

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
WICHITA FALLS DIVISION

VALERO ENERGY CORPORATION)
and its subsidiaries,)
)
Plaintiff,)
)
v.)
)
UNITED STATES ENVIRONMENTAL)
PROTECTION AGENCY)
)
and)
)
REGINA MCCARTHY, in her Official)
Capacity as Administrator,)
United States Environmental Protection)
Agency,)
)
Defendants.)
_____)

CIVIL ACTION NO. _____

ORIGINAL COMPLAINT AND APPLICATION FOR INJUNCTIVE RELIEF

Plaintiff Valero Energy Corporation and its subsidiaries¹ impacted by the United States Environmental Protection Agency’s fuel programs (collectively, “Valero”) hereby alleges as follows:

NATURE OF THE ACTION

1. Valero brings this action against the United States Environmental Protection Agency and the Honorable Regina McCarthy, in her official capacity as Administrator of the Environmental Protection Agency (collectively, “EPA”), to compel EPA to perform non-

¹ Valero Refining - Texas, L.P.; Diamond Shamrock Refining Company, L.P.; The Premcor Refining Group Inc.; Ultramar Inc.; Valero Refining Company – California; Valero Refining Company – Oklahoma; Valero Refining - New Orleans, L.L.C.; Valero Refining - Meraux LLC; Valero Refining Company - Tennessee, L.L.C.; Valero Renewable Fuels Company, LLC; Valero Marketing and Supply Company.

discretionary duties required by the Renewable Fuel Standard (“RFS”) program under Clean Air Act (“CAA” or the “Act”) section 211(o), 42 U.S.C. § 7545(o).

2. EPA has failed to annually evaluate and adjust the regulations implementing the RFS program (including the definition of “obligated party”) to ensure that they are “appropriate” as required by section 211(o)(2)(A), (o)(3)(B), 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B). EPA has also failed to complete the periodic review mandated by section 211(o)(11), 42 U.S.C. § 7545(o)(11), to allow for the appropriate adjustment of the requirements of the RFS program. Valero requests a declaration that EPA failed to perform these non-discretionary duties, and Valero applies for an injunction requiring EPA to conduct promptly a rulemaking to ensure the requirements of the program are met, to conduct the periodic feasibility and impacts reviews, and to appropriately and fairly regulate entities.

JURISDICTION AND VENUE

3. This Court has jurisdiction over the subject matter of this action pursuant to section 304(a)(2) of the Act, 42 U.S.C. § 7604(a)(2) (“The district courts shall have jurisdiction . . . to order the Administrator to perform such act or duty”). This Court also has jurisdiction pursuant to 28 U.S.C. § 1331 (federal question jurisdiction) and 28 U.S.C. § 2201-02 (declaratory judgment).

4. Venue is proper in this district because a substantial part of the events or omissions giving rise to this civil claim against the government occurred in this district. 28 U.S.C. § 1391(e)(1). Valero maintains numerous regulated assets in this district. For example, there are Valero-branded retail gasoline stations in the district, and Valero sells gas and diesel at the Holly Terminal in Wichita Falls. Additionally, Valero’s McKee Refinery in Sunray, Texas is fed by a pipeline that originates in Wichita Falls. Valero markets and sells fuel that is obligated

under the RFS program in the district. Valero is adversely impacted by EPA's actions or inactions as described in this Complaint in the district.

5. Because the RFS program is implemented in this district, the effects on Valero of EPA's action and inaction are felt in this district, and Valero's regulated assets in this district are injured by EPA's action and inaction. Valero experiences an economic impact of EPA's regulations in the district. Moreover, EPA's failure to take required action under the statute and failure to regulate rack sellers appropriately within this district are omissions giving rise to Valero's claims. Venue is proper is here.

THE PARTIES

6. Valero Energy Corporation is a Delaware corporation with its principal place of business in San Antonio, Texas. Valero Energy Corporation and its subsidiaries are subject to and impacted by the RFS program. Valero, through its subsidiaries and joint ventures is the world's largest independent refiner and the nation's third-largest ethanol producer and largest renewable-diesel producer. Valero is a "person" within the meaning of section 302(e) of the Act, 42 U.S.C. § 7602(e).

7. As a refiner of gasoline and diesel, Valero is an "obligated party" under the RFS program; it must therefore demonstrate on an annual basis that it meets four different Renewable Volume Obligations.² These obligations are calculated by multiplying the quantity of gasoline and diesel Valero produces or imports each calendar year with the annual percentage standards established by EPA for each of the four types of renewable fuel.

8. Defendant United States Environmental Protection Agency is a federal executive agency charged with implementing and enforcing the CAA, including the RFS program.

² Unless otherwise noted, capitalized terms have the same meaning as they do in the CAA and implementing regulations.

9. Defendant Regina McCarthy is the Administrator of the United States Environmental Protection Agency and is sued in her official capacity. Administrator McCarthy is the federal official ultimately responsible for all official actions or inactions of the United States Environmental Protection Agency challenged in this Complaint.

10. Pursuant to Federal Rule of Civil Procedure 4(i) and 42 U.S.C. § 7604(c)(3), Defendants may be served with process by delivering copies of the summons and complaint via registered or certified mail to the United States Attorney for the district in which this action is brought, to the Attorney General of the United States, and to the EPA Administrator.

STATUTORY AND REGULATORY FRAMEWORK

11. Congress enacted the RFS program as part of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005), to require the use of renewable fuels such as ethanol and biodiesel to replace or reduce the quantity of petroleum-based transportation fuel used in the United States. At that time, the statute mandated 4 billion gallons of renewable fuels be used in 2006, with the volumes increasing each year until reaching 7.5 billion gallons in 2012. Under the Energy Independence and Security Act of 2007, Pub. L. No. 110-140, 121 Stat. 1492 (2007), Congress greatly increased the mandated annual volumes and extended the program through 2022. Pub. L. No. 110-140 § 201, 121 Stat. 1492, 1519, 1521-22 (2007).

12. The RFS program mandates the use of renewable fuels in four different categories: renewable fuel, advanced biofuel, biomass-based diesel, and cellulosic biofuel. 42 U.S.C. § 7545(o)(2)(B). Congress granted EPA the authority to alter the statutorily mandated volumes if, after notice and comment, EPA finds that (1) implementation of the RFS program's requirements "would severely harm the economy or environment" or (2) "there is an inadequate domestic supply" of renewable fuels. *Id.* § 7545(o)(7).

13. The Act requires EPA to promulgate annual “regulations to ensure that transportation fuel sold or introduced into commerce in the United States . . . , on an annual basis, contains the applicable volume” of each of the four categories of renewable fuel. *Id.* § 7545(o)(2)(A). To “ensure[]” that the requirements of the RFS program are met, EPA must “determine and publish” these standards “[n]ot later than November 30” of each calendar year. *Id.* § 7545(o)(3)(B)(i).

14. EPA must express the annual regulations as a “percentage of transportation fuel sold or introduced into commerce in the United States.” *Id.* § 7545(o)(3)(B)(ii)(II). The obligation to satisfy these annual percentage standards “shall . . . be applicable to refineries, blenders, and importers, as appropriate.” *Id.* § 7545(o)(3)(B)(ii)(I).

15. EPA initially chose refiners and importers, but not blenders as “obligated parties” under the RFS program. *See* Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program, 72 Fed. Reg. 23,900, 23,937 (May 1, 2007).

16. The Act requires EPA to regulate the “appropriate” entities to ensure that the statutorily required fuel volumes are met. 42 U.S.C. § 7545(o)(2)(A)(iii), (o)(3)(B)(ii). To this end, EPA must regulate “appropriate” entities to ensure that its own rule does not contribute to the necessary use of the statute’s waiver authority to address the inadequate supply of renewable fuel. 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B).

17. The Act requires EPA to conduct “periodic reviews of . . . the feasibility of achieving compliance with the requirements” and of “the impacts of the requirements . . . on each individual and entity” regulated under the program “[t]o allow for appropriate adjustment” of the statutory volumes. *Id.* § 7545(o)(11).

FACTUAL BACKGROUND

18. EPA has repeatedly failed to meet the annual November 30 statutory deadline to conduct a rulemaking that considers whether the “Point of Obligation” under the RFS program meets the statutory requirement that the “appropriate” entities are regulated to ensure the statutory mandates are being met. For example:

- Despite receiving at least one petition in 2014 and numerous comments in 2015 requesting that EPA address the appropriateness of the Point of Obligation, EPA did not consider the appropriateness of the Point of Obligation when it promulgated the final renewable fuel standards for 2014, 2015, and 2016 and the final biomass-based diesel volume for 2017 on December 14, 2015. Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017, 80 Fed. Reg. 77,420, 77,431 (Dec. 14, 2015) (claiming that changing the Point of Obligation is “beyond the scope of th[e] rulemaking”); and
- EPA did not consider the Point of Obligation when it promulgated the final RFS regulations for renewable fuel, advanced biofuel, and cellulosic biofuel for 2017 and the RFS regulations for biomass-based diesel for 2018 on December 12, 2016. Renewable Fuel Standard Program: Standards for 2017 and Biomass-Based Diesel Volume for 2018, 81 Fed. Reg. 89,746, 89,781 n. 133 (Dec. 12, 2016) (noting only that EPA had previously proposed to deny petitions for a rulemaking to change the Point of Obligation).

