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Via Electronic Mail and U.S. Mail

Commissioner Karen Douglas
California Energy Commission
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Re: Docket Number 07-HFS-1
Fuel Delivery Temperature Study

Dear Commissioner Douglas:

As discussed at our meeting on February 23, 2009, with, among others, Commissioner Jeffrey Byron, Michael Smith, Deputy Director for Fuels and Transportation, Gordon Schrempf and Nick Janusch, we are writing to set forth proposed changes and alternative language respecting the January 2009 Committee report dealing with the issues of (i) the net economic benefit to consumers under the cost/benefit analysis and (ii) the permissive use of automatic temperature compensation ("ATC") in California.

1. Net Economic Benefit to Consumers

The current CEC report at page 74 "calculated that the decreased quantities of gasoline gallons were valued at about $376.4 million and diesel fuel at about $61.1 million . . . This amount of money [$437.5 million] is the representative value of the reduced quantity of gallons for which consumers would not have purchased if ATC had been in place at retail stations in California during the study period." However, as to the "net [economic] benefit to consumers", the CEC also concluded at page 3 "that ATCs should not be required since the results of the cost-benefit analysis show a net cost for consumers."

As we expressed at our meeting, there is no basis in or foundation for the current report to conclude that all costs to fuel retailers of ATC will be passed on to consumers. The methodology and conclusions contained in the report of Jeffery J. Leitzinger, Ph.D. of Econ One Research, Inc. should be considered and expressly acknowledged in the report of the CEC as

well as those of the county Weights and Measures officials (Messrs. Atkins, Boitano and Floren). Based on these submissions, at a minimum, it is unlikely that retail service stations would be able to recapture all cost and lost margin from hot fuel after introduction of ATC at retail pumps in California. Under that range of scenarios, there would be a material net economic benefit to consumers through the use of ATC.

Thus, Dr. Leitzinger, submitted written comments to Fuels and Transportation Division on January 5, 2009 concluding:

> ATC would unmask temperature-driven fuel prices differences, forcing retailers of warmer fuel (and by implication their suppliers) to choose between surrendering some margin or competing at an increased fuel price disadvantage.
>
> * * * *
>
> The absence of temperature correction provides retailers of hot fuel with a hidden source of margin advantage over their cooler-fuel competitors. As a result, they make more money than those competitors even while charging the same prices. Consumers do not have information about fuel temperature differences and, one can fairly assume, do not realize the lower energy content in a hot gallon given the myriad of other factors that affect their per-gallon driving mileage. Consequently, consumers do not have the means to create competitive erosion of hot fuel margin premiums.
>
> ATC would change that. By correcting retail fuel sales volumes to the same standard temperature, the source of the existing hidden hot fuel margin premiums would disappear.
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> * * * *
>
> In my opinion, the reality of the California fuel market casts serious doubt on the underlying assumptions upon which the conclusions of the no-benefit proponents rest. In particular, by failing to take into account the market significance of temperature-adjusted fuel volumes, differences between retailers as to fuel temperature, size, and business models, or the broader fuel market structure in which retailers participate, the no-benefit proponents overlook the market mechanisms through which ATC could readily benefit consumers.
>
> Depending upon the extent of margin recapture (by refiners, wholesalers, and retailers in combination), there would be significant and long-term consumer net benefit from ATC. . . . As is shown in Exhibit 1, ATC would provide a net consumer benefit in the first year even if the degree of margin recapture is as much as just over 76 percent. Exhibit 2 assumes that margin recapture exactly meets this first-year (net) break-even point and, taking account of recurring ATC-related costs, carries the net consumer benefit analysis forward for 10 years. Exhibit 2 shows that even at this high level of margin recapture,

> consumers would achieve a net benefit of $844 million over the next ten years. As is shown in Exhibit 3, a 50 percent margin recapture would leave a net consumer benefit of $2.1 billion over the next ten years.

(pages 28, 30-31, 39-40) (emphasis added)

Dr. Leitzinger offered express examples of circumstances where the industry had not passed on all cost increases to consumers (*see* Leitzinger report at pages 25-27) Further, Dr. Leitzinger concluded that, if there was a 25% margin recapture by motor fuel retailers, there would be a net consumer benefit over $3.2 billion over the next ten years. (*Id.* at Exhibit 4).

