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DATE: March 7, 1996

TO: Messrs. J. F. Boles
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FROM: L. D. Hopkins

SUBJECT: FUTURE GASOLINE SPECIFICATIONS

There is a fuels issue of national significance which continues to gather momentum. The issue, being doggedly pursued by the American Automobile Manufacturers Association (AAMA), is one of: 1) altering ASTM gasoline specifications, and 2) finding a more 'efficient' process for making changes to fuel specifications.

From a long-range perspective, it appears that the AAMA are seeking benefits of tighter fuel standards that will come from: a) reducing the variability in gasoline that motorists purchase, and b) restricting key fuel parameters that are perceived to be costly or troublesome to vehicle control systems. Although perhaps presumptive, one could conclude that if the auto companies had their wish, gasoline would be defined as having a very narrow boiling range, be of constant density, be of constant energy content, and not contain any non-hydrocarbon compounds. In this manner, it is alleged, vehicle systems could be designed, built and operated at lowest cost and maximum emissions benefits, notwithstanding the fact that the gasoline suppliers would incur unbearable costs that the Auto's had avoided.

The natural instincts of fuel suppliers (API) to the above issue is a strong, unified defensive posture of taking action to see that the burden of 'fixing' a vehicle problem is not shifted to the oil industry. However, given the trend in recent years and the global drive for cleaner fuels, it is inevitable that the gasoline industry will continue to be regulated and/or pressured toward tighter gasoline specifications. Some suppliers may even voluntarily accede to the desires of the Auto's if they perceive a niche opportunity for competitive advantage.

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The above situation was discussed at a Puget Sound Plant strategic planning meeting in January. From those discussions it became clear that this was not the most critical strategic challenge facing PSP. It was not even determined definitively to be a 'negative', given the business environment on the West Coast as discussed below.

As observed over the last few years and as projected well into the future, the most critical factor facing the refining industry on the West Coast is the surplus refining capacity, and the surplus gasoline production capacity. (The same situation exists for the entire U. S. refining industry.) Supply significantly exceeds demand year-round. This results in very poor refinery margins, and very poor refinery financial results. Significant events need to occur to assist in reducing supplies and/or increasing the demand for gasoline. One example of a significant event would be the elimination of mandates for oxygenate addition to gasoline. Given a choice, oxygenate usage would go down, and gasoline supplies would go down accordingly. (Much effort is being exerted to see that this happens in the Pacific Northwest.)

Within this context, the question was raised as to whether any parts of the AAMA fuel specification proposal (see 'Attachment 1' of the attached letter) would serve to benefit our most critical problem on the West Coast. For example, on the surface it would appear that a reduction in T90 maximum would serve to reduce gasoline supplies since it would drop the heavy end of gasoline down into the distillate pool (as one solution). But such a proposal raises many questions concerning the over-all impact on the refining markets, on Texaco and Star Enterprise, and on our competitive posture. In addition, the two examples used here would only incrementally serve to reduce supplies, whereas large adjustments are necessary. But they may be directionally beneficial.

The attached paper is a response to this issue raised during the PSP strategic planning session. It gives more in-depth treatment to the technical issues than it does to the business issues, but both require a lot more analysis, discussion and consensus-building before a conclusion can be reached for TRMI or Star Enterprise.

I would appreciate your review of this issue and advice as to whether you think we should put together a small work-group to assess the issue, identify opportunities, and develop a consensus on the proper position for Texaco/TRMI/Star Enterprise. From your responses, I will provide further direction. Please provide your reply by March 22, 1996.



LDH:

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