19. Under section 211(o)(2)(A)(iii), (o)(3)(B)(ii), 42 U.S.C. § 7545(o)(2)(A)(iii), (o)(3)(B)(ii), EPA is obligated to evaluate and adjust annually the regulations implementing the RFS program to ensure that it regulates the “appropriate” parties (known as “obligated parties”). EPA has failed to meet this statutory deadline every year since 2010.

20. Under section 211(o)(11), 42 U.S.C. § 7545(o)(11), EPA is obligated to complete the periodic review to allow for the appropriate adjustment of the requirements of the RFS program. EPA has continually failed to perform this statutory duty since 2010.

21. On June 8, 2016, Valero petitioned EPA to conduct a rulemaking applicable to calendar years 2016 and thereafter that would satisfy EPA’s non-discretionary duties in 42

U.S.C. § 211(o)(2)(A), (o)(3)(B), and (o)(11), and that would provide a forum for EPA's thorough consideration of adjusting the Point of Obligation to maximize the supply of renewable fuels in the market (the "Petition for Rulemaking"). A true and correct copy of the Petition for Rulemaking is attached to this Complaint as Exhibit A.

22. EPA issued a Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation on November 10, 2016 (the "Proposed Denial"), attached to this Complaint as Exhibit B. EPA published notice of its Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation on November 22, 2016. *See* Notice of Opportunity to Comment on Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation, 81 Fed. Reg. 83,776 (Nov. 22, 2016).

23. The Proposed Denial does not provide the relief that this Complaint seeks because it fails to recognize that EPA's duty to consider the Point of Obligation is non-discretionary under the Act.

24. EPA's Proposed Denial also wrongly concludes that Valero's Petition for Rulemaking is subject to the statutory criteria for petitions for reconsideration under section 307(d)(7)(B), 42 U.S.C. § 7607(d)(7)(B). *See* Proposed Denial at 5. In fact, there is no burden or criteria that must be established by any party for EPA to consider the Point of Obligation in the RFS program because EPA must do so under the Act as directed by Congress.

25. Because EPA proposed to deny the petitions and denies that the Point of Obligation is within the scope of the two RVO rules issued in 2015 and in 2016, Valero cannot obtain relief sought in this action in a timely manner. Legal action to challenge EPA's final denial cannot begin until EPA issues a final denial, and, because EPA denies any statutory duty related to the Point of Obligation and the petitions, EPA may delay issuing a final action on the

petitions and delay possible relief for Valero for years. Each year that passes increases the harm to Valero.

INJURIES RESULTING FROM EPA'S FAILURE TO ACT

26. Valero is directly and indirectly harmed by EPA's failure to fulfill its statutory duties. The market inefficiencies associated with the misplaced Point of Obligation harm Valero as a refiner, as the brand owner of retail fuel, and as a renewable fuel producer.

27. The delay caused by EPA's failure to act injures Valero. As a refiner, Valero is an obligated party under the RFS rules and faces excessive costs to comply with the RFS volume mandates because it lacks control at the point of compliance – blending at the rack. Valero branded retail stations are also harmed by unfair competitive advantages that the RFS provides for large retailers and branded retail stations of refiners under the current RFS structure. Harm to Valero-branded retail stations harms Valero. As a renewable fuel producer, Valero is harmed by any constraint on the renewable fuel market that limits the efficiency and incentives for promoting renewable fuel consumption.

NOTICE

28. Section 304(a)(2) of the Act, 42 U.S.C. § 7604(a)(2), provides that:

Except as provided in subsection (b) of this section, any person may commence a civil action on his own behalf . . . against the Administrator where there is alleged a failure of the Administrator to perform any act or duty under this chapter which is not discretionary with the Administrator.

Section 304(b)(2) of the Act, 42 U.S.C. § 7604(b)(2), provides that “no action may be commenced . . . under subsection (a)(2) of this section prior to 60 days after the plaintiff has given notice of such action to the Administrator”

29. Valero gave actual notice to EPA of its intent to file this civil action in a letter addressed to the Administrator dated November 3, 2016 (the “Notice Letter”). A true and

correct copy of the Notice Letter is attached to this Complaint as Exhibit C and is incorporated by reference herein. This Notice Letter satisfies the pre-suit notice requirement of section 304(b) of the Act, 42 U.S.C. § 7604(b).

30. The 60-day period required by section 304(b) of the Act, 42 U.S.C. § 7604(b), between issuance of the Notice Letter and commencement of this civil action expired on January 2, 2017.

CLAIMS FOR RELIEF

COUNT I: Failure to Perform Non-Discretionary Duty to Annually Evaluate and Adjust the RFS Regulations to Ensure They Are “Appropriate” as Required by CAA Section 211(o)

31. Plaintiff re-alleges and incorporates herein the allegations in Paragraphs 1 through 30 as if fully set forth herein.

32. An actual controversy exists regarding EPA’s implementation of the RFS program. EPA has failed to evaluate and adjust annually the regulations implementing the RFS program (including the definition of “obligated party”) to ensure that they are “appropriate” as required under section 211(o)(2)(A), (o)(3)(B), 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B).

33. EPA’s failure to perform this non-discretionary duty continues to this day. Absent an appropriate order of this Court, EPA will continue to disregard this non-discretionary statutory duty.

34. The delay caused by EPA’s failure has harmed and continues to harm Valero.

35. As provided in sections 304(a) and (d) of the Act, 42 U.S.C. § 7604(a) and (d), EPA’s failure to perform its non-discretionary duty subjects EPA to injunctive relief, costs, and attorneys’ fees for this action.

COUNT II: Failure to Perform Non-Discretionary Duty to Conduct the Periodic Review Required by CAA Section 211(o)

36. Valero re-alleges and incorporates herein the allegations in Paragraphs 1 through 35 as if fully set forth herein.

37. An actual controversy exists regarding EPA's implementation of the RFS program. EPA has failed to perform its non-discretionary duty to complete the periodic review mandated by section 211(o)(11), 42 U.S.C. § 7545(o)(11).

38. EPA's failure to perform this non-discretionary duty continues to this day. Absent an appropriate order of this Court, EPA will continue to disregard this non-discretionary statutory duty.

39. The delay caused by EPA's failure has harmed and continues to harm Valero.

40. As provided in sections 304(a) and (d) of the Act, 42 U.S.C. § 7604(a) and (d), EPA's failure to perform their non-discretionary duty subjects them to injunctive relief, costs, and attorneys' fees for this action.

RELIEF REQUESTED

WHEREFORE, Valero prays that the Court:

A. Declare that Defendants have failed to perform a non-discretionary duty to annually evaluate and adjust the regulations implementing the RFS program (including the definition of "obligated party") to ensure that they are "appropriate" as required under section 211(o)(2)(A), (o)(3)(B), 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B);

B. Declare that Defendants have failed to perform a non-discretionary duty to complete the periodic review mandated by section 211(o)(11), 42 U.S.C. § 7545(o)(11);

C. Order Defendants to conduct a rulemaking by a date certain forthwith to satisfy their non-discretionary duties under 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B), and (o)(11);

- D. Order Defendants to take other appropriate actions to remedy, mitigate, and offset the harm to Plaintiff caused by Defendants' disregard of their statutory duty;
- E. Retain jurisdiction to ensure compliance with the Court's order;
- F. Award Plaintiff its costs and reasonable attorneys' fees as the Court may deem just and proper; and
- G. Grant such other relief as the Court deems just and proper.

Dated: January 17, 2017

Respectfully submitted,

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EXHIBIT A



BY OVERNIGHT DELIVERY

June 13, 2016

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

Re: Petition for Rulemaking: Renewable Fuel Standard Definition of Obligated Party –
40 C.F.R § 80.1406

Dear Administrator McCarthy:

The Valero Energy Corporation and its subsidiaries (“Valero”) hereby petition EPA to propose and take final action on a rule in 2016 to address a flaw in the Renewable Fuel Standard (“RFS”) program, 40 C.F.R. Part 80 Subpart M. Valero petitions EPA to align the obligation to blend increasing volumes of renewable fuels into transportation fuel with the ability to do so by defining “obligated party” as

the entity that holds title to the gasoline or diesel fuel, immediately prior to the sale from the bulk transfer/terminal system (as defined by IRS regulations in 40 CFR §48.4081-1) to a wholesaler, retailer or ultimate consumer and is required to report federal excise tax liability for the gasoline or diesel on its Form 720 – Quarterly Federal Excise Tax Return, within the 48 contiguous states or Hawaii, during a compliance period or the entity that is the enterer (as defined by IRS Regulations in 40 CFR §48.4081-1) of the gasoline or diesel fuel into the 48 contiguous states or Hawaii outside of the bulk transfer/terminal system and is required to report federal excise tax liability for the gasoline or diesel on its Form 720, during a compliance period.¹

Currently, the obligation for the RFS is placed on refiners and importers — the Point of Obligation is the refinery gate and the entity that imports — regardless whether the refiner or importer have the ability to affect the amount of renewable fuels blended and sold to consumers. This placement has created multiple problems that impair the RFS program’s proper functioning and prevent it from ensuring that renewables enter the transportation fuel market. The inefficiencies of the Point of Obligation’s current placement harm renewable fuel producers, independent refiners, retailers and U.S. consumers. Among the most significant is that, because it prevents the value of Renewable Identification Numbers (“RINs”) from being passed through to consumers, it only minimally encourages renewable fuel consumption.