Significantly, in the discussion regarding general methodology and analysis of costs/benefits contained in your staff's Workshop Materials dated June 5, 2008, the Fuels and Transportation Division set forth a methodology and quantified the benefits to consumers and the costs to retail service stations of implementing ATC in Alameda County and Fresno County. The monthly benefit calculation was the amount of fuel sold in each county multiplied by the fuel price and multiplied by a "volume correction factor" that was based on the temperature of the fuel (page 70). The cost estimate calculation methodology was based on the cost of new fuel dispensers, retrofit kits for existing pumps, labor costs, slightly higher inspection fees and maintenance costs, and increased inspection time of regulators. (pages 66, 68) Further, at pages 71-74, the Fuels and Transportation Division assumed zero margin recapture (*i.e.*, no pass through to consumers of lost hot fuel margins), and found that the benefits to consumers outweighed the costs in Alameda County by almost $9.5 million per year after the first year and in Fresno County by roughly $11.5 million each year after the first year.

While the Staff's assumption as of June 5, 2008 of NO recapture by the retailers was revised later, presumably as being unfounded and unrealistic, so to is the current unfounded and unrealistic polar opposite assumption in the current draft, namely that ALL such margins will be 100% recaptured by the retailers from day 1 following implementation of ATC. The likely truth regarding the degree of recapture over time is somewhere in between, and we respectfully submit the final report must acknowledge the probability of different ranges of recapture, and the resultant significant and material impact that range of possibilities has on the economic benefit to consumers under any basic cost/benefit analysis. The CEC does not possess a crystal ball which enables it to predict precisely how the industry and consumers will react to ATC costs and recapture. Simply put, without advising the CEC of the economic ramifications of recapture at less than all of such costs and lost revenues, we respectfully suggest the report opens itself to the same loss of credibility which presumably lead your Staff to change its conclusions of June 5, 2008. The reality is there will not be 0% or 100% recapture, and the report should and must show the ranges of other possibilities and the economic impact of those ranges on the amount of economic benefits to the consumer.

Indeed, such an approach would also be entirely consistent will the revised position of the Staff regarding the issue of permissive use, where the Staff has concluded it is important to acknowledge in the Report differences of opinion. Similarly, such differences of opinion on a matter of speculation as to the future degree of recapture must also be acknowledged given the markedly divergent conclusions these differences offer as to the economic cost-benefit analysis.

Further, in a letter to the California Energy Commission, dated January 4, 2009, Kurt E. Floren of the Los Angeles Department of Agricultural Commissioner/Weights and Measures (the county which consumes 25% of California motor fuel each year) concluded:

> The findings of the report support a conclusion that automatic temperature compensation at the retail level for transportation fuel sales is both feasible and beneficial to the purchasing consumer as well as for competing dealers. Given the certain premise that liquids do expand and contract with temperature, it is imperative that consumers know, in making purchase decisions, exactly what they are receiving for their money at the time such decisions are made. This is all the more pertinent in considering that the retail fuel market is, indeed, highly competitive and consumers make purchase decisions based upon very slim per-gallon price variances among competitors. The lack of certainty regarding temperature and resulting fuel expansion that exists in the absence of automatic temperature compensation (ATC) technology at retail fuel stations results in the potential obliteration of the ability to compare value among such minimal price variances.
>
> Regarding retail fuel dealers, as the vast majority of wholesale fuel purchases are conducted on a temperature compensated basis, ATC at retail ensures that fuel sellers can both recover their wholesale costs and apply a profit margin that is consistent and reliable, as sales volumes and revenues would be directly proportional to their wholesale fuel purchases. The need to continually monitor fuel tank contents and fuel temperatures and to make continual adjustments to advertised fuel prices to achieve those cost recoveries and profit gains become entirely unnecessary, as delivery adjustments are automatic via the technology's compensation functions. . . .
>
> First is the recognition that temperature compensation has been implemented in the majority of wholesale transactions to ensure consistency and accuracy within that level of motor fuel commerce for at least half a century, as noted in the report. . . .Finally, the observations of Canada's voluntary implementation of ATC at a rate exceeding 90% is evidence of Canadian retailers' recognition that fuel sale volumes and maintenance of desired and reliable profitability are successfully facilitated by ATC in cold weather environment. Certainly, it can be assumed that the same should be true in a typically warm weather environment as exists in California.
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> * * * *
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> The bottom-line goal of the AB 868 Fuel Delivery Temperature Study has been to conduct a cost-benefit analysis to determine whether the cost of ATC implementation at retail is warranted. As a weights and measures regulatory official with twenty-four years of experience overseeing the nation's largest county in which nearly two-thousand retail fuel stations operate over 56,000

dispensers and conduct nearly 25% of the state's annual fuel sales, I submit to you that the answer is "Yes."

