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February 22, 2017

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The Honorable Scott Pruitt  
Administrator  
U.S. Environmental Protection Agency  
1200 Pennsylvania Ave., NW  
Washington D.C. 20460

**Re: Proposed Denial of Petitions for Rulemaking To Change the RFS Point of Obligation (EPA-HQ-OAR-2016-0544)**

Dear Administrator Pruitt,

The Society of Independent Gasoline Marketers of America (“SIGMA”) and the National Association of Convenience Stores (“NACS”) hereby support the Environmental Protection Agency’s (“EPA” or the “Agency”) proposal to deny petitions for rulemaking to change the point of obligation under the Renewable Fuel Standard program (“RFS” or the “Program”).<sup>1</sup> SIGMA and NACS file this letter as an addendum to its comment letter dated August 15, 2016 (Attachment 1), which it respectfully requests be formally incorporated into this docket.<sup>2</sup>

To promote stability in the Program and to ensure business investments in renewable fuels are not undermined, SIGMA and NACS call on the Agency to finalize the denial of petitions promptly. The rationale that EPA laid out in its proposal to deny the petitions is sound – changing the point of obligation would undermine the RFS and lead to higher prices at the pump for consumers. It would be irrational for the Agency to reverse course when the data shows that the RFS has been working as intended for over a decade, particularly in light of the massive disruptions changing the point of obligation would cause.

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<sup>1</sup> Environmental Protection Agency, Petition for Rulemaking, Notice of Opportunity to Comment on Proposed Denial of Petitions for Rulemaking To Change the RFS Point of Obligation, 81 Fed. Reg. 83766 (Nov. 22, 2016).

<sup>2</sup> Letter from R. Timothy Columbus to Administrator McCarthy (Aug. 15, 2016), Docket Filing Identification Number: EPA-HQ-OAR-2016-0544-0015, available at <https://www.regulations.gov/document?D=EPA-HQ-OAR-2016-0544-0015>.

## **I. Introduction and Background**

### **A. Overview of SIGMA and NACS.**

Collectively, SIGMA and NACS represent approximately 80 percent of retail fuel sales in the United States.

SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel. NACS is an international trade association representing the convenience store industry with more than 2,100 retail and 1,600 supplier companies as members, the majority of whom are based in the United States.

In 2015, the fuel wholesaling and convenience industry employed more than 2.7 million workers and generated \$574.8 billion in total sales, representing approximately 3.2 percent of the U.S. Gross Domestic Product. Of those sales, approximately \$349 billion came from fuel sales alone. Because of the number of fuel and other transactions in which the industry engages, fuel retailers and marketers handle approximately one of every 30 dollars spent in the United States. Fuel retailers serve about 160 million people per day —around half of the U.S. population —and the industry processes over 73 billion payment transactions per year.

Nevertheless, the convenience store and fuel retail industry is truly an industry of small businesses. Approximately 63 percent of convenience store owners operate a single store, and approximately 75 percent of the industry is composed of companies that operate ten stores or less.

The fuel wholesaling and convenience store market is one of the most competitive in the United States. SIGMA's and NACS' members operate on tiny margins (around 2 percent or less) and are unable to absorb incremental cost increases without passing them on to consumers.

### **B. The Retailer's Objective.**

These associations' members' sole objective is to sell legal products, in a lawful way, to customers who want to buy them. As new fuels enter the market, they want to be able to sell those fuels lawfully and with minimal volatility and risk. While agnostic on which liquid fuel they sell to satisfy consumer demand, SIGMA's and NACS' members do have a bias: they believe it is best for the American consumer and America's industrial position in the world marketplace to have reasonably low and stable-priced energy.

## **II. The Current Point of Obligation is Supported By Nearly the Entire Fuels Value Chain**

As EPA is aware, different fuels industry stakeholders have vastly different views of the RFS. However, the current petitions before the EPA are remarkable in that they have brought together a significant majority of participants across the United States' transportation fuels value chain — stakeholders who have never before been in accord unanimously over a fuels matter — all in opposition to the petitions and moving the point of obligation. Associations representing the

fuels marketing community, petroleum producers, and renewable fuels producers jointly signed a letter to EPA expressing the “unified position in opposition to efforts by petitioners to move the point of obligation for RFS compliance ” (Attachment 2).<sup>3</sup> The associations state that “[t]here is no sound public policy rationale for moving the point of obligation and further, such a change would add complexity and uncertainty to the current RFS program.”<sup>4</sup>

Further, the current point of obligation is supported by significant end users of fuel, including trucking and railroad groups as well as the American Highway Users Alliance , which represents millions of U.S. drivers , including motorists, commercial drivers, RVers, and motorcyclists, all of whom understand the negative effects that would be brought about by a change in the point of obligations.<sup>5</sup> (Attachment 3) The groups state that they “are united in our concern for and protection of the American consumer,” and thus must oppose the petitions.<sup>6</sup> “Granting these petitions would disrupt the fuels markets, raise consumer fuel prices, and do so with no added benefit to the consumer or the [RFS] program,” the groups added.<sup>7</sup> Prior to this letter, none of the signatories had been active in RFS policy debates. Yet, because of the serious, negative unintended consequences altering the point of obligation would have on their industries, they have taken the unusual step of speaking out on this matter . This show of unity – in conjunction with fuel trade association described above – demonstrates that virtually the entire fuel supply chain and fuel end-users, including American drivers ( with the exception of a small handful of refining companies), oppose changing the point of obligation under the RFS.

All of these groups understand that the objective of the petitions is not to further the goals of the Program, but instead, to promote the financial interests of a few select companies. One reason the RFS has been successful is because it has channeled stakeholders’ profit -motives in a manner that will achieve the Program’s objectives. The petitioners failed to make investments that are aligned with the goals of the RFS, and now want to change the rules of the road to burden those that did make such investments. Poor planning by petitioners is not a reason to undercut investments made by market participants acting in good faith, especially when the change sought by petitioners would do far more harm than good.

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<sup>3</sup> The letter is signed by the Advanced Biofuels Association (ABFA), the American Petroleum Institute (API), Growth Energy, the National Association of Convenience Stores (NACS), the National Association of Truckstop Operators (NATSO), and the Renewable Fuels Association (RFA). Letter to Administrator McCarthy (Nov. 30, 2016), Docket Filing Identification Number: EPA-HQ-OAR-2016-0544-0077, *available at* <https://www.regulations.gov/document?D=EPA-HQ-OAR-2016-0544-0077>.

<sup>4</sup> Id.

<sup>5</sup> The original letter is signed by the Association of American Railroads, the American Short Line and Regional Railroad Association, the American Trucking Associations, and the Owner-Operator Independent Drivers Association. Letter to Administrator McCarthy (Jan. 17, 2017), Docket Filing Identification Number: EPA-HQ-OAR-2016-0544-0101, *available at* <https://www.regulations.gov/document?D=EPA-HQ-OAR-2016-0544-0101>. The updated letter is included as Attachment 3.

<sup>6</sup> Id.

<sup>7</sup> Id.

Market participants are rarely in agreement on the RFS, but on this case it is clear. The vast majority of market participants know that the petitions before the EPA, if granted, are bad for the fuels markets and bad for consumers. The EPA should finalize its proposed denial to give all market participants the certainty that is necessary to make investments moving forward.

### III. RIN Recovery v. RIN Pass-Through

#### A. Today, Obligated Parties are Recovering RIN Costs.

Petitioners in favor of changing the point of obligation claim that the costs of complying with the RFS are too high and threatening their companies' operations. This is simply not supported by the facts. When determining how much of a product to produce and at what price, refiners use linear programs that examine a multitude of variables to determine what product output will generate the best result for the refiner. As available market data highlights, Renewable Identification Number ("RIN") costs are one of the variables that refiners consider and incorporate into their economic decision-making models. In its report, *Do Obligated Parties Include RINs Costs in Product Prices?*, Argus Media Group Consulting Services concludes, based on an analysis of historical wholesale price data, that "obligated parties consistently consider the cost of RINs in their trading decisions around obligated products and that "obligated parties consistently incorporate expected RINs costs into their obligated products pricing."<sup>8</sup> (See Attachment 4 for the complete report)

In other words, costs associated with RIN compliance are built into the price of fuel when sold by that refiner. Valero itself notes that RIN prices are generally incorporated into supply contracts. During a recent earnings call, Valero noted a change in the point of obligation does not change "the dynamics of the export market" because "the export market has over time recognized the RIN."<sup>9</sup> In essence, Valero is stating that fuel contracts already incorporate the value of RINs; in this case, the export market incorporates the value of RINs by being priced without any corresponding RIN cost in the sales prices since exports do not have a corresponding obligation under the RFS.

Even for retailers that operate below the rack (and thus would not be obligated parties if the point of obligation is set at the fuel terminal on "position holders"), the value of RINs is incorporated into the retail price of fuel and passed along to consumers. The current structure of

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<sup>8</sup> Argus Media Group Consulting Services, *Do Obligated Parties Include RINs Costs in Product Prices?* (Feb. 2017), prepared for the Society of Independent Gasoline Marketers of America.

Other studies also support EPA's and the associations' position that RIN prices are incorporated into fuel contracts and passed along through higher prices. For example, see Bruce Babcock et al., *Impact on Merchant Refiners and Blenders from Changing the RFS Point of Obligation*, Iowa State University (Dec. 2016), available at <http://www.card.iastate.edu/products/publications/pdf/16pb20.pdf> ("The key point that is neglected in the arguments of those who want to move the point of obligation is that added refiner costs from complying with the RFS are passed on to blenders through higher gasoline prices.")

<sup>9</sup> Valero 4<sup>th</sup> Quarter 2016 Earnings Call (Jan. 31, 2017). Transcript available at <http://www.investorvalero.com/phoenix.zhtml?c=254367&p=quarterlyEarnings>.

the RFS, which has created significant competition above the rack from suppliers and refiners, makes it cost-competitive for those buying below the rack and gives those purchasers a diverse range of suppliers. For blenders operating below the rack, they can also buy blend stocks and blend below the rack; any blending these retailers do below the rack further allows them to reduce prices through the value of RINs.

Obligated parties are able to recover RIN costs today because RIN value is fundamentally incorporated into fuel price calculations and contracts. Many of SIGMA's and NACS' members have supplier contracts that contain language that adjusts price by anticipated RIN value. This is a reality throughout the wholesale fuel market, i.e. available to all market participants.

**B. RIN Values are Passed on to Consumers Under the Existing RFS Structure.**

As expounded upon in the associations' prior comment letter,<sup>10</sup> SIGMA's and NACS' members have significant incentive to keep fuel prices at retail as low as possible. These low prices drive volume and in-store traffic to a retailer's store. Under the existing structure of the RFS, retailers are encouraged to blend and sell renewable fuels in order to use the value of RINs to lower their cost of goods sold. The RIN value is passed along to consumers in the form of more competitively priced (less expensive) retail fuel to entice the customer to stop for gas and come into the store. EPA's analysis in its proposed denial supports what SIGMA and NACS have stated from the beginning: fuel blenders are not keeping the value of the RINs exclusively for themselves (so-called "windfall" profits, as one petitioner claims), but instead use the value of RINs to compete on price at the retail level.<sup>11</sup>

This principle is visible in the E15 marketplace. Historically, consumers have not wanted to buy higher renewable blends for many reasons, but primarily due to price followed by the inconvenience of having to do frequent pit-stops to refuel. In recent years, retailers have been able to experiment with offering E15 by using RIN value savings to invest in necessary equipment and competitively price the product. Despite the unproven performance characteristics of the fuel, consumers are starting to consider E15 because retailers are able to offer it a lower cost compared to E10. Retailers are only able to do this because of the current structure of the Program. Should the RFS be structurally altered, this financial incentive (via RIN savings pass-through) to offer these blends will disappear—refiners will never sell blend stocks for E15 at a price-competitive rate that will enable it to displace E10.

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<sup>10</sup> See Letter from R. Timothy Columbus to Administrator McCarthy, *supra* note 2 (Attachment 1), Section II.B.