Precisely because Congress wanted EPA to be able to identify and resolve these sorts of problems as quickly as possible, the Clean Air Act (“CAA” or “Act”) compels EPA to consider

¹ The current definition excludes Alaska and territories from the RFS. We propose no change in that regard.

adjustments to the RFS program to ensure that (1) it promotes renewable fuels in the U.S. transportation fuel system and (2) the renewable fuel market operates efficiently without irrational and disproportionate burdens. EPA is bound by the Act to undertake rulemaking to change the Point of Obligation so that this flaw in the RFS program does not constrain the renewable fuel market. This Petition is one of several independent actions that Valero has initiated regarding the RFS Point of Obligation, each of which has a separate and distinct legal basis. A 2016 rulemaking to move the Point of Obligation as Valero recommends, however, could resolve all these actions related to the Point of Obligation.

With the recommended change, EPA would regulate a subset of “blenders” —the entities that actually control the hydrocarbon at the primary point of blending. These entities own petroleum fuel at the bulk terminal or truck loading terminal, also referred to as “the rack,” and control the blending decision. Hereinafter, this Petition refers to fuel owners at this blending point as “Rack Sellers.”

The change will relieve supply constraints on renewable fuel in the transportation fuel market and facilitate the market’s ability to respond to renewable fuel volume mandates. The change will thus (1) enable the market to more readily respond to the annual renewable volume obligation (“RVO”) standards; (2) begin to address the structural constraints that EPA identified in the 2015 Renewable Fuel Volume Rule;² and (3) eliminate barriers that prevent the RIN value from being passed through to consumers.

Valero is uniquely situated to raise issues associated with the Point of Obligation in the RFS program, due to its direct experience with the rules from several perspectives. As a refiner, Valero is an obligated party under the RFS rules and must comply with the RFS volume mandates. Valero owns and operates 13 petroleum refineries located in the United States. With a combined throughput capacity of approximately 2.9 million barrels per day, Valero is the world’s largest independent refiner. Valero is a fuel importer with refineries in Canada and the United Kingdom. Valero is a major fuel wholesaler. Approximately one-third of its fuel goes into Valero-branded, rack contract, or wholesale markets. Valero was the first traditional petroleum refiner to enter large-scale ethanol production and now has 11 state-of-the-art plants located throughout the Midwest, including in Iowa, Nebraska, South Dakota, Ohio, Indiana, Wisconsin, and Minnesota. This makes Valero the third largest ethanol producer in the United States. Valero has further diversified its renewable investments into Diamond Green Diesel, a 12,000 barrel-per-day renewable diesel plant next to the Valero St. Charles Refinery, making Valero the largest renewable diesel producer in the U.S.

As a renewable fuel producer, Valero is directly harmed by EPA’s failure to ensure that the RFS program does not impede growth in the renewable fuel market. As the largest independent refiner and a major renewable fuel consumer, Valero’s business is harmed by an inefficient renewable fuel market that artificially increases the price of RINs and the risks associated with RIN acquisition. Because of its uniquely diversified position, Valero engages

² Final Rule Setting Renewable Fuel Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017 (“2015 RVO Rule”), 80 Fed. Reg. 77,420, 77,423 (Dec. 14, 2015).

with and must balance the interests and concerns of different stakeholders involved in the RFS program. Valero’s business interests thus reflect concerns of a broad spectrum of market participants that EPA must consider to ensure that the RFS program functions as Congress intended and to properly implement the terms of the CAA RFS provisions.

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I. Introduction and Summary: Moving the Point of Obligation will improve the RFS program by eliminating market distortions and disincentives that constrain renewable fuel consumption.

The Clean Air Act charges EPA with designing the RFS to maximize renewable fuels in the U.S. fuels market, yet the current RFS structure hampers the growth of renewable fuels. That impairment is attributable to the misplacement of the current compliance obligation point. Because the obligation is not placed at the natural compliance point, it has generated competing incentives that prevent RIN value pass-through to consumers and preclude the installation (or expansion) of blending infrastructure. As a result, the misplacement hampers the penetration of renewable fuels at higher levels. These developments cut to the heart of the legislatively mandated program, because the statute mandates that EPA annually review the appropriateness of the regulation precisely to prevent such problems. Moreover, special statutory alarm bells go off when EPA uses the statutory waiver authority to address supply constraints; when it does, the agency must review and reconsider the appropriateness of the current regulatory structure in satisfying the goals of the RFS. Through these statutory requirements, Congress expects EPA to quickly respond if the regulatory structure itself has become a constraint.

EPA has repeatedly recognized that the RFS program is not functioning as Congress intended and that the supply of renewable fuel to the transportation fuel market is constrained by a number of factors.³ EPA identified lack of infrastructure as the leading constraint on renewable fuel supply. In comments on the 2015 RVO Rule, Valero demonstrated how obligating the appropriate party in the RFS program will directly incentivize investment in needed infrastructure to bring more renewable fuel to market. Thus, the point of obligation is not a standalone issue EPA may address sometime in the future, but is at the root of the infrastructure supply constraint. And EPA’s failure to consider the point of obligation virtually ensures that the infrastructure constraint will continue unabated.

EPA, like economists and experts, recognizes that the current RFS structure causes market disparity and distortions that keep consumers from benefiting from better renewable fuel prices

³ See 80 Fed. Reg. at 77,452.

and availability.⁴ Despite EPA's denial that this flaw substantially harms some refiners over others, the very flaw that EPA acknowledges (and the resulting disparate impacts on refiners) is what prevents the RFS program from creating incentives to blend renewable fuel as Congress intended. As structured, the system inhibits capital investments needed for renewable fuel infrastructure. Based on the comments submitted during past RFS rulemakings and in the 2015 RVO rulemaking, renewable fuel producers clearly have not felt the full market support that the RFS program intended to provide. In short, the very structure of the current RFS program is the source of supply constraint—and that is a problem of EPA's own making that EPA must eliminate.

Unlike various challenges EPA faces implementing the RFS, EPA can easily resolve this defect by shifting the RFS compliance obligation to Rack Sellers, ensuring that all parties would have an equal incentive to maximize the generation of RINs, thus eliminating current structural constraints on that generation. As EPA identified in the 2015 RVO Rule, the infrastructure needed to increase renewable-fuel market penetration is located downstream of refiners.⁵ Rack Sellers are not only downstream of refiners, but possess the ability and market power to invest in infrastructure for additional renewable fuel blending and marketing. As long as Rack Sellers lack compliance obligations, however, there will not be adequate market motivation to invest in downstream infrastructure. By moving the obligation from the point of refining to the place where blending actually occurs and where renewable fuel is purchased and delivered, EPA would incentivize Rack Sellers to maximize blending and marketing of renewable fuel. The parties with the greatest market power would then be fully compelled by the obligation to promote increased use of renewable fuel. No party would have a surplus of RINs by virtue of their downstream position alone, while all parties would be equally obligated and, most importantly, all parties' incentives would fully align with the Act's goal of pushing renewable fuels into the market.

The change will not only improve the RFS and resolve serious harms and prevent further harm in the fuel sector, it will also benefit small retailers, biofuel producers, and consumers. Contrary to views expressed by some opponents, the change will not harm market participants. As further described in this petition, where some parties once advocated for the proper placement of the RFS obligation, several now profit from the very dysfunction they once decried. Thus, they no longer support (and in some cases, vehemently oppose) a change. Other parties have discovered the revenue potential of the program dysfunction and now seek to preserve the

⁴ EPA "acknowledge[s] that there is a theoretical possibility that parties that accumulate RINs through their own blending activities could decide to bank the maximum quantity of RINs for their own future use or for future sale, and that if this practice were widespread that there could be a shortfall in available RINs for parties who do not engage in renewable fuel blending activities themselves and have not entered into sufficient contracts with blenders or other parties to acquire sufficient RINs." 80 Fed. Reg. at 77,430. In the final rule, EPA also relied on "An Assessment of the Impact of RIN Prices on the Retail Price of E85", which states "In reviewing the available data we conclude that E85 wholesalers and/or retail station operators appear to be seeking to maximize their profits from E85 sales, rather than seeking to maximize E85 sales volumes." Dallas Burkholder, U.S. EPA, Office of Transportation and Air Quality, *An Assessment of the Impact of RIN Prices on the Retail Price of E85* at 1 (Nov. 2015) [hereinafter the "Burkholder Memo"]; see also *id.* at 10.