* * * *

Weights and measures laws and regulations are intended to facilitate value comparison [emphasis in original] . . . . Many measuring devices that were previously implemented for commercial use are no longer permitted, as technology has advanced, become available at reasonable cost, and has proven to provide greater assurance of accuracy than that of the preceding equipment. Similarly, newer and improved accuracy tolerances and device specifications have been required and implemented in their place as they became available, even though higher costs were incurred, as they provided greater protection to commerce. Such should be done in the case of automatic temperature compensation technology.

* * * *

The issue of monetary benefits from ATC to California consumers is, admittedly, a convoluted issue. As reflected in the CEC staff study report, sales of gasoline and diesel fuel in California amounted to approximately 15.625 billion gallons and 3.056 billion gallons, respectively, during the study period. Had ATC been in use, California consumers would have paid for a total of 136 million fewer gallons amounting to a value of $438 million. Opponents of ATC will argue that this value is presented in error, as it is to be presumed that cost savings to retailers (fuel not actually delivered) is reflected in the per-gallon prices offered to consumers and they, therefore, did not incur the actual expense. Facts supporting such a presumption, though, have not been presented or documented in any way by the opponents. Opponents will also argue that, if ATC were to be implemented, costs would need to be passed on to consumers, resulting in no net benefit to them. This brings the matter to its bottom-line question: Is there a net benefit? I again submit, "Yes."

There can be no assurance, under current non-ATC retail fuel sales practices, that temperature variables have been taken into account in establishing retail per-gallon prices. There is a demonstrated recurring problem of uncertainty amounting to over $400 million that can be remedied by a one-time $123 million solution, using the CEC's high-end calculation of implementation costs. Even if passed through to consumers in its entirety, this solution will be offset by a one-year increase in retail fuel prices of less than a penny per gallon (7/10 of a cent) over the course of a single year, with ongoing costs (at the high-end) of seven-hundredths of a cent per gallon. By any reasonable standard, such a cost is negligible.

* * * *

> Accuracy and reliability in measurement standards is critical to the maintenance of a fair marketplace and to facilitate value comparison, benefiting consumers and competitors, alike." (emphasis added).[1]

Accordingly, we propose that regarding the economic benefits and costs associated with temperature compensation for retail sales of gasoline and diesel fuel in California, the following language be added to the "Executive Summary" of the report, replacing the fourth paragraph on page 1:

> This report quantifies the economic benefits and costs associated with temperature compensation for retail sales of gasoline and diesel fuels in California. The conclusion of the cost-benefit analysis is predicated on whether motor fuel retailers in California may be able to pass on to consumers the costs of installing the ATC equipment and their reduced margins from selling hot fuel (that is, pass on to consumers all costs associated with ATC-cost of implementation and reduced margins on gallons sold in excess of 60 degrees F.). It is not possible to predict whether retailers (refiners, wholesalers, and retailers in combination) can or will be able to successfully pass on to consumers all costs associated with the introduction and use of ATC. Therefore, the amount of net benefit to consumers depends on the degree to which retailers of motor fuel in California pass through to consumers their reduced margins and costs to consumers.
>
> Depending on the amount of margin recapture by retailers of motor fuel, there is a range of potential economic benefits to consumers. For example, assuming a 75% margin recapture by motor fuel retailers, consumers would achieve a net benefit of $844 million over the next 10 years. Assuming a 25% margin recapture by retailers, there is a net economic benefit to consumers in excess of $3.2 billion over the next 10 years.
>
> Finally, through ATC, there is value in the public perception of increased fairness, accuracy, and consistency of fuel measurement that support mandating ATC at California retail stations.

