

BEFORE THE
SUBCOMMITTEE ON DOMESTIC POLICY
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

TESTIMONY OF R. TIMOTHY COLUMBUS
ON BEHALF OF THE
NATIONAL ASSOCIATION OF CONVENIENCE STORES
AND THE
SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

REGARDING “HOT FUELS”

JUNE 8, 2007

R. Timothy Columbus
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
202.429.6222
tcolumbus@steptoe.com

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Good morning Mr. Chairman and Members of the Subcommittee. My name is R. Timothy Columbus. I am a member of the law firm of Steptoe & Johnson and appear today in my capacity as the general counsel of our clients the National Association of Convenience Stores (NACS) and the Society of Independent Gasoline Marketers of America (SIGMA).

NACS is a trade association representing convenience and petroleum retailers throughout the United States and the world. The domestic convenience store industry is comprised of approximately 145,000 retail locations and in 2006, sold approximately \$405 billion worth of motor fuels.

SIGMA is an association of approximately 255 motor fuel marketers which operate in all 50 states. SIGMA's members sell more than 30 percent of all the motor fuels sold in the United States and supply more than 35,000 retail outlets across the country. Members of NACS and SIGMA sell well over half of the motor fuels sold in the United States.

As per the Subcommittee's letter of invitation to testify, my comments focus primarily upon the impact on commercial transactions of the thermal expansion of gasoline, some of the "solutions" already offered, and my client's perception of the consumer's interest in this matter. For the reasons set forth in this testimony, it is the recommendation of NACS and SIGMA that,

with the exception of activities to develop and disseminate relevant information, the federal government should take no action related to the matter we are discussing today.

Before turning to those matters, Mr. Chairman, I must make one thing perfectly clear about this whole debate. This dispute has virtually nothing to do with the integrated oil companies. These companies own, much less operate, less than 10 percent of the retail outlets. So please make no mistake. This is all about independent retailers.

BACKGROUND

For over 70 years, liquid motor fuels have been sold throughout the country to retail consumers on the basis of regularly posted price for each liquid gallon (231 cubic inches) of fuel delivered into the motorist's tank at a retail outlet. State regulators regularly inspect retailers' fuel dispensers to assure that each is, within acceptable tolerances, delivering 231 cubic inches of the product being dispensed.

The range of characteristics and performance standards for gasoline and diesel fuel are uniformly recognized as having been established by the American Society for Testing and Manufacturing (ASTM). Gasoline is defined by ASTM D 4814-07 and diesel fuel is defined by ASTM D 975-07. As a review of the definition indicates, gasoline is a liquid fuel which fulfills the performance characteristics set forth in ASTM D 4814-07. Similarly, diesel fuel is defined as a liquid fuel which fulfills the performance characteristics set forth in ASTM D 975-07.

At all times in the modern area of fuels marketing, these facts have been uniformly accepted and those agencies charged with the protection of a consumer's interests in motor fuel transactions have held motor fuel sellers accountable for assuring that the consumer receives products which meet the appropriate definition. Notably, nowhere in these definitions does ASTM define the energy content of a gallon of gasoline or diesel fuel. The Btu content of a

gallon of gasoline or diesel fuel will vary based upon the process by which it was manufactured and the components blended to achieve the performance required by the relevant ASTM standard.

Gasoline is, for the most part, an entirely fungible commodity. Manufacturers of gasoline make it to ASTM standards and generally ship their production to market in batches which in the process of transportation are co-mingled with the production of other manufacturers. Simply stated, for the most part, all retailers in a particular market acquire product at a terminal facility which contains the co-mingled products of many manufacturers. The only “product differentiation” between products takes place as sellers inject different additives into the product as it is delivered from the terminal into a transport truck. In most metropolitan markets all retailers obtain their products from terminals supplied by the same common carrier pipeline, located in sufficiently close physical proximity as to experience the same ambient temperature, deliver them by trucks driving through the same ambient air temperature, and deliver this product into storage tanks surrounded by ground of the same ambient ground temperature.