⁵ EPA's list of constraints on the use of renewable fuel includes various constraints on the market that are downstream of refiners, including market-based and infrastructure constraints associated with distribution and retail infrastructure. See 80 Fed. Reg. at 77,452.

economic gains. EPA must pay careful attention to the motives of any opponents to the change; none are motivated to improve the efficiency and power of the RFS to promote renewable fuel.

No substantial obstacles could block the regulatory change necessary to correct the program's flaw. To the contrary, the fix is simple—moving the Point of Obligation to the owners of the fuel immediately prior to blending at the rack (Rack Seller) is a straightforward edit to the definition of obligated party. No administrative burden justifies any delay in revising the RFS program. Nor is the fix speculative, as California's program has already demonstrated the effectiveness and efficiency of the regulatory management of fuels through market mechanisms at the terminal rack-level.

While Valero's suggested regulatory change faces neither serious impediments nor any valid basis for inaction, its advantages are massive. Redefining "obligated party" would

- increase penetration of biofuels into the market, helping to effectively overcome the supply constraints associated with the blend wall;
- remove the market distortion that harms independent refiners, small retailers and small renewable fuel producers;
- create a level playing field in all fuel-market sectors, thus generating greater competition for renewable fuels on all levels;
- substantially reduce the opportunity for RIN fraud and RIN speculation because the parties with RFS obligations would be those who generate RINs; and
- lead to reliable, third-party verification for the obligated parties' RVO and most RIN-generation, using federal excise tax documents, a remarkably simple solution to the major challenges to verification today.

All this and more can be achieved without radically restructuring the transportation fuel market, which has been trending away from vertical integration.

Valero has attached to this Petition a report⁶ produced by National Economic Research Associates ("NERA") Economic Consulting (hereinafter the "NERA Report"), which is part of the administrative record for the 2015 RVO Rule. The report's authors include economists with substantial experience and expertise in the energy and environmental markets as well as an expert on antitrust and market competition. After completing an analysis of the RFS program and EPA's 2015 proposed rule, NERA concluded that

If [EPA] leaves the RFS2 program as currently designed, it must accept the fact that there will be little potential for increasing renewable fuel use in the transportation sector. Therefore, if EPA wants RFS2 to have any chance of meeting its original goals, it must consider changes to its design.⁷

⁶ Paul Bernstein, et al., NERA Economic Consulting, EFFECTS OF MOVING THE COMPLIANCE OBLIGATION UNDER RFS2 TO SUPPLIERS OF FINISHED PRODUCTS (July 27, 2015) [hereinafter "NERA Report"], provided here as Attachment A.

⁷ *Id.* at 16.

As recently as April 2016, an industry analyst warned of the potential for a repeat of the 2013 RIN crisis.⁸ In that crisis, high levels of use of banked RINs would be driven by limited market penetration of renewable fuels, limited pass-through of RIN value, and limited and distorted incentives for renewable fuel infrastructure investments. EPA can prevent another RIN crisis by moving the Point of Obligation before the end of 2016 to those at the natural compliance point—Rack Sellers.

In particular, Valero recommends the following revision to § 80.1406 (Obligated Party):

(a)(1) An *obligated party* is ~~any refiner that produces gasoline or diesel fuel~~ the entity that holds title to the gasoline or diesel fuel, immediately prior to the sale from the bulk transfer/terminal system (as defined by IRS regulations in 40 CFR §48.4081-1) to a wholesaler, retailer or ultimate consumer and is required to report any federal excise tax liability for gasoline or diesel on its Form 720 – Quarterly Federal Excise Tax Return, within the 48 contiguous states or Hawaii, during a compliance period or the entity that is the enterer (as defined by IRS Regulations in 40 CFR §48.4081-1) of the gasoline or diesel fuel into the 48 contiguous states or Hawaii outside of the bulk transfer/terminal system and is required to report any federal excise tax liability for gasoline or diesel on its Form 720, during a compliance period., any importer that imports gasoline or diesel fuel . A party that simply blends renewable fuel into gasoline or diesel fuel, as defined in § 80.1407(e) or (e), is not an obligated party.

We recommend that EPA also adopt the following IRS definitions:

Bulk transfer/terminal system means the taxable fuel distribution system consisting of refineries, pipelines, vessels, and terminals. Thus, taxable fuel in a refinery, pipeline, vessel, or terminal is in the bulk transfer/terminal system.

Enterer generally means the importer of record (under customs law) with respect to the taxable fuel, except that—

(1) If the importer of record is a customs broker engaged by the owner of the taxable fuel, the person for whom the broker is acting is the enterer; and

(2) If there is no importer of record for taxable fuel entered into the United States, the owner of the taxable fuel at the time it is brought into the United States is the enterer.⁹

⁸ E-mail from Tom Kloza, OPIS, to opisethanol@announce.opisnet.com, *BIOFUELS UPDATE: Rinsanity Sequel? Top Analyst Sees Problems with Calculating RIN Bank*, (Apr. 13, 2015, 4:42 PM).

⁹ 26 C.F.R. § 48.4081-1(b).

II. Relevant market structure and participants.

Both the current problems and Valero's proposed solution require a brief overview of how the market functions. As described by the GAO:

The U.S. petroleum refining industry consists of firms of varying sizes that, in addition to operating refineries, may also have operations in other related industry segments: (1) the upstream segment, which consists of the exploration for and production of crude oil; (2) the midstream segment, which consists of pipelines and other infrastructure used to transport crude oil and refined products; (3) the downstream segment, which consists of the refining and marketing of petroleum products such as gasoline and heating oil; and (4) the renewable fuels segment, where biorefineries produce renewable fuels that are blended with petroleum products at wholesale terminals before being distributed to consumers. To varying degrees, refiners may primarily operate refineries—these are called merchant refiners—or may be integrated, participating in various other related industry segments. HollyFrontier Corporation is an example of a merchant refiner that purchases crude oil from unaffiliated producers and sells refined products to other companies operating retail fuel outlets, while Chevron is an example of a fully integrated company, a refiner that also produces crude oil and operates pipelines and retail fueling outlets across the United States.¹⁰

For the purposes of this Petition, the relevant market participants are (1) the refiner, who refines petroleum crude into the blendstocks for gasoline and diesel; (2) terminal owners and operators of blending infrastructure and terminals, where gasoline and diesel are sent for sale and distribution and where renewable fuel blending decisions are made; (3) wholesale purchasers, marketers or distributors who may purchase from refiners before or after blending at the terminals and distribute the fuel to retail stations; and (4) retailers who own retail fuel stations, where there may be a decision to blend additional renewable fuels. Thus, the refiner is at one end of the system, and the retailer is at the other end. The bulk terminal or truck loading terminal, where refiners and others sell to marketers and distributors, is the middle of the system. *This middle point* (and downstream) is where renewable fuels are blended,¹¹ and where compliance with the RFS is largely achieved. It is thus the natural point of compliance with RFS volume mandates.

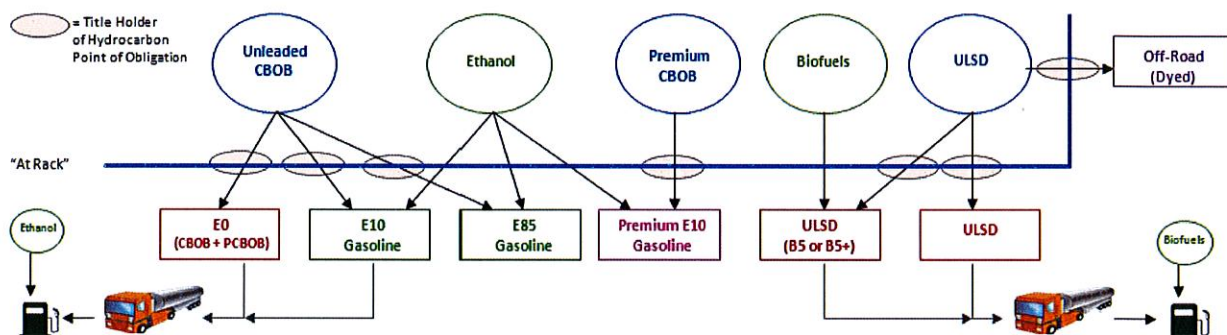
This middle point—the loading terminal—is known as “the rack.” The actual blending takes place as the gasoline and diesel are loaded for the buyer of the fuel at the rack. Thus, the “Rack Seller” is both (1) the owner of the gasoline and diesel as the fuel is blended and (2) the party that pays the federal excise tax for the gasoline or diesel. The “Rack Buyer” is the party that receives the already-blended fuel. Rack Buyers can choose not to buy gasoline or diesel blended with renewable fuel, but Rack Sellers always retain control over what is offered for sale across

¹⁰ GAO, GAO-14-249, PETROLEUM REFINING: INDUSTRY'S OUTLOOK DEPENDS ON MARKET CHANGES AND KEY ENVIRONMENTAL REGULATIONS 8-10 (Mar. 2014), available at <http://www.gao.gov/assets/670/661710.pdf>.