<sup>11</sup> A closer look at studies supporting this "windfall profits" position, such as the study put forth by Bernard L. Weinstein at SMU Cox (<http://www.smu.edu/-/media/Site/Cox/CentersAndInstitutes/MaguireEnergyInstitute/RINS-updated-2-17-17.ashx?la=en>), reveal their weak methodology and analysis. Changing the point of obligation will not "fix" the supposed disequilibrium between branded and unbranded marketers as Dr. Weinstein attests. Branded retailers have locked-in supply agreements that only allow them to purchase product from select suppliers, which naturally means they have a limited ability to acquire the lowest cost product by "shopping around." Those retailers have chosen to trade off the ability to shop around on price for security of supply, among other benefits. The fact that some small retailers are now at a disadvantage because their branded suppliers have chosen not to pass along values obtained from renewable fuel blending is not something that will be fixed by changing the point of obligation. Organizations, such as RINAlliance, exist today precisely to help small retailers realize benefits from blending renewable fuels and RIN trading, presuming they are not stymied by a supplier.

#### **IV. The Agency Should Preserve the Existing Point of Obligation**

EPA should finalize its denial of petitions to change the point of obligation under the RFS. Today, the RFS is working as intended. The associations' members are incentivized to blend renewable fuels and, as the closest proxy for the consumer, are the best equipped (and most likely) to pass along savings to consumers that encourage renewable fuels consumption. Changing the point of obligation at this juncture will inject massive uncertainty into the Program and ultimately impede achievement of the Program's objectives.

SIGMA and NACS commend EPA for its responsible implementation of such a complex regulatory regime—and are prepared to assist EPA as it considers this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "R. Timothy Columbus". The signature is fluid and cursive, with a prominent initial "R" and "T".

R. Timothy Columbus  
Counsel to SIGMA and NACS

# **Attachment 1**

Letter from R. Timothy Columbus to Administrator McCarthy (Aug. 15, 2016),  
Docket Filing Identification Number: EPA-HQ-OAR-2016-0544-0015

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August 15, 2016

The Honorable Gina McCarthy  
Administrator  
U.S. Environmental Protection Agency  
1200 Pennsylvania Ave., NW  
Washington D.C. 20460

**Re: Opposition to Petition for Rulemaking to Change Definition of Obligated Party  
Under the Renewable Fuels Standards 40 C.F.R. § 80.1406**

Dear Administrator McCarthy,

The Society of Independent Gasoline Marketers of America (“SIGMA”) and the National Association of Convenience Stores (“NACS”) hereby oppose the petition for rulemaking to change the point of obligation under the Renewable Fuel Standard program, which was submitted by Valero Energy Corporation and its subsidiaries (“Petitioner”) on June 13, 2016, as well as a similar petition submitted by the American Fuel & Petrochemical Manufacturers (“AFPM”) on August 4, 2016.<sup>1</sup>

Congress created the Renewable Fuels Standard to reduce U.S. dependence on unstable petroleum sources, promote environmental benefits, and enhance price and supply stability. Thus far, the Renewable Fuels Standard program (“RFS” or the “Program”) has been working.<sup>2</sup> Contrary to Petitioner’s assertion, the current structure has incentivized SIGMA’s and NACS’ members to blend as many renewable fuels as they possibly can. Fuel retailers do not create demand; they respond to demand. The Environmental Protection Agency (“EPA” or the “Agency”) designed the RFS to encourage consumption of renewable fuels. Under the existing RFS structure, the associations’ members are able to use Renewable Identification Number (“RIN”) value to lower the cost of goods sold. Put another way, SIGMA’s and NACS’ members are able to use RIN value to sell products blended with renewables at a price that is competitive with unblended products. Because consumers are hyper-price conscious, they do not normally want to purchase a renewable fuel blend that costs more than an unblended alternative. Thus, if

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<sup>1</sup> Valero, Petition for Rulemaking: Renewable Fuel Standard Definition of Obligated Party –40, C.F.R. § 80.1406 (June 13, 2016); American Fuel & Petrochemical Manufacturers, Petition for Rulemaking: Renewable Fuel Standard Definition of Obligated Party–40, C.F.R. § 80.1406 (Aug. 4, 2016). While this letter directly responds to the Valero Petition, all of the statements and arguments herein apply to the petition submitted by AFPM as well.

<sup>2</sup> The RFS is largely working as intended: U.S. Ethanol production has increased dramatically since 2007 and the marketplace has adapted to increased renewable fuels. In 2015, for example, ethanol displaced the gasoline equivalent of 527 million barrels of crude oil. See Renewable Fuels Association, Energy Security, <http://ethanolrfa.org/issues/energy-security/>.

fuel retailers were unable to price blended product competitively, U.S. consumption of renewable product would decrease, ultimately frustrating the goals of the RFS.

Petitioner calls on EPA to change the point of obligation to address so-called inequities and “distortions and disincentives” in the marketplace.<sup>3</sup> Before going into the specifics about why changing the point of obligation would be a disastrous policy move, let us first acknowledge the elephant in the room: SIGMA’s and NACS’ members have, for the most part, successfully adjusted their business models to function efficiently under the RFS. This is not a bad thing. Despite Petitioner’s contentions to the contrary, all parties involved in the fuel supply chain (including Petitioner) have one underlying similarity: they all want to turn a profit. Unfortunately for Petitioner, one reason the RFS has been successful is because it has channeled stakeholders’ profit-motives in a manner that will achieve the Program’s objectives. The RFS has created financial incentives for private companies to behave and go to market in ways that result in positive externalities for American society. In all, the Program has been a success in terms of implementing its policy objectives. Changing the point of obligation, however, will impede achievement of the Program’s objectives.

If EPA changes the point of obligation, it will decrease the penetration of biofuels into the marketplace because it will remove the incentive to blend renewable fuels into the fuel supply that currently exists. Currently, the RFS supports robust competition in the wholesale and retail markets for motor fuels. That competition benefits consumers above all others. Should EPA change the point of obligation, however, many companies that currently buy fuel above the terminal may move further downstream, reducing competition at the rack. When that happens, businesses like Petitioner will have reduced incentives to price competitively at wholesale—a result that will harm independent retailers and will lead to higher retail fuel prices for consumers. At that point, the incentives to expand renewable fuels blending and consumption will be reduced to the Program’s detriment. Moreover, EPA will face additional administrative burdens that will make it more difficult and costly to administer and enforce the Program. Taken together, changing the point of obligation will guarantee reduced consumption of renewable fuels, ultimately undermining the very goals of the RFS.

Although Petitioner may be at a disadvantage compared to other RIN-long refiners, any perceived “inequity” Petitioner is experiencing is entirely of its own making. Petitioner bemoans that its business is “harmed by an inefficient renewable fuel market that artificially increases price of RINs and the risks associated with RIN acquisition”—however, Petitioner elected to spin off its retail store locations while the Program was in place.<sup>4</sup> Ownership of retail locations could have guaranteed a supply of RINs to allow Petitioner to fulfill renewable volume

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<sup>3</sup> Valero, Petition, *supra* note 1, at 4.

<sup>4</sup> Business Wire, *CST Brands, Inc. Spins Off from Valero Energy Corporation* (May 1, 2013), <http://www.businesswire.com/news/home/20130501005416/en/CST-Brands-Spins-Valero-Energy-Corporation>; see also Reuters, *Valero may raise \$3.5 billion through retail arm auction* (Sept. 27, 2012), <http://www.reuters.com/article/us-valero-retail-auction-idUSBRE88Q12D20120927>; MarketWatch, *Valero retail spinoff CST Brands to start trading Thursday* (May 1, 2013), <http://blogs.marketwatch.com/energy-ticker/2013/05/01/valero-retail-spinoff-cst-brands-to-start-trading-thursday/>; Vicki Vaughan, *Valero sells remainder of CST Brands shares* (Nov. 14, 2013), <http://www.mysanantonio.com/business/local/article/Valero-sells-remainder-of-CST-Brands-shares-4984168.php>.

obligations (“RVOs”) under the RFS. Therefore, any statements that Petitioner is unfairly placed at a RIN-short disadvantage are misplaced. In fact, Petitioner essentially is asking EPA to fix a business decision it made while fully cognizant of how the Program worked. Were EPA to initiate a rulemaking to change the point of obligation (and ultimately change the point of obligation), the Agency would be helping Petitioner fix a problem of its own making.

For the reasons presented below, SIGMA and NACS respectfully urge EPA to deny these petitions and keep the RFS functioning the way it has functioned successfully over the past decade.

## **I. Introduction and Background**

### **A. Overview of SIGMA and NACS**

Collectively, SIGMA and NACS represent approximately 80 percent of retail fuel sales in the United States.

SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel. NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,800 supplier companies as members, the majority of whom are based in the United States.

In 2015, the fuel wholesaling and convenience industry employed more than 2.5 million workers and generated \$574.8 billion in total sales, representing approximately 3.2 percent of the U.S. Gross Domestic Product. Of those sales, approximately \$349 billion came from fuel sales alone. Because of the number of fuel and other transactions in which the industry engages, fuel retailers and marketers handle approximately one of every 30 dollars spent in the United States. Fuel retailers serve about 160 million people per day —around half of the U.S. population —and the industry processes over 73 billion payment transactions per year.

Nevertheless, the convenience store and fuel retail industry is truly an industry of small businesses. Approximately 63 percent of convenience store owners operate a single store, and approximately 75 percent of the industry is composed of companies that operate ten stores or less.

The fuel wholesaling and convenience store market is one of the most competitive in the United States. SIGMA’s and NACS’ members operate on tiny margins (around 2 percent or less) and are unable to absorb incremental cost increases without passing them on to consumers.

### **B. The Retailer’s Objective – An Overview of the Retail Fuels Marketplace**

These associations’ members’ sole objective is to sell legal products, in a lawful way, to customers who want to buy them. As new fuels enter the market, they want to be able to sell those fuels lawfully and with minimal volatility and risk. While agnostic on which liquid fuel they sell to satisfy consumer demand, SIGMA’s and NACS’ members do have a bias: they believe it is best for the American consumer and America’s industrial position in the world marketplace to have reasonably low and stable-priced energy.

### **i. Price Flow at Retail**

Price competition is fierce in the fuel market in large part because it is one of the most transparent commodities markets in the world. Consumers see SIGMA's and NACS' members' price signs from blocks away or compare prices on applications on their cellular phones. The competitive nature of this market compels retailers to pass through cost savings to consumers in order to maintain and enlarge their market share. To be clear, retailers are always attempting to increase the amount of fuels they sell to consumers. This is not only because those sales drive profit opportunity, but also because such sales drive in-store traffic, which is a source of profit for the retailer.

Given the structure of the retail fuels market, therefore, all of SIGMA's and NACS' members are "price takers" at retail, meaning they must take the price of fuel the market sets and compete to gain market share as the transparency of the market exerts a constant downward pressure on retail fuel prices. It is important to remember, however, that there is a long chain of stops before fuel is sold to consumers at retail—and any costs that are incurred along the fuel production and supply chain will be passed down to retailers and ultimately will be absorbed by consumers.<sup>5</sup> When a retailer blends, she is able to separate and sell RINs. Then, the RIN revenue is passed along to consumers in the form of more competitively priced (less expensive) retail fuel to entice the customer to stop for gas and come into the store. In short, retailers have an incentive to blend under the RFS because blending enables retailers to separate and sell RINs, which lowers the cost of the goods they sell every day. And, as described above, retailers want to be more competitive at retail because increased fuel sales volume drives traffic through the stores. Therefore, and contrary to assertions made by Petitioner, retailers, including retailer-position holders, are incentivized and in fact do pass along RIN value to the consumer at retail because it enables them to be more cost competitive and drive in-store traffic. Today, however, most of SIGMA's and NACS' members only sell E10. While open to selling higher blends of renewable fuels, they face significant infrastructure limitations. Those infrastructure limitations, which are discussed in more detail in Section I.B.iv, will only be surmounted when adequate demand presents itself to justify the investments necessary to overcome those limitations.

