PMCI of

PETROLEUM MARKETERS AND CONVENIENCE STORES OF IOWA

Motor Vehicle Fuel Study Committee
Comments on Behalf of

Petroleum Marketers & Convenience Stores of Iowa

November 4, 2005

Good Morning Ladies and Gentlemen. My name is Dawn Carlson. I serve as President of the Petroleum Marketers & Convenience Stores of Iowa, a trade association representing some 800 small businesses with nearly 2,000 outlets that offer a valuable service to Iowa consumers. *According to the U.S. Energy Information Administration, Bureau of Census August 2005 data, there are 2,735 outlets total in Iowa.* Our members handle roughly ninety percent of all diesel and seventy-five percent of all gasoline sold in Iowa. We are independent small business owners, we're your neighbors serving neighbors. We are sponsors of little league teams and employers of hard working mothers, fathers and teens. We are not major oil.

Major oil companies do not own any retail sites in the state of Iowa. The brand sign you may see at your local convenience store or service station is for practical purposes, a rented sign; it is leased through a contract that the local business owner has with the supplier of fuel to that business. This point is worth making because as consumers we are all very sensitive to the recent media reports of record earnings by oil companies. It is important to understand and distinguish the players in the industry. We are customers of oil companies, not shareholders.

As customers, we buy refined products such as gasoline and diesel from various suppliers. We buy from refineries direct, we buy from major oil companies and we buy from unbranded sources of fuel supplies. In most cases, our purchases are governed by a contract that dictates what product shall be purchased, how many gallons shall be purchased, and even when it shall be purchased. Prices are dictated much like corn and soybeans and cattle where you have the local cash price, future contract prices and hedge accounts.

Oil is a commodity traded on the New York Mercantile Exchange (NYMEX). Every day, the amount of barrels of oil traded is equal to at least 2.5 times our nation's energy needs. There were a few days during the recent hurricane crisis where non energy traders were trading contracts at 27 times the daily usage in one day. This summer we experienced rising crude oil prices which in turn resulted in rising spot or cash prices. The NYMEX traders play a tremendous role in the fuel prices that eventually reach our retail pumps. Throw in a hurricane or two and the impact is enormous. Damage to drilling rigs and refineries this fall exasperated already tight supplies of refined product driving retail prices even higher. The higher prices were a combination of consumer fear driving trading energy on the NYMEX and actual spot and cash price increases. PMCI was actually telling consumers through the media to "not buy our product" and help us slow down demand. Consumers can play a vital role in responsible energy conservation such as proper auto maintenance and tire pressure as well as minimizing their driving. Slowing demand was the only way to soften the impact of this trend and as we have seen since August, it is not an overnight change.

How Gasoline is Priced at Retail

Changes in the price of gasoline reflect changes in wholesale prices. The wholesale--bulk (commonly called "rack")--market also has complexities that lead to retailers having different cost structures, whether they are branded or unbranded, have long-term contracts or buy on the spot market, and in the case of tight supply periods and rising wholesale prices, even the time of day wholesale product was purchased can play a role in determining the retail price.

Retail Gasoline Prices

At their core, retail gasoline prices are based upon product replacement costs. In an ascending market (when wholesale prices are increasing), gasoline retailers must set retail prices at a level that will permit them to generate sufficient cash to replace the gasoline sold; in a descending market, the same holds true. However, these calculations are tempered by robust competition for customers that often constricts gross margins as retailers absorb wholesale price increases. As gasoline prices at wholesale increase, retail prices tend to follow, albeit generally with a one to three day lag. The same is true when wholesale prices decrease--the retail market tends to follow the wholesale market down.