The uniformly enforced requirement that a consumer, when purchasing a motor fuel, receive 231 cubic inches of a product meeting the appropriate ASTM definition, coupled with the near total transparency of pricing in the retail motor fuels markets, has resulted in perhaps the most competitive and generally understood commodity market in the country.

THE ALLEGED PROBLEM

Because motor fuels are volatile they are subject to physical expansion and contraction in response to changes in temperature. (For example, 231 cubic inches of most conventional gasoline at 60 degrees Fahrenheit when heated to 80 degrees Fahrenheit will occupy 234 cubic inches of space.) Critics of retail motor fuels marketers allege that because marketers purchase

motor fuels as if these fuels had been delivered at a temperature of 60 degrees Fahrenheit, consumers are being cheated if they purchase product being sold and measured in standard gallons at ambient temperature. This allegation does not recognize that many retailers purchase gasoline and diesel fuels on a “gross gallons” (non-temperature corrected) basis. These critics allege that because a retailer purchases product on a temperature corrected basis and obtains 234 cubic inches of gasoline at 80 degrees Fahrenheit for a price term that assumes it purchased 231 cubic inches of that product at 60 sixty degrees Fahrenheit, the retailer has deceived the consumer if it charges the consumer a price for 231 cubic inches of gasoline at a temperature of 80 degrees Fahrenheit. In this example critics would claim that the consumer has been cheated out of three cubic inches of gasoline and the British thermal unit (Btu) content of those three cubic inches of gasoline.

While superficially attractive, this allegation is in itself deceiving for a number of reasons. Foremost of these reasons, as discussed in detail below, is that a gallon of gasoline, sold at retail, is not comprised of a fixed number of molecules or a certain number of Btu’s, but rather is uniformly acknowledged to consist of 231 cubic inches of a mixture which meets the definition of gasoline established by ASTM. That is what consumers buy and that is what retailers sell, nothing more or less. There are no additional terms or conditions as to what is being transferred and as a consequence there is no confusion or consumer harm.

THE REAL PROBLEM

As discussed above, the promised and delivered transaction which occurs when a consumer purchases a gallon of “gasoline” is the transfer of 231 cubic inches of a mixture of hydrocarbons which meets the definitional criteria to qualify as gasoline within the specifications established by ASTM. The heretofore uniform acceptance of the validity of that statement has

resulted in consumers benefiting from the most transparent and competitive of all of the major commodity markets in the United States. In this market consumers know precisely what they are buying and that the posted offer to sell published on large price signs at retail motor fuel outlets are for the same “gallon” of gasoline. These price signs force retailers to compete on the basis of pennies per gallon, empowering customers to shop for the best price, and best value, without ever leaving their vehicles.

Implementation of proposals to require retailers to “temperature correct” the gallons sold at retail would result not only in no increase in consumer benefit, but most probably in genuine consumer confusion and economic harm in the form of unnecessarily higher prices.

SOLUTIONS ALREADY OFFERED

For advocates of change, there are two mutually exclusive general approaches to temperature adjusted retail gasoline dispensing: mandatory or permissive. A careful analysis of both demonstrates consumers would be negatively impacted by either.

Permissive Temperature Adjustment. The primary problem with a “permissive” approach to dispensing temperature adjusted retail gallons stems from the potential for undue complexity in the market and confusion in the minds of consumers. If each retail outlet potentially sells differing volumetric gallons of gasoline (whether at the same or differing prices), the prospect of a consumer sorting through purchase options and arriving at a standard basis for making a purchase decision is daunting, if not impossible. Nor would a proliferation of point-of-sale disclosures likely lead to clarity. To the contrary, physics lessons at the pump island could be expected to intensify confusion, not dispel it. And, of course, all the cost benefit concerns expressed below apply, as well.

Mandatory Temperature Adjustment. A “mandatory” approach could provide some degree of greater certainty (and market place clarity) than would a “permissive” approach. However, for the reasons discussed below, the direct and indirect costs of implementation loom large and depending upon the administrative and technological approach, a mandatory regime runs the risk of creating the worst of all possible worlds where all the costs are incurred and absolutely no offsetting benefit is provided.