The following language be added replacing the paragraph under the first bullet on the middle of page 3 of the "Executive Summary":

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[1] *See* also the submission dated January 5, 2009, Mike Boitano, California Agricultural Commissioners & Sealers Association ("The facilitation of value comparison in commercial transactions and the assurance of accuracy in conducting such transactions are central to the regulatory efforts of our members. Automatic temperature compensation (ATC) technology provides enhancements to the means for achieving each of these endeavors. * * * * CACASA recognizes the benefits of ATC to fuel measurement accuracy, its ability to aid consumers in performing value comparison when shopping for fuel, and the reasonable pass-through cost of implementation.") (emphasis added); submission dated December 19, 2008, Robert G. Atkins, San Diego Department of Agriculture, Weights and Measures ("Automatic temperature compensation would result in the same 'gallon' being sold at retail as it is at wholesale so that buyer and seller are both dealing in 'net gallons'. The obvious benefit for consumers is improved retail price transparency.") (emphasis added). (After Los Angeles county, San Diego county is the largest consumer of motor fuel in California)

"There is a range of potential net financial benefits to consumers depending on the amount of margin recapture by retail station owners, wholesalers, and refiners."

The following language be added replacing the first bullet point under "Primary Recommendations" on page 3:

"If the only criterion for assessing the merit of mandatory ATC installation for use at California retail stations is the net economic benefit to consumers, results of the cost-benefit analysis depend on whether retail stations can and will pass on to consumers all costs associated with ATC. If they can and do pass on all costs of ATC to consumers, there is no net economic benefit to consumers and ATC should not be mandated. If, however, retail stations cannot or do not pass on all those costs to consumers, depending on the amount of pass through, there are material and sizable net economic benefits to consumers and ATC should be mandated."

To make these changes/deletions regarding the net benefit to consumers after the introduction of ATC in California, the following portions of the existing report should be deleted and/or modified:

- Page 3 (Executive Summary): Delete first bullet point on bottom of page three ("If the only criterion for assessing the merit of mandatory ATC …the results of the cost-benefit analysis show a net cost for consumers.").

- Page 57 (Chapter Four): After the third full paragraph on page 57 under "Cost-Benefit Analysis Approach and Methodology", add "Accuracy and reliability in measurement standards is critical to the maintenance of a fair marketplace and to facilitate value comparison, benefiting consumers and competitors, alike."

- Page 74 (Chapter Four): In the first full paragraph, delete the first sentence ("The conclusion, therefore, is that retail station owners will in fact raise their fuel prices to compensate for selling fewer units, all other things being equal"). Add "It is unclear whether, and the degree to which, retail station owners will be able to raise motor fuel prices depending on market conditions and other factors."

- Pages 76-80 (Chapter Four): Revisions under section entitled "ATC Retrofit Cost-Benefit Analysis Results for Society" and "ATC Retrofit – Potential Net Benefit to Consumers Under Certain Circumstances". Add "It is unclear whether retail stations owners would be able to pass on increased costs of ATC and increased size of gallons (*i.e.*, margin recapture) and there is a range of possibilities depending on the amount of pass through to consumers. For example, if there is a 50% margin recapture by retailers, consumers would have a net benefit of $2.1 billion over the next ten years."

- Pages 111-112 (Chapter Seven): Delete last bullet point ("But the perception by various stakeholders…the Conclusion is that retail stations owners will in fact raise

their fuel prices to compensate for selling fewer units, all other things being equal."). Add "The net benefit to consumers depends on the degree to which retailers can pass on to consumers their decreased margin. It is unclear whether retail stations owners will be able to raise their fuel prices to fully compensate for selling fewer units (*i.e.*, margin recapture). Thus, the net benefit to consumers is unclear and there is a range of possible economic benefits to consumers."

- Page 113 (Chapter Seven): Second bullet point delete last sentence ("As such, it is unlikely that there are any plausible circumstances whereby some consumers could realize a small net benefit of ATC at retail in California."). Add "Thus, the net economic benefit to consumers is unclear and there is a range of possible economic benefits."

- Page 114 (Chapter Seven): Delete last bullet point ("Any attempts to increase the level of information...and the electronic cash register or Point of Sale (POS)").

- Page 116 (Chapter Seven): Delete first bullet point under "Recommendations" ("If the only criterion for assessing...is the results of the cost-benefit analysis showing that costs for consumers."). Add "There is a range of possible net economic benefits to consumers depending on the amount of margin recapture by retailers, wholesalers, and refiners."