In setting their retail prices to be posted at their outlets, gasoline retailers attempt, if competition in their local markets permits, to add to their wholesale cost of gasoline the following costs and expenses:

- Federal, state, and local excise and sales taxes, which average approximately 45 cents per gallon in the United States (The federal gasoline tax is 18.4 cents per gallon and each state has additional gasoline taxes)
- Transportation fees (one to 3 cents per gallon, depending on distance)
- Credit card transaction fees (approximately 3 percent of the price of each transaction)
- Retailer overhead (employee wages, rent, electricity, and other costs of doing business)
- Retailer net profit (varies from day to day and market to market--retailer net profits can range from negative numbers to several cents per gallon). NACS estimates that the average retailer had a net profit, after taxes, of between one and two cents in 2004

There is a difference between gross retail margins (the difference between the tax-paid wholesale cost of gasoline and the retail price of gasoline at the dispenser) and net retail margins (the gross retailer margin minus the costs of doing business outlined above). For example, a gross retail margin of 10 cents per gallon may well result in a net retail margin of one cent or less per gallon once all retailer costs are taken into account.

In addition, gasoline retailers must set their retail prices based on the cost of replacing the gasoline currently at their retail locations, not the cost of that product itself. Retailers must generate sufficient cash from their current retail sales to purchase their next delivery of gasoline; otherwise, retailers would be constantly using debt to finance their gasoline purchases.

Finally, local price competition in a retailer's area may overwhelm all of these factors in a retailer's decision as to where to set its retail gasoline price. If close competitors are priced lower than a retailer's costs, then a retailer may have no business choice but to move its retail price lower to meet competition and maintain the volume of its retail sales. Consequently, depending on local and regional competition and market conditions, a gasoline retailer's net margin may be negative in some instances, meaning that this retailer is losing money on every gallon of gasoline sold.

Wholesale Gasoline Pricing

Wholesale gasoline prices generally are tied to one of two data points:

- A price based on a differential from the current price of a future gasoline delivery contract from a commodities exchange (New York Mercantile Exchange, known as "the Merc" or "NYMEX") or from a gasoline price tracking service, such as Platts, Oil Price Information Service, or DTN; or,
- A price based on the "cash" or "spot" market for gasoline.

NYMEX- or Platts-based wholesale pricing is used primarily for short-, medium- and long-term contracts for gasoline supplies between refiners, blenders, importers and traders and gasoline wholesalers and retailers. Such a contract might call for a supplier to sell a certain quantity of gasoline at "NYMEX plus 2 cents" or "local OPIS low rack minus one cent."

Spot market-based wholesale pricing is used primarily by gasoline wholesalers and retailers for immediate delivery of gasoline supplies by these parties. Such pricing might call for immediate delivery of 10,000 barrels of 87 octane unleaded at New York harbor for a set price.

NYMEX and spot market gasoline prices move independently and are influenced by many factors, including national and regional gasoline inventories, the price of crude oil, weather and market events such as pipeline disruptions and refinery shutdowns.
When market conditions become more volatile because of weather or crude oil events, NYMEX-based prices may rise somewhat, while spot market prices may soar. A gasoline market in which spot market prices are higher than NYMEX prices for future deliveries is termed a "backwardated market" and generally indicates that the markets believe that current upward pressures on prices will ease in the future.

Many gasoline wholesalers and retailers use the NYMEX to hedge their gasoline supply needs, thereby reducing their exposure to future gasoline price movements. However, many trades of NYMEX futures contracts are undertaken by "paper traders"--brokers and speculators that never expect to take physical delivery of a gallon of gasoline from a NYMEX futures contract. These paper traders tend to lead NYMEX contract prices up or down based on market conditions and breaking news events.

How Does Motor Fuel Arrive in Iowa
From the Gulf Coast, there are pipes underground that travel up through Texas, Oklahoma, Kansas and Missouri where refineries there turn crude oil into gasoline and diesel. It is pumped through these 12" diameter pipes from the refineries all the way to Iowa at a rate of approximately 4 mph or walking speed.

Since the hurricanes hit, we have had to struggle on our own with less than normal supplies coming up through those pipes as other areas of the country were in greater need for the product and drawing a higher price than our market would bear. Price changes for the people in this room that sell motor fuel used to come weekly by mail, over time we have come to the point, and natural disasters exasperate this fact, that price changes can come as frequent as a few times in one day. We are often asked why price changes go up so quickly and this is part of the reason why. Our replacement costs for that next tanker of fuel go up quickly and we are truly at the mercy of the price quote on the end of our DTN or email service. The good news is that eventually it can go down too and we are enjoying the benefits of that trend today with respect to gasoline. Decreased demand for gasoline has helped.

