

**WILLIAM WEHRUM
ACTING ASSISTANT ADMINISTRATOR
OFFICE OF AIR AND RADIATION
U.S. ENVIRONMENTAL PROTECTION AGENCY
BEFORE THE COMMITTEE ON ENERGY AND COMMERCE**

May 10, 2006

Mr. Chairman, and members of the Committee, I appreciate the opportunity to come before you today to testify on gasoline fuel quality specifications and supply. As the Acting Assistant Administrator for the Office of Air and Radiation, my responsibilities include overseeing all air-related activities of the Environmental Protection Agency (EPA or Agency). I am pleased to be here on behalf of my colleagues at EPA who have developed and worked closely with states to implement the highly successful programs that reduce harmful emissions from highway and off-road vehicles, engines and fuels.

My testimony will first provide an overview of existing federal regulatory clean fuel programs, followed by more discussion of state clean fuel quality programs, often referred to as “Boutique” Fuels.

Overview of Clean Fuel Programs

Fuel controls for emission reductions is often one of the most cost-effective methods to help reduce emissions. In the Clean Air Act Amendments of 1990, Congress directed EPA to develop and implement several important new clean fuel programs to improve air quality to reduce emissions that cause or contribute to the formation of ozone and air toxics. Many of these programs are national in scope, such as summertime controls on gasoline volatility and year round controls on gasoline sulfur. Congress set specific cities, performance standards and an oxygenate requirement for the reformulated gasoline (RFG) program which began in 1995.

Provisions such as banking, averaging and credit trading have also been built into many of these regulatory programs and are designed to provide greater flexibility and reduce production costs.

Clean fuel programs have been an integral part of the nation's strategy to reduce air pollution and they have been successful. They provide significant, cost-effective and timely reductions in motor vehicle emissions.

State Boutique Fuel Programs

There is much confusion over what a boutique fuel is. The Clean Air Act (CAA) allows states to implement their own clean fuel programs. Quite simply, a boutique fuel is a unique fuel specification that is developed by a state or local air pollution agency and approved by EPA as part of the State Implementation Plan (SIP) for the affected area.

Most states that do not use RFG to address their air quality issues have elected to use gasoline with lower volatility than federal conventional gasoline standards. Sometimes states adopt these low Reid vapor pressure (RVP) fuels because the CAA does not allow them to join the federal RFG program. In other cases where states could have opted-in to the federal RFG program, local fuel providers worked with states to develop an alternative fuel specification that can be produced at a lower cost and still support their air quality needs. What this has typically meant in practice is the avoidance of the oxygen mandate in the RFG program because it is more expensive in some areas. It is worth noting that boutique fuels do not include other clean fuel requirements, such as Federal fuel controls (e.g., reformulated gas, winter oxygenated fuels), California clean fuel requirements, and area-specific fuels required by state law for purposes other than air quality (e.g., Minnesota's ethanol mandate).

Currently 12 states have approved boutique fuel programs. Eight states limit the volatility of gasoline and are in effect only during the summer months. Four other states control other

parameters of fuels, such as aromatics and sulfur in gasoline or diesel fuel, or allow California's cleaner burning gasoline to be sold within their boundaries. [See attached map.] This reduces evaporation of gasoline which helps reduce smog in urban areas. [See attached chart of boutique fuel programs.] The state plans are required to estimate the additional cost. Those state estimates range from 0.3 to 3 cents per gallon above the cost of conventional gasoline. It is important to note that the cost of producing boutique fuels does not translate into retail consumer prices at the pump. Since many economic factors influence the retail price of gasoline, I will defer to experts from the Energy Information Agency to describe the difficulty of translating fuel production costs to impacts on retail prices.

The Clean Air Act imposes strict limitations on EPA's approval of boutique fuels. Specifically, a State may prescribe and enforce a fuel quality control if, after review and approval of the SIP, the Administrator finds that the State control or prohibition is necessary to achieve the national primary or secondary ambient air quality standard and no other measures are available to bring about timely attainment. Where implemented, these fuels are an important and powerful tool for combating local air pollution problems.

EPA's 2001 Evaluation of Boutique Fuels

For sometime there has been concern about potential adverse effects of boutique fuels on fuel pricing, supply and distribution. As part of the President's 2001 National Energy Policy Report, EPA was directed to conduct a study to determine whether boutique fuels were contributing to such problems and if so to recommend solutions. EPA conducted an extensive review that included close cooperation with the Department of Energy (DOE) and extensive outreach to the fuels industry and other interested stakeholders. EPA issued a report to the President in October 2001. EPA's report focused on two primary issues. First, we assessed the

possible need for greater flexibility in the process that fuel marketers used to make the transition from winter to summer grade gasoline. Second, we investigated the growing number of state and local boutique fuel programs and the challenges this growth presented to the gasoline distribution system.

The report concluded that during times of normal conditions, the fuel production and distribution system works well and is able to provide adequate supplies of boutique fuels to the required areas. However, because the specification of the fuel varies from the conventional fuel used in surrounding areas, if production or distribution disruptions occur, such as hurricanes, pipeline breaks or refinery fires, boutique fuel requirements can limit the availability of supply to the area and therefore contribute to potential supply problems and short term price spikes.

