To: Dravis, Samantha[dravis.samantha@epa.gov]
From: Brien, Michael P
Sent: Wed 4/26/2017 2:44:31 PM
Subject: Point of Obligation follow-up
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Samantha,

It was a please meeting you yesterday. I wanted to follow-up on your question regarding RIN pass-through. We met with Mandy and Brittany a few weeks ago and they raised this among other questions. I sent the note below as follow-up. Please let me know if any of this is unclear or you have additional follow-up questions. Thanks

Mike

Michael Brien

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From: Brien, Michael P
Sent: Tuesday, April 18, 2017 12:27 PM
To: Gunasekara.Mandy@epa.gov; bolen.brittany@epa.gov
Cc: Stout, Robert; Streett, Mary; Brien, Michael P
Subject: Point of Obligation follow-up
Importance: High

Mandy and Brittany,

Thanks for meeting with us this past Monday, April 10 to discuss our perspective on the RFS and the point of obligation (PoO). We appreciated your clear framing of the pertinent questions and the overall quality and candor of the dialogue. I hope the discussion was useful to you as well.

As expressed at the meeting, we believe the debate on PoO distracts from progressing reforms to the RFS that could in fact deliver greater clarity and certainty to both obligated parties and biofuel producers. The noise around the PoO also undermines and severely disrupts what is currently an efficient RIN market.

As promised, we have collected comments from the docket (and linked them to the Source material) that address each of the points you were seeking clarity on:

1. Moving the PoO will result in a significant *increase in the number of obligated parties*.

2. Wholesale fuel markets are operating efficiently and *RIN prices are quickly passed through*.

3. Moving the PoO will require *significant infrastructure changes* to the current system.

4. The current RIN market structure *does not create windfall profits* for the blender or out of pocket cost to the refiner.

If you have additional questions regarding these citations or other issues you would like to clarify please let me know.

Mike

1. Increase in the Number of Obligated Parties

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Most respondents agree that moving the PoO would significantly increase the number of obligated parties and overall program complexity. It would layer regulations, inspections, and paperwork on businesses that have no experience with compliance, and increase the chance of fraud in the RIN market because of more obligated parties and fewer EPA inspectors.

In public comments, many diverse companies and trade associations reference this issue:

American Coalition for Ethanol: "Changing the point of obligation would result in at least 1,000 new obligated parties." (pg.3)

Petroleum Marketers and Convenience Stores of Iowa (PMCI): "Moving the point of obligation would pull thousands of companies into this requirement ultimately impacting consumers negatively." (pg.2)

Kinder Morgan, Inc.: "The proposed change could easily triple the number of obligated parties." (pg.2)

Marathon Petroleum Corporation: "Over 1,000 locations where gasoline and diesel transactions would need to be measured and recorded." (pg.7)

2. Pass-through

Studies show that RIN prices are passed through quickly into the wholesale prices of obligated fuels, demonstrating that current wholesale fuels markets are operating efficiently. The refiner is compensated for the RIN cost and the blender uses the RIN value to offset the higher cost of the blend stock.

In a study entitled, "The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuel Standard,"Christopher Knittel, Sloan School of Management, MIT; Ben Meiselman, University of Michigan; and James Stock, Harvard University found:

"When we examine wholesale prices on comparable obligated and non-obligated fuels, for example the spread between diesel and jet fuel in the U.S. Gulf, we find that that roughly one-half to three-fourths of a change in RIN prices is passed through to obligated fuels in the same day as the RIN price movement, and this fraction rises over the subsequent few business days. Using six different wholesale spreads between obligated and non-obligated fuels, we estimate a pooled long-run pass-through coefficient of 1.01 with a standard error of 0.12." (pg.2)

"We also examine the transmission of RIN prices to retail fuel prices. The net RIN obligation on E10 is essentially zero over this period, and indeed we find no statistical evidence linking changes in RIN prices to changes in E10 prices." (pg.2)

In the whitepaper "Preliminary Assessment of RIN Market Dynamics, RIN Prices and Their Effects" EPA concludes that RIN values are transferred efficiently through the retail value chain:

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"While RIN prices were significantly higher in 2013 than in previous years, we did not see, nor would we expect to see, a corresponding net increase in the overall retail price of transportation fuels across the entire fuel pool. This is because the RIN price, rather than acting as an additional cost, generally acts as a transfer payment between parties that blend renewable fuels and obligated parties who produce or import petroleum-based fuels and are required to obtain RINs for compliance purposes. RINs are generated by renewable fuel producers and sold attached to volumes of renewable fuels to fuel blenders or obligated parties. When the RINs are separated from the renewable fuel and sold independently, the RIN seller may use the revenue received for the RIN to discount the effective cost of the renewable fuel. In order to recover the cost of purchasing RINs, however, obligated parties are expected to increase the selling price of the petroleum products they produce. If fuel prices are fully flexible, markets are

perfectly competitive, and we assume no changes to the price of renewable or petroleum based fuels, these two price impacts, the discounting of renewable fuels enabled by the sale of the RINs and the higher petroleum prices that result from the cost of purchasing RINs, are expected to offset each other, resulting in the RIN price having no net impact across the entire fuel pool." (pg.2)

"Merchant refiners, who largely purchase separated RINs to meet their RFS obligations, should not therefore be disadvantaged by higher RIN prices, as they are recovering these costs in the sale price of their products. Were this not the case, merchant refiners could, and we expect would, avail themselves of other compliance strategies such as contractual arrangements and investing in fuel blending and distribution infrastructure, which are available to merchant refiners looking for alternative methods for meeting their RIN obligations." (pg. 3)

3. Infrastructure changes

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Shifting the PoO downstream would (i) created stranded sunk costs for companies that have invested in infrastructure projects in reliance upon the current RFS structure that has existed for many years, and (ii) force companies to incur additional costs for infrastructure and compliance with a potential new system.