### **ii. Price Flow at Wholesale**

The primary reason that many of SIGMA's and NACS' members obtain product above the rack is that it allows them to seek out cost savings. In contrast to retail pricing, at wholesale SIGMA's and NACS' members are "price seekers," meaning they seek out the best price they can get for fuel products in the wholesale market. Thus, every contract made at wholesale occurs at the point where the price is best. The option to purchase fuel above the rack, therefore,

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<sup>5</sup> Nowhere is this price pass-through phenomenon more visible than in the retail fuel industry. See U.S. Energy Information Administration, Michael Burdette and John Zyren, *Gasoline Price Pass-Through* (Jan. 2003), available at [http://www.eia.gov/pub/oil\\_gas/petroleum/feature\\_articles/2003/gasolinepass/gasolinepass.htm](http://www.eia.gov/pub/oil_gas/petroleum/feature_articles/2003/gasolinepass/gasolinepass.htm) (noting that "a ny change in price at the refinery, or any intermediate point of sale downstream, should be expected to affect prices at each successive sale").

provides fuel retailers with a greater ability to compete on price at retail and thus drive in-store traffic.

Significantly, businesses compete at wholesale as if wholesale prices and sales had no impact on retail prices. Unlike retail, there are minimal pressures exerting downward pressure on price. In fact, the only thing that does exert downward pressure on rack prices is a loss of volume. Because refiners, importers, and manufacturers of petroleum products (collectively “refiners”) are sensitive to the volume of sales made to downstream customers, it is only when downstream retailers begin to purchase fewer gallons of fuels at the rack that refiners are pressured to bring prices down.

It is also important to note that most of the products fuel retailers acquire and ultimately sell to consumers go through common carrier pipelines and warehouses, which are by definition available to *all* who wish to use them. Therefore, SIGMA’s and NACS’ members are not the only ones who can choose to actively seek savings at the rack. They are, however, the players most likely to pass those savings onto consumers.

### **iii. Retailers Do NOT Create Demand, They Respond to Demand.**

Throughout the petition, Petitioner supports its argument to change the point of obligation by asserting that retailers create demand. This could not be further from the truth and flies in the face of hundreds of years of economic history. The retail fuels market is not a “Field of Dreams.” Offering a product for sale does not guarantee that consumers will purchase it. Rather, retailers sell what consumers demand. In fact, the number one trait of any successful retailer is an ability to identify what his or her customers want to buy, and then sell that product at a cost that enables the retailer to earn a profit. Motorists do not purchase products because members of SIGMA and NACS sell them; members of SIGMA and NACS sell products because their customers purchase them.

Nowhere has this maxim been evident more clearly than in the E85 marketplace. Many unbranded marketers were the first movers into sales of E85 and have substantial experience with this product. Sadly, E85 has proven to be a commercial failure and very few retailers selling mid to high-level ethanol-gasoline blends such as E15 or E85 have seen substantial sales of these products. Indeed, retailers have found that even consumers with E85-compatible flex-fuel vehicles tend to purchase E10.

Although E85 normally can be sold for fewer dollars-per-gallon than the more widely available E10, this price differential does not generate sufficient demand to justify a retailer’s capital investment costs. Because E85 provides vehicles fewer miles per gallon (“MPG”) than E10, retailers must sell it at a discount in order to be priced equal to gasoline on a dollar per British Thermal Unit (“BTU”) basis. Even if E85 is sold on an equal dollar per BTU basis as E10, for E85 to infiltrate the market on a more widespread basis, there likely would have to be an *additional* discount to justify consumers having to stop and purchase the product more frequently relative to E10. The economics are simply not present in most places in the United States for this level of price discounting and market infiltration to occur.

It is important to keep in mind that of the various mandates contained in the RFS, Congress did not include a mandate for consumers to purchase anything. While the U.S. Department of Agriculture is attempting to increase the number of retail outlets offering E15 and E85 through its Biofuel Infrastructure Partnership, the number of outlets selling these blends will not by itself generate notably greater E15 and E85 consumption. Unless there is a substantial increase in consumer demand for higher fuel blends, retailers will naturally be reluctant to make the investments that are necessary in order to sell them.

In sum, despite the realities in the demand-supply cycle, Petitioner incorrectly argues that if retailers would only bankrupt themselves, they would create more demand. This will be further explored below.

#### **iv. Infrastructure Limitations and Retailer Liability**

While there remain significant infrastructure limitations throughout the fuel supply chain, nowhere are there greater infrastructural impediments to renewable fuels consumption than at retail. When Congress enacted its fuel usage policies in 2005 and 2007, it fundamentally failed to address the critical components of achieving its goals, such as the fuels distribution network and its infrastructure. As a result, federal and state laws and regulations pose significant potential legal liabilities for selling fuel blends with concentrations of ethanol greater than E10.

As SIGMA and NACS have noted previously—and as EPA cited in its final rule for 2014, 2015, and 2016 RVOs—retailer liability concerns are a key factor in fuel retailers’ decision to not sell gasoline containing more than 10 percent ethanol.<sup>6</sup> The Occupational Safety and Health Administration’s (“OSHA”) regulations require retailers to use equipment that has been listed by a nationally recognized testing laboratory as compatible with the fuel the equipment is storing and dispensing.<sup>7</sup>

The primary testing laboratory is Underwriters Laboratories (“UL”). However, prior to 2010, UL had not listed a single dispenser as compatible with any ethanol concentration greater than 10 percent. Further, under UL’s policy, no device listing can be revised. Consequently, retailers who wish to sell any gasoline containing more than 10 percent ethanol (such as E15 or E85) must acquire a new dispenser that has been listed as compatible with the product if they have not purchased new dispensers in the last six years.<sup>8</sup> This is no small requirement.

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<sup>6</sup> EPA, Final Rule, Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass Based Diesel Volume for 2017, 80 Fed. Reg. 77420 (Dec. 14, 2015), at 77464 (noting that EPA “[does] not believe, based on past experience, that the core concerns retailers have with liability over equipment compatibility and misfueling would change if the RFS volume requirements were increased significantly . . . [and does] not believe that the E15 expansion can occur on the scale and timeframe that ethanol proponents believe it can”), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-12-14/pdf/2015-30893.pdf>.

<sup>7</sup> 29 C.F.R. 1926.152(a)(1) (“Only approved containers and portable tanks shall be used for storage and handling of flammable and combustible liquids.”) . “Approved” is defined at 29 C.F.R. 1910.106(35) (“Approved unless otherwise indicated, approved, or listed by a nationally recognized testing laboratory.”) ; see also 29 C.F.R. 1910.7 (providing the definition and requirements for a nationally recognized testing laboratory).

<sup>8</sup> To sell higher ethanol blends, retailers must also ensure that the small component parts that allow fuels to be dispensed from an UST to a vehicle (e.g., overfill valve, tank probe, sump sensor, impact valve, etc.) are compatible

Dispensers can cost upwards of \$20,000 and many retailers are understandably disinclined to dispose of functional and modern dispensers in order to sell a new fuel for which demand is at best uncertain.<sup>9</sup>

It is feasible to convert dispensers to ensure compatibility with higher levels of ethanol-blended fuel, but it is much more complicated to determine the compatibility of underground storage equipment for the many reasons described below.

- *Recordkeeping* – Retail fueling facilities often change hands several times after a tank system is installed. In fact, retail outlets have experienced significant turnover in recent history, leaving current owners uncertain of the listing status of underground equipment. Many retail gasoline outlets were once owned by major integrated oil companies. That is no longer the case, and those companies now own and operate fewer than 4 percent of the facilities. In fact, today when Americans fill up their tanks at a Shell or Exxon station, it is highly likely that gas station is a mom-and-pop operation. Further, for decades, there have been no regulations that require retail outlets to keep records of their underground equipment. With the turnover in the industry and lack of records on underground storage equipment, determining compatibility with higher ethanol content fuels is nearly impossible without breaking concrete, at which point costs can quickly exceed \$100,000 per location.<sup>10</sup>

Last year, EPA published a final rule updating its Underground Storage Tank (“UST”) regulations.<sup>11</sup> Under the new regulations, UST owners and operators storing any regulated substance blended with greater than 10 percent ethanol or greater than 20 percent biodiesel must now demonstrate compatibility through either: (a) certification or listing of their system equipment or components by a nationally recognized testing laboratory (such as UL) for use with the fuel stored; (b) explicit written approval of the equipment or component by the manufacturer; or (c) another method that the

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with those blends. The costs of replacing these smaller items can rapidly add up into the many thousands of dollars. For example, it costs approximately \$2,100 to replace a tank probe, so if a retailer had four USTs at a particular site, it would cost about \$8,400 just to replace the tank probes in those tanks. These costs serve as yet another deterrent for a retailer to invest in a fuel where demand is at best uncertain.

<sup>9</sup> The two primary device manufacturers (Gilbarco and Wayne-GE) have obtained UL listing for retrofit kits for some of their units to upgrade their compatibility to accommodate fuels containing up to 25 percent ethanol. These units are currently available for \$2,000 - \$4,000 per kit and may be available for more than 50 percent of the dispensers in the market. This reduces the costs for many retailers, but the expense still equates to nearly 10 percent of a store’s annual pre-tax income—a significant risk given uncertain consumer demand.

<sup>10</sup> Petitioner contends that its proposed change would benefit small retailers. This is a touching sentiment given the high costs of upgrading equipment for high renewable fuel blends that are particularly difficult for small retailers to shoulder.

<sup>11</sup> Environmental Protection Agency, Final Rule, Revising Underground Storage Tank Regulations – Revisions to Existing Requirements and New Requirements for Secondary Containment and Operator Training, 80 Fed. Reg. 41566 (July 15, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-07-15/pdf/2015-15914.pdf>.

implementing agency determines to be no less protective of human health and the environment than the other two options.<sup>12</sup>

Failure to demonstrate compatibility with these regulations is a violation of the Resource Conservation and Recovery Act, which could subject retailers to penalties of up to \$37,500 for each day of noncompliance. As a practical matter, without the ability to verify and proactively demonstrate that their equipment is UL-listed to store E15 or other ethanol blends, the retailer is assuming liability risk if it stores such fuels.

- *Misfueling* – Assuming a retailer’s equipment is listed as compatible with E15, there is still liability exposure if customers misfuel. EPA’s rule authorizing the sale of E15 restricts its use to vehicles manufactured after 2001 and prohibits its use in earlier models or small engines.<sup>13</sup> EPA issued a misfueling mitigation rule requiring the placement of dispenser decals near the E15 selector and requiring additional measures, but there are no *physical* applications available to prevent consumer misfueling.<sup>14</sup> Further, it is expected that a sizeable percentage of consumers may not know when their vehicles were manufactured.

This puts retailers in a precarious situation. If they offer E15 and a consumer uses that fuel in a non-approved engine, retailers can be held responsible for violating the Clean Air Act and be subject to fines of up to \$37,500 per violation. Even if the retailer is fully compliant with EPA’s misfueling mitigation requirements, it may be subject to civil litigation under the Act’s private right of action provision.<sup>15</sup>

- *Automobile Warranties* – As mentioned above, many engine manufacturer owner’s manuals and warranties do not authorize the use of E15. Retailers may be subject to liability for engine damage or for selling a fuel that voids the consumer’s warranty. This exposure could threaten a facility’s economic viability.

The simple threat of enforcement actions or litigation deters many retailers from offering higher ethanol blends.

## **II. Altering the RFS Point of Obligation Will Undermine the Goals of the Program by Leading to a Decrease in the Blending and Consumption of Renewable Fuels.**

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<sup>12</sup> 40 C.F.R. §280.32.

<sup>13</sup> See 40 C.F.R. 80.1504; see also EPA, Final Rule, Regulation to Mitigate the Misfueling of Vehicles and Engines with Gasoline Containing Greater Than Ten Volume Percent Ethanol and Modifications to the Reformulated and Conventional Gasoline Programs, 76 Fed. Reg. 44406 (July 25, 2011).

<sup>14</sup> See also Federal Trade Commission, Final Rule, Automotive Fuel Ratings, Certification and Posting RIN 3084 - AB390, 81 Fed. Reg. 2054 (Jan. 14, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-01-14/pdf/2015-32972.pdf>.

<sup>15</sup> See 42 U.S.C. § 7604.