¹¹ Renewable fuels cannot be blended upstream of the rack because renewable fuels cannot be transported in pipelines; thus, renewable fuels are not blended into fuel at the refinery by the refiner before the fuel is delivered to the rack.

the rack and the price for the various fuel blends for sale. All four categories of market participants can be Rack Sellers. However, for any specific volume of fuel, the primary control over blending of that volume is in the hands of the Rack Seller of that fuel. In other words, the market participant that controls the fuel at the rack has primary control over blending.

Rack Detail



Integrated refiners participate in all four segments: as refiner, terminal owner/operator, marketer or distributor, and retailer. Merchant refiners or independent refiners typically lack market power in the three segments other than refining. Both integrated refiners and merchant refiners sell at the rack and thus are Rack Sellers. Integrated refiners, however, sell more at the rack than they refine, while merchant refiners typically sell far less at the rack than they refine. This is because integrated refiners and others buy fuel from merchant refiners to sell from the rack. Unlike integrated refiners, most merchant refiners have little or no market power in the distribution and retail segments; some have no retail shares at all.

On the other hand, Rack Sellers include retailers and other parties that have no refining at all. Over 20% of retail stations are owned by large company retailers or mega-retailers. These large retailers have access to more infrastructure than small retailers. Due to their downstream positions, some of these large company retailers have acquired positions at the Rack at the blending point. In other words, some large retailers, with no RFS obligation, own the gasoline or diesel before the blending decision is made and have control over blending renewable fuels into gasoline and diesel where refiners have no control. Access to RIN revenues have given these large retailers a competitive advantage over small retailers that threatens the future of small retail stations and could undermine retail competition and harm the consumer.

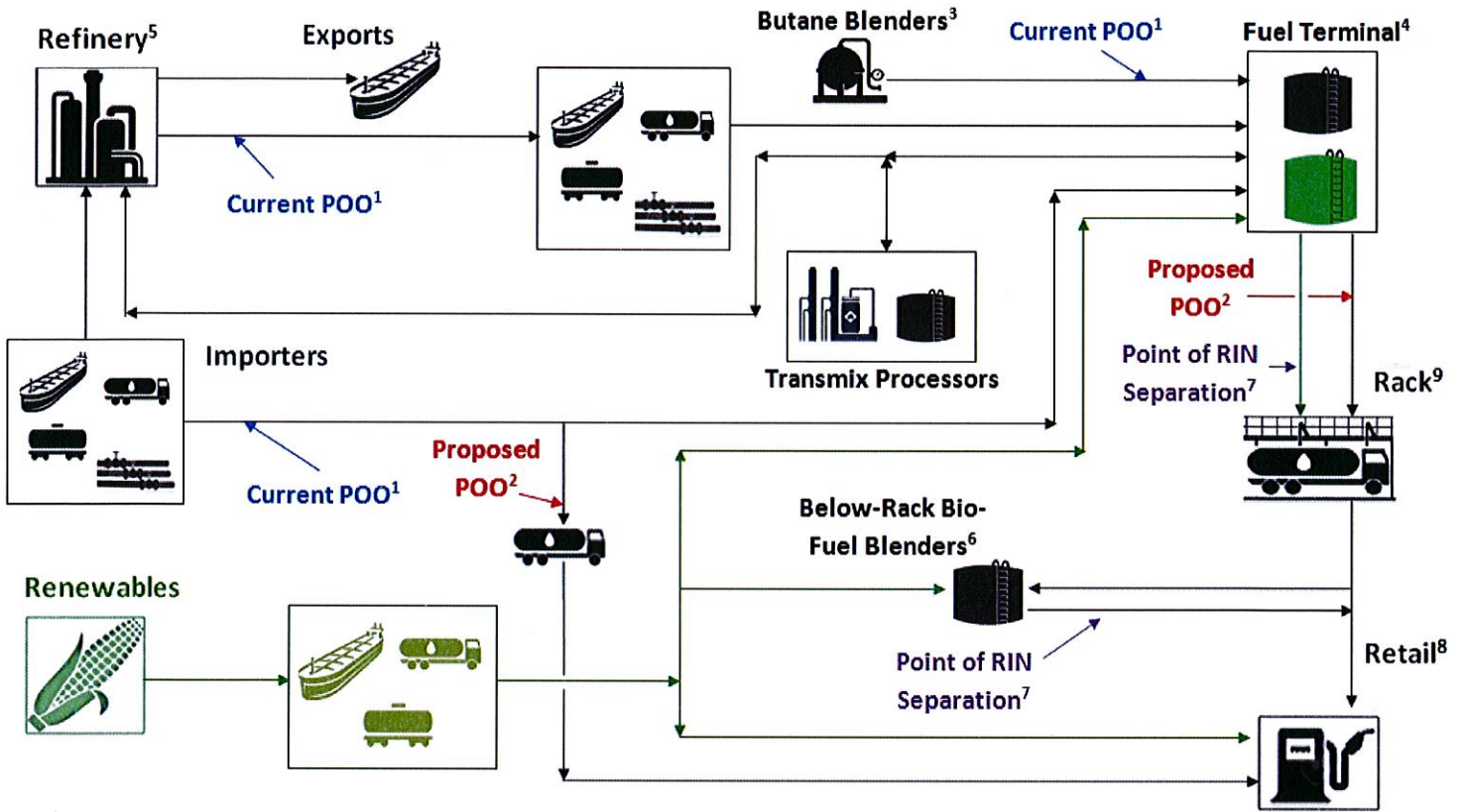
The statute gives EPA authority to regulate “blenders” as appropriate, but the term “blender” may reference: (1) the owner of the gasoline or diesel that can make the blending decision when selling the fuel at the rack, i.e., Rack Sellers; (2) the owner and operator of the rack or terminals and blending equipment; and/or (3) buyers of gasoline or diesel who blend renewable fuel below the rack (“Rack Buyers”). EPA can regulate any of these parties but need not set mandates for all.

Rack Sellers are blenders that include refiners and others that hold or have contracted for positions above the rack. Valero provides in Attachment D to this Petition a list of current Rack Sellers. Of the Rack Sellers on the list, those that are also refiners are currently obligated parties. Others include large retailers that have taken positions as Rack Sellers primarily to take advantage of the RIN value. These Retailer-Rack Sellers control blending decisions but currently have no corresponding RFS compliance obligation whatsoever. Thus, these Retailer-Rack Sellers generate RINs only to sell them to obligated parties for a profit. Although a few might generate some RINs below the rack, their position at the rack creates neither additional volumes of RINs nor additional blending of renewable fuel. These Retailer-Rack Sellers are not incentivized by an obligation to blend the most renewable fuels or to keep RIN prices low but may be affirmatively incentivized *not* to do so; they are using their resources to wrestle control over existing RINs and are motivated to keep the value of the RIN high by limiting the number of RINs available.

Blenders that are not Rack Sellers need not be obligated parties to achieve the benefits of the change proposed by Valero. Owners and operators of the rack or terminal and blending equipment that are not Rack Sellers are unlikely to be able to control decisions regarding changes necessary to increase renewable fuel blending. Some operate as service providers via contract with the fuel owners, have contracts with multiple parties, and cannot make infrastructure investments without agreement from these rack customers, *i.e.* Rack Sellers. Moving the Point of Obligation would make all rack customers equally motivated to blend renewable fuel and service providers at the rack would be able to make infrastructure investments for additional blending of renewable fuel.

Blenders that are Rack Buyers that blend renewable fuel below the rack can benefit from a change in the point of obligation. These include marketers, distributors and retailers that take advantage of renewable fuel blending tax credits for higher level blends and other below the rack blending opportunities which generate incremental RINs and additional revenue. With the proposed change to the Point of Obligation, downstream blenders would not be obligated parties. Nonetheless, all downstream blending would continue to be beneficial to the RFS program and is likely to be encouraged by Rack Sellers to increase the volume of RINs for compliance, particularly where downstream blending is more efficient. The proper placement of the Point of Obligation would eliminate the competitive disadvantage that small retailers have simply due to RIN revenue generation capability of large retailers. With the change, all retailers would be able to compete for RIN revenue downstream of the rack. In addition, to encourage downstream consumption, Rack Sellers would pass the RIN value to the retail level. Thus, retailers could realize additional price benefits from rack level blending as well as additional revenue generation from RINs created through additional downstream blending. Ultimately, consumers will benefit.

