly
22 not years. What economists have measured quite
23 carefully is that it's a matter of days or weeks,
24 at most.

25 So the long term in the CEC Staff report

1 really starts next week. It has to because this
2 is a competitive industry and these guys would go
3 out of business if they didn't respond that
4 nimbly.

5 So I take strong issue with the idea
6 that this recapture will occur only in the long
7 run, or alternatively what has to be the case is
8 that the long run, as I say, starts next week.
9 And any notion that there will be a significant
10 period of free money or free benefits for
11 consumers until the retailers get their act
12 together and recapture it is a fantasy.

13 And as I say, for proof just look at the
14 literally dozens of incidents now that we have had
15 in California of sudden increases in retail prices
16 because of some incident in the industry that
17 translates to an increase in the wholesale costs
18 of retailers. They have to react immediately.

19 Now, I'm switching gears on you a little
20 bit because what I'm moving into now is just a
21 quick illustration of how it is that the current
22 system, without temperature compensation, without
23 an ATC retrofit mandate, does adequately adjust
24 retail prices for the effects of temperature on
25 both fuel volumes.

1 I take it that it is generally accepted
2 that retail prices would respond or react very
3 quickly if there was suddenly a change in the
4 volume unit for measuring retail fuel sales.

5 For example, if instead of selling fuel
6 in U.S. gallons, we move to the metric system and
7 fuel would be priced or sold in terms of liters.
8 No one seriously contends that retailers would
9 continue to charge, pick whatever number is going
10 on now, a buck-75 per unit, when the unit switched
11 to liters, right.

12 And so the idea that retail prices
13 adjust instantaneously so as to keep a retailer's
14 total revenue constant in the event of a change in
15 the size of the unit used to measure his sales of
16 gasoline, ought to be generally accepted.

17 But the CEC Staff report seems to accept
18 that. But then insists that somehow temperature
19 variation is different. That rule doesn't apply.
20 And what I want to emphasize, and will emphasize
21 in the report, is that's not true. Temperature is
22 just another way of measuring fuel in cubic
23 inches.

24 And that's because, as I said here, and
25 as I illustrate in this chart, there is an exact

1 linear relationship between fuel temperature and
2 fuel volume. You tell me the temperature and I
3 will tell you, to whatever degree of accuracy you
4 want, the number of cubic inches that a net or a
5 U.S. petroleum gallon will occupy at that
6 temperature.

7 In fact, if you tell me the number of
8 cubic inches that a U.S. petroleum gallon is
9 occupying right now, right here in front of me, I
10 can tell you what the temperature is. You can go
11 back and forth, one to the other.

12 In fact, look at this chart at the 60-
13 degree mark and you see that obviously it
14 corresponds exactly to 231 cubic inches. There's
15 no magic in that.

16 So, because retailers in competition
17 will always lead to an instant and perfectly
18 offsetting or compensatory switch in prices to
19 accommodate any change in the size of the unit
20 used to measure retail fuel sales, so as to keep
21 their target revenue constant, in this case the
22 24,000, it follows that, for example, and this is
23 just one switch, if you go from a 231 cubic inch
24 gallon to a 232.72 cubic inch gallon, which
25 happens to correspond to the so-called California

1 gallon at what is it, 71.7 degrees Fahrenheit,
2 that has to lead to an increase in the target
3 retail price. In this case it's about 2.2 cents
4 per gallon, or per California gallon.

5 So, even though temperature is
6 implicated in the change in the size of the unit,
7 it gets analyzed like any other change in units
8 that can be measured in cubic inches.

9 And this leads into the next-to-the-last
10 point I want to make, and that is that retail
11 competition already leads to appropriate
12 adjustments in pump prices that offset the effects
13 of seasonal temperature variation.

14 And just to be technical at this point
15 now, what I'm talking about is the variation that
16 was noted as a result of the California fuel
17 temperature survey, and which is incorporated into
18 the CEC Staff report. And that's this variation.
19 That on average retail fuel inventories in
20 California follow this seasonal pattern.

21 Right now I'm not talking about how much
22 individual retailers might vary around that point
23 on a particular date at a particular location.
24 I'll come to that. But this is the variation I'm
25 talking about, and that I am saying is already

1 well handled by the current competitive retail
2 environment.

3 The key insight to understanding how
4 this happens is that the seasonal variation in
5 fuel temperature, coupled with the force of retail
6 competition, induces changes or forces changes in
7 a retailer's target pump price per gallon that
8 exactly offsets the effects of temperature
9 expansion.

10 Let me illustrate. Now, we're going
11 back to that same type of chart that I introduced
12 earlier. Every month of the year the retailer
13 receives his 8000 gallons gross. But because of
14 the varying fuel temperature, the number of net
15 gallons that he realizes from that varies, as you
16 see in the one, two, three, third column.

17 Now, I'm going to assume that this
18 retailer does get his wholesale loads measured and
19 priced in terms of net gallons. But that's not
20 always the case. Even the CEC Staff report
21 acknowledges that, at best, only most retailers
22 operate this way. Which I take to mean that a
23 significant minority do not. But for the purposes
24 of this example I will go along with that.

25 What the key point of this chart starts

1 now in the column that says the wholesale price
2 per gross gallon. Because of the temperature, the
3 effects of temperature, the wholesale price per
4 gross gallon is varying. Now, that's not the most
5 important thing. We're going to still add the
6 \$1000 dealer target margin.

7 Which enables us, when you add that to
8 what the load of fuel costs measured in terms of
9 net gallons and dollars per net gallon, you get a
10 target sales revenue, which is the fourth column
11 from the right.

12 That's what the retailer is aiming for.
13 Again, I'm not insisting that he's going to be
14 able to hit this every time. But that's his goal.
15 And if he doesn't hit it in the long run, he's
16 going to go out of business. He's not going to be
17 able to sell more because competition won't allow
18 him. He may be able to sell less for awhile, but
19 sooner or later he would have to exit the
20 industry.

21 So, even though his target retail price,
22 expressed in terms of net gallons, if you wanted
23 to work this out with a calculator, is always \$3 a
24 gallon. His target retail price per gross gallon
25 varies, as you see in the next-but-last column.

1 And it's varying inversely with the temperature.

2 That's critical.

3 And so as a result, as the temperature
4 increases, and now I'm looking at the last column,
5 as the temperature increases from the 60 degree
6 that I started with in January, his target gross
7 price per gallon falls. This is the inevitable,
8 inexorable effect of retail competition and
9 temperature expansion.

10 This is already in the current retail
11 system. So his resulting target retail price, and
12 this is the result I'm trying to get to, retail
13 price per gross gallon varies inversely with fuel
14 temperature.

15 So, when fuel temperature goes up from
16 the winter into the spring and summer, and then
17 declines, his target retail price per gross gallon
18 moves in the opposite way.

19 And this is what I mean by saying that
20 the current system already handles seasonal
21 variation in temperature. And if you believe, as
22 the CEC Staff report says, that retail gasoline
23 sales are highly competitive, this is the result.

24 Okay, now I know that, you know, some
25 would point out the fact that, well, what about

1 the variation within a particular local market on
2 a particular, you know, at one point in time.
3 What about that variation?

4 And I refer to this as cross-sectional
5 temperature differences. And we don't have a
6 whole lot of data on that. The California fuel
7 temperature survey did not attempt to go out and
8 document the extent or severity of this problem.

9 So to do this last exercise in my
10 discussion today I've drawn upon some examples
11 that Henry Opperman included in slide
12 presentations he gave to the National Council on
13 Weights and Measures. Which showed the variation
14 of retail fuel temperatures in the Topeka, Kansas
15 area.

16 And what I'm going to show you is an
17 example of what's called Monte Carlo sampling.
18 I'm going to use this technique, and to imagine
19 that you have 10,000 motorists, each separately
20 buying 20 gallons a week, 52 purchases over the
21 year, from randomly selected retailers in the
22 Topeka area.

23 Now, the variation that I'm going to
24 show you here in a second can be just as well
25 thought of as the variation that a consumer would

1 encounter if they kept going back to their
2 favorite retailer.

3 And they get to that retailer at
4 different points of time, or different amounts of
5 elapsed time since the retailer got his last load
6 from the refinery.

7 So, what you can do is create these
8 10,000 separate samples each containing 52
9 observations. And analyze them to see, based on
10 this Monte Carlo experiment, how likely is it that
11 a consumer going out and buying gasoline at
12 regular intervals could wind up with annual
13 purchases whose average temperature significantly
14 exceeded the average temperature in that same
15 market.

16 So, here are the actual temperatures
17 reported by Opperman. Four different dates, all
18 in the greater Topeka, Kansas area, and you see
19 the temperatures that were measured. And what
20 drives this is not the temperatures, themselves,
21 but how much variation there is. In fact, people
22 have been talking about that today, you know, that
23 you go into a particular area and you can see as
24 much as what, eight, ten degrees or more variation
25 between the highest and the lowest temperature on

1 that particular date.

2 In his January 8th through 12th sample,
3 it looks like Mr. Opperman found a 15.5 degrees
4 difference. The next one is 11.5 degrees. So you
5 see that even in relatively colder periods you can
6 see this variation.

7 So these are the 48 observations in my
8 population from which I then construct 10,000
9 synthetic samples. Just have the computer go off
10 and do it. Randomly choose among those 48
11 observations. Do it 52 times for each of your
12 10,000 assumed consumers. And what do you get?

13 You get this distribution. This is the
14 distribution of the Monte Carlo results from this
15 particular experiment. I've done the same
16 experiment for consumers who go out and buy
17 gasoline every two weeks; and I've done it for
18 consumers who buy gasoline twice a week.

19 And the results are largely invariant,
20 especially in terms of the dollars involved. And
21 you look at this distribution and it tells you out
22 of my 10,000 trials how many of them exhibited
23 particular deviations, average deviations from the
24 overall Topeka, Kansas average temperature.

25 So, just to find a number that's easy to

1 read, look way over on the right. How many of my
2 10,000 samples resulted in a calculated average
3 fuel temperature that was as much as two degrees
4 greater than the Topeka, Kansas average. And out
5 of my 10,000 the answer is one.