According to Petitioner, the current placement of the point of obligation creates “inefficiencies” in the RFS, which is why EPA should initiate a rulemaking that would “align the obligation to blend increasing volumes of renewable fuels to those with the ability to do so.”<sup>16</sup> Altering the definition of “obligated party” to the “position holder” will, according to Petitioner: “(1) enable the market to more readily respond to the annual renewable volume obligation standards; (2) begin to address the structural constraints that EPA identified in the 2015 Renewable Fuel Volume Rule; and (3) eliminate barriers that prevent the RIN value from being passed on to consumers.”<sup>17</sup> In supporting its request, Petitioner problematically relies on several faulty assertions and premises, which are discussed in detail below:

**A. Petitioner’s Assertion That the Existing RFS Structure is Hampering the Growth of Renewable Fuels Consumption and Impeding Investment in Infrastructure is False.**

Since enactment of the RFS, there has been a significant increase in the use of renewable fuels in the United States.<sup>18</sup> Thus, there is no foundation for Petitioner’s claim that “the current RFS structure hampers the growth of renewable fuel” and that the “impairment is attributable to the misplacement of the current compliance obligation point.”<sup>19</sup> As described in Section I.B, there are many legitimate reasons for why the nation’s renewable fuels usage has fallen short of the benchmarks established by Congress, including decreased demand and retailer liability risk. EPA recognized these obstacles in its final rule for 2014, 2015, and 2016 RVOs.<sup>20</sup> Moving the point of obligation will not get rid of, nor will it ameliorate, these impediments. Rather, it would make it more difficult to increase renewable fuels usage.

Today, retailers have an incentive to blend as much renewable fuel as they can into the fuel supply. Even with this incentive, investment in renewable fuel-compatible infrastructure has been slow because it is expensive and the demand just is not there. Petitioner contends that the current point of obligation “disincentivizes the infrastructure investment that is indispensable for increasing renewable fuels.”<sup>21</sup> This assertion is incorrect. Fuel retailers are investing in downstream infrastructure. The only reason the infrastructure is not going in as quickly as RFS

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<sup>16</sup> Valero, Petition, *supra* note 1, at 1.

<sup>17</sup> Valero, Petition, *supra* note 1, at 2.

<sup>18</sup> As EPA is no doubt aware, ethanol is present at almost every terminal in the United States. For information on the displacement of petroleum by ethanol, *see* Renewable Fuels Association, Energy Security, <http://ethanolrfa.org/issues/energy-security/>.

<sup>19</sup> Valero, Petition, *supra* note 1, at 4.

<sup>20</sup> EPA, Final Rule, Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass Based Diesel Volume for 2017, 80 Fed. Reg. 77420 (Dec. 14, 2015), at 77464 (noting that EPA “[does] not believe, based on past experience, that the core concerns retailers have with liability over equipment compatibility and misfueling would change if the RFS volume requirements were increased significantly...[and does] not believe that the E15 expansion can occur on the scale and timeframe that ethanol proponents believe it can.”).

<sup>21</sup> Valero, Petition, *supra* note 1, at 19.

supporters would like is that demand is lacking. Changing the point of obligation does not fix this quandary ; and to contend otherwise shows a complete lack of understanding of the wholesale and retail fuels market and the regulatory framework that encompasses it. If the Agency chooses to alter the point of obligation, retailers will move below the rack rather than risk taking on obligations that they cannot be sure to satisfy. In other words, if fuel retailers and marketers are unsure they have the infrastructure in place (and the consumer demand) to sell the amount of renewable blends that will be needed to satisfy any RVOs acquired by above-rack purchasing, they will move below the rack.

Petitioner also asserts that “because Rack Sellers are not obligated parties, there is not sufficient infrastructure for biodiesel blending at terminals.”<sup>22</sup> This is an interesting statement because many of the associations’ members are doing substantial biodiesel blending at terminals even if Petitioner is not. While there are still infrastructure limitations that have slowed the introduction of renewable fuels, including biodiesel, into the marketplace, such infrastructure limitations are not caused or exacerbated by the current point of obligation. As emphasized throughout this letter, the current RFS structure actually incentivizes investment in infrastructure precisely because it incentivizes ever-greater blending. Nowhere is this more evident than in the biodiesel market. Greater infrastructure investments are slow-going only because the consumer demand is not high enough to justify the significant costs of such investments. Many of SIGMA’s and NACS’ members are blending more and more biodiesel. If Petitioner is concerned that there should be greater biodiesel blending, in lieu of using supposed infrastructure limitations as an excuse, it could increase the amount of B5 it sends to the rack in pipelines that do not carry jet fuel.

**B. Contrary to Petitioner’s Assertion, RIN Values are Passed on to Consumers Under the Existing RFS Structure.**

Retailers, says Petitioner, only become “rack sellers,” to generate RINs and sell them to obligated parties for a profit and do not pass (and have no incentive to pass) RIN value to the retail level.<sup>23</sup> The petition also states that “ownership at the rack is not critical to their business — these retailers’ choice to acquire fuel at the rack is purely artificial, driven solely by the incentive structure of the current Point of Obligation definition.”<sup>24</sup> There are many problems with these statements. For starters, many retailers currently purchasing product above the rack became position holders long before the RFS was ever established and did so in order to seek out cheaper prices on bulk product —they did not decide to become position holders solely to separate and then trade in RINs.<sup>25</sup> As explained in Section I.B, they did this so they could become better competitors at retail where they are forced to pass along savings to consumer in order to stay in

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<sup>22</sup> Valero, Petition, *supra* note 1, at 23.

<sup>23</sup> See generally, Valero, Petition, *supra* note 1, at 10; AFPM, Petition, *supra* note 1, at 12.

<sup>24</sup> Valero, Petition, *supra* note 1, at 22.

<sup>25</sup> It is also important to note that Petitioner’s statement, “Retailer-Rack Sellers generate RINs . . .” is inherently flawed because retailers do not generate RINs. Under the RFS, a RIN is generated at the point of renewable fuels production, not at the point of blending. Valero, Petition, *supra* note 1, at 10.

business. If Petitioner wishes to sell more product at the rack, it absolutely could. But to do so Petitioner would have to price its product under the rack at a more attractive level so it would be advantageous for customers to buy in bulk at that point rather than ahead of the rack. Petitioner has chosen not to do this.

Similarly, Petitioner's assertion that RIN prices are not passed down at retail are flawed. Nowhere is this more evident than in the biodiesel market, which has been one of the Program's greatest success stories. Unlike ethanol, which is an economically attractive source of octane, and therefore a likely element to be blended in with gasoline with or without the existence of the RFS, there is no similar reason to blend biodiesel into diesel. In addition, biodiesel is generally significantly more expensive than ultra-low-sulfur diesel ("ULSD"). Therefore, at retail one would expect biodiesel blends to cost more than ULSD. Yet, the opposite is true. Biodiesel blends generally cost less than unblended diesel fuel at retail —and because of that more consumers are purchasing biodiesel.<sup>26</sup> In EPA's own words, "the ability for retailers to offer biodiesel blends at competitive prices relative to diesel that does not contain biodiesel, even at times when oil prices are low, is a key factor in consumer acceptance of biodiesel and renewable diesel."<sup>27</sup> The only reason why retailers are able to offer biodiesel at a price that is more competitive than unblended diesel is because they are able to pass along the RIN values to consumers.<sup>28</sup> To suggest that retailers are not passing along RIN values to consumers is hogwash.

While Petitioner conveniently has ignored data from the biodiesel market, it seeks to prove that RIN value is not passed through to consumers with evidence that there is a "lack of response in the fuel price spread" in the E85 market.<sup>29</sup> Although the complexities of E85 were discussed earlier in Section I.B.iii, it bears repeating that even though E85 normally can be sold for fewer dollars-per-gallon than E10 —and a statistically relevant number of SIGMA's and NACS' members have tried to sell E85 in this way —the price differential still does not generate sufficient demand to justify a retailer's capital investment costs. Candidly, there is not sufficient RIN value to compensate for the price spread necessary to sell large quantities of E85. Despite acknowledging that "pricing has no impact on consumption" in the E85 market, Petitioner nevertheless uses the lack of demand for and consumption of E85 as evidence that retailers are not passing RIN values through to consumers.<sup>30</sup> This position is simply absurd.

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<sup>26</sup> See, e.g., National Association of Truck Stop Operators ("NATSO"), Comment on Proposed Rule, Renewable Fuel Standard Program: Standards for 2017 and Biomass-Based Diesel Volume for 2018 (EPA-HQ-OAR-2016-004)(July 11, 2016), Appendix C (price comparison of ULSD and biodiesel blends), available at <https://www.regulations.gov/document?D=EPA-HQ-OAR-2016-0004-1830>.

<sup>27</sup> 81 Fed. Reg. at 34794.

<sup>28</sup> EPA correctly observed that: "The economic incentives provided by the . . . RIN have made it possible for some retailers to realize additional profits when selling biodiesel blends, while in many cases offering these blends at a lower price per gallon than diesel fuel that has not been blended with biodiesel." 81 Fed. Reg. 34794.

<sup>29</sup> Valero, Petition, *supra* note 1, at 12; see also AFPM, Petitioner, *supra* note 1, at 11.

<sup>30</sup> Valero, Petition, *supra* note 1, at 19.

SIGMA and NACS emphasize, however, that evidence from the ethanol market also disproves Petitioner's contention that retailers are not passing RIN values through to consumers. Recently, ethanol prices have been higher than gasoline prices. Without the ability to pass through ethanol RIN value, retailers could not offer competitive prices on E10. In fact, retailers continue to offer E10 to consumers, and it is offered at a price that is often lower than that charged for E10. The reason retailers can afford to price this product competitively is because they can use the value of the RIN to lower the cost of goods sold.

Petitioner urges EPA to change the point of obligation to the "position holder" because, according to Petitioner, "Rack Sellers would pass the RIN value to the retail level."<sup>31</sup> With this statement, Petitioner contradicts itself. When pushing to change the point of obligation to position holders, Petitioner uses as evidence the unsupported statement that RIN value is not passed through to consumers to lower renewable fuel prices and stimulate demand. If the Agency is confused by Petitioner's argument that position holders would pass along the RIN value to encourage downstream consumption after it has stated that large retailer position holders are not doing so today, it is in good company. This is a particularly bizarre statement when one also considers that Petitioner has no retail arm and therefore no reason to lower prices for consumers.

**C. Petitioner, and Other Fuel Manufacturers, are Responsible for any Existing RIN Price Inflation.**

Petitioner claims that RIN prices are inflated, RIN-Short refiners are highly vulnerable to inflated RIN prices, and the system creates disparities in RIN access.<sup>32</sup> Assuming, for a moment, that the associations agree with Petitioner on this point, it is nonetheless inappropriate to blame this on retailer-position holders.<sup>33</sup> The blame rests with refiners and importers, who persist in manufacturing at heightened levels.<sup>34</sup> This excess manufacturing, without a corresponding increase in consumer fuel demand, has created gasoline and diesel supply gluts across the nation. This renders RVO compliance exceedingly difficult because existing obligated parties incur RIN obligations when they manufacture petroleum products<sup>35</sup> and can only satisfy those obligations once RINs are freed after blending. Having such significant refined product stockpiles absent increased demand for finished products has generated an imbalance between the volume of RIN obligations incurred by obligated parties and the availability of RINs to satisfy those obligations.<sup>36</sup> By over-manufacturing refined product, refiners have generated increased RIN

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<sup>31</sup> Valero, Petition, *supra* note 1, at 10.

<sup>32</sup> Valero, Petition, *supra* note 1, at 13, 18-19.

<sup>33</sup> As SIGMA and NACS have noted in previous filings with EPA, the timely setting of RVOs by EPA is also a key factor to ensuring RIN price stability.

<sup>34</sup> Christopher Sell, *Here's Why It's All Downhill for Oil Refiners* (July 28, 2016), <http://www.bloomberg.com/news/articles/2016-07-28/here-s-why-it-s-all-downhill-for-oil-refiners>.

<sup>35</sup> Since Petitioner sold its guaranteed RIN supplier — it may in fact have a more difficult time fulfilling its RVOs compared to integrated refiners. Nevertheless, this difficulty was of Valero's own making.

<sup>36</sup> This problem may be exacerbated by a slowing in the export market. It is also worth mentioning the current system is not incentivizing non-renewable exports. When export market is strong (i.e., when there is strong demand

obligations that cannot be offset by the existing levels of blending—a reality that has led to higher RIN prices.

Obligated parties, including Petitioner, are able to recover RIN costs today because RIN value is fundamentally incorporated into fuel price calculations and contracts. Many of SIGMA's and NACS' members have supplier contracts that contain language that adjusts price by anticipated RIN value. This is a reality throughout the wholesale fuel market, i.e. available to all players.