2. Permissive Use of ATC

In May 2007, the Department of Agriculture, found, in accordance with Business & Professions Code Section 12500.5, an ATC device to temperature compensate the delivery of motor fuel at retail service station pumps "meets the requirements of this [Business & Profession] code" and approved the ATC device for "use in commerce" in California (*i.e.*, on motor fuel pumps in California). Consistent with that certification, under California law, in a 2007 national survey by the National Institute of Standards and Technology of State Weights & Measures officials regarding the legality of temperature correction on retail sales of motor fuel, California responded that temperature compensated retail motor fuels were now permissive and lawful at California retail stations. *See* http://www.ncwm.net/events/atc2007/States_Survey_On_ATC.doc.[2]

Accordingly, as we urged at our meeting this week, we respectfully suggest that the current version of the report at page 2 be changed and the following language added to the end of paragraph 2 following the first bullet point question:

> For purposes of this report, the CEC assumes that permissive use of ATC at retail motor fuel pumps in California is now permitted under California law. (Footnote 1)

[2] The November 2008 Staff Report of the CEC concluded at page 2 "[p]ermissive voluntary use of automatic temperature compensation (ATC) devises at California retail stations is already permitted under California Law as it is not specifically prohibited." That report further concluded that it is now "legal to use [ATC devices] on a voluntary basis per DMS regulations." (page 106)

Footnote 1: The CEC recognizes that certain stakeholders assert divergent positions respecting whether the use of ATC is now permitted in California and that litigation is now pending in California and elsewhere regarding certain issues relating to the temperature of motor fuel sold to consumers. Thus, lawyers for the oil industry filed two letters arguing that the use of ATC is now prohibited in California while a lawyer representing consumers filed a letter concluding that the use of ATC is now permitted in California.

To be consistent with this conclusion, the portions of the existing report that need to be deleted and/or changed are as follows:

- Page 2 (Executive Summary): Delete second half of sentence under first bullet point ("and it is unclear whether the voluntary use of ATC devices is permitted under California law.").

- Page 4 (Executive Summary): Delete second and third bullet points ("If the Legislature chooses not to mandate…consumer labeling provisions for ATC at retail stations.").

- Page 8 (Chapter One): In fourth paragraph under "Retail Transactions and Temperature Compensation" delete the sentence ("[i]t is unclear whether the voluntary use of ATC devices for retail transactions of gasoline and diesel fuel is permitted under California Law.").

- Page 89 (Chapter Six): Delete third full paragraph under "Permissive vs. Mandatory ATC at Retail Stations".

- Page 90 (Chapter Six): Delete and/or modify first full paragraph, second full paragraph, and last paragraph on this page as "The Department of Agriculture has approved an ATC device 'for use in commerce' as meeting all the requirements of the Business & Professions Code." Add "For purposes of this report, the CEC assumes that permissive use of ATC at retail motor fuel pumps in California is now permitted under California law."

- Page 95 (Chapter Six): Delete first full paragraph ("If voluntary use of ATC at the retail level is clarified…").

- Page 105 (Chapter Seven): Delete last bullet point ("Currently, there are no retail ATC devices…is permitted under California law").

- On page 114: Delete bullet point ("The status of permissive (voluntary) use of ATC devices at California retail stations is currently in dispute with various stakeholders.") Add "For purposes of this report, the CEC assumes that permissive use of ATC at retail motor fuel pumps in California is now permitted under California law."

- Page 116 (Chapter Seven): Delete fourth and fifth bullet points under "Recommendations" ("If the Legislature chooses not to mandate the use of ATC…and consumer labeling provisions for ATC at retail stations.").

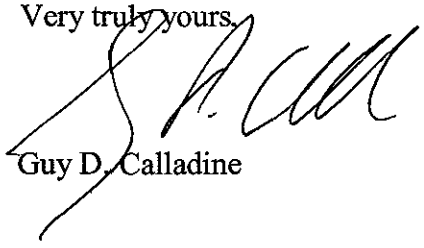
- Page 118 (Chapter Seven): Delete all three bullet points under "Permissive vs. Mandatory ATC at Retail Stations". Add "For purposes of this report, the CEC assumes that permissive use of ATC at retail motor fuel pumps in California is now permitted under California law."

- Page 118 (Chapter Seven): Delete last bullet point under "Labeling" ("If voluntary use of ATC…").

We are available to further meet and confer with you, the other Commissioners, or their staff to discuss these issues. We very much appreciate the time, dedication and effort that you and the CEC have expended in preparing and conducting the cost/benefit analysis and in preparing the various reports.

Thank you for your cooperation and consideration.

Very truly yours,



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