6 The important question is what's the
7 probability that a consumer could wind up with
8 fuel, his average annual fuel purchases, with a
9 temperature greater than say 1.5 degree, or 1
10 percent of the total. And you just have to start
11 adding those figures you see on the right. And
12 keep adding till you get to 100. How far towards
13 zero deviation do you have to go before you even
14 account for 1 percent of the sample?

15 And I did this recently. It's somewhere
16 around 1.3 degrees. So there's about 1 percent
17 chance that a consumer buying gasoline once a week
18 over an entire year would inadvertently wind up
19 with the average temperature of his annual
20 purchases that differed from the community average
21 by 1.3 percent.

22 At gasoline at \$2 a gallon, and this
23 individual is buying 1040 gallons, it's not very
24 much. It's just a couple dollars. And there's
25 only 1 percent probability of that.

1 So, the bottomline is that the current
2 market arrangements do a pretty good job of
3 handling both the seasonal variation in
4 temperature and the instantaneous or cross-
5 sectional variation in temperature.

6 And that's all I'm going to have time
7 for. Now, what will happen is that this, and the
8 rest of my remarks, will be in a whitepaper that I
9 understand that at some point will be submitted to
10 the Commission, and then made available to the
11 public.

12 Questions?

13 MR. SIEBERT: I've got a question for
14 you guys down here. On 17, could you flip back to
15 17, the chart. It just so happens that 2007 was a
16 really strange year.

17 So I went back for California and looked
18 at it for the last seven years. And in two years
19 it did some funky thing like this. But is this
20 your normal pricing structure over a year? Or do
21 you not see the prices peaking in August when the
22 fuel is the hottest?

23 MR. EICHBERGER: That's a good point,
24 John. And I think what you are seeing in chart 7
25 is not actual temperature observations. It is

1 Mike's calculated target price based on net
2 billing terms at wholesale, and the calculated
3 cost per gallon, to derive a \$1000 profit margin
4 per load delivered.

5 Clearly June, July, August, especially
6 in California, gasoline retail prices are much
7 higher than the first of the year.

8 What Mike's trying to demonstrate here
9 is when the fuel temperature, as described in
10 chart 16, when the fuel temperature increases that
11 changes the calculated target price for gross
12 gallons based upon the net billing terms to break
13 even with the \$1000 per load profit.

14 MR. FLYNN: In that same period. If you
15 gave me a different temperature profile over a
16 year, in fact I've done this for individual dates,
17 you'll get a different impact on target retail
18 prices.

19 Now, this is not to suggest that these
20 are what wind up as the street prices, because
21 there's lots of other factors that go into the
22 determination of the competitive retail price.

23 And everyone is familiar with the fact
24 that when you take all of these into account at
25 the same time, that generally retail prices are

1 higher during the summer.

2 But that's not because of the failure
3 for the competitive mechanism to induce
4 adjustments due to temperature. It's because of
5 increased demand and other factors that lead to
6 what, on net, are higher prices during the summer.

7 This is just illustrating the effect of
8 temperature, which is what I think we're all here
9 talking about.

10 MR. EICHBERGER: And if you look at all
11 the examples Mike used, he's using standard
12 numbers. He's using a standard 8000 gallon
13 delivery at a standard cost of \$23,000. So this
14 is not a real world example, it's more of a
15 theoretical exercise in terms of what the
16 calculation would be between gross to net.

17 (Parties speaking simultaneously.)

18 MS. DUGAN: My point exactly. This is a
19 theoretical exercise. This is unprovable without
20 real world evidence.

21 MR. FLYNN: Well, actually it is
22 provable, and here's how you prove it.

23 MS. DUGAN: It's provable within its own
24 universe. It's not provable in the real world.

25 MR. FLYNN: No, here's -- and this is,

1 if I can editorialize for just a moment. And this
2 is in comparison, in contrast to the so-called hot
3 fuel profit theory.

4 People have been able to calculate the
5 so-called hot fuel ripoff profits. You can pick
6 up the Kansas City Star or read other blogs and so
7 forth and they'll give you a dollar amount.

8 And in their mind this proves that these
9 profits exist. And my rejoinder is, has anybody
10 ever seen them. Has anybody ever gone out to the
11 accounts and the financial statements and the tax
12 returns of gasoline retailers --

13 MS. DUGAN: We'd love to do that. We
14 would love to do that.

15 MR. FLYNN: Okay, I can give you some --
16 there's publicly available information, Judy. I
17 can send some of it to you.

18 MS. DUGAN: By station.

19 MR. FLYNN: Not by -- well, yes, by
20 station.

21 MS. DUGAN: Well, it has to be by
22 station.

23 MR. FLYNN: It is by station.

24 MS. DUGAN: And it has to be a
25 representative large sample of stations.

1 MR. FLYNN: There is. There's one
2 that's called Risk Management Associates that
3 publishes --

4 MS. DUGAN: That's above my pay grade to
5 get that.

6 MR. FLYNN: I can send it to you. It
7 shows you the profitability of individual retail
8 stores each year.

9 MS. DUGAN: Over time.

10 MR. FLYNN: Over time.

11 MS. DUGAN: Compared to --

12 MR. FLYNN: Not necessarily the same
13 store --

14 MS. DUGAN: -- is there a fuel
15 temperature comparison in there?

16 MR. FLYNN: No.

17 MS. DUGAN: I rest my case. Now, can we
18 -- it has to include that. And I will ask one
19 question here. You say that, and I agree with you
20 on this, at any particular temperature there is
21 one and only one size of a net gallon of gasoline
22 or diesel fuel. And knowing the fuel temperature
23 is the same as knowing the size of a net gallon in
24 cubic inches.

25 So, in effect, what you're saying is

1 that knowing the temperature allows you to
2 determine the value of the fuel.

3 So why wouldn't we --

4 MR. FLYNN: No, that 's --

5 MS. DUGAN: -- want to know the
6 temperature?

7 MR. FLYNN: No, you're missing the point
8 there. The point of that is that adjusting target
9 retail prices for temperature is no different than
10 adjusting them for any other change in the size of
11 the unit in cubic inches.

12 MS. DUGAN: Can we just stick to the way
13 you said it here?

14 MR. FLYNN: Well, we --

15 MR. EICHBERGER: Mike, let me jump in
16 real quick.

17 MR. FLYNN: Sure.

18 MR. EICHBERGER: I think what the basis
19 of this whole thing is, yes, if you compensate for
20 temperature the gallon size is going to change.

21 MS. DUGAN: Right.

22 MR. EICHBERGER: Okay. What we're
23 saying is consequently the gallon price is going
24 to change an equal amount.

25 So if you're going to change the volumes

1 of the gallon by 1 percent volume based upon a 15
2 degree variation in temperature, the price is
3 going to change 1 percent. Which begs our
4 question, our conclusion is --

5 MS. DUGAN: How do I -- how do I confirm
6 this as a consumer on the street with your nozzle
7 in my tank?

8 MR. EICHBERGER: How are you going to
9 calculate anything when you don't know the whole
10 cost structure of the store? That's the whole
11 thing we're talking about here --

12 MS. DUGAN: I can take --

13 MR. EICHBERGER: -- is that we --

14 MS. DUGAN: -- a shoe and look at the
15 leather of it; I can check the heel; I can see the
16 quality.

17 MR. EICHBERGER: Um-hum.

18 MS. DUGAN: I can say, this is Italian,
19 this is Brazilian, that's Chinese. Every rubric
20 of a shoe I can look at.

21 MR. EICHBERGER: But you don't know how
22 much each of those rubrics cost.

23 MR. FLYNN: There's whole --

24 MS. DUGAN: I don't care if I know the
25 quality of what I'm getting. What I'm talking

1 about is the quality in value of what I am buying.

2 MR. FLYNN: But there's other evidence
3 that retail stores are not generating and enjoying
4 these kinds of profits. One of them is how else
5 do you account for the fact that the majors, the
6 supposed villains in this story, --

7 MS. DUGAN: I have never - I'm not even
8 calling you a villain.

9 MR. FLYNN: No, no, but why are they
10 getting rid of their retail stores if they are so
11 profitable?

12 MS. DUGAN: Well, for one thing, they
13 are not the most profitable end of the business.
14 Obviously. Look at Exxon's bottomline. That is
15 neither here nor there.

16 MR. FLYNN: But I mean according to the
17 hot fuel ripoff stories, for example in the Kansas
18 City Star, if you take those figures and divide
19 them by the number of retail stores in California,
20 according to the Kansas City Star every retailer
21 in California, on average, is squirreling away
22 \$55,000 a year in nonfuel profit. Where is it?

23 MS. DUGAN: I did not -- I read that
24 whole series and I, frankly, do not take that away
25 from it. Where is that? Which part of it?

1 MR. FLYNN: All you have to do is go to
2 that chart -- wish I had it here --

3 MS. DUGAN: Well, let's you and I --

4 MR. FLYNN: No, no, I can tell --

5 MS. DUGAN: -- talk about that later,
6 but the point is --

7 MR. FLYNN: -- you, -- yeah --

8 MS. DUGAN: -- that you are saying,
9 knowing the fuel temperature is the same as
10 knowing the size of a net gallon in cubic inches.
11 This is information that the retailer has --

12 MR. FLYNN: No, you're misinterpreting
13 that point. I'm saying that there --

14 MS. DUGAN: I'm just reading it.

15 MR. FLYNN: No, I'm saying that there is
16 no difference in adjusting prices for temperature.
17 It's the same thing as adjusting prices for the
18 change in the size of the volume unit in cubic
19 inches. They're identically the same thing.

20 MS. DUGAN: This assertion is made over
21 and over, but it cannot be proven without real
22 life evidence. And I am here to challenge you,
23 all of you who deal in gasoline, to give us the
24 information to prove that.

25 MR. FLYNN: Well, the proof is -- it's

1 indirect proof, but the proof is that --

2 MS. DUGAN: No, no, indirect proof is
3 not proof.

4 MR. FLYNN: The proof is that if what,
5 if your take on this is correct, then these guys
6 are rolling in money. And someone should have
7 spotted it.