**D. Many Market Participants OPPOSE Changing the Point of Obligation.**

Petitioner supports its position by contending that “renewable fuel producers and refiners have advocated for placing the point of obligation on the entity with control over blending” and “will not be harmed by the proposed changes.”<sup>37</sup> To support its claim, Petitioner cites several statements from renewable fuels producers—but none of these statements are up-to-date. These statements were made back in 2009, *prior* to the establishment of the RFS2. Petitioner does not present evidence that those statements are still accurate, which they likely are not given the passage of time since implementation of the Program. In contrast, NACS and SIGMA present EPA with copies of recent statements by renewable fuels producers, including the Renewable Fuels Association and the Advanced Biofuels Association, that “adamantly” oppose altering the point of obligation.<sup>38</sup>

Such statements of opposition should surprise no one. Today, there is a guaranteed demand for renewable fuels products and fuel retailers are incentivized to blend as much renewable fuels as possible into the fuel supply. This benefits renewable fuels producers. If EPA were to alter the point of obligation, retailers would have a limited incentive to blend renewables and would decrease their overall blending of renewables. By removing the RIN incentive that enables retailers to lower their cost of goods sold, the cost of product blended with renewable fuels will increase, which will render that product less attractive to consumers at retail. This result would harm renewable fuels producers.

**E. Making Position Holders Obligated Parties Will Increase EPA's Administrative Burden Because the Number of Obligated Parties Will Increase Significantly.**

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for U.S. petroleum products), there may be an incentive to export if the price is right because there is no RIN obligation. However, there have been significant changes in the export market—many sophisticated foreign buyers have learned that they can lean on sellers to adjust price to account for lack of RVO.

<sup>37</sup> Valero, Petition, *supra* note 1, at 28.

<sup>38</sup> See Appendix A.; see also American Petroleum Institute, Comment on Proposed Rule (filed July 11, 2016), EPA, Renewable Fuel Standard Program: Standards for 2017 and Biomass-Based Diesel Volume for 2018 (EPA-HQ-OAR-2016-004), 81 Fed. Reg. 34778 (May 31, 2016), at 41, *available at* <https://www.regulations.gov/document?D=EPA-HQ-OAR-2016-0004-3512>.

According to Petitioner, “no analysis has found that moving the Point of Obligation ... would increase the number of obligated parties at all, and certainly not in any significant way. More likely, even with some new obligated parties and others dropping off, the total number of obligated parties would decrease.”<sup>39</sup> Based on discussions with members of the associations and other companies listed on Petitioner’s “Master list of Rack Sellers,”<sup>40</sup> SIGMA and NACS believe there are many more position holders than were enumerated in the petition. SIGMA and NACS concur with previous comments by EPA that changing the point of obligation would “would result in a significant change in the number of obligated parties” and likely create significant disruptions in the Program.<sup>41</sup> If, however, EPA is interested in quantifying this number, the associations encourage the Agency to consult the Internal Revenue Service.

There are substantially fewer fuel manufacturers and importers than position holders, which include downstream fuel marketers as well as other companies not traditionally associated with the fuel industry.<sup>42</sup> It is understandably easier for EPA—or any other federal agency—to administer and enforce any program where there are fewer parties that are obligated to demonstrate compliance. Thus, EPA’s ability to ensure that all “obligated parties” are compliant with their RFS obligations is relatively straightforward and manageable under the existing structure.

If downstream fuel marketers became obligated parties, it would disrupt EPA’s RFS enforcement regime because there would be many more obligated parties than exist currently. For example, EPA would require significantly greater resources and staff hours to ensure that the now-larger number of obligated parties fulfill their requirements under the RFS. Candidly, any increase in EPA’s administrative workload would render the RFS more complex and would make it more difficult to achieve the Program’s objectives. The costs to potentially new obligated parties would also be significant, as those businesses would need to hire compliance officers and adjust their business models to a new regulatory reality. Finally, altering the point of obligation would inject significant uncertainty into the Program and likely destabilize the RIN market. Such a result would disrupt investments, contracts, and other RFS compliance plans that were developed under the existing structure.

**F. Evidence from California’s Low Carbon Fuel Standard (“LCFS”) Program Does Not Demonstrate that Changing the Point of Obligation Would be Effective.**

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<sup>39</sup> Valero, Petition, *supra* note 1, at 36. It is interesting to note that Petitioner obliquely concedes with this point that changing the point of obligation will lead to some companies “drop off” and decide to move below the rack, a convenient result for Petitioner which currently is forced to compete with those entities at the rack.

<sup>40</sup> See Valero, Petition, *supra* note 1, at Appendix D.

<sup>41</sup> EPA, Final Rule : Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program. 75 Fed. Reg. 14670, 14722 (Mar. 26, 2010) (“Moreover, a change in the designation of obligated parties would result in a significant change in the number of obligated parties and the movement of RINs, changes that could disrupt the operation of the RFS program during the transition from RFS1 to RFS2.”).

<sup>42</sup> *E.g.*, Railroad companies and mail shipping companies such as UPS.

According to Petitioner, California’s regulations are a “successful example of how the marketing aspects of regulating fuels are best managed from the rack level” and “illustrates that placing the obligation at the rack effectively incentivized market penetration of renewable fuels.”<sup>43</sup> Since imposition of the LCFS, small shippers have abandoned the rack in droves—and for the remaining small and mid-size shippers, it is questionable how long will they stay at the rack. The capital investment needed for these entities to continue competing at the rack is substantial, and SIGMA’s and NACS’ members in California have explained that by mid-2017, those businesses that are still at the rack will begin to face difficulties in meeting their LCFS credit obligations and will likely abandon those positions.<sup>44</sup> As businesses have moved below the rack, competition at the rack has decreased significantly. This has ensured that remaining position holders can raise the price for product—and more expensive renewable products are less appealing to consumers.

If anything, California’s experience with the LCFS supports maintaining the current point of obligation. By placing the compliance obligation on position holders, California’s LCFS has decreased competition at the rack. Without such competition, there has been less downward pressure on price and, as expected, prices at the pump have increased. When faced with purchasing a renewable fuel product that is more expensive than a pure petroleum product, consumers will always choose the option that benefits their pocketbooks. Thus, if EPA wishes to discourage the blending and consumption of renewable fuels, it should absolutely follow California’s lead.

### **III. The Current RFS Structure Is Appropriate to Achievement Of Its Objectives. If EPA Changes the Point of Obligation, It Will Derail the Program.**

Today, the RFS is working as intended. It is reducing U.S. dependence on foreign petroleum, stimulating environmental benefits, and promoting price and supply stability. The primary reason the Program is working as intended is because renewable fuels are being integrated into the American motor fuel supply. Renewable fuels are being integrated into the country’s fuel supply because they are price-competitive with unblended petroleum products. The reason they are price competitive is because the existing RFS structure incentivizes fuel retailers via RIN values to blend renewable fuels into petroleum products.

Petitioner asserts that changing the point of obligation would promote greater integration of renewable fuels into the marketplace—that simply will not happen. Changing the point of obligation will lead to higher prices for motor fuel (particularly renewable fuel blends) at retail, which will likely lead to a decrease in consumption of renewable products.<sup>45</sup> Non-manufacturer position holders, which include numerous SIGMA and NACS members, do not control how fuel is introduced into the market and do not control the product’s composition, which determines whether the base product can be blended with renewable fuels to create a lawful product.

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<sup>43</sup> Valero, Petition, *supra* note 1, at 42.

<sup>44</sup> It is too soon to tell where things stand with greenhouse gas obligations, since the first compliance window is November 2016.

<sup>45</sup> This will also have a negative ripple effect into other industries beyond the fuel industry.

Rephrased slightly, fuel retailers do not produce refined product, they buy refined product. It is because refiners, manufacturers, and importers control the characteristics of petroleum products and the manner in which such products are introduced into commerce that they are (and should remain) obligated parties.

Without RFS obligations, manufacturers have zero incentive to displace their main product—petroleum—with renewable fuel blends. Since the Program is designed to displace petroleum with renewable blends, EPA appropriately placed the point of obligation on entities that are the gatekeepers of the base product that permits renewable fuel blending.<sup>46</sup> Downstream entities, unlike refiners and importers, would be unable to control how to meet their obligations if they became obligated parties. Rather, their ability to satisfy their obligations under a revised RFS structure would be dictated by their upstream counterparts. In this situation, those upstream counterparts would have significant leverage and incentive to raise prices. While blendstocks amenable to renewable fuel blending will not necessarily disappear if the point of obligation were changed, they would become specialty products for which manufacturers will charge a premium. If manufacturer's customers become obligated parties, they will have to buy those blendstocks and will be obligated to pay a premium for them.

Petitioner argues that the concerns referenced above will not be a burden on the newly obligated parties because they will be able to separate the RINs required to satisfy their obligations when they blend the product, thereby satisfying their obligations under the RFS. That conclusion is inaccurate. An obligated party does not have one RVO, it has four RVOs.<sup>47</sup> Position holders who only deal in gasoline will not be generating additional RINs that will satisfy biodiesel or cellulosic RVOs, obligations that proponents of this proposal would impose on them. Merchant refiners, in contrast, can refuse to sell to anyone who does not contract to give them back the RINs. If obligated, therefore, retailer-position holders would no longer realize the same above-the-rack savings (because any bulk price savings will be outweighed by RVOs) and will be incentivized to change the way they participate in the distribution process to avoid being an obligated party.

To avoid RVOs, the number of retailer-position holders will decrease because many will move below the rack. At that point, there will be fewer entities competing at the rack, which means that retailers of all sizes will have fewer upstream suppliers from whom they can purchase product. As has been seen in California, this will lead to price increases as the remaining position holders can raise prices with no risk of being undersold by competition. All of these price increases will inevitably be passed down to consumers in the form of higher gasoline prices.

As renewable fuel blends become less price attractive to consumers, consumption of such products will decrease. Such a result will undercut the very purpose of the RFS.

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<sup>46</sup> As a reminder, CBOB did not exist prior to the RFS and was developed because manufacturers needed to ensure that their product could be blended with renewables so they could comply with their RVOs.

<sup>47</sup> The existing structure of the Program takes into account the fact that some obligated parties did not control the downstream blending of renewable fuels and therefore need a way to access RINs. EPA addressed this concern in part, by allowing a certain number of RINs to be carried over to the following year to ensure that obligated parties can hedge against RIN accessibility.

#### IV. Conclusion

For the reasons articulated above, SIGMA and NACS adamantly urge EPA to deny Valero's and AFPM's petitions to change the point of obligation under the RFS. Today, the RFS is working as intended. The associations' members are incentivized to blend renewable fuels and, as the closest proxy for the consumer, are the best equipped (and most likely) to pass along savings to consumers that encourage renewable fuels consumption. Changing the point of obligation at this juncture will inject massive uncertainty into the Program and ultimately impede achievement of the Program's objectives.

SIGMA and NACS commend EPA for its responsible implementation of such a complex regulatory regime—and stand ready to assist EPA as it considers this matter.

Sincerely,



R. Timothy Columbus  
Counsel to SIGMA and NACS

CC:

Janet McCabe, Acting Assistant Administrator, Office of Air and Radiation, EPA

Christopher Grundler, Director, Office of Transportation and Air Quality, EPA

# APPENDIX A



June 30, 2016

Submitted Via Email

The Honorable Edward Whitfield  
Chairman  
House Energy and Commerce Subcommittee on Energy and Power

The Honorable Bobby Rush  
Ranking Minority Member  
House Energy and Commerce Subcommittee on Energy and Power

Dear Mr. Chairman and Mr. Ranking Member:

The signatories of this letter represent motor fuel distributors and renewable fuel producers. The Society of Independent Gasoline Marketers of America (SIGMA) is a trade association representing a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel. The Renewable Fuels Association (RFA) is the leading national trade association for the domestic ethanol industry and includes 300-plus members.

During the House Energy and Commerce Subcommittee on Energy and Power's June 22<sup>nd</sup> hearing on the Renewable Fuel Standard (RFS), several members raised the possibility of changing the definition of "obligated party" under the RFS Program. While this issue was not discussed in detail during the hearing, SIGMA and RFA wish to convey to the Subcommittee that we adamantly oppose changing the point of obligation under the RFS.