RFS2 and the Point of Obligation



¹ Current Point of Obligation are the refiners and importers.

² The obligated party is the entity that holds title to the gasoline or diesel fuel, immediately prior to the sale from the bulk transfer/terminal system (as defined by IRS regulations) to a wholesaler, retailer or ultimate consumer and is required to report federal excise tax liability for the gasoline or diesel on its Form 720 – Quarterly Federal Excise Tax Return. An obligated party also includes the entity that is the enterer (as defined by IRS Regulations) of the gasoline or diesel fuel into the U.S. outside of the bulk transfer/terminal system and is required to report federal excise tax liability for the gasoline or diesel on its Form 720. Moving the POO equitably impacts all providers of gasoline and diesel in the distribution system. It will also eliminate double counting of refinery-processed transmix and eliminates the need for the transmix exemption.

³ Under the proposed changes to the POO, butane blenders are no longer obligated parties. Volume increases from butane blending are captured at the new Point of Obligation

⁴ Fuel Terminal includes bulk terminals, truck terminals, wholesale purchases, etc.

⁵ Small Refiner Exemption can be eliminated.

⁶ Below-the-rack blenders will not be impacted. Retail is unaffected.

⁷ The points of RIN separation are unchanged with the new point of obligation.

⁸ "Retail" also includes those wholesale purchaser and other, ultimate consumers which may receive fuels after the POO but not through the typical retail market.

⁹ See page 9 for Rack detail.

III. The current Point of Obligation inhibits the RIN market from increasing renewable fuels, but placing the obligation on Rack Sellers would correct this problem.

In 2010, EPA acknowledged factors favoring moving the compliance obligation, but nonetheless chose to make no change. Serious problems plague the current system and no other resolution for these problems is likely. Since 2010, the factors that EPA said justified a change have become more pronounced. The CAA and EPA's regulations require higher volumes of renewable fuels in the market, which results in volumes that push up against (and beyond) the blend wall. Achieving those volumes is made even more difficult by the decline in petroleum consumption. "With structural disincentives stemming from the current Point of Obligation, meeting EPA's goal of increasing renewable fuels consumption is unlikely."¹²

- A. Under the current Point of Obligation, RIN value is not passed through to consumers to lower renewable fuel prices and stimulate demand.

Increased consumer demand for renewable fuel (and the corresponding incentives to invest in renewable fuel infrastructure) requires as an initial step that RIN prices pass-through to consumers, because this will make high-ethanol fuels or biofuels less expensive and encourage consumption. Experts have concurred: "If the RIN price savings inherent in blends with high biofuels content are not passed on to the consumer, then this key mechanism of the RFS is not functioning properly."¹³ But under the current definition of obligated party, this pass-through is not encouraged,¹⁴ as NERA economists observed:

The lack of response in the fuel price spread means that RIN economics do not affect the blender's decision process about the relative pricing of finished fuels. In other words, the blender is not passing through the value of the RIN to the retailer in order to encourage greater E85 sales, and RIN profits are being retained by the blender.¹⁵

The RIN system, in other words, is not promoting full investment in renewable fuel infrastructure. Rather, because the value of the RIN is not passing through to consumers but is largely being retained by Rack Sellers, the RIN system disincentivizes infrastructure investment and renewable fuel blending. This disincentive alone justifies changing the RFS structure. Although EPA has identified several structural barriers in the renewable fuel market and hypothesizes that obligated parties might find incentives over time to overcome the market barriers by investing in renewable fuel infrastructure, EPA fails to recognize its own role in removing artificial market barriers now. The current structure of the RFS prevents the market from realizing the opportunities to invest in renewable fuel infrastructure.

¹² NERA Report, *supra* note 6, at 10.

¹³ See Christopher Knittel, et al., THE PASS-THROUGH OF RIN PRICES TO WHOLESALE AND RETAIL FUELS UNDER THE RENEWABLE FUEL STANDARD 20 (June 2015) [hereinafter "Knittel Report"].

¹⁴ Burkholder Memo, *supra* note 4 at 12.

¹⁵ NERA Report, *supra* note 6, at 19 (citing Burkholder Memo at 12).

In his comment letter on the 2015 Proposal, Former Special Assistant to the President for Energy and Environment on the staff of the National Economic Council at the White House Ron Minsk illustrates the failure of the RIN market to promote renewable fuel:

[W]ith the challenges that began in late 2012 and early 2013 as the market recognized that the fuel supply could not accommodate the statutory obligations without breaching the blend wall, the question of how this system was working to incentivize the use of higher ethanol blends increasingly animated the interagency review process. If the market was functioning as expected, and RIN prices were rising—making higher ethanol blends more valuable—why were we not seeing the expected rise in E85 market penetration?¹⁶

In short, while the RFS program is supposed to facilitate the development of the renewable fuel market, the current design of the RIN system undermines that statutory goal.

- B. While the current system creates disparities in RIN-access that highly prejudice merchant refiners, create windfalls for others, and foster RIN speculation (not creation), the proposed definition would eliminate those perverse market effects.

EPA has set the RFS Point of Obligation at the refining point even though compliance is achieved not at refining, but downstream, primarily at the truck loading rack and even further downstream at retail. Unsurprisingly, this obligation/compliance disconnect has prevented the RFS from working properly. First, while almost all refiners have sales across the rack and they generate some RINs, few are balanced. Several historically integrated or dominant branded refiners market more fuel than they produce. Their RIN generation potential thus exceeds their refining obligation, making them RIN-long refiners. On the other hand, there is a rising class of independent merchant refiners, who often have no significant rack sales and may not even know where their bulk spot fuel sales will be marketed. These refiners often lack meaningful control over where or how their fuel will be blended. They largely must purchase RINs in the secondary market. They are RIN-short refiners who are dependent on the market working. As obligated parties that cannot respond to higher prices by generating RINs from increased volumes of renewable fuels, RIN-short refiners are highly vulnerable to inflated RIN prices and they are in direct competition with the RIN-long refiners.

The trend in the market has been for refiners to become less integrated. Yet the market disparities created by the current Point of Obligation heavily favor integrated refiners at a demonstrable cost to merchant refiners and, ultimately, consumers. NERA, recognizing that integrated refiners are more likely to hold banked RINs, described the expected long-term detrimental consequences of the current system:

¹⁶ Letter from Ronald E. Minsk to Janet McCabe, Acting EPA Assistant Admin. for Air and Radiation at 3 (July 24, 2015) (Docket ID No. EPA-HQ-OAR-2015-0111-1307) [hereinafter “Minsk Letter”], provided here as Attachment B.

The most likely outcome of continuing a regulatory system that systematically raises the cash operating costs of Merchant Refiners relative to Integrated Refiner/[Rack Sellers] is that *the structure of the industry will change and merchant refiners could disappear*. If merchant refiners do reduce supply of gasoline blendstock at existing prices, the resulting gap in supply and demand caused by exiting Merchant Refiners would likely be filled by other Integrated Refiner/[Rack Sellers] and/or Importers, but at higher costs, and increasing prices to consumers may ensue.¹⁷

In 2014, various news sources reported on RIN windfalls and the clear disparity among obligated parties.¹⁸ Reports described that some obligated parties and a number of non-obligated parties gained huge windfalls while some refiners bore massive and inequitable RIN costs.¹⁹ Notably, these windfalls are not generated by heroic blending of renewable fuels but are generated by virtue of the advantaged position of fuel ownership at the rack.

From 2012 through mid-January 2013, RINs traded for less than ten cents. RIN prices then rapidly rose tenfold to over \$1.00. The impact of the price spike and continued high price of RINs fell disproportionately on merchant refiners. Yet the higher prices did not aid renewable fuel producers,²⁰ much less improve E85 or E15 prices for consumers. Higher prices, therefore, neither generated investment in renewable fuel infrastructure nor increased renewable fuel sales.²¹

The price spike controversy revealed “a major weakness in the system:”

Importantly, the E10 blend wall and current high prices of D6 RINs may be revealing a significant flaw in the way EPA designates obligated parties for RFS2. In 2010, EPA considered, but rejected, the alternative of moving all RVOs downstream of refineries and importers to those who supply finished gasoline at the retail level. This change would have resulted in a more homogenous group of obligated parties and better aligned an obligated party’s RVO with access to RINs. Such realignment may have precluded some of the current diverse impacts of high RINs prices on obligated parties and minimized the cost of RFS2 compliance.²²

The RFS program was not intended to reduce competition among refiners or create windfalls for one type of obligated party or refinery at the expense of other obligated parties or refiners. Nor was it intended to create new revenue generation for non-obligated parties such as large retailers or commodity traders at the expense of independent refiners and consumers. Yet,

¹⁷ David Montgomery, et al., NERA Economic Consulting, ANALYSIS OF RFS2 RIN MARKETS 45 (Oct. 15, 2013) (emphasis in original) [hereinafter “NERA Oct. 2013 Report”].