8 MS. DUGAN: No. I am saying that I wish
9 to have you prove to me, with data, that it's from
10 real life, that this is true.

11 MR. FLYNN: Okay, well, I'll try and do
12 a better job in the whitepaper.

13 MR. EICHBERGER: Well, I think, I mean
14 our bottomline is any change in cost that is
15 incurred by retailers is going to be recovered.
16 That's the CEC's conclusion; that's our
17 conclusion.

18 MS. DUGAN: This is another loaf of
19 bread over here.

20 MR. EICHBERGER: No, no, no. No, this
21 is the bottomline. If there is no financial
22 benefit for consumers from selling net gallons at
23 net prices compared to gross gallons at gross
24 prices, then the only cost or benefits involving
25 the entire proposal is a cost of implementation,

1 which will be passed through.

2 So, if we're looking at a situation
3 where the end result is going to be an increased
4 price to consumers, why in the world would we do
5 this?

6 MS. DUGAN: First of all, the increased
7 price to consumers is not a settled matter. I
8 mean I do not agree that all costs could be passed
9 through in a competitive environment.

10 MR. EICHBERGER: That's not quite --

11 MS. DUGAN: I do not agree that all
12 costs would be paid by consumers directly. That
13 there are other actors who could pay some of them.
14 But let's just agree to disagree on that.

15 But the point is you do not -- there is
16 value in knowing the value of what you buy. And
17 today, even looking at that Topeka regression that
18 you did there, the Monte Carlo -- I wish the Monte
19 Carlo for my 401(k) had worked as well as yours.

20 But even on that you see higher bars on
21 the upside than on the downside. And it is even,
22 you know, it's not a perfect bell. So I mean it
23 is pushing toward the higher temperature side on
24 the number of people who bought at high
25 temperature than at low temperature.

1 MR. FLYNN: Trust me, the weighted
2 average of that Monte Carlo distribution is
3 identically zero.

4 MS. DUGAN: Pardon me?

5 MR. FLYNN: The weighted average of that
6 distribution is identically zero. I checked it.
7 I wanted to make sure, myself, and it is.

8 MS. DUGAN: Okay, just that it certainly
9 -- maybe it's just a less even progression. But
10 the point is again you have made a theoretical
11 point not based on real world behavior. And
12 perhaps it's right and perhaps it's not.

13 MR. FLYNN: I think it would then be
14 incumbent upon you to explain the mechanism by
15 which consumers would go out and make their
16 purchases over a year in a market and somehow
17 manage to achieve a really skewed result, which is
18 entirely not random.

19 MS. DUGAN: It could depend on where
20 they live and where they buy. But the point is if
21 consumers even knew in real time the temperature
22 of the gasoline they were buying, they would be
23 able to determine value. They would get used to
24 it, they would be able to -- I don't care you do
25 it, but let's make it fair throughout the system.

1 MR. EICHBERGER: So are you arguing that
2 if we were to put on next to the price, the
3 current temperature of our fuel?

4 MS. DUGAN: Yes.

5 MR. EICHBERGER: They would be able to
6 derive -- hour, make an economic calculation in
7 their head as to what the best value is?

8 MS. DUGAN: I know guys who can re-do
9 the compression in their cars --

10 MR. EICHBERGER: Maybe two out of 1000.

11 MS. DUGAN: -- in five minutes.

12 MR. EICHBERGER: I mean we've done
13 consumer surveys -- before. Out of 1200 consumers
14 surveyed across the nation, 30 percent will drive
15 ten minutes out of their way to save 3 cents a
16 gallon. On that transaction they lose a buck-50.
17 But in their mind, that's value.

18 MS. DUGAN: I --

19 MR. EICHBERGER: But we see now is --

20 MS. DUGAN: Maybe it's value in my mind,
21 I don't know how much money you make --

22 MR. EICHBERGER: Well, they've got it
23 down, they go, a buck-50, you lose a buck -- you
24 lose \$1.50 in transaction, it's not a valuable
25 proposition.

1 MS. DUGAN: Most people make those
2 decisions across the street.

3 MR. EICHBERGER: Okay, and they will
4 turn left across the intersection to save 3 cents
5 a gallon.

6 MS. DUGAN: Right.

7 MR. EICHBERGER: Because they think a
8 gallon's a gallon, the same size. The same
9 product they're buying.

10 MS. DUGAN: If they --

11 MR. EICHBERGER: You're proposing
12 they --

13 (Parties speaking simultaneously.)

14 MS. DUGAN: Once they understood, once
15 they understood the value of temperature the would
16 also base their calculations on temperature. I
17 guarantee you, car people are obsessive.

18 MR. EICHBERGER: I will conclude our
19 comment to the Commission that we believe, as the
20 CEC Staff report believes, there is no financial
21 benefit to consumers from implementing ATC.

22 There are costs associated with the
23 implementation. Those costs will be passed
24 through, whether you calculate the nonfinancial
25 benefit the way the CEC did, which we believe is

1 underestimating the potential costs and the rate
2 of pass-through, whether you calculate it on an
3 instantaneous pass-through based upon a
4 calculation of costs and target retail sale
5 margin, you're going to see no financial benefit
6 to consumers.

7 You're only going to see a pass-through
8 of the financial cost of implementation,
9 regulation and everything that is involved with an
10 ATC scheme.

11 So, with that we are way over our 20
12 minutes.

13 PRESIDING MEMBER BOYD: Thank you for
14 recognizing that. Mr. Siebert, you are next on
15 the agenda.

16 (Parties speaking simultaneously.)

17 MR. SIEBERT: If you guys want to stay,
18 you can stay. You can be my people.

19 MR. EICHBERGER: We're not leaving.

20 MR. SIEBERT: Well, keep close to a
21 microphone.

22 MR. EICHBERGER: I'll stay here.

23 MR. SPEAKER: I had choices on the last
24 one, but I didn't -- I was going to take it on his
25 time instead of my time.

1 (Pause.)

2 MR. SIEBERT: While he's setting it up,
3 we talked about the up-like-a-rock, down-like-a-
4 feather. There was an instance where we had a
5 storm out in the Gulf. In Kansas City prices went
6 up a quarter a gallon that day.

7 And then the next week BP had a rusty
8 pipe up in Valdez and they said it was going to
9 cut 8 percent of the production. It went up
10 another quarter. We were up 50 cents and neither
11 one of those things were real.

12 If I were running a really big oil
13 company I'd have a rumor department, because it
14 results in real money. After Congress subpoenaed
15 the pipe, all of a sudden it wasn't going to cut
16 the supply 8 percent, it was going to be replaced
17 that week and be done with.

18 Why the Missouri -- oh, I come from
19 Missouri -- why the Missouri study hasn't been
20 made public, and probably never will be, Ron Hayes
21 runs our weights and measures department. And he
22 is a member of the cabal in National Weights and
23 Measures that is against ATC. And he will say
24 that, but he will not support it. He won't bring
25 it out and he won't publish it.

1 Oh, and the other part, I'm sorry, I'm
2 sorry, but I made a note and I said, I'm from
3 Petroleum Marketing, I'm taking care of you as you
4 sleep, trust me.

5 Without consumers knowing some of this
6 stuff it becomes -- consumers know a lot about a
7 lot of other stuff.

8 Okay, I'm John Siebert. I'm with the
9 Owner/Operator Independent Drivers Association. I
10 thank the Commissioners and my fellow --

11 PRESIDING MEMBER BOYD: How many people
12 belong to your association?

13 MR. SIEBERT: 160,000 independent
14 drivers who own and drive their own trucks. They
15 drive 110,000 miles a year on average. They get
16 six miles per gallon. So they're buying 18,000
17 gallons. And at \$3 a gallon, that's \$54,000. At
18 \$4 a gallon that's \$72,000. And at \$5 a gallon,
19 it's \$90,000. And they do not have the luxury of
20 not driving when the price is high because it's
21 part of their business. They have to do it.

22 I don't know if I ought to do this, but
23 in light of full disclosure, I am an employee of
24 the Owner/Operator Independent Drivers Association
25 Foundation. I am paid \$61,000 a year. I have not

1 had a raise in the last three years; won't get one
2 this year. And I've had a \$1000 bonus. Anybody
3 else that comes up that would like to talk and
4 tell how much they're making off hot fuel from
5 being retailed by coalitions who are diametrically
6 opposed to its adoption in the public realm, feel
7 free.

8 Let's see. The report leaves some
9 questions that were asked by the Commission
10 unanswered. It raises new questions about the
11 methodology. And has some conclusions that
12 contradict earlier sections of the work. And then
13 accepts assumptions that aren't supported by real
14 world practices. And primarily I'll go through
15 these in these four sections.

16 The very first page of the executive
17 summary poses this question: If temperature
18 compensation has been instituted for the most
19 wholesale transactions for the purpose of removing
20 inequity of temperature variations from financial
21 transactions, why has that practice not extended
22 all the way to the California retail consumer.

23 And I'm sorry, but the report has that
24 question left unanswered. There are people in
25 this room who are retailers who were in my shoes

1 not that long ago. Because they were being sold
2 fuel by the refiners at gross. And they said,
3 it's traded everywhere else in the chain by net.
4 We deserve to get it net, too.

5 And the refiners relented and changed,
6 rather than have it go through a court case.

7 The report seems to focus on C stores;
8 80 percent of the fuel in California is sold
9 through C stores. But there's no real attempt to
10 differentiate the other 20 percent, which is a
11 sizeable portion of the market.

12 There are large retailers in California
13 who are adding fuel islands just to get people
14 into their store parking lots. And to do that
15 they're hitting break-even, or even going as far
16 as a loss leader. Why in the world would they
17 pass through to the consumer the additional cost
18 if they're not even getting their wholesale costs
19 right now?

20 Now, I've got to say, this in-the-long-
21 run argument is quite an argument. Because in the
22 long run dinosaurs haven't disappeared, and are
23 probably going to take over when humans get wiped
24 out. Because all the little birdies are
25 dinosaurs, in the long run.