There are many challenges faced by motor fuel retailers each day in providing the most affordably priced fuel to consumers: hurricanes; federal regulations requiring a wide variety of different types of fuels to be manufactured for different cities or different parts of the country [see exhibit A]; credit card fees eating away any level of profit [see exhibit B]; competition by companies who are able to subsidize "below-cost" motor fuel prices through either the sales of inside store products or other more profitable retail sites in their company; efforts to monopolize, dictate, mandate or even subsidize sales of certain products... all impact the supply and ultimately price paid for motor vehicle fuel.

CREDIT CARD FEES [Exhibit B]
As gasoline prices go up, consumers use credit cards more. Today some 70% of all gasoline purchases are made with credit cards. The banks that offer these cards are making more money than the gasoline retailers themselves. It is a national problem that needs to be addressed.

IOWA AVERAGE RETAIL MARGINS
Retail gasoline margins in Iowa are consistently among the lowest in the country. There is a reason for this. It is called competition. Competition among 2,800 retail outlets in Iowa will always result in the best prices for consumers. Losing small businesses will impact this statistic and eventually in a negative manner. Look at California and the small number of companies that own the retail outlets there. Margins are often double what we see in Iowa. Some states have what is referred to as a minimum markup law and some have laws that prevent retailers from selling below their cost, which by the way is a common practice in Iowa. I was asked to provide a list of the states with such laws, which you will find in Exhibit C.

STORE CLOSINGS
A Sioux City television station recently reported a story that is a sign of times to come. "Community Begs Buyer for C-Store". This community, like hundreds of others in rural Iowa, depended on their local convenience store to provide not only gasoline but milk and bread and other items. Because of the economic challenges of gasoline retailing, the owner was forced to close with no buyers in line. This community and its people have suffered a loss. It is a sign of things to come. Local gasoline retailers and convenience stores provide a service to their community by staying open. They provide the first jobs our young people typically take.

I have a list of 124 store closings and sales within the last couple years to illustrate the vast number of property transactions that are occurring in our industry. Many of these are closures after more than one individual has tried to make a go of it. Mr. Mulgrew will go into more detail on these examples later in the agenda. This list does not include the number of bulk plants that have closed in the last two years. Bulk plants are the tank farms you see typically in rural Iowa that are storage facilities allowing marketers to haul to farm and company accounts. They are a necessity in our industry, particularly when we see terminals practicing "just in time" inventory management. When terminals are tight on product and shippers are allocating only a certain amount of deliveries to their customers, these shortages have a ripple effect through the market in terms of prices.

WHO WILL BE LEFT
If you look at the number of underground storage tanks licensed with the Iowa DNR each year, over the past five years you'll find that because of their increased enforcement of this policy, tank registrations have overall remained steady. You'll also find that of the 192 total new facilities registered in the last five years, 70% of these new facilities are registered to just five companies.

Before I began working for petroleum marketers, I represented farm cooperatives for eight years. And before that I was farming with my father and I am still engaged in farming today. What we have seen happen due to the industrialization of agriculture and the demise of the family farmer is no different than what we are experiencing in the petroleum industry. As lawmakers, you are asked to do address these problems every year to help the family farmer. There are government subsidies and there are even proposals to mandate everyone buy the "Iowa grown" farm product. I would suggest to you today, that what we are experiencing in the petroleum industry also needs your attention. We need these small business owners serving the motor fuel and grocery needs of their rural communities just as we need our family farms.

MANDATES

Ladies and gentlemen, the law that you passed two years ago providing an economic incentive to petroleum retailers who promote ethanol sales is the best law in the country. It has helped Iowa marketers to push sales of ethanol-blended gasoline from 40% of all sales to nearly 80% of all sales. When you drive across the country and through other states that sell ethanol, you will rarely if ever see ethanol blended gasoline (a mid-grade product) marketed at a price below the regular unleaded 87 octane product. But in Iowa you do…and you did even before the incentive passed. Iowa petroleum marketers have worked hard to promote an Iowa grown product and we are proud of our efforts to push sales of ethanol blended gasoline despite trends that frequently put ethanol prices well above regular unleaded gasoline prices.