In a comment letter, UPS (currently a non-obligated party but a large bulk fuel purchaser and blender of biofuels) said that a shift in PoO would diminish their ability to continue leadership in the adoption of renewable fuels into their ground fleet. UPS would likely have to change how it operates and could reduce the level of biofuel blending it performs today:

"We have an inventory position, and a subsidiary that serves as a licensed reseller, often because we need to turn over product held for more than month in storage. Consequently, we bear little resemblance to the parties who currently have the RFS purchase obligation. They are typically refiners or importers of product at the top of the fuel supply chain. The Valero net would also capture many parties like UPS who are not blenders. The unintended consequences on the RFS program of capturing such parties as UPS should worry the EPA." (Pg.2)

"If the RFS obligation were shifted downstream, it would force UPS to re-examine its above-the rack purchases, which we began long before the RFS began. We engage in above the rack purchases in order to reduce the cost to us of diesel fuel, jet fuel and gasoline and lower our cost of delivering packages. For us, the RFS program would move from an effective incentive to purchase renewable fuels voluntarily to a disincentive to our purchase of fuels above the rack. This would raise our fuel costs, lower price competition above the rack, and disrupt our plans to incorporate renewable fuels into our fleet." (pg.3)

The National Association of Truck Stop Owners (NATSO), representing America's truck stops and travel plazas, submitted comments in strong opposition to the change in PoO. They state that moving the PoO would not prompt investment in infrastructure:

"For example, moving the point of obligation would not prompt investment in infrastructure that is listed by a testing laboratory as being compatible with higher renewable fuel blends – it would do the opposite. Fuel marketers would stop buying fuel above the rack if they are not certain that they have the infrastructure in place to sell the requisite gallons of renewable fuel to satisfy their RVOs." (pg.7)

"The 'small retailers' fundamental problem, therefore, is caused not by the point of obligation, but by their suppliers' business stratagem. Changing the point of obligation will not address any of their concerns – unbranded marketers would still be nimble enough to buy fuel more efficiently and price it more competitively than their branded counterparts. What's more, there is absolutely no reason to believe that suppliers, who do not pass meaningful values through to their branded retailers today, will have a charitable change of heart should the point of obligation move downstream." (pg.13)

4. Windfall Profits

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The findings of multiple academic researchers, along with EPA's own findings, show that RINs represent neither a windfall profit to the blender nor an out-of-pocket cost to the refiner.

Edgeworth Economics conducted a study entitled "Economic Issues Associated with a Change of the RFS Point of Obligation" on behalf of Growth Energy to provide independent opinions

regarding economic issues raised by parties on both sides of the argument. They found that the current structure creates no windfall profits or out of pocket costs:

"…[T]he cost of RIN acquisition for blenders is integrated in their cost to acquire ethanol—ethanol with RINs attached costs more than ethanol without RINs."(pg.2)

"Because prices of gasoline blendstocks sold at wholesale reflect RIN values, merchant refiners recoup their costs to acquire RINs when they sell their gasoline products…" (pg.2)

"…Notwithstanding the fact that some companies report RIN expenses or RIN revenues as distinct line items in their financial statements, the overall impacts of RIN generation and sales (for nonintegrated blenders) and RIN acquisitions (for merchant refiners) are largely or perhaps completely offset by countervailing costs or revenues experienced by the companies in their transactions of component fuels." (pg.12)

EPA addressed these claims directly and at length in its Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation. EPA concluded that RIN transactions do not represent windfall gains to non-integrated blenders and integrated refiners, nor do they represent discriminatory costs to merchant refiners:

"Less obviously apparent, however, is the impact of the RFS program on the market price for the petroleum blendstocks that merchant refiners sell. As discussed further below, all refiners and importers of gasoline and diesel fuel incur costs to comply with RFS obligations. This is true whether the refiners and importers acquire RINs by blending renewable fuels or purchasing separated RINs – meaning no fundamental inequity exists." (pg.17)

"First, we note that the fact that companies report income for RIN sales does not indicate that these companies are receiving a windfall from the RFS program. This is equivalent to claiming a company's reported sales are equivalent to their profits, while ignoring their expenses to acquire the good sold… Such an assessment ignores costs that the company realized in order to acquire these RINs, such as lower fuel margins than would have been realized if the party did not blend renewable fuels and any investments in infrastructure that the company has made to enable them to blend renewable fuels and distribute these fuel blends." (pg.19)

"We believe that it is unlikely that any party, including both unobligated blenders and integrated refiners, would be able to realize windfall profits from RIN sales in the highly competitive fuel sales markets in the United States. Because we believe the cost of RINs is recovered by all obligated parties, whether they purchase separated RINs or acquire RINs along with renewable fuels they produce or purchase, we do not believe increased prices for RINs lead to competitive imbalances among different obligated parties, as suggested by petitioners." (pg.21)

A report by Iowa State University entitled "Impact on Merchant Refiners and Blenders from Changing the RFS Point of Obligation" shows that high RIN prices, holding constant gasoline consumption levels, have no impact on profits of refiners, blenders, or integrated oil companies:

"Our analysis of the impacts of high RIN prices differs sharply from those who advocate moving the point of obligation to blenders. Thus, it is no surprise that we conclude that moving the point of obligation would have little-to-no impact on the distribution of gains and losses from high RIN prices or on the overall effectiveness of the program. This conclusion also sets aside the issue of whether the administrative complexity of the RFS program would be increased by moving the point of obligation to blenders." (pg.9)

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