We appreciate your interest in this issue and the RFS, and we are happy to provide any additional information that you or your staffs may require.

Sincerely,

**R. Timothy Columbus**  
General Counsel  
Society of Independent Gasoline Marketers of America

**Bob Dinneen**  
President and CEO  
Renewable Fuels Association

Cc: Members of the House Energy and Commerce Subcommittee on Energy and Power

June 30, 2016

Submitted Via Electronic Mail

The Honorable Edward Whitfield  
Chairman  
House Energy and Commerce Subcommittee on Energy and Power

The Honorable Bobby Rush  
Ranking Minority Member  
House Energy and Commerce Subcommittee on Energy and Power

Dear Mr. Chairman and Mr. Ranking Member:

The signatories of this letter represent motor fuel marketers and advanced biofuel producers.

During the House Energy and Commerce Subcommittee on Energy and Power's June 22<sup>nd</sup> hearing on the Renewable Fuel Standard (RFS), several members raised the possibility of changing the definition of "obligated party" under the RFS Program. While this issue was not discussed in detail during the hearing, the undersigned entities wish to convey to the Subcommittee that we adamantly oppose changing the point of obligation under the RFS.

We appreciate your interest in this issue and the RFS, and we are happy to provide any additional information that you or your staffs may require.

Sincerely,

Advanced Biofuels Association  
National Association of Convenience Stores  
NATSO, Representing America's Travel Centers and Truckstops  
Petroleum Marketers Association of America



Cc: Members of the House Energy and Commerce Subcommittee on Energy and Power

## **Attachment 2**

Fuels Industry Point of Obligation Opposition Letter

November 30, 2016

The Honorable Gina McCarthy  
Administrator  
Environmental Protection Agency  
William Jefferson Clinton Federal Building  
1200 Pennsylvania Avenue, N.W.  
Washington, DC 20460

Dear Administrator McCarthy,

The undersigned associations represent a significant majority of participants across the United States' transportation fuels value chain. While each association has an individual, unique position – often conflicting – regarding the broader Renewable Fuel Standard (RFS) program, we write to express our unified position in opposition to efforts by petitioners to move the point of obligation for RFS compliance. It is unprecedented for all of these undersigned groups to unite in a single letter to express a uniformly held position.

Each of the undersigned associations strongly supports the Environmental Protection Agency's (EPA) proposed denial of petitions for a rulemaking to change the point of obligation under the RFS. There is no sound public policy rationale for moving the point of obligation and further, such a change would add complexity and uncertainty to the current RFS program.

We urge EPA to finalize its conclusion and deny the petitions to move the point of obligation.

Sincerely,



## **Attachment 3**

Third Party End User Point of Obligation Opposition Letter

February 14, 2017

The Honorable Catherine McCabe  
Acting Administrator  
U.S. Environmental Protection Agency  
1200 Pennsylvania Avenue, NW  
Washington, D.C. 20460

Dear Acting Administrator McCabe:

The undersigned associations represent a variety of interests and industries, many of which have differing opinions about the wisdom of the Renewable Fuel Standard (RFS) program. Regardless of those differing opinions, we are united in our concern for and protection of the American consumer. With that in mind, we write to express uniform opposition to moving the point of obligation under the RFS.

We believe that the Environmental Protection Agency (EPA) has acted responsibly in denying previous petitions for a rulemaking to change the point of obligation and support EPA's current regulatory action to deny similar petitions. The current petitions are proposing to move the point of obligation to entities that have never been obligated previously and that are not equipped to comply. Granting these petitions would disrupt the fuels markets, raise consumer fuel prices, and do so with no added benefit to the consumer or the program. We represent diverse interests but we are in agreement about this point.

We urge EPA to reject the petitions to move the point of obligation.

Sincerely,



## **Attachment 4**

Argus Media Group Consulting Services,  
*Do Obligated Parties Include RINs Costs in Product Prices?* (Feb. 2017)



argus consulting services

argusmedia.com

# Do Obligated Parties Include RINs Costs in Product Prices?

February 2017 | Prepared for: SIGMA



Bioenergy

illuminating the markets

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This Report is confidential, made available strictly under license and has been prepared for the internal use of SIGMA. In addition, SIGMA is permitted to include the Report in its entirety as an exhibit to its comments related to the Environmental Protection Agency's proposal to deny petitions to change the point of obligation for compliance under the Renewable Fuel Standard program. Any other use or disclosure of this Report and its contents without specific written permission from Argus is strictly prohibited. No duty of care is owed by Argus to any third party and Argus disclaims all liability in relation to any third party who seeks to rely upon or use the Report or any of its contents. The Report, including the Argus trademarks and logo/legal notices, may not be altered. Derivative works of all or part of the Report may not be created without prior written permission.

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## Executive Summary

Argus Consulting Services was engaged to research the influence the cost of the RINs (Renewable Identification Numbers) from the Renewable Fuels Standard (RFS) on the product pricing behavior of parties obligated under the RFS program. Our research was focused on determining if the market price of RINs was commonly incorporated by the obligated parties into their petroleum products prices, and if they incorporated the cost primarily into the type of products that have generated an obligation to acquire RINs under the RFS.

Argus approached the study by looking for influences from RINs prices in obligated-party trading prices and behavior. We directly examined actual historical wholesale prices for quantitative evidence of influence of RINs prices on obligated party product prices. Argus looked for influence from RINs prices on market activity by obligated parties (trading trends and practices).

Our conclusion is that obligated parties 1) consistently consider the cost of RINs in their trading decisions around obligated products, and 2) that obligated parties consistently incorporate expected RINs costs into their obligated products pricing. This conclusion is consistent with previous research on market dynamics with respect to RFS influence on obligated parties.<sup>1</sup>

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<sup>1</sup> Burkholder, 2015

## Section 1: Influence of RVO costs on obligated product prices

### Chapter 1.1: Background

The RFS system was designed to increase the use of renewable fuels (biofuels) in US on-road transportation fuels, such as finished gasoline and diesel. The system obligates producers (generally refiners) of non-renewable (petroleum) on-road transportation fuels and importers of non-renewable on-road transportation fuels to demonstrate use of the mandated biofuels. The annual mandate for obligated parties is expressed as a percentage of the amount of non-renewable transportation fuels each obligated party generates or imports.

The RFS caused the implementation of a system for tracking the production and use of biofuels through Renewable Identification Numbers (RINs) which are assigned to each gallon of biofuel produced, when it is produced. The RINs ultimately act as a proof of use or "receipts", and the RFS requires annual accumulation of RINs by the obligated parties to demonstrate compliance with the mandate. Simply put, an obligated party has a biofuels usage mandate that is a percentage of their petroleum fuels production, and that percentage of production determines the number of RINs the party must acquire to demonstrate annual biofuels usage.

The total annual RINs required per obligated party is called the annual Renewable Volume Obligation (RVO). Since the total RVO obligation is calculated from a percentage of the total petroleum production for transportation by each obligated party, this RVO can also be expressed proportionately as a percentage of the obligation per individual gallon of obligated petroleum product produced. This is often called the *RVO per gallon*, or just RVO. The RVO per gallon represents the number (or fraction) of RINs necessary to cover the per-gallon portion of the total RVO that is incurred by the producer of that petroleum fuel. Since total RVO (a percentage of total obligated fuels generated) is applied to all obligated parties, the RVO per gallon is the same for all obligated fuels from all obligated companies.

The RINs system was designed to be flexible in who could use biofuels and how they could be used in the existing complex of fuels production, distribution and use. For example, ethanol is generally blended with gasoline at the distribution rack, but many obligated parties may not have business operations at the distribution rack where they might be able to buy and use ethanol. Therefore, the RINs system allows non-obligated parties as well as obligated parties to acquire RINs through purchasing and/or using biofuels, and then trade those RINs to parties needing to accumulate RINs to meet their compliance obligation. This creates a market for RINs, and these prices are tracked by Argus and other price reporting agencies.

The annual mandate for obligated parties from the RFS – the RVO – is broken into separate requirements to collect different quantities of a variety of types of RINs representing multiple categories of renewable fuels. To achieve compliance, obligated parties must acquire proportional amounts of each of the RINs types based on the RVO percentages for that year. For the purposes of this analysis, we will not need to divide the RVO "basket" of requirements into the separate RINs components and their prices. The RVO can be

expressed on a per-gallon basis as the sum of the various percentages of different RINs required based on that year's annual RFS rulemaking.

The cost to acquire the various percentages of RINs needed to cover the RVO per gallon can be calculated and is commonly referred to as the RVO cost per gallon. For the purpose of this analysis we will use the calculated RVO per gallon in any given year and day and simplify the discussion by using the term "RVO cost" to represent this calculated, per-gallon obligation at the time in question. It is common practice to discuss the requirement cost in this manner.

Prices for RINs are driven by various factors, including (but not limited to) the cost to produce and blend different biofuels; the complex nature of the different types of RINs and their use under the RFS; changes in policy; and RINs supply and demand. The cost of various RINs in the marketplace is tracked and Argus is one of the leading price reporting agencies covering this market. The RVO cost per gallon is also calculated and reported by Argus and other price reporting agencies based on the RVO percentage requirements for that year and the component RINs prices for that day. The calculated RVO cost, as reported by Argus, will be used in this analysis.

This analysis will examine whether obligated parties, primarily refiners and importers, commonly incorporate RVO costs in their product sales decisions and prices. It is important to emphasize that the RFS does not require obligated products to have an RVO cost attached to the price or the obligated product. Nor does the RFS require obligated parties to pass through the cost (if any) of buying any RINs for their RVOs with any product. The RFS only requires that the obligated party acquire the number of RINs specified in the RVO incurred by each gallon of transportation fuel sold into the market.

## Chapter 1.2: Obligated parties and RVO costs

The strongest evidence that obligated parties include RVO costs in the decisions and pricing of obligated products would be found in historic product pricing data. RINs prices rose from a fairly insignificant cost to front page headlines in 2013. The RVO cost per gallon rose from essentially zero to an average of slightly above \$0.06 per gallon of obligated product for the four years of 2013 to 2016.

Argus first analyzed if there was evidence of any increase in wholesale petroleum product prices from refiners (obligated parties) in response to the increased RVO. Argus examined the average wholesale price of gasoline and diesel, as a ratio to the cost of crude<sup>2</sup>, before and after the years when RVOs may have impacted refiners. We chose pipeline prices because these represent a point of sale closest to the obligated parties (refiners) in the sales and distribution chain. The results in Table 1 show an increase of approximately 7% in the ratios of the refiner's product prices to crude prices in the 2013-16 period versus a baseline of the same ratio in previous years.

**Table 1: Change in wholesale product prices as a ratio of crude prices**

Product	2013-16 Average Price Ratio to Crude*	Pre-2013 Average Price Ratio**	Change
RBOB Buckeye Pipeline NYH	1.21	1.13	7.1%
ULSD Buckeye Pipeline NYH	1.25	1.17	6.8%

\* LLS (Louisiana Light Sweet Crude)  
 \*\* Baseline across available data range, RBOB: 2003-12, ULSD: 2006-12  
 — Argus Consulting Services

The correlation of increases in refiner product prices with increased RINs costs is significant. But there are many additional economic factors that could influence refiner margins in this timeframe; the most significant would be the largest economic downturn in recent US history. To see more specific evidence of RVO cost inclusion in refinery product pricing, and to see if and how refiners choose to pass on RVO costs, we looked for a signal from RVO costs in a spectrum of obligated and non-obligated products as priced by refiners.

<sup>2</sup> Ratios are used to help negate the effects of different crude price regimes, which inherently make a difference-based (spread-based) analysis misleading when oil prices are fluctuating significantly.

## Chapter 1.3: RVO influence in product pricing by obligated parties

To examine the influence of the RVO costs on product pricing decisions by obligated parties, we examined prices of obligated versus non-obligated petroleum products. It is generally assumed by market participants that obligated parties pass along RVO costs on the products that incur an obligation, but, as stated before, the RFS does not require this approach. Certainly, it would be a competitive disadvantage to pass along an RVO premium if it were not necessary or common practice among competing refiners.