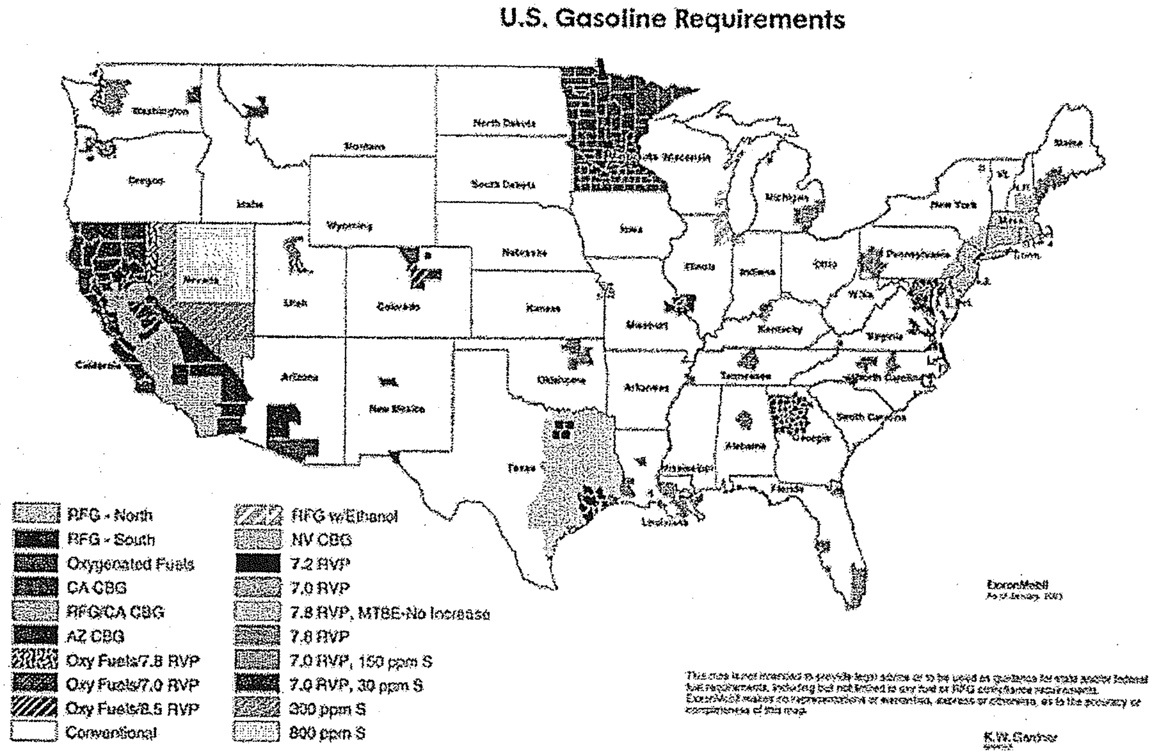
Ethanol does not track corn prices. Ethanol is priced by ethanol manufacturers (plants) as a commodity that tracks gasoline prices. See Exhibit D. The incentives help us to push a product despite a higher price... Today in Des Moines, the price for ethanol blends is higher than unleaded gasoline. We have seen many occasions where ethanol blends are extremely higher than gasoline. During the hurricanes, pure alcohol prices were jumping as much as 60 cents per day... Is that because corn prices were going up? Those of you in the room who farm know for a fact that corn prices are at all time lows... $1.40 to $1.50 per bushel. I would submit to you that the family farmer is not the benefactor of laws that mandate the use of their grain. Investors in ethanol plants most certainly are.