1 But in the day-to-day operation right
2 now we're still facing this differential in
3 temperature.

4 The recognition that the \$3.2 million in
5 consumer benefits that the report has reverses the
6 preliminary findings of the last public meeting
7 that we had of this group in which it was
8 suggested that there was an RLI of six months.
9 And that the annual consumer benefits would reach
10 24 million a year for just two counties, I believe
11 it's Fresno and Alameda. Is there an explanation
12 for this shift between the time that we were
13 having open meetings and the time that we -- and
14 now?

15 Let's see. It still has the \$438
16 million in there. And the part of this
17 calculation thing goes back to the appendix R,
18 which is a theoretical model for information not
19 being square with everybody.

20 And it seems like appendix R could have
21 California values stuck into it. That if it
22 actually is the model which was used to calculate,
23 that there could be numbers on those curves and
24 axes, and we could actually look at it and see it.
25 And I think it would be an advantage to everybody

1 to actually see the calculation for that.

2 There's an awful lot of assumptions
3 assuming this and assuming that. One of them was
4 the assumption was that the cost of a new pump
5 with ATC was exactly the same as doing an in-the-
6 field retrofit. And, my gosh, that seems counter-
7 intuitive. It seems like you should get economies
8 of scale of having people put that kit in on the
9 assembly line, not have to drill obvious holes and
10 do it in the rain and snow and everything. And
11 travel to Timbuktu to do the thing.

12 And if we're going to be changing out
13 normally -- well, we heard that just today a lot
14 of the pumps bit the dust in the '90s. And so
15 if -- oh, well, we're almost ready for a 20-year
16 lifecycle, aren't we?

17 But even if we only did 5 percent that
18 would give us in the six years coming, that would
19 give us 30 percent of the new pumps coming in
20 having ATC at a much reduced cost to having a
21 retrofit kit put on it. But 100 percent of the
22 estimated costs are for retrofit kits.

23 There seems to be an awful lot of
24 concern in the labeling section about confusion
25 should ATC be permissive. And, gosh, we've talked

1 to them. They've told us that it's very smooth up
2 in Canada. Of course, it's very cold up there and
3 they eat a lot of maple syrup, so there's no
4 telling what's going on there.

5 But right now the status quo for
6 consumers in California is that they are totally
7 ignorant that there is a temperature impact on
8 what they're buying. Everybody says it's the most
9 transparent transaction in the world. Right there
10 is the price. They don't tell you that the price
11 is for a different unit of being able to move your
12 car.

13 And not just the California public, but
14 the American public thinks that this is a fungible
15 product; that one gallon is equal to another
16 gallon. And although the marketers will say,
17 well, we never claimed that. No, but they've
18 never clarified it, either. Well, some of them
19 are; some of them are putting stickers up that say
20 they sell by volume now.

21 Oh, and speaking of the Canadians, in an
22 early section of this report it talks about
23 consumers were benefitting. Gosh. And the
24 retailers were having a difficult time due to
25 inventory shrinkage. Why didn't they hire you

1 guys to tell them what fools they were?

2 We've got a mind trust here that could
3 have saved them all that money, because in the
4 long run the Canadians got zippidy freaking
5 doodah, right? Wrong. They did it because they
6 made more money after its adoption. They were
7 selling a littler liter for the same amount of
8 money. We talked about inelasticity of the
9 market. They had a smaller liter, the price did
10 not go down.

11 Now, you can start singing the Southpark
12 "Blame It On Canada", but they spent real money.
13 They spent ten years doing it. And they're
14 extremely happy with it because the petroleum
15 marketers are making more money than they were
16 before. That's the only reason it was done.

17 Shouldn't the exact opposite in a warm
18 climate be true? Why would it be a flat nothing
19 here and an advantage to retailers in Canada?

20 We seem to have identified some things
21 that were really important. And we have always
22 said this, that there was price transparency,
23 information symmetry, more accurate measure and
24 equity. Even the National Weights and Measures
25 Conference, who has a difficult time playing with

1 this topic, has come out unanimously saying it is
2 a more accurate measurement than was previously
3 available. And now it is inexpensively available,
4 and it's not, to quote Ross, it's not if, it's
5 when we go to ATC.

6 Now, the folks up here who represent our
7 members of PUMP, who is a coalition put together
8 to oppose ATC at any level, at any time, for all
9 time, not just until we have sufficient knowledge,
10 but for all time. We have results that are
11 monetary, but these, if everything at the end of
12 the day is a wash, and it's costing a dime a
13 motorist, wouldn't these benefits to consumers be
14 worth it?

15 They think so in Germany. They think
16 so. Actually the EU has got recommendations to
17 harmonize temperature compensation across the
18 entire country, they're becoming a country now.

19 I'm going to keep on going. The
20 assumption of this 100 percent pass-through. This
21 is one of the things that has just really kind of
22 stoked me. Because you only get 100 percent pass-
23 through in two situations, a purely theoretical
24 total competition or a purely theoretical
25 monopoly.

1 And although California's fuel market
2 exhibits portions of both of these things, it's
3 not. It's neither one of them.

4 Yes, sir?

5 MR. MURPHY: I'm Kevin Murphy; I'm an
6 economist at the University of Chicago. And that
7 slide you just put up is just simply wrong, as a
8 matter of economics. I don't know where you
9 learned your economics, but that slide is just not
10 true.

11 MR. SIEBERT: Okay, --

12 MR. MURPHY: Neither one of those are
13 sufficient nor necessary to get 100 percent pass-
14 throughs.

15 MR. SIEBERT: Okay.

16 MR. MURPHY: I don't know if you're an
17 economist or not, but it certainly is not correct.

18 MS. DUGAN: Was that in the --

19 MR. SIEBERT: No.

20 MR. MURPHY: Believe me, I'm not trying
21 to pull your leg here; that's not correct.

22 MR. SIEBERT: Oh, you can pull my leg.

23 We'll take that under consideration, and
24 continue with the makeup of the markets in
25 California. And this I have a little bit more --

1 I'm a little clearer on this.

2 Ten percent of the retailers are owned
3 by the refiners; 46 percent are major lease
4 dealers; and 26 percent are branded independents.
5 Only 18 percent are unbranded independents.

6 The 10 percent owned by the retailers
7 are in a faux wholesale situation because the
8 wholesale price is being handed to them by the
9 refiner. The other two sections there are tied to
10 refiners by long-term supply contracts that are
11 very difficult to buck. Because if one should
12 start doing some independent margin setting on
13 their own, they can find their next month's bill
14 adjusted to make it more in line with the company
15 line.

16 The 18 percent are the ones who are
17 actually able to go out and find the cheapest
18 supply and set their own margins without anyone
19 looking over their shoulders. And they also add a
20 element of competition where in other situations
21 you don't have so much; you have more of a tacit
22 collusion of keeping the retail high.

23 Within a monopoly your market power
24 exhibited by one of the people in pricing, the
25 refiners aren't out there refining to meet demand.

1 They're refining to hit the sweet spot of just
2 below demand so that they can keep the demand
3 there without raising the price. Because raising
4 the price will lower the demand because consumers
5 are price sensitive.

6 At the same token, if you have a small
7 competitive core of stations around each other,
8 and there is one independent in it, if the
9 independent becomes a branded station or a leased
10 major, the price in that competitive area will go
11 up a nickel. Because that independent has been
12 buying at the cheapest price they can find;
13 they're setting their own margin. And without
14 them there, then competition ceases to be with the
15 remaining stations.

16 It was the last time that we were here
17 that Jay mentioned that we'd gone from 12 percent
18 to 5 percent margins in C stores' profits. It
19 didn't look that way in the report.

20 But you can see why they said -- someone
21 previously said that they could try to get the
22 money out of their sales of gasoline. But they
23 get more profits out of \$10 of chips and soda than
24 they do \$50 worth of fuel. So if I was going to
25 pass through the cost, I'd sure put it on the pop.

1 As I pointed out last meeting, it's the
2 refiners and the wholesalers that are contracting
3 the C store margins. It's not this sense of
4 overriding competition, because the wholesalers
5 and the refiners are experiencing record profits
6 at this time. And those record profits are being
7 squeezed out of the retailers. That's one of the
8 reasons that the refiners don't want to be in the
9 retail business. They're in the squeeze.

10 My concluding thoughts is that we should
11 have a report that's internally consistent. The
12 conclusions should flow naturally from well
13 considered analysis. And I see well considered
14 analysis; I see completeness of thought processes
15 in the front of the report. And then I get to the
16 conclusions and I see well, assuming that I'm
17 right, I'm right. It should be based on sound
18 economics and actual practice in the state. And
19 we ought to have the calculations.

20 And although there will probably be
21 those who'd like to stand up -- these aren't just
22 off-the-cuff comments of mine. We actually will
23 submit a written response. I'll have the
24 references in it from the papers that I picked the
25 information from.

1 Thank you.

2 PRESIDING MEMBER BOYD: Thank you, Mr.
3 Siebert.

4 Next we have Mr. Murphy.

5 MR. MURPHY: Thank you very much. It's
6 my pleasure to be here today. I guess my goal is
7 to try to make things as clear as possible and
8 tell you how I'm thinking about it.

9 Not only I'm here representing Pilot
10 Travel Center, Circle K, 7/11, Chevron, BP and
11 Valero, a lawyer can't really speak for them. I
12 can only tell you what I think.

13 So, let me go through. Let me talk a
14 little bit about the economics of ATC. And I
15 really think the staff's to be commended here.
16 They really correctly identified the key economic
17 issues related to ATC. And the results of that
18 are summarized in tables 7 and 8.

19 And I have a set of stand-alone copies
20 of 7 and 8 that I can hand around to people that
21 help you look at them. Because you don't want to
22 have to be holding the report open, so it's nice
23 to look at 7 and 8 as I go through.

24 I'll do a little bit of a summary, and
25 then I'll come back to try to hopefully shed a

1 little light. Because I've heard a lot of things
2 that are kind of in the right direction today. I
3 think it's a matter of putting all the pieces
4 together correctly. And I hope they will become
5 clear eventually to those that need to make the
6 decision as to what the right analysis is in this
7 case.

