INDEPENDENT LUBRICANT MANUFACTURERS ASSOCIATION

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Mr. Robert M. Olree
Chairman, ILSAC/Oil Committee
c/o General Motors Corporation
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Pontiac, MI 48340-2920

Dear Mr. Olree:

The Independent Lubricant Manufacturers Association ("ILMA") appreciates your letter on behalf of the ILSAC/Oil Committee, responding to the Association's concerns with the draft ILSAC GF-4 Specification. Because the ILSAC/Oil Committee is accepting comments on revisions to the draft ILSAC GF-4 Specification, ILMA submits the following additional information and comments.

Base Oil Supplies

ILMA has reviewed the presentation, "Future Supply Of and Demand For API Group II Basestock," by William Downey of Kline & Company ("Kline"), that was attached to your letter. As an initial matter, the Association appreciates the ILSAC/Oil Committee's efforts to address our comments concerning the impact of GF-4 on supplies of Group II base oils. Moreover, ILMA has the utmost respect for Mr. Downey and Kline. However, ILMA does not agree with Kline's assessment of current supply and demand and its forecast for 2010. Accordingly, the Association remains convinced of the potential for insufficient supplies of Group II base oils to meet near-term demand.

Kline's base oil refinery capacities include all viscosity grades produced by those plants. However, in the "de-blend" for engine oil formulations to determine demand, Kline should have used only 100 through 300 viscosity grades. Some 20 percent of the refineries' output has to be subtracted when you exclude the base oils other than those in the 100 through 300 viscosity grades. According to our calculations, this 20 percent difference roughly equals the 250 million gallons excess in supply Kline forecasts for 2010.

In addition, Kline bases its forecast on the assumption that base oil refineries will operate at a 90 percent utilization rate. ILMA believes this assumption is too liberal, in that historic utilization rates are closer to 85 percent when one factors in scheduled turnaround for maintenance and catalyst changes. This difference in utilization rates alone eliminates Kline's conclusion of "not by much."

Kline's de-blend scenario predicts a shortage of Group II+ base oils in 2010. If the de-blend demand is compared to base oil plant capacities, Kline assumes that a Group II refinery is producing a slate of 76 percent Group II oils and 24 percent Group II+ oils. However, ILMA understands from refinery experts that is uneconomical to run a Group II base oil refinery at less than 85 percent for Group II oils. Accordingly, Kline's predicted Group II+ shortage will be worse than forecast.[1]

ILMA questions the amount of substitution of Group I base oils for Group II stocks in Kline's de-blend scenario. For example, if one compares the list of Group II, II+ and III producers with the largest market share positions for finished engine oils (both passenger car motor oils and heavy-duty oils), one finds the same companies. ILMA questions whether these companies from an operational standpoint will use Group I stocks when their marketing divisions will push the improved benefits of a Group II-type oil, such as improved oxidation stability, lower volatility, better VI index and better low-temperature performance when they sell hydraulic oils, tractor fluids, and other products. As a result, ILMA believes that a potential shortage of Group II base oils is more likely.

Kline's presentation does not deduct any White Oil sales. This is a 150 million gallons a year market which can be serviced by Group II oils.

ILMA also questions Kline's assumptions about New World-sized plants coming on stream. Refiners are investing substantial sums of money for approaching low-sulfur gasoline and diesel fuel regulations. The Association believes that investments in base oil upgrades are not the highest return on the investment of shareholders' capital.

On page 19 of Kline's presentation, there is no recognition under "Yesterday" formulation assumptions that Dexron H automatic transmission fluids require Group II base oils. In addition, on the same page under "Tomorrow" assumptions, there is no mention of 10Wxx engine oils. We expect that 10Wxx oils will remain a significant portion of the engine oils market.

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[1] It may be possible to minimize the shortage with Group III base oils; however, the cost penalty is unknown. Further, ILMA understands that when a base oil refiner increases the amount of Group II+ produced from its plant, it reduces the amount of Group II base oils produced by more than a one-for-one basis.

ILMA is not as optimistic as Kline about the surplus of Group II base oils after 2010 from gas-to-liquids plants coming on stream. Because too much capacity means lower margins and because lower margins mean lower return on investment, the Association believes that some gas-to-liquid investments will be delayed until the market situation becomes clearer.

Based upon ILMA's analysis of the Kline presentation, we are not convinced that there will be adequate near-term supplies of Group II oils to meet the GF-4 Specification and other uses. Accordingly, the Association remains concerned with possible restraints of trade in the supply of Group II base oils.

Increased Oil Consumption

The ILSAC/Oil Committee either misread ILMA's comments or chose not to address the Association's concerns with oil consumption in older vehicles using GF-4 oils. The ILSAC/Oil Committee, in drafting the GF-4 Specification, has not answered the question that lighter viscosity grade oils will lead to increased leakage of oil from older vehicles, creating releases to the environment. The ILSAC/Oil Committee should have test results to demonstrate to the U.S. Environmental Protection Agency ("EPA") and the motoring public that the GF-4 Specification will not lead to increased oil consumption in older vehicles through leakage into and potential harm to the environment.

Approval Period

ILMA disputes your contention that marketers have 19 months to upgrade from GF-3 to GF-4 oils. The ILSAC/Oil Committee is well aware from past experience that the market moves faster than 19 months. In addition, the Alliance of Automobile Manufacturers ("Alliance") and the Association of International Automobile Manufacturers ("AIAM") have represented in an October 23, 2003, letter to EPA that:

> Oils meeting the new GF-4 standard will be *readily and widely available* at auto dealerships, lubricant retailers, service outlets and other locations because GF-4 oils are expected to replace all GF-3 oils in the marketplace by *the spring of 2005*.[2](Emphasis added.)

It is the automobile manufacturers, not ILMA, that are representing to EPA, and by extension to the motoring public, that GF-4 oils will be "readily and widely available" within the 10-month "window."[3] These manufacturers told EPA that they "will promote the widespread use of GF-4 oil." Thus, independent lubricant manufacturers do not have 19 months in reality to

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[2] The Alliance and AIAM letter also asserts to EPA that "our members will continue to instruct dealers to supply and use only API certified GF-4 oils….."

[3] The Alliance and AIAM letter actually has the "window" at nine months.

seek approval and licensing of their GF-4 oils, if they intend to remain competitive in the marketplace. If the automobile manufacturers intend to keep their promise to EPA, then it will require marketing tactics with dealers and others that may be restraints of trade. A performance specification to improve emissions control and fuel economy should not be the excuse for automobile manufacturers to enhance their revenues from another product code and for a small group of oil companies with control over Group II base oil supplies to take market share through an unrealistic approval period they set.

While the ILSAC/Oil Committee has taken steps to address the Association's previous comments, the Association remains convinced that the ILSAC/Committee's responses, including the Kline study, are *post hoc* rationalizations. If ILMA and other parties' comments were to be taken seriously, then why did the Alliance and AIAM, prior to the completion of the comment process, write to EPA, make assertions of schedule and "widely available" GF-4 oils, and ask for a new "Dear Manufacturer" letter for GF-4 oils?

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ILMA appreciates this opportunity to submit these additional comments and express its continuing frustration that a process intended to maintain a "level playing field" in the engine oils market is being further tilted away from fair competition.

Sincerely,

Celeste Powers

Celeste M. Powers, CAE
Executive Director

cc: ILMA Board of Directors
Jeffrey L. Leiter, Esq.
Kevin Ferrick, API