These are important factors for you to be aware of when discussing motor vehicle fuel pricing laws. It is a matter of time before every farmer will understand the true impacts of what a proposed ethanol mandate will do to corn prices. And every consumer will indeed bear the expense of a mandate if passed. It is not appropriate to box retailers in to sell a product when there may be less costly alternatives available. Today, we have the ability to offer consumers the best prices in the country for gasoline. One way to continue this and be appreciated by consumers and the farming community and petroleum retailing community alike is to build upon the law you already have in place. Further incentives the sales of ethanol. Build more tiers into the incentive to push the ethanol blended percentages even higher. We have a proposal prepared to do just that and increase sales of ethanol even higher than the state to our north which sells ethanol in 90% of their gasolines even with a mandate. We would also propose a change in law allowing petroleum marketers to buy directly from Iowa ethanol plants. Because of contract stipulations, many marketers, particularly branded marketers are bound by contract to purchase ethanol from their major oil supplier. This prohibits us from shopping locally and supporting our local farmers and ultimately prohibits us from buying at the best price. PMCI will be seeking support for legislation to address Iowa's contract law so that petroleum marketers will have the opportunity when they renew their supply contracts to be able to buy ethanol directly from their local farmer owned ethanol plants.

We are thankful to have the opportunity to visit with you and hopefully have been helpful in explaining how our industry operates and how we, as local small business owners, are engaged in the viability of each of our communities and the best interests of our customers.

U.S. Gasoline Requirements

Exhibit A



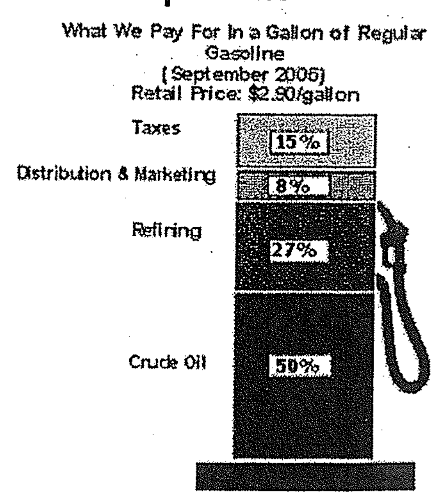
Gasoline Price-Credit Card Fees

Exhibit B

Example of $2.00 Iowa Retail Gasoline Price Component

49% crude............................ $0.980
20% tax................ ... .$0.401 (State .217, Fed .184)
3% credit card...................... $0.06
26% refining & distribution........$0.52
1% retailer profit...................$0.039
$2.00 per gallon GASOLINE

Graphic at right illustrates EIA national data from Sep 2005



Brief Summary of Motor Fuels Fair Marketing Laws **Exhibit C**

ALABAMA (1984)
No minimum markup, calculation of "cost" based on cost of doing business.
Enforcement: Private right of action, civil penalties, attorney's fees, injunctive relief.

COLORADO (1993)
No minimum markup, calculation of cost based on cost of doing business.
Enforcement: Attorney General and private right of action.

FLORIDA (1985)
No minimum markup; calculation based on cost of doing business.
Enforcement: Enforcement transferred to Department of Agriculture in 2000, however Agriculture Dept. has not enforced due to action by Murphy Oil (attempt to repeal). Private right of action allowed, recovery of treble damages and attorney's fees.

MARYLAND (2001)
Law passed 5/2001.
No minimum markup. Cost is based on OPIS average or invoice cost plus freight, whichever is lower.
Enforcement: Maryland Office of the Comptroller.

MASSACHUSETTS (1950)
No minimum markup; calculation based on cost of doing business.
Enforcement: Attorney General.

MINNESOTA (2001)
Amended state's Unfair Competition Law 6/2001 to include motor fuel.
Requires gasoline retailers to charge either 6% or 8cts/gal, whichever is less, over wholesale rack, taxes and fees. Effective date 8/1/2001.
Enforcement: Cease-and-desist orders issued by the state Dept. of Commerce.

MISSOURI (1993)
No minimum markup; calculation based on cost of doing business.
Enforcement: Right of private action; treble damages, attorneys fees, injunctive relief.

NEW JERSEY (1938; changes made in 1983 but did not affect petroleum section)
No minimum markup; calculation based on cost plus "reasonable selling expenses."