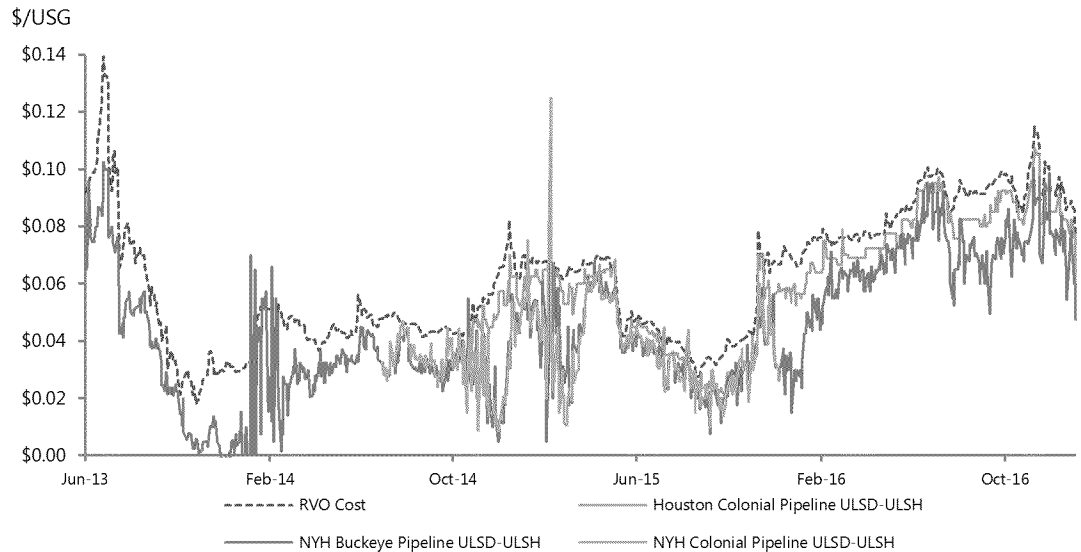
The criteria for optimal comparative price data are product prices that would achieve the clearest representation of obligated-party activity relative to the RVO. Ideal comparative product pricing data would include the following considerations:

- 1) Pricing data closest to representing prices offered by obligated parties (e.g. for refiners, prices for products in pipeline).
- 2) Comparative data sets of fuels with similar processing and importing cost variables (e.g. similar fuel quality).
- 3) Comparative data sets of products with similar market demand variables.

Unfortunately, the definition of obligated versus non-obligated products builds immediate differences into possible product comparisons that could mask signals from RVO considerations by obligated parties. Obligated products include non-renewable fuels used for on-road transportation in the US, primarily on-road diesel and gasoline that is ready for ethanol blending (e.g. blendstocks for oxygenate blending, or BOBs). Non-obligated products are products designated for export, heating, or other off-road use (e.g. jet fuel and marine fuels). So most obligated and non-obligated products are entirely different fuels, selling into different market segments (or countries) with different demand factors and quality requirements.

In light of these considerations, the best comparable prices for obligated versus non-obligated products are in the pipeline prices of ultra-low sulfur diesel (ULSD) versus ultra-low sulfur heating oil (ULSH). Refiner production of diesel for on-road use incurs an RVO under the RFS, while heating oil does not. The quality of the two fuels is nearly identical, as are production costs, and both are sold into the domestic market. These products have daily price histories in pipeline hubs, which allow daily cost comparisons at a point in the sales cycle close to the refinery level (in comparison to other common points of sale with reported data). Diesel and heating oil have a long history of price linkage, although they sell into markets that occasionally experience different seasonal demand factors. Figure 1 shows a comparison of the daily RVO costs and three sets of ULSD to ULSH pipeline price differentials over the time period since RVO prices have increased from non-trivial levels.

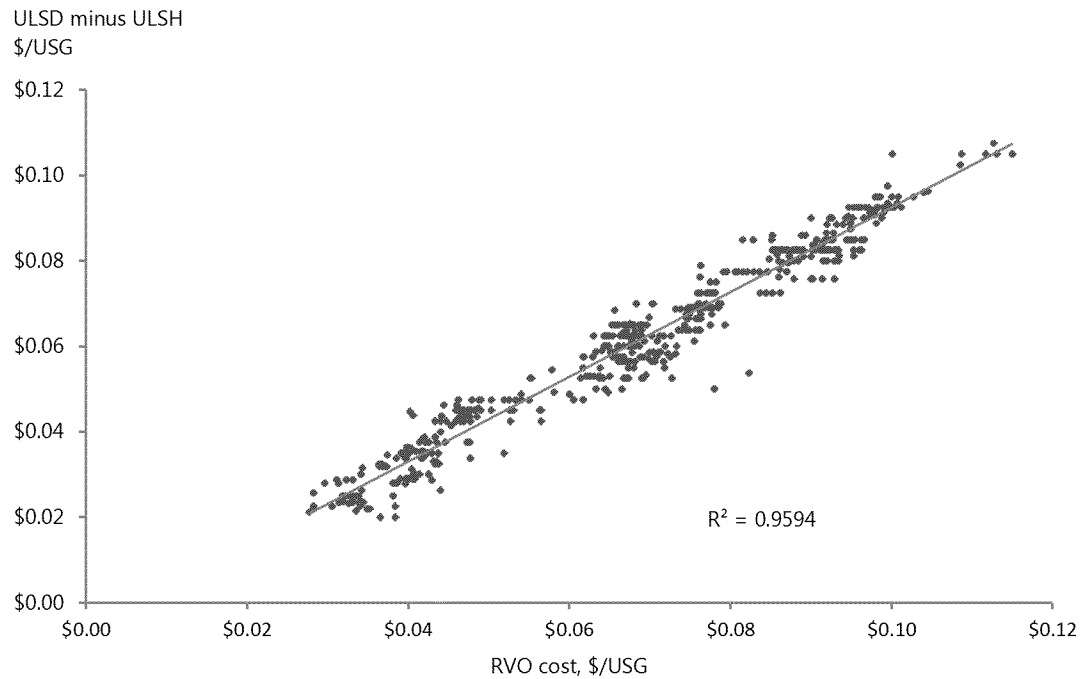
Figure 1: 2013-2016 daily RVO cost and pipeline hub prices of ULSD minus ULSH



— Argus Consulting Services

There is a clear correlation between the daily RVO cost to obligated refiners and the price differential for the cost of obligated diesel against non-obligated heating oil. Heating oil does have some different demand drivers than diesel. For example, the NYH Colonial and Buckeye pipeline price data demonstrate that wintertime demand for heating oil can increase prices and decrease the differential to diesel in the northeast region (the primary region of heating oil consumption). The price data for the Houston Colonial pipeline shows less seasonality because it is further removed from regional heating demand in the market chain. Figure 2 shows the strong correlation between swings in RVO costs and the differentials in prices between obligated diesel and non-obligated heating oil pipeline price.

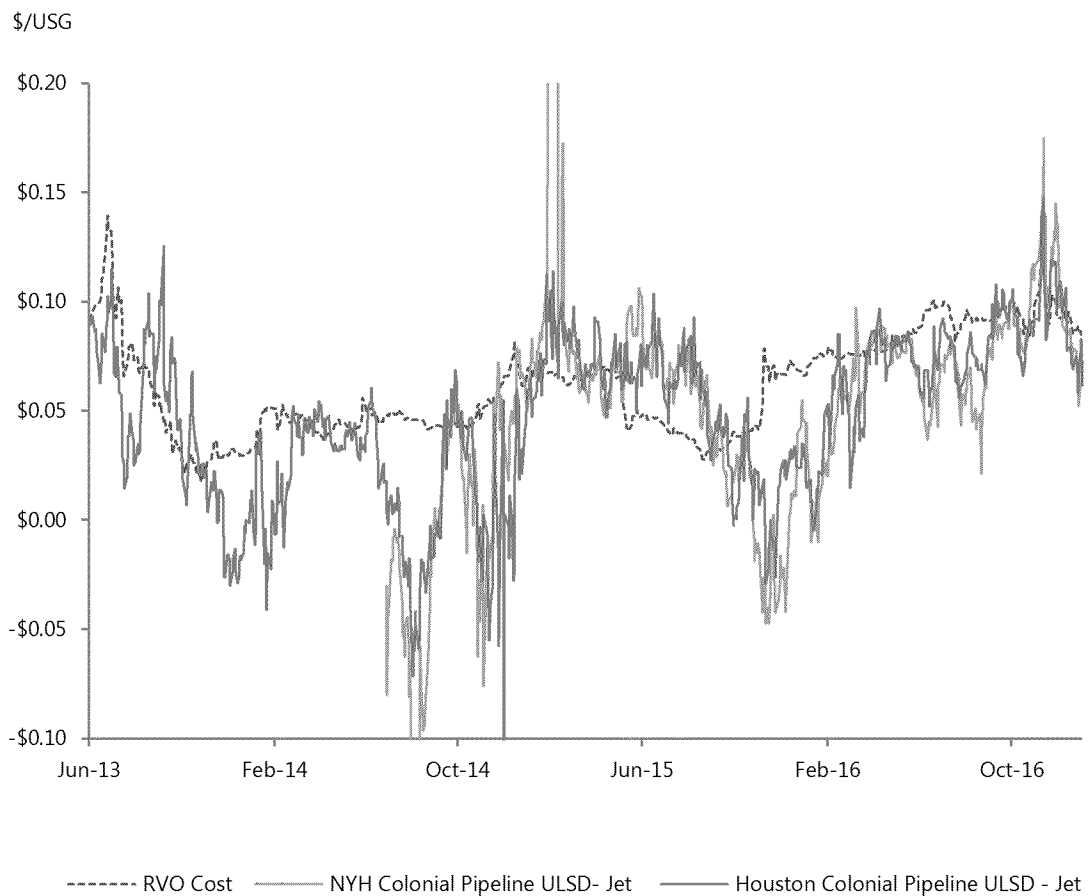
Figure 2: 2013-2016 Houston Colonial Pipeline minus ULSH prices vs RVO costs



— Argus Consulting Services

Jet fuel is also a non-obligated fuel with similarities to diesel, and pipeline price data at the same points as diesel are available. But comparing jet fuel with on-road diesel increases the number of different price drivers over the previous example. Jet fuel is produced to different fuel quality standards than diesel and, more importantly, is selling into a significantly different market with nearly unrelated demand drivers. Despite the increasing differences between the two products, there is still some apparent correlation between the historic RVO cost per gallon to refiners and the price differential between these obligated and non-obligated products, as seen in Figure 3.

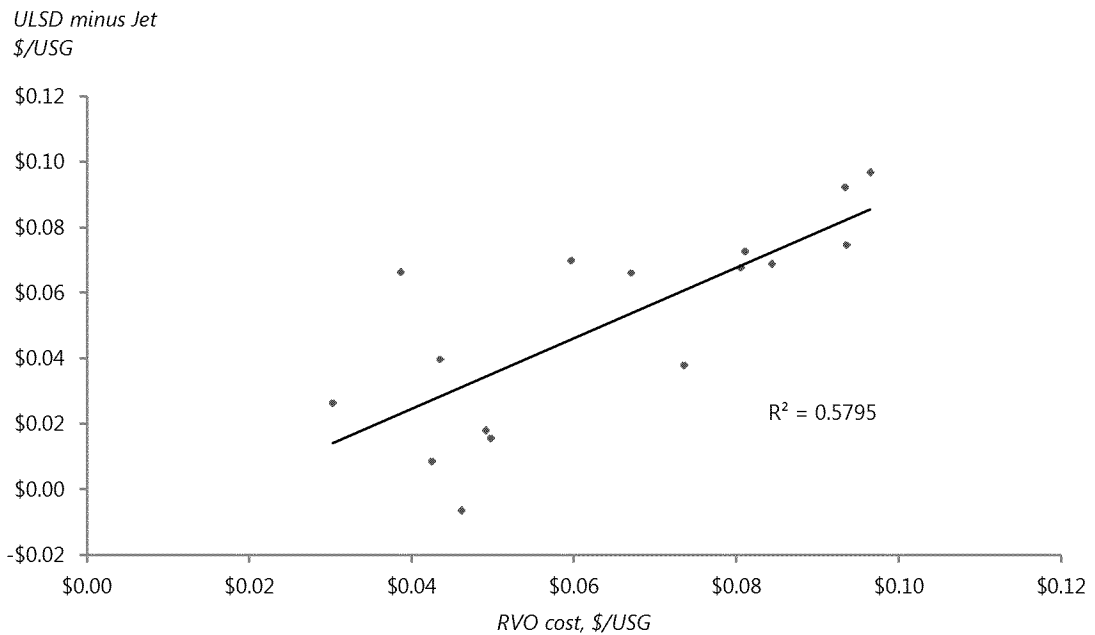
Figure 3: 2013-2016 RVO cost and pipeline hub prices of ULSD minus jet fuel



— Argus Consulting Services

As expected, any potential signal of the RVO cost in the ULSD-jet fuel differential is weaker than the comparison of more similar products. The jet fuel market is significantly detached from the ULSD market, because of different quality requirements affecting refining costs and different demand drivers. Although previous research (Burkholder, 2015) implied that the ULSD-jet fuel differential did correlate to RINs prices spikes in 2013-14, the RVO cost signal is not as significant in a longer-term analysis of similar data. Figure 4 below shows RVO versus ULSD minus jet fuel, averaged quarterly to reduce “noise” from the wide fluctuations in the data.

