CIOMA CALIFORNIA INDEPENDENT OIL MARKETERS ASSOCIATION
3831 North Freeway Blvd., Suite 130 • Sacramento, CA 95834-1928 • Tel. (916) 646-5999 • Fax (916) 646-5985

August 12, 2004

CIOMA ALERT

SIGNIFICANT FUEL SUPPLY PROBLEMS PREDICTED AS A RESULT OF BAKERSFIELD REFINERY CLOSURE

To: All Interested Parties
From: The California Independent Oil Marketers Association

The California Independent Oil Marketers Association (CIOMA) has determined that significant fuel supply problems are likely, along with related fuel price spikes, as a result of the closure of the Shell Bakersfield refinery, especially in the San Joaquin Valley. These problems will affect not only fuel marketers -- impacts will be felt throughout area and state economies.

This conclusion has been reached after extensive research and several meetings with knowledgeable and concerned parties. The most recent meeting was held last Friday, August 6th. It included representatives from the California Energy Commission, the Attorney General's Office and industry experts who are intimately familiar with fuel supply logistics and constraints inherent in providing fuel supply into the Central Valley.

Unless there is a major change in the announced closure of the refinery in early October (such as the refinery being sold and remaining in operation) we believe that there will be a continual decline of fuel supply (both gasoline and diesel) into the San Joaquin market from this point forward. Some tightness has already occurred as Shell has reduced commitments to fuel exchange customers. It is our understanding that Shell will gradually reduce refinery output, or commit output to their own reserves, thereby reducing the number of "wet barrels" available to local customers – this will be especially felt by purchasers of unbranded fuel. Further, while Shell has indicated that they will continue to supply "contracted" customers, those customers will have to travel extended distances once the Shell supply terminal in Bakersfield is closed. Shell has indicated that it will take approximately 11 months from the time of refinery closure until it can arrange for pipeline changes allowing flow of fuels from northern California to resume to the Bakersfield area. It is during this period that supplies will be most constrained.

There is insufficient pipeline capacity from northern California refineries to make up the fuel shortage during the 11 months the terminal will be closed. The only realistic way of supplying fuels into the area will be by truck. In reviewing the logistics of moving the replacement volumes of fuel by truck we are convinced that problems will occur. First, there are a finite number of trucks and drivers that are authorized to move fuel – we believe there is insufficient trucking capacity to ferry fuel into the area and then provide delivery to ultimate customers. Further, there is a lack of storage and loading facilities in the area, so developing contingency storage or set-asides is not a realistic short-term option. And there will be extended delivery times and distances needed to get the fuel into the area, which may create other difficulties such as drivers reaching their legal hours of continuous operation. Further, we believe demand at the alternate fueling locations will be increased, lengthening the time it takes to get trucks loaded, and creating "ripple" supply shortages. The extended time and distances encountered in obtaining fuel will substantially increase fuel price as well, along with wholesale price increases that occur when fuel supplies become diminished.

We believe the Governor should be prepared to issue a Declaration of Energy Emergency which would allow allocation of fuel supplies by the Energy Commission. Further the Energy Commission should prepare a Fuel Contingency Plan which addresses potential shortages in the area and how to remedy such situations. A particular emphasis should be placed on agricultural operations since the reduction in fuel supply will coincide with peak demand, especially for diesel, during this fall's harvest season. Also supplies to governments, emergency services and essential services (telephone, utilities, etc) should be addressed. A suspension of fuel taxes during periods of heightened price should also be evaluated – government should not reap windfall tax benefit from this situation. Finally emergency relief to small businesses should be addressed. Many CIOMA members are small, family-owned businesses that are not able to withstand protracted adverse economic conditions that this closure will bring about. Already a number of our members are reaching credit limits and banks are becoming nervous about expanding credit lines. Without operating capital, small businesses have no other choice but to throw in the towel. We also ask the major oil companies and fuel suppliers to relax credit and payment terms to marketers so they can remain viable customers.

Time is running short – we urge all those involved in the petroleum supply chain to plan for this situation - with many small efforts maybe some of the worst-case scenarios can be avoided.

For further information regarding this alert, contact Jay McKeeman, Executive Vice President of CIOMA at 916-646-5999.