8 One of the things they note is that the
9 average temperature of fuel dispensed in
10 California is higher than 60 degrees. That's
11 roughly 71.1. I think most people would agree
12 that's in the right ballpark.

13 And a shift to ATC will reduce the
14 number of gallons sold, but will not change the
15 amount consumers spend on gasoline. So if you
16 look in table 7, that would be the retained retail
17 motorist benefits, that's a zero in that column.

18 Second thing they find is that the
19 dispensed temperature varies across location,
20 stations and time. I think this was referred to
21 earlier in terms of discussion of consumer
22 shopping. A switch to ATC will change the
23 information available to consumers.

24 And the Commission, I think, correctly
25 concludes that the effect of this change is very

1 small. They quantified it to be about 17/1000 of
2 a cent per gallon. I actually think that number's
3 probably a little smaller than that. But we could
4 talk about it. At least they have the right
5 methodology and the right general approach to
6 arriving at the number.

7 Number three, that the added costs of
8 the ATC equipment will be passed on to consumers
9 in the form of higher prices for fuel, and
10 possibly higher prices for other products. That's
11 their columns labeled initial and reoccurring
12 industry costs.

13 And number four, they conclude in the
14 final column that the cost of ATC outweigh the
15 benefits. And I'll say that these conclusions, in
16 my mind, based on my analysis, I think are
17 basically correct.

18 So, how would I think about it, and how
19 do I think the right economic approach to this
20 problem looks like? The first thing to realize is
21 that the implementation of ATC in California would
22 have three primary effects. And it's really
23 important to separate these out, because I think
24 what's causing a lot of confusion is a lot of
25 mixing and matching.

1 I'll talk about things that are
2 generated over here and use a concept that's
3 appropriate over there. And hopefully we can try
4 to straighten some of that out.

5 The first one is that there would be a
6 change in the average size of the, quote, gallon.
7 Remember it's not the same gallon, so it's a
8 change from the current 231 to a varying sized
9 gallon that would have, you know, say 233 roughly,
10 up or down depending on temperature, in the case
11 of the ATC equipment, or a fixed California gallon
12 that would be bigger than 231.

13 The second thing, and again we can
14 analyze this separately from the economic point of
15 view, there would be a change in the information
16 available to consumers. And I think that's been
17 brought up here, that if you did put in ATC
18 consumers would know some things different than
19 they know now.

20 And I hadn't thought about the
21 possibility of just posting the temperature up
22 there, but that would also provide different
23 information than they have today.

24 I should say that the staff has really
25 thought about that issue and has tried to quantify

1 those benefits using the methodology in that final
2 appendix. And I agree, it would be great to have
3 numbers associated with that. And I'll submit a
4 whitepaper, and I will put numbers associated with
5 exactly those concepts.

6 There would be additional costs
7 associated with installing the ATC equipment. So
8 there are three things. One, we're going to
9 change the average size of the gallon. Two, we're
10 going to change the amount of information. And,
11 three, we're going to have some costs associated
12 with equipment.

13 Each of those things, it turns out, is
14 economically different and requires a somewhat
15 different analysis. And I'll try to explain in a
16 little bit why they're different. But they can be
17 put together to get a systematic analysis. And I
18 think the Commission Staff is well on their way to
19 doing that.

20 If we just straighten a few things out
21 we'll get there. We'll have a document. We'll
22 have a study that everybody can rely on to get a
23 very good analysis of the situation.

24 So, the staff report deals directly with
25 each of these in their cost/benefit analysis in

1 those two tables. That's what I talked about
2 moments ago.

3 Basically, number one is the middle
4 column of zeroes. Number two is the column next
5 to that, which is the increased transparency
6 benefits. And number three is the first two
7 columns of that table. So they really have all
8 the pieces. Let's just think about how we might
9 put them together.

10 So my primary concern, and my report
11 today is mostly about number one. I got up
12 earlier and spoke on two and three because I
13 didn't really put that in my report. That's why I
14 made some responses. My final paper will deal
15 with all three of them.

16 The report's discussion of an initial
17 shift in revenue, and then subsequent revenue
18 recaptured, caused by the change in the available
19 volume of a gallon I think is highly susceptible
20 to misinterpretation. And I want to try to make
21 clear why that is.

22 In fact, this analysis has already been
23 misinterpreted. We see people citing in the press
24 this phantom number that somehow there's this huge
25 benefit. Yet when we look at the report we see

1 that, in fact, that benefit doesn't show up as a
2 benefit. So, it's kind of a phantom number that's
3 out there.

4 And if you have any questions, please
5 stop me. I'd be more than happy, because I don't
6 like lecturing.

7 The second is the discussion of the
8 shift in revenue, and in fact, a revenue
9 recapture, in fact, aren't even correct as a
10 matter of economics. You don't want to talk about
11 it that way for reasons I'll describe in a moment.

12 Market prices for fuel, in fact, are
13 determined by supply and demand. Both of which
14 are unaffected by ATC. And I'm not saying here
15 the markets have to be perfectly competitive.
16 What I'm saying is in any type of marketplace the
17 prices that you see are determined by two things:

18 What consumers are willing to pay for
19 what it is they want. And what it costs
20 producers, be they competitive, monopoly,
21 oligopolies, whatever, to provide those services.
22 You hold those two things constant and outcomes
23 won't change. Okay.

24 So we want to know have we changed
25 supply and demand in this market. So, average

1 temperature and the impact of ATC.

2 As we said before, when fuel was
3 dispensed at temperatures above 60 degrees
4 switching to ATC has two effects. Again, right
5 now we're focused on number one, only, changing
6 the average size of the gallon.

7 ATC increases the size of each gallon,
8 so consumers require fewer of these new gallons to
9 fill their tank. So, think about me, I'm driving
10 my car up to the station. I'm going to fill my
11 tank until that little handle goes click and it
12 stops going in. I'm going to put it back. So
13 that's what I'm going to do.

14 But I'm going to take fewer of these new
15 bigger gallons. At the same time, of course, the
16 retailer's cost for those new larger gallons will
17 rise. And, in fact, it's going to rise by exactly
18 the same percentage as the number of gallons I
19 require goes down.

20 So if the gallons are 1 percent bigger,
21 their costs are going to be 1 percent higher. If
22 they're 2 percent bigger, 2 percent higher.

23 That's something we ought to keep in mind.

24 However it's critical to realize that
25 the ATC does not change the temperature of the gas

1 or the total volume of the gas that I get. So
2 when I pulled up to the old pump and I put my gas
3 in the pump, wait till it went click, put it back.
4 Come back the next week after ATC has been
5 installed. Stick the hose in there, turn it on;
6 goes click. I get the same exact amount of gas
7 that I used to.

8 The retailer's cost of that tankful of
9 gas is exactly the same as it was before we put in
10 ATC. The value to the consumer, how much he
11 valued the gas that's in the tank, is the same
12 after we put in ATC.

13 You see where I'm going here, right?
14 That is it costs the retailer the same to fill my
15 tank. I value filling the tank exactly as much as
16 I did before. I get exactly the same amount of
17 product as I did before. What do you think is
18 going to happen to the price of that tank if it's
19 determined by what consumers are willing to pay
20 and what producers cost them to produce. It's
21 going to be the same for the tank. That's where
22 we're headed.

23 Since the consumer's value would be
24 given physical volume of fuel is unchanged, and
25 the retailer's cost of that same volume is also

1 unchanged, the market price for that tankful of
2 gas will be unaffected by ATC.

3 This implies that the amount paid by the
4 consumer for the tankful will be the same. The
5 revenues received by the retailer will be the
6 same. And the volume of gas sold will be the
7 same.

8 This is the key point here. There is no
9 revenue shifted from retailers to consumers
10 through temperature adjustment. So there is no
11 revenue to be recaptured and no reason for prices
12 of other commodities to adjust.

13 And that's the key point. When we make
14 the gallons 1 percent bigger, and the retailer
15 charges 1 percent more, the retailer gets just as
16 much revenue as before. The consumer pays just as
17 much as he paid before. The idea that this is a
18 competitive market and you can't pass costs on is
19 irrelevant.

20 Whether he could pass costs on or not,
21 I'm not passing anything on. The same amount of
22 money is being transacted. His credit card is
23 getting charged for exactly the same amount of
24 money the day after ATC than it was before.

25 So the idea that the price charged for a

1 tankful would remain unchanged doesn't depend on
2 anybody's ability to pass anything through. It
3 just says what was the market equilibrium price
4 for a tank of gas is the same before and after
5 ATC.

6 You see what I'm saying? There's no --
7 people said, well, it's a competitive business. I
8 can't pass it on. What does that mean? It means
9 I can't charge the consumer more than I used to.
10 Well, just adjusting the price to compensate for
11 the fact that the gallon is bigger doesn't require
12 charging the consumer any more than he was before.

13 And it's not just true for the tankful.
14 The guy who shows up to buy \$5 worth of gas, he
15 gets the same amount of gas for his \$5 after ATC
16 as before. He just gets 1 percent fewer gallons
17 and 1 percent higher price per gallon. But he
18 ends up with the same exact amount of fuel in his
19 tank. And he comes back to the station the next
20 day, puts \$5 more in. And he gets the same amount
21 once again.

22 That's the point about ATC. That's the
23 point about these phantom dollars. They don't
24 exist. There's no recapture. It's just a matter
25 of saying you're going to charge the same amount

1 for the same thing one day to the next.

2 So if all that was going on was number
3 one, that we were just changing the average size
4 of the gallon there would be no effect. There
5 would be nothing would happen.

6 Now, does that mean there's nothing
7 whatsoever to ATC? No. We've still got number
8 two and number three. But that's where our
9 attention should be focused.

10 Number two is what's the value of the
11 information, how valuable is it. Number three,
12 what's the cost of putting on the equipment, and
13 who's going to pay for it. We worry about two and
14 three.

15 Number one, to me, is a phantom issue.
16 Number one just says prices are going to adjust to
17 compensate for the average size just because the
18 market equilibrium price for a given volume, what
19 the consumers are willing to pay didn't change,
20 the cost to producers doesn't change, nobody has
21 to change their behavior at all.