¹⁸ See, e.g., Cezary Podkul, *The Tally is In: Ethanol ‘Blend Wall’ Cost Refiners at Least \$1.35 Billion*, REUTERS, (Mar. 31, 2014 8:22 AM), <http://www.reuters.com/article/us-rins-spike-costs-analysis-idUSBREA2U0PT20140331>.

¹⁹ See, e.g., NERA Oct. 2013 Report, *supra* note 17, at 20, 35, 43;

²⁰ NERA Report, *supra* note 6, at 23.

²¹ *Id.* at 15-18; Knittel Report, *supra* note 13, at 20.

²² Susanne Retka Schill, *Ethanol RINs Market Explodes*, ETHANOL PRODUCER MAGAZINE (Apr. 16, 2013), <http://www.ethanolproducer.com/articles/9753/ethanol-rins-market-explodes> (citations omitted).

these are among the significant unintended consequences that the current rule has on the industry. But the fact that the RIN system has resulted in windfalls²³ to parties controlling the blending should be a telltale sign for EPA about where market power lies—and where the Point of Obligation should be.

An RFA article²⁴ includes quotes from obligated parties that enjoyed windfalls from selling RINs:

Our retail and terminal networks generate more renewable credits than we require to meet our supply needs. We're generating around \$20-million/month of excess RINs. [For the third quarter] if you were to take the current pricing in place right now and say you sold all the RINs at that price, you could expect us to record an after-tax benefit of \$35-40 million.

[Increase in refining income was] primarily due to better results [i.e., higher sales prices] for ethanol renewable identification numbers (RINs) in the current period... Profit from ethanol RIN sales was higher in 2013 due to significantly stronger sales prices for these credits.

A dysfunctional RFS system not only undermines the goals of the CAA but if left unchecked, it also threatens to reduce competition in the market for transportation fuel, further harming the fuel consumer. The structure of the RFS threatens the future viability of merchant refiners, threatens competition in the transportation fuel sector, has the perverse effect of discouraging higher level blends of renewable fuel and ultimately hurts consumers.

The dysfunction has already begun to change the marketing and retail segments of the fuel market and threatens the future of small retailers. Over 50% of transportation fuel stations are owned by small retailers but over 20% are owned by large companies.²⁵ Murphy USA Inc. is one of these large companies.²⁶ Murphy reported that RIN revenues increased \$91 million in 2013 to

²³ Sabina Zawadzki, *BP Wins as U.S. Refiners Suffer Under Biofuel Mandate*, REUTERS (Jul. 30, 2013 5:46 PM), <http://www.reuters.com/article/bp-rins-idUSL1N0G011120130730> (“BP Plc said on Tuesday it did ‘quite well’ during a recent spike in the price of U.S. ethanol credits that is costing some U.S. refiners hundreds of millions of dollars.”).

²⁴ Geoff Cooper, *What do Big Oil's Quarterly Earnings Say About the Real Impact of RINs on U.S. Gas Prices?*, RENEWABLE FUELS ASSOCIATION (Aug. 1, 2013 12:04 PM), <http://www.ethanolrfa.org/exchange/entry/what-do-big-oils-quarterly-earnings-say-about-the-real-impact-of-rins-on-u/> (citations omitted).

²⁵ Mike Nichols, *Small gas retailers thrive across the country*, in WPRI SPECIAL REPORT 2016: REAL-WORLD IMPACTS OF WISCONSIN'S MINIMUM MARKUP LAW at 22-23, available at http://www.wpri.org/WPRI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf.

²⁶ Murphy USA retail stations have been part of Walmart. In 2016, Walmart and Murphy announced that they will develop retail gas independent of each other. See News Release, *Murphy USA Announces Independent Growth Plan and Share Repurchase Program* (Jan. 25, 2016), available at <http://ir.corporate.murphyusa.com/phoenix.zhtml?c=251856&p=irol-newsArticle&ID=2132039>; Ashlee Kieler, *Walmart Ditching Murphy USA After 20 Years; Will Run Its Own Gas Stations Going Forward*, CONSUMERIST (Feb. 4, 2016), <https://consumerist.com/2016/02/04/walmart-ditching-murphy-usa-after-20-years-will-run-its-own-gas-stations-going-forward/>.

\$118 million in 2015.²⁷ Murphy, a formerly integrated refining company with blending assets, described the revenues from its RIN business as follows:

By participating in the broader fuel supply chain, we believe our business model provides additional upside exposure to opportunities to enhance margins and volume. For example, incremental revenue is generated by capturing and selling Renewable Identification Numbers (RINs) via our capability to source bulk fuel and subsequently blend ethanol and bio-diesel at the terminal level.²⁸

Our revenues are impacted by our ability to generate revenues from activities such as blending bulk fuel with ethanol and bio-diesel to capture and subsequently sell Renewable Identification Numbers ("RINs"). The market price for RINs fluctuates based on a variety of factors, including but not limited to governmental and regulatory action and market dynamics. In recent years, we have benefited by our ability to attain RINs and sell them at favorable prices in the market....²⁹

Like Murphy, other marketers with blending assets and retail companies that have acquired positions or contracted for positions above the rack have realized the revenue potential of RINs under the current RFS.³⁰ The RIN revenue potential is very significant – Murphy reported \$117 million in RIN sales compared to the total net revenue from operations for 2015 was \$159 million; 85% of its net revenue was from RINs.³¹ The ability of large companies with access to blending to obtain free RINs to sell to obligated parties places the large companies at a significant competitive advantage over small retail fuel stations by providing the large companies an additional revenue stream that small retailers cannot obtain. The RFS should not be designed to increase the disparity between large retailers and small retailers as the disparity does not promote the goals of the RFS —ironically, no additional RINs are created by this disparity and no additional renewable fuel is blended. This is largely about position at the point of compliance to capture the RINs when renewable fuel is blended into the finished product for distribution.

The current structure has created a new revenue stream and thus, a competitive advantage to large retailers who have or can take positions above the rack. Yet, the RFS in no way has made it easier or possible for large or small independent refiners to move to the rack. EPA has suggested that RIN-short obligated parties (independent refiners) can resolve their compliance obligations and help resolve the infrastructure issues by reversing the industry trend away from integration and becoming more integrated by acquiring more assets further downstream in the fuel sector to gain more blending capabilities.³² This suggestion only highlights that the *true* point

²⁷ Murphy USA, Inc., U.S. SEC Form 10-K for the fiscal year ended December 31, 2015 at 33, provided here as Attachment C.

²⁸ *Id.* at 3.

²⁹ *Id.* at 14.

³⁰ The Master List of Rack Sellers, Attachment D, includes several large retailers and commodity traders that are not obligated parties.

³¹ Murphy USA, Inc. Form 10-K at 33-34.

³² Dallas Burkholder, U.S. EPA, Office of Transportation & Air Quality, *A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effects* at 30 (May 14, 2015) [hereinafter "Burkholder Preliminary Assessment"].

of compliance is downstream of refining and that the power over compliance is at the blending, not refining, point. Changing the Point of Obligation to the natural point of compliance is a far simpler, more effective, and less disruptive solution than a major restructuring of the transportation fuel sector. Among many obstacles to acquiring downstream positions to increase blending capabilities, the necessity of taking market share held by others that are already competing in the downstream segment of the fuel market alone demonstrates the futility of EPA's suggestion. Again, Murphy provides a good example of the importance of shipper status on major pipeline systems as well as access to terminal locations and bulk markets:

We source fuel at very competitive industry benchmark prices due to the diversity of fuel options available to us in the bulk and rack product markets, our shipper's status on major pipeline systems, and our access to numerous terminal locations. In addition, we have a strong distribution system in which we analyze intra-day supply options and dispatch third-party tanker trucks to the most favorably priced terminal to load products for each Murphy site, further reducing our fuel product costs....It would take substantial time and investment, both in expertise and assets, for a competitor to try and replicate our existing position and we believe this continues to be a significant barrier to any attempt to emulate our business model.³³

As observed in the NERA report:

The current design of the regulatory enforcement of RFS2 is analogous to placing the burden of meeting fuel economy standards on the parts suppliers to automobile manufacturing companies, rather than on the automobile manufacturers themselves who decide the final vehicle design including its miles per gallon. Just as CAFE standards place the burden on the manufacturers of the product responsible for meeting the standards – the vehicle – the RFS2 policy should place the RVOs on the parties that produce, price, and sell the different finished fuels that contain the product being regulated (i.e., the renewable fuel). In order to correct this misspecification with RFS2, EPA should change the obligated party from the refiners and importers to the [Rack Sellers] who mix petroleum blend stocks with renewable fuels to produce the finished product and are the party authorized to separate the RINs from the renewable fuel.³⁴

Having Rack Sellers obligated for renewable fuel blending would improve competition among refiners, Rack Sellers, and retailers. Competition among refiners would no longer be impacted by RIN prices. Refiners will still obtain the RINs they need to meet their obligations, as their obligation will be directly proportional to the volumes they sell over the rack. Integrated refiners would no longer have an automatic supply of extra RINs nor will they be disadvantaged. Refiners and blenders would no longer have incentives conflicting with the intent of the RFS. Instead, Rack Sellers would increase the volume and types of renewable fuels they blend in order to ensure compliance with the RFS and to have carry-over credit for future compliance. They will be naturally neither long nor short; they will want as many RINs as they can get, and will want

³³ Murphy USA, Inc., Form 10-K at 3.

