

designation occurred by a given entity, the records of each entity from which it received fuel and to which it sent fuel over the course of an entire year would also have to be compared. An electronic reporting mechanism would likely have to be set up to facilitate reporting and to track the volumes of fuel received and shipped out by each entity in the distribution system down to the terminal. If any entity in the distribution system were unable to verify through their records that they distributed the same amount or more of NRLM fuel as they took in with this designation, then they, not the refiners, would be presumed liable for violating the provisions of the highway rule. Therefore, in addition to our concerns of ensuring compliance, we invite comment on the appropriateness of shifting the compliance burden for tracking fuel volumes, maintaining records, reporting to the Agency, and responding to enforcement audits from the refiners to the downstream parties, particularly since many of these entities are small businesses.

In addition to the number of entities involved and transactions needing to be tracked, there are a number of complications which would make such an approach difficult to implement. First, due to contamination in the distribution system that results in some product being downgraded from one grade to another in the distribution system, in actuality the volumes of fuel designated at the refinery and those downstream will likely never match. Some means of addressing this situation would have to be developed which did not allow fuel produced as NRLM fuel to be subsequently sold as highway fuel. Second, kerosene will be blended into NRLM diesel fuel in northern areas during the winter months. It is difficult to understand how refiners would be able to designate portions of this fuel as NRLM fuel or highway fuel at the refinery gate given its many other uses. Therefore, this would further disrupt the volume reconciliation. Third, it would not always be entirely clear who should be the entity responsible for compliance, recordkeeping, and reporting. In many cases in the distribution system there are entities who have custody of the fuel while a variety of other entities maintain ownership. A means of sorting out who the responsible party was under such circumstances would have to be determined.

One of the advantages of the proposed baseline approach is that once 500 ppm fuel leaves the refinery gate, the distribution system has complete flexibility to shift it to either the

highway or the NRLM markets to respond to changing market conditions. Conversely, as discussed above, one of the main advantages of the designate and track approach is that it allows refiners complete flexibility to modify their relative production of 15 ppm and 500 ppm fuel by their choice of designations (highway or NRLM). However, the market will demand a certain volume of highway fuel and NRLM fuel, and these decisions will be made downstream. If the market demands more highway diesel fuel than what the refiners designated as highway on an annual basis, then under the designate and track approach the terminals will be restricted from responding to this market change. They could shift NRLM fuel into the highway market on a temporary basis, but by the end of the year, they would have to be able to reconcile their highway and NRLM volumes. Given the refiner's inability to predict future demand precisely, and their economic incentive to produce as little 15 ppm diesel fuel as possible, there is a real possibility that some terminals could find themselves in a noncomplying situation. Were this to occur, a terminal would be faced with two difficult choices. They could stop shipping highway diesel fuel, in which case they would not only fail to deliver on their contracts to their customers, but would also constrain highway diesel fuel supply, raising market prices. Or, they could continue to respond to market pressure and sell additional volumes of fuel designated as NRLM into the highway market. In this case, they would risk significant non-compliance penalties from EPA, were we able to detect the violation. Thus, we are concerned that the designate and track approach could result in either widespread noncompliance or disruption of the fuel distribution system.

We are also concerned that the designate and track approach would not maintain the benefits and integrity of the highway program. Nearly a third of all non-highway distillate today is produced to the highway specifications due primarily to limitations in the distribution system. The sulfate PM and SO<sub>2</sub> emission benefits predicted from the highway rule, and the assumptions with respect to program cost and fuel availability, were all based on the assumption that 80% of this spillover volume would comply with the 15 ppm highway standard and would be available for highway use if needed. Under the proposed dye approach, in the future this "spillover" from the highway market could technically be

died at the refinery gate to avoid compliance with the 2006 highway standards. However, our expectation is that the majority of the spillover today would continue into the future as it would be costly to significantly change the current distribution practices. While the dye approach would not ensure this and spillover could decline, it would be unlikely to drop significantly. Similarly, the proposed baseline approach would maintain spillover at historical rates (either 2003–5 the average level or June 1, 2006–May 31, 2007, level). However, under the designate and track approach, wherever undyed 500 ppm was distributed as a grade of fuel, the prior spillover volume could instead be designated as NRLM fuel, and would no longer be subject to the highway program standards (*i.e.*, 80 percent of it would no longer have to meet the 15 ppm sulfur standard.). The segregation and associated cost that previously led to spillover would be gone. As a result, the benefits projected from this fuel volume under the highway rule would be reduced. Furthermore, with the reduced volume of 15 ppm fuel produced, we would need to reevaluate whether sufficient 15 ppm fuel would still be available in all parts of the country for the vehicles that would need it. The areas where availability of 15 ppm fuel would be of greatest concern would be those areas where 500 ppm fuel would be distributed and spillover would decline under the designate and track approach. The enforcement concerns cited in the paragraphs above only serve to heighten this concern.

EPA requests comments on the practical viability of this approach. In addition to the issues noted above, we specifically request comments on the following:

- (1) What would be the impacts of this approach on fuel distributors?
- (2) What information would need to be kept and/or reported?
- (3) How might the required reports be automated in a common, electronic format?
- (4) How often should reports be required (*e.g.*, annually, quarterly, each batch if electronically)?
- (5) How might the record keeping requirements be combined with those already required by the U.S. Internal Revenue Service?
- (6) How would the record keeping requirements work for pipelines and certain terminals that handle fuel without taking ownership and that do not control the decision to dye certain diesel fuel prior to sale?
- (7) How might the IRS records for refiners, importers and distributors be used as an independent check on the