22 People clear on that first one? Because
23 I've got a couple of examples. But if it's clear
24 I'll just skip them. Because I can -- it's up to
25 you guys if you want me to keep going. I know

1 this has been a long day for you guys. I don't
2 want to drag you through it if you don't need it.

3 PRESIDING MEMBER BOYD: Well, I'm
4 worried about the audience more than I'm worried
5 about --

6 (Laughter.)

7 MR. MURPHY: You guys want to hear it?
8 Okay. I'll give you a little example. So, my
9 point is consumers pay the same amount for gas,
10 retailers earn the same profits, supply and demand
11 remain in balance.

12 The key here is this whole idea that
13 aren't markets so competitive that it couldn't
14 pass it through or wouldn't the oil companies be
15 willing to absorb anything. There's nothing to be
16 absorbed. When you simply make the gallons 1
17 percent bigger and people charge 1 percent more
18 per gallon, the dollars don't flow anywhere. They
19 don't go to the consumer, they don't flow back to
20 the retailer, there's nothing for the wholesaler
21 to offset, there's nothing for anybody to adjust.
22 Everybody's where they started.

23 We just played a little musical chairs
24 and everybody got back in their seat.

25 All right. So the direct revenue effect

1 will be zero. And that's why there's a zero in
2 that middle column in my mind. The zero in that
3 middle column simply flows from that simple fact.

4 All right. So, my example was simple.
5 You're dispensing fuel at 75 degrees. I chose
6 that because that's a 1 percent volume difference
7 at 75 degrees, \$2 per gross gallon. Consumer
8 purchases enough gas to fill his tank. In this
9 case I said it's 20 gallons, \$40, with a margin of
10 14 cents per gallon, the retailer earns a variable
11 profit of 280. And the fuel had the cost of 3720
12 for the gasoline dispensed.

13 So, now what happens when you switch to
14 ATC, as I said, consumer buys the same total
15 volume of gas at the same total price which would
16 fill his tank, because the thing stops filling at
17 exact same point it would have otherwise.

18 The consumer now buys 19.802 net gallons
19 at 2.02 per gallon. The consumer spends the same
20 40 bucks. The retailer still gets 37.20 since the
21 gas to fill the tank costs the same amount the day
22 after ATC as it cost the day before. See, that's
23 the other key. The cost to fill that tank is the
24 same as it was.

25 And this leaves the consumer and

1 merchant in exactly the same position as before.

2 So there's no reason for any of them to change
3 their behavior. Retailer doesn't want to change
4 his Twinkie price because he's found his gas
5 business is the same as it was.

6 The consumer drives just as much as
7 before because a tank of gas costs him just what
8 it cost him the day before. The guy buying \$5
9 worth of gas gets just as much gas as he got
10 before. Nobody's going to change their behavior.
11 Whatever cleared the market with supply and demand
12 clears the market still.

13 There's no revenue to recapture or
14 increased costs to be passed through on other
15 items. That's the bottomline.

16 You can also do it in the aggregate.
17 Same result can be looked at sales in the
18 aggregate. I'm just going to skip this. That was
19 my last slide.

20 So, it's been a long day, so that was
21 all my presentation that I had. And I just wanted
22 to make that one simple point. I'll go back a
23 little bit on two and three because, you know, I'm
24 trying to keep it brief. So I hope that earned a
25 little bit of time.

1 On number two I think the Commission has
2 the right general thoughts here. We just have to
3 work what's the right question. And I think,
4 Commissioner Douglas, I think you were on the
5 right line here, is that there really is an issue
6 here about information that has to do with
7 situations where the consumer has a choice. And
8 maybe that choice is influenced by his lack of
9 information. I think that's the place where you'd
10 want to think about it.

11 Those numbers I still don't think are
12 very big, but that's where you want to do your
13 thinking. Because if number two is going to have
14 value that's mostly where it's going to be.

15 The variation of the year is actually
16 trickier because it turns out that you have to
17 worry, not just this fuel varying because of
18 temperatures, fuel varying for other reasons.

19 And what can look like it makes
20 information better could actually make information
21 worse if other factors were actually causing
22 summer fuel to have more energy density rather
23 than less.

24 In some sense you'd be giving half the
25 story and actually making things a little worse.

1 You've got to take that into account, but that
2 framework, that's what's nice about that
3 framework. That framework allows you to do that.
4 That framework allows you to take all these things
5 together and say what's the economic value of
6 information.

7 And I've heard a lot of discussions
8 today about information. And I agree, information
9 is the fundamental change here. The size of the
10 gallon is a red herring. The information is the
11 place that we want to look at.

12 And there's a value to information,
13 which is what the Commission tries to calculate in
14 number two. There's a cost of information, which
15 is what the Commission tries to calculate in
16 number three. Which is how much does it cost to
17 install, and who's going to pay.

18 Now, unlike my discussion of number one,
19 where the idea that the price would adjust, seems
20 to me very straightforward.

21 Number three, you have to think a little
22 harder about pass-through. Now, because it's not
23 what we call in economics a marginal cost, it
24 doesn't affect the cost of each gallon gas. We
25 know from empirical evidence -- people asked

1 earlier about empirical evidence -- if you look at
2 the relationship between the retail price and the
3 wholesale price, you find it's a very very tight
4 relationship.

5 And I think I'll put in my report the
6 results. You were asking earlier about evidence
7 on pass-through. You do that regression for
8 California it's almost exactly 1. That is, you do
9 something that affects the cost of a gallon at
10 wholesale, it's going to affect the price of a
11 gallon at retail penny-for-penny. So we'll get
12 back to that.

13 But for things that we call in economics
14 fixed costs, that is things like changing the cost
15 at the pump, which I don't pay for it every gallon
16 I pump, I just pay for it once, you got to think
17 harder about those pass-through issues.

18 Now, the Commission talked a little bit
19 about well, it's unclear that they can pass these
20 costs through because they look at things like,
21 say, well rent went up, wages went up, and credit
22 card fees went up. And we didn't see all that
23 showing up in gasoline.

24 But remember, those costs -- the costs
25 of all retailers. That is, anybody who wants to

1 sell Twinkies when the wage rate goes up, or the
2 rent price goes up, they're going to have their
3 costs rise, too.

4 And it's not surprising, therefore, that
5 you see the prices of all commodities rising when
6 those general costs go up.

7 Our question here is if you do something
8 that only raises the cost of fuel dispensing, will
9 that show up in Twinkies. And the reason it's
10 unlikely to show up in Twinkies is because there
11 are a lot of people who sell Twinkies who don't
12 sell gasoline. And their costs don't go up when
13 you mandate ATC.

14 And those Twinkies sold at the gas
15 station have to compete against Twinkies being
16 sold at the drug store, in Walgreen's or SaveOn,
17 or wherever else you go to get your little sugar
18 fix, you know. They got to compete on that
19 margin.

20 And therefore, it's not surprising that
21 we don't see a concentration of those other costs
22 on fuel. We wouldn't expect it. Okay.

23 I still think the vast majority of
24 things like retrofit costs are going to show up on
25 fuel because exactly that, it's a cost that's only

1 borne by fuel sellers. And so the only price in
2 the market that could really absorb that greatly
3 would be fuel. Most of the other commodity prices
4 are going to be pinned down with competition with
5 nonfuel sellers, which is why you're going to see
6 most of it on fuel.

7 But I mean 100 percent on fuel. But
8 remember, this is only for the retrofit cost.
9 Number one cost of 438 million or whatever that
10 number is, that's all going to show up in fuel
11 because there is no pass-through. It's just
12 keeping the status quo.

13 So that's what I had to say. I'd be
14 happy to answer any questions that you guys might
15 have.

16 PRESIDING MEMBER BOYD: Thank you. Any
17 questions?

18 MR. MURPHY: Thank you.

19 MS. DUGAN: One.

20 PRESIDING MEMBER BOYD: One question.

21 MR. MURPHY: Sure.

22 MS. DUGAN: Sorry. Judy Dugan. You're
23 lucky we all have to catch planes here. First of
24 all, you talk about the transaction between the
25 retailer and the customer as though it's a

1 transaction in a vacuum.

2 But it's really a transaction, it's a
3 very complicated business, you know, selling fuel.
4 It starts in Tajikistan at an oil field. Then it
5 comes down ultimately to the retailers, so that
6 everybody along the way has an interest in selling
7 the gasoline.

8 MR. MURPHY: I understand. But think
9 about what I just said. When the volume adjusts
10 and the price adjusts to compensate, nothing real
11 happens at retail.

12 So no matter how complicated the
13 linkages are out there, if there's no action in
14 the first instance, how can it have ramifications
15 back that long chain of events?

16 MS. DUGAN: There's a ramification on
17 the price sign, as you well know.

18 MR. MURPHY: No, there's not a
19 ramification, because what consumers care about is
20 how much does it cost to fill my tank. What I
21 care about, if I put \$5 worth of gas in my tank,
22 is not how many gallons it says on the sign; how
23 far can I drive on that five gallons --

24 MS. DUGAN: That what --

25 MR. MURPHY: -- that \$5. And that

1 doesn't change when you get one-for-one
2 compensation on the price for the volume.

3 MS. DUGAN: That may be partially true,
4 but I would --

5 MR. MURPHY: What do you mean partially?

6 MS. DUGAN: Because people look at the
7 price sign when they buy gasoline.

8 MR. MURPHY: And what? Then they just
9 drive on air? They just drive and it keeps
10 driving because they thought it was cheaper than
11 it was?

12 MS. DUGAN: It's also a matter of will
13 costs be borne anywhere else in the system --

14 MR. MURPHY: They won't be because
15 there's no cost --

16 MS. DUGAN: -- aside from the retailer.

17 MR. MURPHY: -- to be passed back.

18 MS. DUGAN: Yes, there is. This is
19 semantics.

20 MR. MURPHY: No, it's not semantics.
21 That's what I'm telling you, focus on the ATC
22 cost. Because the --

23 MS. DUGAN: I am.

24 MR. MURPHY: -- focus, the ATC cost, I'm
25 not talking about --

1 MS. DUGAN: The 4-3, we're looking at
2 the 4-3, it's right here.

3 MR. MURPHY: No, no, 4-3-8 is just,
4 create the 438 in an instant and it evaporates
5 because of price compensation. Nobody outside the
6 system is affected whatsoever. Consumers buy just
7 as many gallons. Retailers sell just as many
8 gallons.