Enforcement: Division of Taxation
New Jersey planning to attempt to pass new legislation in 2001 or 2002.

NEW YORK
New York allows marketers to go 5% below cost.

NORTH CAROLINA
Information not available.

SOUTH CAROLINA (1998)
No minimum markup; wholesalers prohibited from selling a product "at retail at a price as low as such person sells the same merchandise at wholesale in the same town or locality;" retailers may not sell below cost of "acquiring the product plus taxes and transportation."
Enforcement: Attorney General.

TENNESSEE (1988)
No minimum markup; cost of product plus "reasonable cost for overhead at that location."
Enforcement: Attorney General and right of private action.
Current legislation pending in Tennessee Legislature to redefine competition aspects of law.

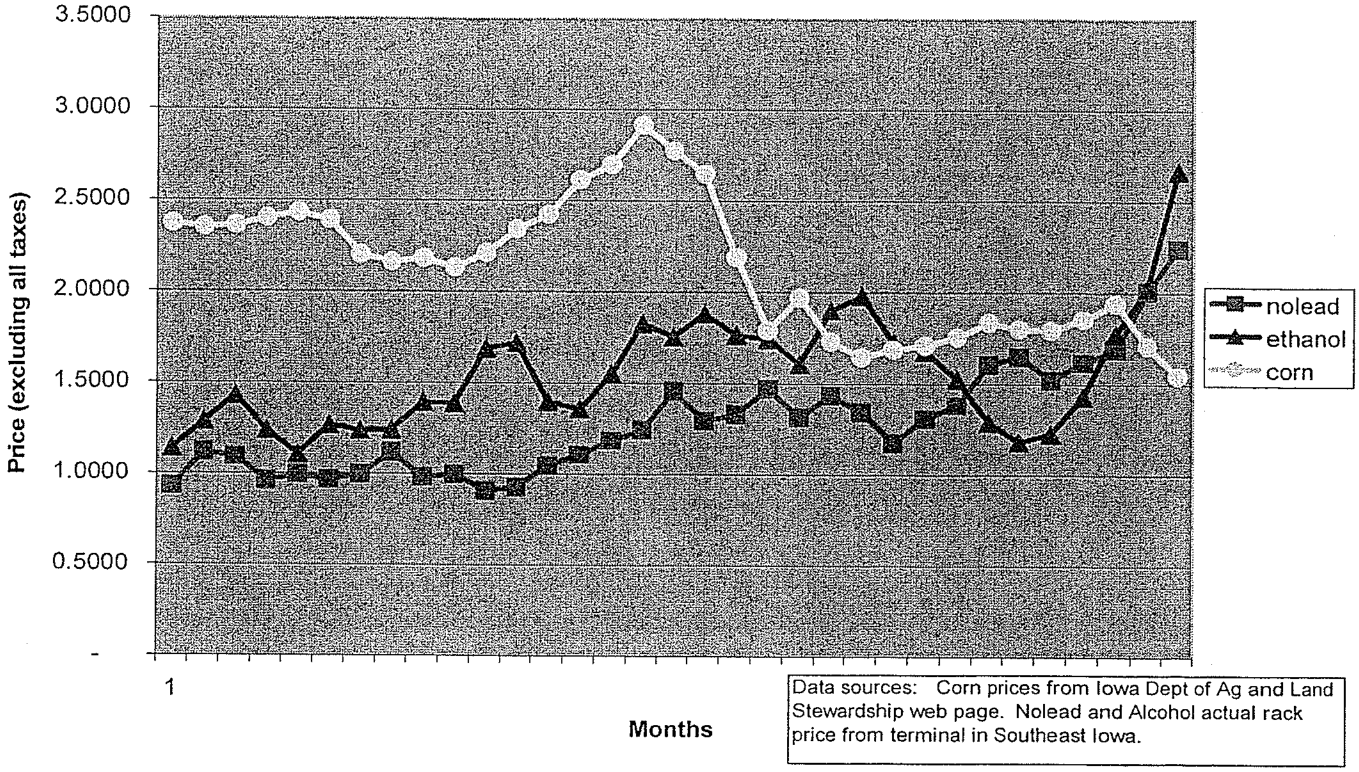
UTAH (1981)
No minimum markup. No allowance for cost of doing business. Law changed this year to include only invoice cost plus taxes and freight in calculation of cost. Previously had 6 percent minimum markup.
Enforcement: Attorney General and right of private action, can recover attorney's fees and damages and get injunctive relief.