Figure 4: 2013-2016 quarterly averaged Colonial Pipeline ULSD minus jet fuel prices vs RVO cost



— Argus Consulting Services

We also examined other potential products for comparison. But with increasing differences in the product types and end-market drivers, the potential for a price signal from RVO costs decreases relative to other variables. Refiner gasoline prices were compared with non-obligated (potential) gasoline components (naphtha and reformate), which can be produced and/or sold by refiners. As expected, no correlation with RVO was found because these non-obligated components are sold into a variety of different markets, such as transportation fuel and chemical production.

Importers of obligated products become obligated parties under the RFS and incur an RVO obligation, and so there have been attempts to compare foreign gasoline prices (Eurobob non-oxygenated fuel) with domestic gasoline prices (RBOB) to look for a price signal from RVO costs (Burkholder, 2015). But comparing similar products produced in foreign markets confronts even larger differences in demand drivers than the before-mentioned examples of different products within the same domestic markets. Replication of this research showed no clear RVO cost signal in the differential between US obligated products and European counterparts. There is also insufficient price data on imported cargoes of products (e.g. cargoes of gasoline in the northeast) before they incur obligation, which could be compared to domestic products which have already incurred an obligation. Likewise, there is insufficient data on export transaction prices for comparison of non-obligated export product prices (e.g. diesel exports from the US Gulf Coast) to their obligated domestic counterparts.

## Chapter 1.4: RVO cost influence on obligated party trading activity

If RVO costs are influencing refiners and those costs are regularly included in obligated-party product pricing, we should expect changes in wholesale trading behavior and industry standard practices in the wholesale markets where importers and refiners sell products. This might include consideration of RINs or RVO costs in the common language on contracts (which would be private and unavailable to disclose here) or in public contracts or common tools used for wholesale petroleum sales, such as pricing reporting or exchanges. In fact, evidence of trading practices with RINs and RVO cost considerations are present in most of the tools and exchanges used by wholesale products traders.

Argus presents wholesale price information designed for wholesale customers, and the methodology for all of Argus' reported prices and assessments for US refined petroleum products specify the RVO considerations along with other duties that may be common for the product at the wholesale level.<sup>3</sup> Other price reporting agencies also include RVO cost considerations in their pricing methodology.<sup>4</sup> Having the product pricing description specify that the RVO cost is included is necessary for accuracy because it is standard practice for refiners to include that cost into their on-road transportation product prices, and users of the price assessment may wish to trade with that information included in their decisions. For example, all waterborne gasoline assessments include the RVO cost along with duties, and some assessments of gasoline cargoes calculate and include the RVO cost into the reported assessment based on daily RINs prices. This might assist potential importers of fuels (obligated parties) by providing them with an accurate description of the price that they will probably see in the market for their imported product after they include RVO costs into their sale, which is standard practice. In addition, price reporting from Argus and other price reporting agencies (which include RVO considerations) are used to produce financial tools to assist wholesale petroleum sales activity on public exchanges such as the CME Group.

In addition to the hundreds of assessments that include (by definition) or calculate the RVO in the product price, Argus also offers 27 "ex-RVO" price assessments. These are wholesale price assessments of transportation fuels with the daily RVO cost removed to facilitate transactions where an RVO would not be included in a product price. For example, transportation fuels intended for export do not incur an RVO, but a majority of the market prices are determined by refiners (obligated parties) making products for domestic use, and these prices include the RVO cost as a standard practice. A company that wishes to export fuels would be interested in the value of that product without the RVO cost, and so Argus provides an assessment of a product price calculated without the current RVO cost.

Again, it is important to emphasize that the RFS does not require obligated parties to pass along any expenses in fuel prices, nor specify that if they do that it must be attached to the obligated fuel products. But the standard practices displayed in the pricing tools used in the

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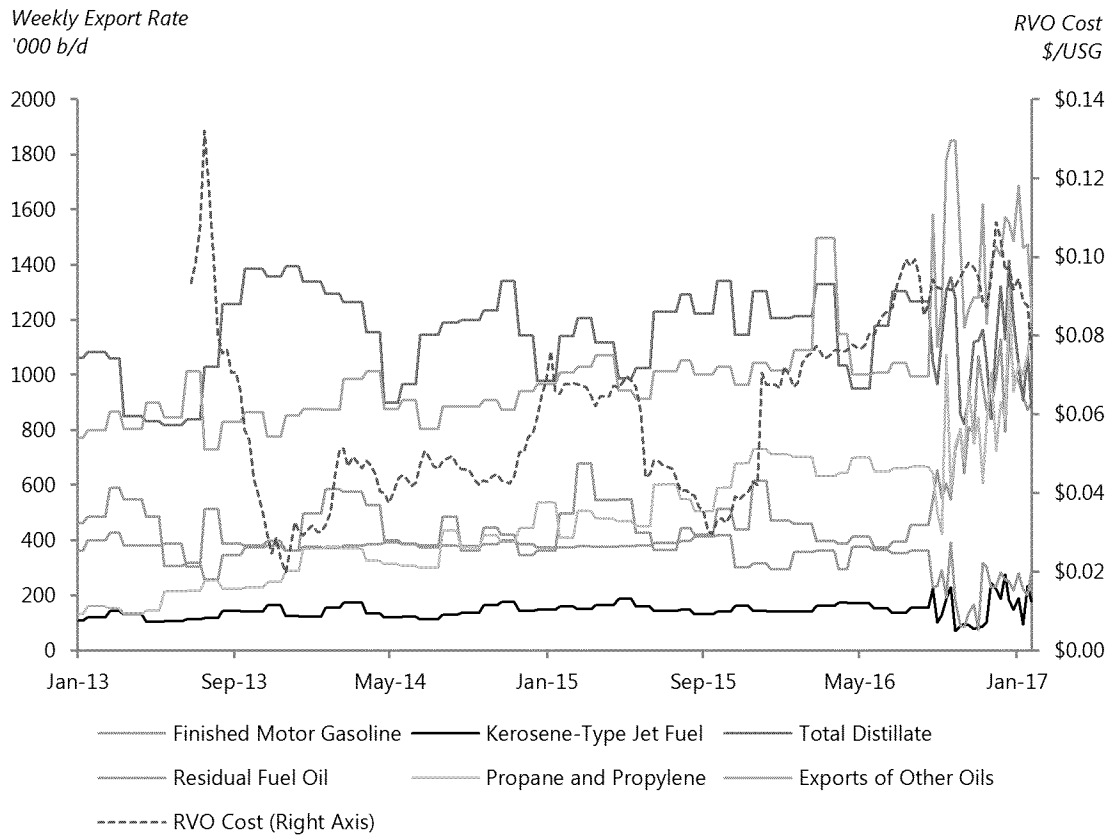
<sup>3</sup> *Argus Methodology...* pgs 7-9 (see *Appendix A: References*)

<sup>4</sup> *Platts Methodology...* pgs 15, 19-22, 24, 34 (see *Appendix A: References*)

wholesale market presents corroborating evidence that obligated parties (refiners and importers) specifically consider the RVO costs when trading obligated fuels, that they intend to pass down the RVO cost related to RINs prices, and that they pass along this full RVO cost in their obligated products.

It has been commonly reported that, in an attempt to avoid increasing RINs costs, refiners pivot their product trading toward exports, which do not incur a RVO.<sup>5</sup> This behavior would support the argument that refiners expect to absorb the cost of the RINs from the sale of domestic obligated products instead of passing along the RVO cost in the product prices. But aggregate export data contradicts this assumption and shows no correlation can be identified between historic RVO costs and aggregate export data for obligated or non-obligated products (see Figure 5).

Figure 5: 2013-2016 petroleum product export rates and RVO costs



— Argus Consulting Services with EIA data

<sup>5</sup> Platts, 2013 *Skyrocketed RINs prices boost US diesel exports: trade* <http://www.platts.com/latest-news/oil/newyork/skyrocketed-rins-prices-boost-us-diesel-exports-21325808>

## Section 2: Summary

### Chapter 2.1: Summary and discussion

There is strong historical evidence (see table 1) that showing a positive correlation between increased RINs costs post 2012 and concurrent increases in the obligated party's (primarily refiner's) obligated product prices. There are very specific correlating price data for diesel that indicate that refiners not only pass along the RINs cost, but that refiners pass along RINs costs on the obligated diesel product proportionally to the RVO incurred by the gallon of obligated diesel produced and sold. The industry standard pricing tools also indicate that it is standard practice to assume that the full RVO per gallon has been included in all obligated fuel product prices. This industry standard assumption corroborates with the argument that the first seller of obligated products (the importer or refiner) has included the RVO cost in their pricing.

The available public and non-confidential business information data cannot be used to prove that the exact amount of the RVO costs are consistently passed along by refiners or importers on each obligated non-renewable gallon of fuel. But the strong correlation between RVO costs, pricing trends, and information about industry practices indicates that 1) obligated parties consistently consider RINs costs in their trading practices, and 2) obligated parties expect to pass along RVO costs incurred by the sale of obligated products.

## Appendix A: References

Argus Media, *Methodology and Specifications Guide, Argus US Products* pgs 7-9  
[http://www.argusmedia.com/~media/files/pdfs/meth/argus\\_us\\_products.pdf?la=en](http://www.argusmedia.com/~media/files/pdfs/meth/argus_us_products.pdf?la=en)

Burkholder, Dallas, *A Preliminary Assessment of RIN Market Dynamics. RIN Prices, and Their Effects*, 2015 <https://www.epa.gov/renewable-fuel-standard-program/renewable-identification-number-rin-analysis-renewable-fuel-standard>

Platts, *Methodology and Specifications Guide, Americas Refined Oil Products* pgs 15, 19-22, 24, 34  
<http://www.platts.com/IM.Platts.Content/MethodologyReferences/MethodologySpecs/Americas-refined-oil-products-methodology.pdf>

## Appendix B: Argus acronyms

b/d – barrels per day

LLS – Louisiana Light Sweet Crude

NYH – New York Harbor

RBOB – reformulated blendstock for oxygenate blending

RFS – Renewable Fuels Standard

RINs – Renewable Identification Numbers

RVO – Renewable Volume Obligation

ULSD – ultra-low sulfur diesel

ULSH – ultra-low sulfur heating oil

USG – US gallon

## Appendix C: Data Sets

Diesel ULSD Buckeye pipe - NYH (Argus)

Diesel ULSD NYH Colonial 62 offline pipe – (Argus)

Diesel ULSD Colonial 62 pipe – Houston (Argus)

Gasoline reg RBOB Buckeye pipe – NYH (Argus)

Heating oil ULSH NYH Colonial 67 pipe – (Argus)

Heating Oil ULSH Buckeye pipe – (Argus)

Jet fuel Colonial 54 pipe – Houston (Argus)

Jet fuel NYH offline Colonial 54 pipe – Houston (Argus)

LLS month 1 – pipeline St. James, LA (Argus)

RIN Argus Renewable Volume Obligation year – (Argus)

Product export data – (EIA) [http://www.eia.gov/dnav/pet/pet\\_move\\_wkly\\_dc\\_nus-z00\\_mbbldpd\\_w.htm](http://www.eia.gov/dnav/pet/pet_move_wkly_dc_nus-z00_mbbldpd_w.htm)

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