+++ END +++

Meeting Notes
August 6, 2004 Meeting
CEC & Attorney General's Office
Shell Bakersfield Refinery Closure Issues

Participants

Jay McKeeman, CIOMA
Peter Hughes, Beneto Bulk Transport
Doug Hawkins, Beneto Marketing
Ken Dewar, JB Dewar Petroleum
Ken Rathmann, Rathmann Oil
Mark DelPapa, Fleet Card Fuels
Scott Parry, Buck Petroleum
Deborah Mattos, Mattos & Associates
Gordon Schremp
Collette Preszler Riley, AG' Office
Bob Sponheim, AG's Office

Shell Supply –
Gordon estimates that about ½ of the supply from the Shell refinery goes into the unbranded market. He is going to follow-up with major suppliers in the area to confirm and refine this estimate.

Shell is now indicating that most of their "replacement" fuel to contracted customers is going to come from their southern California locations. Gordon is to supply a firm list of alternative supply locations from Shell, although it appears that Van Nuys will be the location for gasoline and Wilmington/GATX will be the diesel supply locations.

Gordon noted that, for the longer term Shell is estimating that approximately 7-9 TBD diesel is going to be produced from their Martinez refinery and that Paramount, in Jan/Feb 2005 will begin producing 8.8 TBD diesel and 7.5 TBD of gasoline. In total this will make up for the diesel deficit, but still leave the gasoline market short. The main problem remains of getting wet barrels into the Central Valley, especially during the time that the Shell Bakersfield rack is closed (approximately 11 months from the time of the refinery closure).

Mark DelPapa noted that he had heard that Shell would begin cutting supply in the beginning of September with diminishing supplies until the October closure date.

Several participants asked that the AG and CEC evaluate the market control Shell would gain by operating their terminal in a proprietary manner when it reopens, and do what they could to make sure that other fuel suppliers would have a chance to utilize the terminal.

Supply logistics –
The main problem hindering supply into the Central Valley is limited pipeline capacity, lack of trucks and already crowded conditions at supply racks.

The supply problems are going to be felt most severely by small marketers since they lack the trucks, drivers and logistical flexibility to obtain fuels at alternate supply racks. Marketers that use the Fresno rack are going to be most affected since they have long travel times to other locations – LA is really not an option for them. Further it was noted that the Fresno rack is pretty well maxed out in terms of truck traffic and that little could be done in the short term to resolve that problem. It was also noted that the Fresno tanks could not realistically be operated "full" since Kinder needs some excess storage so that they can keep the tanks and the pipelines in continuous flow conditions (i.e. if the tanks reach "full" Kinder would have to stop the pipeline unless there was demand at the rack to keep the tanks from being overfilled). Another problem is that gasoline flows, to replace product that has been supplied by the Bakersfield refinery, are being increased on the southbound pipeline which displaces diesel delivery capability.

A question was raised regarding the maximum flow that the current Kinder line to Fresno could handle.

Most agreed that Concord was probably the biggest bottleneck problem and that obtaining better throughput there was not something that could be solved in the short-term.

All agreed that the issue of insufficient trucks and drivers was a major limiting factor. This problem will hit the small marketer especially hard since they have limited means (truck and drivers) to put vehicles on long hauls just to obtain fuel. Another problem is that they have specialized equipment for farm and rural deliveries that is not be optimized for long hauls to pick up fuel. Also, the increased traffic at other racks will create long queues adding to the possibility of a driver hitting maximum hours of operation.

Gordon will investigate the hours of operation issues, and whether relief may be granted and under what conditions.

Alternate storage locations/trucking –
Several ideas were discussed regarding the possibility of increasing supply or providing some sort of short-term supply capacity. Some possible locations in the Firebaugh area were discussed. Whitco/Tricor facility in Bakersfield was mentioned. The Sunland facility was also mentioned. There were many questions regarding the condition of these facilities, possible access to railroad spurs, loading rack conditions, etc.

Expanded production from either San Joaquin or Kern is not likely in the short term.

Timing is the biggest problem to alternative storage – bringing tanks up to spec; plumbing delivery areas, permitting, engineering and other time-consuming aspects of refurbishment frustrate quick action in this direction.

Although there were no "silver bullets" identified in this area Gordon was going to look into some of the ideas.