WISCONSIN (1972, major revisions 1987, 1992)
Minimum markup of 6% of invoice cost for retailers (non-refiner and non-wholesaler) or 9.18% of the average posted terminal price. All others (refiner retailers, wholesaler-retailers) have minimum markup of 9.18% of average posted terminal price.
Enforcement: Department of Agriculture or District Attorney.

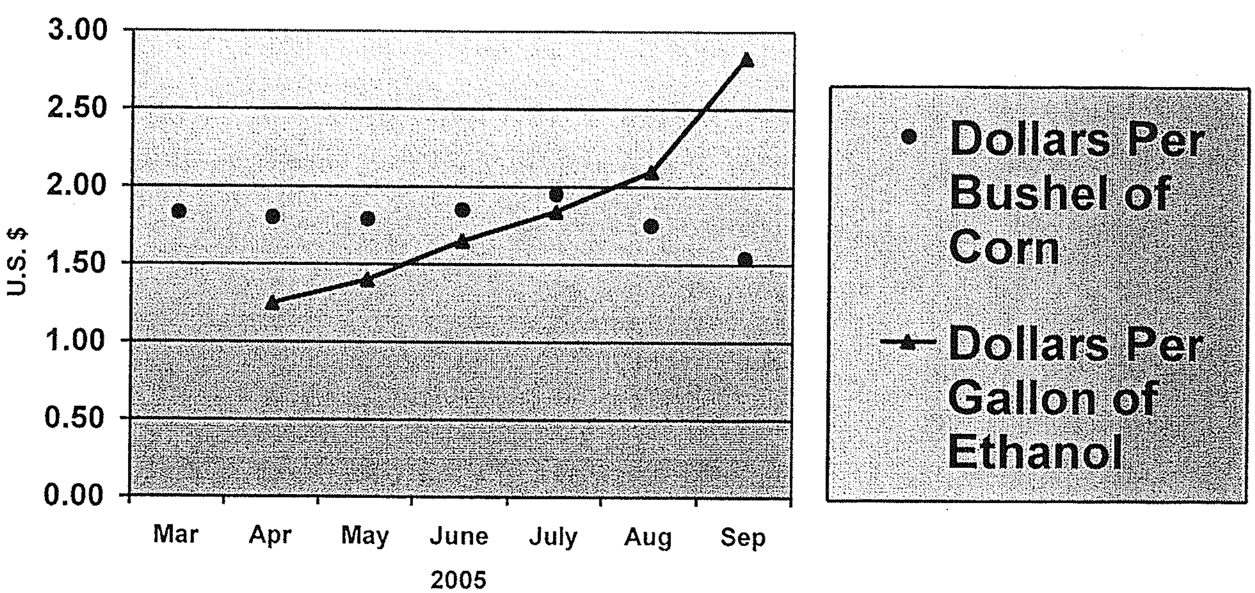
GENERIC BELOW COST LAWS
Arizona
California
Connecticut
Kansas
Kentucky
Louisiana
Maine
Maryland
Massachusetts (also has motor fuel marketing law)
Minnesota
Montana (motor fuel law was repealed)
Nebraska
New Hampshire
Ohio
Oklahoma
Pennsylvania
Rhode Island
Tennessee (also has motor fuel marketing law)
Utah (also has motor fuel marketing law)
Washington
West Virginia
Wisconsin (also has motor fuel marketing law)
Wyoming

Exhibit D

Monthly Average Price Comparison
January 2003 through September 2005



2005 Iowa Average Corn and Ethanol (Rack) Prices in U.S. Dollars



Sources: Iowa Agricultural Marketing Bureau and EthanolMarket.com, LLC, *Weekly News & Market Report*