9 I just don't -- for the life of me --

10 MS. DUGAN: I -- no, nobody says that
11 it -- are you saying it will come out exactly
12 equal at every station all of the time every day?

13 MR. MURPHY: No. That's what I'm not.
14 That's a good point. Because it doesn't. That's
15 only on average. And that's why you separate
16 number two, because the fact that it varies across
17 station and varies across time is exactly the
18 economic issue addressed by their number two.

19 MS. DUGAN: If it varies day to day from
20 station to station, that doesn't mean that it's
21 always going to net out to the dollar. It does
22 not mean that some portion, some portion, can be
23 retained by the consumer.

24 But, let's go to --

25 MR. MURPHY: I know, I'm just saying --

1 MS. DUGAN: Let me go to --

2 MR. MURPHY: Let me -- I'm supposed to
3 answer the question, so I'll answer the question.
4 Which is that is exactly -- your concern that
5 variation, be it over time, across stations, could
6 create some gain or loss for different parties is
7 exactly the economics of number two.

8 So that's why we got to make number two
9 in the analysis that the staff did as clear as
10 possible. Because that is what that type of
11 economics is built to address.

12 MS. DUGAN: You're also saying that it
13 is a simple law of economics that this will be
14 passed through, period.

15 MR. MURPHY: There's no -- I -- I --

16 MS. DUGAN: You expressed it in very
17 simple and inevitable terms.

18 MR. MURPHY: Because I said it's not
19 passed through. See, pass through, it means what
20 causes people not to be able to pass through. And
21 that's that the other side of the market resists,
22 right? The reason somebody can't pass it through
23 is because the other side of the market resists.

24 When we do something that simply keeps
25 the total dollars transacted for the same amount

1 of product unchanged, neither side of the market
2 has to absorb anything. And that's why you see
3 the change you do. That's why it works the way I
4 say.

5 MS. DUGAN: So there is no ultimate
6 cost, in your analysis, to the retailer -- or the
7 wholesaler?

8 MR. MURPHY: There is because the
9 equipment costs something.

10 MS. DUGAN: But the assumption, the
11 CEC's clear assumption is that that would be also
12 passed on.

13 MR. MURPHY: Well, that's -- the CEC has
14 made that assumption. I think we should work on
15 that and figure out how much would be passed. But
16 that is on -- be careful. That's not the 438.
17 The 438 is a side --

18 MS. DUGAN: I understand the difference,
19 believe me, yes.

20 MR. MURPHY: Okay. So this is on the
21 cost of the equipment. I think, and based on the
22 logic I put out a minute ago, and we should verify
23 empirically to the extent we can, because these
24 are only costs for fuel sellers it will be passed
25 through.

1 Also you've got to be very careful
2 because I didn't bring this up, but it actually is
3 a potential issue. The rise in the cost of ATC
4 equipment is the most acute for the retailers that
5 sell the lowest volumes. You would agree with
6 that?

7 MS. DUGAN: That's so -- that is so done
8 with.

9 MR. MURPHY: No, no, no, wait a minute.

10 MS. DUGAN: Accept that they shouldn't
11 have to do it at all.

12 MR. MURPHY: So within a urban area
13 you're going to exempt the guys who sell less?

14 MS. DUGAN: Very low volume, mom-and-
15 pop, mechanical pumps, fine with me.

16 MR. MURPHY: Whichever group you exempt
17 the problem you always have is the guys who
18 dispense the least gas have the biggest cost
19 increase. If those are the marginal retailers, if
20 the guys who are on the margin of being in the
21 business have their costs go up more than the
22 infra-marginal people, you can have pass-through
23 more than one-to-one. You got to be really
24 careful what you wish for here, --

25 MS. DUGAN: It does --

1 MR. MURPHY: -- because this gets back
2 to the point earlier, people talked about
3 competition implies one-for-one pass-through. Be
4 careful. That's only true for uniform cost
5 changes.

6 You get a cost change that affects the
7 marginal suppliers more than the infra-marginal
8 suppliers, they can go the other way. And this is
9 a market in which you know the marginal guys are
10 going to be the guys who sell less gas. So you're
11 raising their costs the most.

12 MS. DUGAN: This has been discussed at
13 length in this forum. And consumers have no
14 problem with giving such people more time, some
15 help, some -- a pass.

16 MR. MURPHY: But who's -- so your view
17 is that the informational benefits are large
18 enough that they more than pay for the cost?
19 Which I think we should -- if that were true we
20 should be able to find that using the methodology
21 laid out --

22 MS. DUGAN: I do not accept the full-
23 cost pass-through.

24 MR. MURPHY: Okay, let's assume that we
25 did the debate the way you want, which I'm all for

1 figuring out the right answer here. Which says,
2 look, let's quantify number two. What's the value
3 of the informational benefits. Put that over
4 here.

5 Remember, --

6 MS. DUGAN: If there --

7 MR. MURPHY: -- remember only some of
8 that goes to consumers. A lot --

9 MS. DUGAN: If there was not a high
10 value to that informational benefit you would
11 never see a truckstop in the desert with a huge
12 tank painted black.

13 MR. MURPHY: No, that's just not true.
14 Again, this gets back -- somebody brought up
15 Canada earlier. The incentives of an individual
16 retailer and the incentives of the group or the
17 market, as a whole, are not the same.

18 In Canada you got voluntary adoption
19 because each retailer thought he, individually,
20 could get a leg up on everybody else. But, of
21 course, when everybody does it, just like price
22 cuts and everything else, it doesn't pan out the
23 way the individual guy wants.

24 And that's the same with the tank in the
25 desert, --

1 MS. DUGAN: I agree, I agree. And
2 that's why I beg the Commission not to demand that
3 a law be passed banning voluntary sales. I mean
4 let the retailers who may see this as a benefit to
5 consumers and to them give it a try.

6 The Division of Measurement Standards
7 has made it clear they have vast experience with
8 other temperature compensated fuels, including
9 LPG. That they are perfectly capable of
10 regulating this form.

11 And passing a law that will prevent them
12 from doing this until, quote, sufficient
13 regulation is in place, is -- it's a word so vague
14 that we know that this ban will never be lifted if
15 it is ever passed.

16 So, to me, this is the crucial thing
17 that the Commission wishes you can do here is to
18 say, do not ban it. I mean, there are people who
19 may want to do this. In fact, there has been one
20 partial attempt to try it that was withdrawn
21 awaiting the conclusions of the Commission.

22 But there is no reason to stop those who
23 wish to do it from doing it. The only
24 alternative, I believe, to at least allowing it to
25 go forth voluntarily would be to set a statewide

1 reference temperature. Because then people would
2 be getting a generally more fair amount,
3 generally, throughout the state.

4 It's very much second best, but
5 preventing a ban, preventing a law that stops this
6 from even happening on a voluntary basis, once it
7 is in place will be very difficult to remove in
8 the legislative arena.

9 So, that's all.

10 MR. MURPHY: Thank you, I'll try to
11 address -- oh, we've got one more question. Sure.

12 MR. SIEBERT: We'll skip the tanks
13 painted out in the desert, although it does
14 happen. We found 127 of them so far. I asked my
15 membership to send me pictures of them.
16 Beautiful.

17 (Laughter.)

18 MR. WILLIAMS: We would like to see
19 those.

20 MR. SIEBERT: Oh, okay, I'll send them
21 to you.

22 (Laughter.)

23 MR. WILLIAMS: -- locations --

24 MR. MURPHY: Don't take anything I've
25 said to say that wouldn't happen, right.

1 MR. SIEBERT: No, no, -- no, no.

2 MR. MURPHY: There's nothing in my
3 analysis --

4 MR. SIEBERT: No, but --

5 MR. MURPHY: -- that says nobody would
6 do that.

7 MR. SIEBERT: -- even with -- there are
8 other things that impinge on the average. And the
9 Conference of Weights and Measures, even Ron Hayes
10 from Missouri, has acknowledged that West Memphis,
11 Arkansas is a hot spot. It's nine miles from a
12 Williams refinery.

13 I can tell you that Bakersfield,
14 California is a hot spot. Who was it -- Flying J
15 bought the refinery there. And when I get reports
16 from California of hot fuel, I say don't happen to
17 be in Bakersfield, do you. And they say, um-hum.

18 And we're not talking the 1 percent.
19 This average thing, we've had fuel as high as 110,
20 115. The highest one, inexplicably, was Boulder,
21 Colorado at 118. Go figure.

22 We're talking a lot more than the
23 average. But they don't know how to handle these
24 hot spots. They are putting out fuel. It is not
25 dwelling in the tanks, it is being sold a tanker

1 an hour. And it's coming in to them at 110, it's
2 going out to the public at 108, and we're talking
3 4 percent change in volume there.

4 MR. MURPHY: But isn't that precisely
5 the kind of thing you'd want to quantify the
6 value? And that's what number two does. I mean
7 if you do number two correctly that calculates
8 exactly the gain or loss associated with what
9 you're talking about. That's what I'm saying.

10 This has nothing to do with number one.
11 This is all about number two. And your --

12 MR. SIEBERT: Love number two. I'm all
13 for number two.

14 MR. MURPHY: Okay.

15 MR. SIEBERT: Just know that the
16 averages will still impact citizens.

17 MR. MURPHY: Any more questions? Thank
18 you very much.

19 PRESIDING MEMBER BOYD: Thank you. You
20 did mention there are other things that confound
21 this issue. And I don't want to go into those --

22 (Laughter.)

23 PRESIDING MEMBER BOYD: I immediately
24 thought of the difference in the energy density of
25 winter fuel versus summer fuel, et cetera, et

1 cetera. And I'm feeling lost in the static here a
2 little bit.