The Agency also evaluated the costs and benefits of several different approaches to limit the number of fuels available for adoption by states.

In response to the report's findings, EPA took several steps to ease the regulations governing the transition from winter to summer gasoline. For example, EPA increased the compliance testing tolerance from 1% to 2% for a limited transition time to allow for a smoother switch to summer-controlled gasoline. The Agency also revised the regulations to allow refiners to upgrade conventional gasoline to RFG, if it meets the RFG performance standards, thereby allowing for greater flexibility in providing additional RFG when supply is tight.

Boutique Fuel Provisions of the Energy Policy Act

First, the Energy Policy Act of 2005 (EPAct) established a fixed limit on the number of boutique fuels that EPA can approve. The list will limit further expansion of the state clean fuel programs. EPA is preparing to publish this list for comment in a Federal Register notice which is expected before the end of this month.

EPA and DOE are also instructed by EPAct to perform a joint study on the effects of state boutique fuel programs on air quality, fuel blends, fuel availability, fungibility and costs, with a focus on making recommendations to Congress for legislative changes supporting developing a federal fuels system that maximizes fungibility and supply and addresses air quality requirements and reduces price volatility. The Agency and DOE are currently coordinating efforts and will work closely in preparing this report.

Further, EPAct requires the Agency to prepare another report by June 1, 2008, concerning variations in regional, state and local motor vehicle fuel requirements. Both reports will build off the EPA 2001 Boutique Fuels Report, accounting for recent and upcoming changes in the U.S. gasoline and diesel markets.

EPAct also authorized removal of the federal oxygen content requirement for RFG. Removal of the RFG oxygenate standard will allow refiners additional flexibility in how they make reformulated gasoline and when and where they blend oxygenates. EPA completed a rulemaking, as directed by Congress, on May 3, 2006 which took effect on May 8, 2006. California is treated differently under the Clean Air Act, this as directed by Congress. EPA removed the oxygen content requirement in California RFG in April, prior to its removal in other states.

Perhaps of greater importance, EPAct also requires EPA to develop and implement a renewable fuels standard, or RFS. This program will require increasing amounts of renewable fuels, such as ethanol and biodiesel, to be blended into the nation's gasoline supply. We currently are developing the program. A comprehensive proposal will be issued later this year.

Governors Task Force on Boutique Fuels

While EPA's regulatory improvements and the new EPCRA provisions have significantly improved key aspects of the boutique fuels issue, concerns about potential adverse effect of boutique fuels have persisted. Hurricane Katrina provided a stark demonstration that when the nation's fuel supply is drastically reduced as it was last year, multiple and differing fuel regulations can complicate the recovery effort. Moreover, persistently high crude oil prices and the resulting high gas prices have caused a renewed effort to look for innovative ways to simplify the fuel distribution system.

Consequently, on April 25th, President Bush directed Administrator Johnson to convene a Governors Boutique Fuels Task Force. All 50 Governors have been invited to participate. The task force will look to assess various state and local clean fuel requirements and the effect the requirements have on supply, quality, price, and air quality.

Last Thursday, Administrator Johnson held a conference call initiating this process. Weekly meetings will be held, with our next meeting scheduled with the task force May 12, where EPA staff will present background information on fuel regulations, the different boutique fuels in use in this country, the results of a 2001 review which the Agency conducted on boutique fuels and other related information. Over the coming weeks we are inviting the input of outside experts from industry, public health organizations, and other interested parties. We also expect to hold a number of technical staff meetings to help EPA prepare a draft report for the task force's review in mid-June.

This ambitious schedule will put us on track to provide the President with our final report within 8 weeks. The key elements of the report should include, a summary of the process we utilized to review boutique fuels; information on actions that have already been undertaken, including EPA's 2001 boutique fuel report and provisions required by the Energy Act; our

current understanding of the use and utility of boutique fuels; stakeholder opinion and feedback; and options, recommendations and additional information needs.

The options in the report will be designed to help the President meet his overall goal of simplifying and unifying the fuel regulation system and increasing cooperation among states on gasoline supply decisions.

Conclusion

In closing, this year's gasoline situation has had some unique influencing factors beyond the normal winter-to-summer gasoline transition practices. For example, the market underwent withdrawal of MTBE from RFG market areas, and the addition of ethanol into those RFG areas that had previously used MTBE. This MTBE-to-ethanol transition led to some additional tank management practices to prepare for the new products. Crude oil prices also hit historic highs. These factors, among others, provided for unusual market conditions. Despite these conditions, the market has managed the transition effectively and maintained the integrity and benefits of important environmental programs.

It is important to note that although a number of states have banned the use of MTBE, there is no federal ban. Refiners of RFG who have phased out the use of MTBE have done so through their own decisions. Of course, now that the RFG oxygenate requirement has been eliminated, refiners are free to produce RFG with or without an oxygenate.

Again, I want to thank you, Mr. Chairman and the members of the Committee for the opportunity to testify before the Committee on these important issues. This concludes my prepared statement. I would be pleased to answer any questions that you may have.