Mandatory temperature correction would, in fact, require the retrofitting or replacement of all existing gasoline and diesel dispensers. While estimates of the total cost of such an exercise vary, it is clear that this cost will be in the thousands of dollars per dispenser. Current estimates are approximately \$2,000.00 plus per electronic dispenser and \$1,500.00 to \$3,800.00 per mechanical dispenser depending upon the number of hoses. (It is noteworthy that the only technology to retrofit a mechanical dispenser is subject to a patent owned by Krause Technology. How an apparent monopolist would react in price terms to a mandate for its technology is unclear.) On average, we could expect an expenditure of approximately \$8,000.00 per outlet. These costs will be passed on to consumers along with an amount representing a return on the investors’ capital. For economically marginal retail outlets, this additional investment may mean the termination of their participation in the market. (The average convenience store/retail petroleum outlet in the U.S. generated a pre-tax profit of approximately \$33,396.00 in 2006. See NACS State of the Industry Report 2007.) Should these marginal outlets leave the market, market concentration will increase generating the prospect of less competition and higher prices.

Similarly advocates of mandatory temperature correction ignore the fact that different hydrocarbon mixtures which meet the definition of gasoline or diesel fuel have different specific gravities and other characteristics which render each such mixture’s physical response to changes

in temperature different. For example, gasolines containing blends of conventional product plus volumes of ethanol are likely to expand and contract differently than a gasoline which contains no ethanol. There is nothing inherently wrong with that. However, two consumers purchasing two different gasolines at outlets across the street from each other may, even if the two products' temperatures are identical and automatically corrected, receive slightly different volumes of product and radically different Btu content. How will the consumer know what he or she is receiving?

Finally, advocates of temperature correction claim that this practice will provide value to the consumer. However this claim has no basis. Selling wholesale gallons based on a 60 degrees Fahrenheit gallon is, just like selling retail gallons on a non-corrected basis, a price term; nothing more. There is no guarantee that a change in that price term will not immediately result in the change of another: the one on the price sign.

CONCLUSION

In conclusion, critics of the long existing practice of delivering to retail motor fuel consumers a standard gallon (231 cubic inches) of gasoline allege that the consumer is being deceived and cheated because that consumer would receive more Btu's if a gallon, the temperature of which exceeds 60 degrees Fahrenheit at the time of retail sale, were temperature corrected to that lower figure. This claim is patently false. No consumer is deceived or cheated. The consumer does not now, and has not in the past, had any legitimate expectation of receiving a certain number of Btu's when he or she purchases a gallon of gasoline, because there is no standard number of Btu's in a gallon of gasoline. No two gallons of gasoline produced by different manufacturers are likely to contain the same number of Btu's at any temperature. Moreover, when ethanol is included in the fuel, the Btu differential is far greater.

As noted above, the adoption of proposals for “permissive” temperature correction is a guarantee of consumer confusion. Mandatory temperature correction provides no increased certainty as to what any particular consumer will receive when buying from one retailer as opposed to when it purchases from that retailer’s competitor. It does, however, guarantee the injection of additional costs into the market for which the consumer unquestionably will be required to pay along with a return on capital invested.

This entire debate has been great fun for journalists and a dream for some plaintiffs counsel. The only thing missing from the conversation has been a documented increase in consumer welfare which will result to compensate the consumer for a loss of market transparency and higher operating costs for vendors.

Mr. Chairman, as I am sure you are aware, House Science and Technology Committee Chairman Bart Gordon has requested the National Academy of Sciences (NAS) to complete an exhaustive study to determine whether a problem exists and whether the use of automatic temperature compensation equipment is warranted. At the very least, we suggest that Congress should not make any decisions relative to this issue until it has the opportunity to review the findings of this NAS study.

SIGMA and NACS deeply appreciate this opportunity to share their views with the Subcommittee. I will be happy to respond to any questions which my testimony may have raised.