Some more creative thinking brought up the possibility of obtaining alternative trucking, outside the normal fuel delivery fleet. Mark DelPapa indicated that they have been contacting crude oil haulers since their trucks can be easily converted to do gravity drop diesel loads. Asphalt trucks were also mentioned. Drivers would have to be hazmat certified and trained to do safe and legal deliveries. It was commonly agreed that these type of trucks would only be able to transport diesel, as gasoline deliveries required more complex vapor recovery equipment. Jay and Gordon agreed to explore these avenues in further detail.

Credit terms & payment periods –
Several participants noted that banks are getting more and more nervous about increasing or extending credit lines. They noted that credit lines are based upon dollar limits, not supply volumes, and that during times of price increases credit maximums can easily be reached. And they are being reached now.

Jay asked CEC and the AG's office to urge the fuel suppliers to recognize the problems that might occur this fall and to provide sufficient credit terms and payment period requirements to allow marketers, especially small ones that are having difficulty obtaining third-party financing, to allow them to stay in business. Jay also noted that CIOMA would develop a letter to all major suppliers in the state asking them to provide flexibility to their fuel marketer customers in terms of credit and payment conditions.

Declaration of Fuel Emergency -
Responding to a question CEC indicated that they do not have independent authority to allocate fuel supplies unless a Declaration of Fuel Emergency is declared by the Governor.

Summary -
The Attorney General's Office indicated that it would have the report from their consultant "very soon". They were focusing on the issue of how to keep the refinery open as the primary solution.

CEC is going to investigate the number of wet barrels that will need to be "replaced" outside of the Shell commitment to serve contracted customers. They are also going to do some research on the "truck & driver" shortage problem. And they are going to survey small marketers to determine the kinds and severity of the problems likely to be encountered. Jay will supply Gordon a list of the small central valley CIOMA members.

Jay and Gordon will investigate the possibility of using non-traditional trucks, especially for diesel delivery. Gordon will determine if there is anything that can be done to help out-of-state drivers to become California compliant.

Barring any major unexpected changes it appears that there will be a major supply problem during the time that the Bakersfield refinery shuts down and the time that Shell reopens the Bakersfield terminal. Prices are expected to increase dramatically both as a function of supply limitation and as a function of increased transport costs. Increased use of credit by marketers would also add to upward price pressure. Significant economic impact on the Central Valley is likely.

Shell Closure Issues
July 21, 2004

Loss of Non-contracted Supply
Purpose of this topic is to cover overall and regional supply changes/shifts for gasoline and diesel fuel if the Shell Bakersfield refinery closes by October 1, 2004.

- What portion of Bakersfield production is contracted?
  - Shell produces 20 TBD of gasoline (Shell figure provided to public)
  - XX percent is contracted?
  - Shell produces 15 TBD of diesel (Shell figure provided to public)
  - XX percent is contracted?
  - Cancellation of exchange agreements – what impact?
- Will there be incremental supply from California refineries?
  - Shell Martinez, 7-9 TBD of diesel fuel (Shell figure provided to public)
  - Paramount, 7.5 TBD of gasoline & 8.8 TBD of diesel (Figures from EIR)
- If so, what is the timing?
- Other new supply?
- Where?

Temporary Logistical Changes
Purpose of this topic is to discuss logistical changes/shifts that could occur between the date the Shell – Bakersfield refinery closes and the date modifications to the Kinder Morgan pipeline system between Concord and Bakersfield, as well as modifications to the Shell terminal in Bakersfield.

- Contracted customers will have to drive greater distances to deliver identical quantity of fuel
- Non-contracted customers will also have to drive greater distances, but have additional uncertainty as to availability of non-contracted supplies
- Termination of exchange agreements can also increase demands for trucks
- Are there a sufficient number of surplus trucks available to meet the incremental demand?
  - What about trucks pulled from the common carrier pool?
- Can driver hour limits be temporary waived or modified?
  - If so, for how long?
  - Potential federal activity
  - Can anyone provide a contact at DOT?

Kinder Morgan Modifications
Purpose of this topic is to discuss the nature and timing of the modifications that would be necessary for the pipeline system, if the Shell – Bakersfield refinery closes.

- What type of modifications will be made to the pipeline system (Concord to Fresno to Bakersfield)?
- When will the modifications be completed?
- Any permit/construction issues that could impact the project timeline?

Other Issues
Purpose of this topic is to raise new topics not covered by the above issues.