3 All right. Well, I don't see Gordon,
4 but this is the time for any other public comment.
5 Anyone else who'd like to -- or now starts public
6 comment. Although there's been lots of public
7 comment.

8 MR. ROBINSON: Do you want me here or do
9 you want me over there? Here.

10 My comments hopefully will be simpler,
11 no bigger gallons, no smaller gallons, and
12 certainly no math.

13 My name is Tom Robinson; I am President
14 of Robinson Oil. Robinson Oil owns and operates
15 34 Rotten Robbie stations and convenience stores
16 in the greater San Francisco Bay Area. We're
17 headquartered in San Jose.

18 Robinson Oil is a family business; I'm
19 the third generation. The fourth generation is
20 now active in the business. I started in the
21 business in 1974. My college degree is in
22 economics.

23 I provide this information to show that,
24 one, our family business has survived for awhile.
25 I have some formal education to discuss economic

1 matters. I have experience and hopefully some
2 understanding regarding how the petroleum
3 retailing industry functions in the real world.

4 Early in my career I had the opportunity
5 to attend Bay Area Air Quality Management District
6 hearings. At that time we were struggling to
7 understand what we needed to do to comply with new
8 vapor recovery requirements and how we were going
9 to afford these expensive upgrades. I guess some
10 things really haven't changed over 30 years.

11 In California petroleum retailers have
12 had the opportunity to comply with many expensive
13 mandates. Some of the mandates have definitely
14 provided societal benefits. In some instances,
15 let's say, the benefits were less than promised.

16 Through all of this the industry has
17 survived and prospered. Maybe we have not
18 prospered as much as many of the companies in my
19 home area of Silicon Valley, but the industry is
20 still here and in reasonable health.

21 So what does this suggest? It suggests
22 that the industry was able to pass on these
23 expensive mandates to consumers. Not every
24 company and every station was able to pass on the
25 mandated costs. Some stations are gone, but the

1 stronger and/or better retailers survived.

2 Stepping back, this is exactly what
3 basic economic principles would predict in a
4 competitive industry. And petroleum retailing is
5 a local competitive industry. We do not compete
6 against retailers from Tennessee, from Mexico or
7 Canada.

8 In a local competitive industry
9 expensive mandates on all retailers are passed on
10 to consumers, because if they are not, businesses
11 become unprofitable and they go out of business.

12 I guess it's also not a surprise that
13 California usually has the highest gas prices in
14 the nation.

15 I congratulate the Energy Commission for
16 understanding this economic reality, and reaching
17 the conclusion that ATC will not be an economic
18 benefit to consumers. Instead it will be an
19 economic cost. Even though I believe the Energy
20 Commission understands the economic realities of
21 competitive industry, I believe the cost to the
22 consumer is significantly understated in the
23 report. If, for no other reason, than costs are
24 always under-estimated.

25 Another concern that I have is that

1 nowhere in the report, or even today, did I find
2 that the true winner was identified. The only
3 group that will clearly receive benefits is made
4 up of equipment manufacturers and service
5 companies.

6 I think identifying this group helps
7 clear up the gain and loss equation. This group
8 receives the benefit. It gets the money.

9 Retailers pay manufacturers and service
10 companies and pass through the costs to consumers.
11 Ultimately consumers will pay the manufacturers.
12 That's how it works.

13 If I look at this issue solely from a
14 selfish viewpoint of what is good for my company,
15 Robinson Oil, and I emphasize solely from a
16 selfish viewpoint, I don't care if temperature
17 correction is mandated or not.

18 As I noted earlier, Robinson Oil has
19 survived expensive mandates. I'm confident these
20 costs will be passed -- these costs, if they were
21 mandated, will be passed on to the consumer, also.

22 With that said, I would prefer that the
23 state did not burden my customers unnecessarily.
24 But if the state cannot help itself and is bound
25 and determined to inflict this on the public,

1 please, please make it mandatory. And have it all
2 go into effect at the same time.

3 It's obvious that this is a confusing
4 issue. There's much information out there now.
5 It cannot be explained with signage. I do not
6 believe the DMS can develop a permissive standard
7 that will not be confusing. Please do not create
8 public confusion. Public confusion is never a
9 benefit.

10 In summary, I hope the state does not
11 ultimately decide to require temperature
12 correction. It will only add costs to the system,
13 which will be paid by consumers.

14 Thank you for this opportunity to make
15 comments, and I'd be more than happy to answer any
16 questions.

17 PRESIDING MEMBER BOYD: Thank you for
18 your comments. I have no questions.

19 ASSOCIATE MEMBER DOUGLAS: No questions.

20 PRESIDING MEMBER BOYD: Thank you.

21 MR. SEARLES: Hello. My name is
22 Prentiss Searles; I'm with the American Petroleum
23 Institute. I'm the Marketing -- Manager there.
24 API is a trade association that represents nearly
25 400 member companies involved in all aspects of

1 the oil and natural gas industry, from exploration
2 and production to retail marketing and
3 distribution.

4 API members, as has been pointed out
5 earlier today, own less than 5 percent of the
6 approximate 164,000 retail stations in the
7 country, and operate less than half of the retail
8 stations that they do own.

9 API members brand approximately 40
10 percent of the retail stations in the U.S. through
11 various branding agreements.

12 As a point of clarification, when a
13 station bears a particular API member's brand, it
14 does not mean that the API member company owns or
15 operates the station. The vast majority of
16 branded stations are owned and operated by
17 independent retailers licensed to represent that
18 brand.

19 According to NACS more than half of the
20 164,000 retail stations in the U.S. are owned by
21 an individual or a family.

22 API has participated in previous
23 workshops and appreciates the opportunity to make
24 this brief presentation to you. And here's what
25 I've got.

1 By law, since the early 1900s retail
2 sales of motor fuel in the U.S. have been made
3 based on a single size of volumetric gas, defined
4 as 231 cubic inches without reference to
5 temperature, as we've heard in very excruciating
6 detail today.

7 These standard size gallons are defined
8 by law, reflected in dictionaries, and have long
9 been used in retail trade. Some parties have
10 suggested that retail sales of gasoline and diesel
11 be based on temperature-adjusted gallons.

12 Temperature-adjusted gallons change in
13 size, becoming larger and smaller as the
14 temperature of the fuel sold rises or falls. The
15 adjustment in the size of the gallon sold would be
16 accomplished using the ATC device described
17 earlier today, installed at retail motor fuel
18 dispensers.

19 Those in favor of ATC propose two
20 possible methods of its implementation. As you've
21 heard, some advocate a mandate that every retailer
22 install ATC equipment to adjust the measurement of
23 all fuel dispensed.

24 Others advocate a permissive approach in
25 which each retailer could choose whether to

1 install ATC devices at their stations. Still
2 others are against ATC and oppose any change to
3 current practice of retail sales of gasoline and
4 diesel based on standard volumetric gallons.

5 API has, and continues to rely on the
6 National Conference on Weights and Measures to
7 make the best decision as to whether ATC is
8 necessary or not. We believe that before any
9 changes are made on how the industry sells and the
10 consumer buys more than 15 billion gallons of
11 gasoline and 3 billion gallons of diesel in
12 California, that that decision should be done with
13 the best and most complete information available.

14 One of the questions that is asked in
15 the CEC report is are consumers losing millions of
16 dollars, as some allege, because there's an
17 automatic temperature -- because there is no
18 automatic temperature adjustment of retail
19 gasoline sales.

20 Simply put, the answer is no. Consumers
21 purchase motor fuel dispensed in a uniform
22 measurement that is developed and approved by the
23 NCWM, adopted by state laws and regulations, and
24 sold in the competitive marketplace in which
25 prices reflect the range of factors such as

1 supply, demand, distribution logistics and
2 temperature.

3 Consumers are able to compare
4 advertising and signage at retail stations and
5 decide which product they will purchase. By
6 definition consumers aren't losing money because
7 they are receiving a gallon of motor fuel for
8 every gallon of motor fuel they purchase. The
9 very unit posted at the pump, and the very unit
10 retailers are legally required to provide
11 throughout the United States.

12 The retail gasoline industry is highly
13 competitive. According to NACS, and you've heard
14 this statistic already, a consumer will turn
15 across a busy highway to save a penny on a gallon
16 of gasoline. The consumer has a completely
17 transparent marketplace today.

18 I simply urge you to fully understand
19 all the potential issues and concerns that have
20 been raised here today. Thank you.

21 PRESIDING MEMBER BOYD: Thank you. Do
22 we have anyone else?

23 Well, we had quite a public discussion
24 earlier.

25 (Laughter.)

1 PRESIDING MEMBER BOYD: Gordon, is there
2 anything else you desire from this body of people,
3 since we have them trapped here for a long --
4 nothing.

5 Well, then I'm going to thank everybody.
6 Appreciate, I think we heard a lot today.

7 Yes, sir?

8 MR. McKEEMAN: Response date? Has there
9 been a decision made on what --

10 PRESIDING MEMBER BOYD: It is what it
11 is.

12 MR. McKEEMAN: Okay.

13 (Laughter.)

14 PRESIDING MEMBER BOYD: We have to live
15 with what we publish, in my opinion.

16 So, okay, thank you, all. I say, we
17 learned quite a bit today. We heard a lot we
18 heard before. We've been fooling around with
19 motor fuel for 20 years, and in all that time this
20 was an interesting one.

21 (Laughter.)

22 PRESIDING MEMBER BOYD: Thank you, all,
23 and be safe out there.

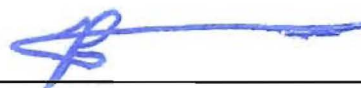
24 (Whereupon, at 3:10 p.m., the workshop
25 was adjourned.)

CERTIFICATE OF REPORTER

I, PETER PETTY, an Electronic Reporter, do hereby certify that I am a disinterested person herein; that I recorded the foregoing California Energy Commission Workshop; that it was thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said workshop, nor in any way interested in outcome of said workshop.

IN WITNESS WHEREOF, I have hereunto set my hand this 26th day of December, 2008.



PETER PETTY