³⁴ NERA Report, *supra* note 6, at 31-32.

them to be affordable. They will have control over their physical blending so if RIN prices are too high, they can direct their own blending. If someone else can blend more cheaply, they can choose to buy RINs instead of blending themselves. The RFS program would no longer adversely affect competition in the refining or fuel market. Competition along the fuel chain will improve, from the refiner, the renewable fuel producer and the marketers to the retailer and consumer. Rack Sellers would necessarily be pushing renewables, not playing the RIN market.

C. Far from facilitating consumer access, the current system has the perverse effect of raising consumer prices for renewable fuels.

Part of how the current rule impedes the statutory goal is its tendency to raise gasoline prices for consumers. Merchant refiners must purchase RINs in the secondary market, while integrated refiners pay only for the ethanol that they blend,³⁵ and get the associated RIN at no extra cost. According to NERA's analysis, nothing indicates that increased RIN prices affected the cost of ethanol to Rack Sellers,³⁶ including to integrated refiners/Rack Sellers. Merchant refiners must attempt to anticipatorily recover the extra RIN cost to them in the base price of the fuel. In doing so, the merchant refiners inadvertently raise the spot price for *all* gasoline. Because they feel no pressure and are the dominant market party, the RIN-long refiners pass the higher gasoline price along to consumers while retaining the additional RIN value, thus gaining high base prices and a RIN windfall. Nothing will change this outcome—bad for the RFS goals and bad for consumers—until EPA adjusts the Point of Obligation. Further, nothing about this is rewarding the blending of renewable fuels.

EPA has speculated that high RIN prices would encourage investment in renewable fuel infrastructure.³⁷ Under the current RFS structure, however, high RIN prices cannot overcome the Point of Obligation placement that impedes investment in renewable fuel because the RIN value does not pass through to the consumer in the form of discounted renewable fuel blends. The RIN system, after all, is supposed to increase *consumption* of renewable fuel, like E85, by decreasing the relative price of such fuel. But there is a “near absence of pass-through of RIN prices to retail E85 prices,”³⁸ like other renewable fuels.³⁹ [T]he disconnect between fluctuations in RIN prices and pump E85 pricing is an important question for understanding how to achieve efficiently the goals for the RFS.”⁴⁰ This dysfunction directly and adversely affects fuel consumers. And it also illustrates why the RFS system must be fixed:

While RIN prices might be passed through at some retail outlets at some times, this is not the case on average using national prices. The goal of the RFS program is to expand the

³⁵ Burkholder Preliminary Assessment, *supra* note 32, at 28 (“For these merchant refiners there is a direct and obvious cost of purchasing RINs to satisfy their obligations. Integrated refiners generally obtain RINs by purchasing renewable fuels with attached RINs. As a result, integrated refiners are not paying a separate price for the RINs they acquire, but rather simultaneously purchasing both the renewable fuel and the associated RINs.”).

³⁶ NERA Oct. 2013 Report, *supra* note 17, at 35.

³⁷ 80 Fed. Reg. at 77,486.

³⁸ Knittel Report, *supra* note 13, at 20.

³⁹ *Id.*; see also Burkholder Memo, *supra* note 4, at 10; 80 Fed. Reg. at 77,459.

⁴⁰ Knittel Report, *supra* note 13, at 20.

use of low-carbon domestic biofuels, and the key economic mechanism to induce consumers to purchase high-renewables blends is the incentives provided by RIN prices. If the RIN price savings inherent in blends with high biofuels content are not passed on to the consumer, then this key mechanism of the RFS is not functioning properly.⁴¹

Valero's experience with its own pricing of E-85 indicates that the RFS is not working to promote renewable fuel or increase consumption of E-85. The current demand for E-85 is limited and very inelastic; as a result, one company's pricing has no impact on consumption. Valero has evaluated different pricing for E-85 and Valero's sales of E-85. For some time periods, Valero priced E-85 well below the market price and below the price of E-10. Valero also responded to changes in the market price of E-85 but continued to price E-85 below the market price but above the price for E-10. Valero found that there was little difference in sales of E-85 no matter how Valero priced E-85 compared to E-10, even though Valero strived to price below the market for E-85. Retail prices of E-85 remained high because Rack Sellers kept the RIN value rather than pass it to the retailer and consumer to promote consumption of E-85.

Based on statements in the proposed and final 2015 RVO rule and elsewhere, EPA does not doubt that prices for RINs and fuel will increase.⁴² The impacts of high RIN prices and price volatility for RINs and ethanol were observed in 2013 and 2014. EPA should consider the potential impact that a dysfunctional RFS system might have on future fuel prices for the consumer.

Valero's proposal directly addresses these pricing problems. If "obligated party" is defined as Rack Sellers, those parties could respond to rising RIN prices by discounting fuels with higher renewable fuel content. Rack Sellers would meet their RVO obligation by selling increased volumes of renewable fuel rather than being forced to purchase RINs on a secondary market and to increase prices to do so. Retailers would enjoy the ability to compete in the retail market by passing price savings to customers. A retailer who benefits from favorable prices for higher renewable fuel gasoline or diesel would want to sell that gasoline or diesel in order to continue to purchase and benefit from the lower prices of the fuel offered by Rack Sellers. Because Rack Sellers are closer to the end users, they are in the best position to react to consumer usage and consumer reaction to prices while also ensuring that renewable fuel is included in fuel decisions.⁴³

D. The current Point of Obligation disincentivizes the infrastructure investment that is indispensable for increasing renewable fuels; the proposed definition does the opposite.

Corresponding to EPA's recognition that RIN prices have failed to incentivize E85 marketing is the disincentivization of infrastructure investment that is essential if renewable fuels

⁴¹ Burkholder Memo, *supra* note 4, at 14-15 (citing Knittel Report, *supra* note 13, at 20).

⁴² *Id.* at 1, 2, 4, 8, 12, 13, 15, 18, 22, 29, 31.

⁴³ James H. Stock, Columbia University SIPA Center on Global Energy Policy, *THE RENEWABLE FUEL STANDARD: A PATH FORWARD* at 29 (Apr. 2015).

are to be as widely available as Congress intended. Valero has found, for example, that RIN-long obligated parties under the current RFS are not posting prices for E85 with OPIS.⁴⁴ If obligated parties under the current RFS are not posting prices for E85, the current RFS is not promoting E85 through infrastructure development. Mr. Minsk further described the problem as follows:

Another data point used to evaluate the functionality of the current system is to look at whether the high RIN prices in early 2013 did indeed incentivize any additional build-out of E85 infrastructure in those areas of the country—where E85 is most readily available. Tellingly, what happened in Minnesota, the state with most stations selling E85, tracked Knittel et al.'s findings—as RIN prices rose in early 2013, the number of stations selling E-85 declined. Reviewing this data leads me to concur with Knittel et al.'s conclusion that the RINs market is simply not functioning as it should.⁴⁵

Mr. Minsk points out the structural disincentive to expand terminal blending infrastructure created by the current Point of Obligation:

The current Point of Obligation is a significant factor inhibiting greater amounts of E85, and perhaps biodiesel, from reaching the market due primarily to the lack of properly aligned incentives and the resulting shortfall in blending infrastructure expansion. Reaching this conclusion only requires extending the reasoning acknowledged above by EPA in 2009, namely: a portion of obligated parties, refiners with large marketing operations, are almost immediately long on RINs at the beginning of every compliance period, a position that occurs because when they market more fuel than they refine, they generate more RINs through blending than they need for their own compliance obligations. Blending ethanol at wholesale distribution facilities at scale often requires modifications to the infrastructure. At many distribution facilities, however, obligated parties long on RINs are the largest customers, and in a position to effectively block installation of infrastructure to promote large scale E85 blending. Once the RIN-long party has met its own RVO, it has little incentive to participate financially in the expansion of blending infrastructure to allow for higher level blends (E85 and E15) or additional advanced renewable fuels (B5-B20) because they already have the RINs they need and do not want additional blending to lower the value of their excess RINs.

Under the current program structure, these parties also may not even have an incentive to blend to the blendwall. Because they have the RINs that they need, and the availability of fewer RINs can keep RIN prices higher, generation of fewer RINs could help them maximize their return on existing blending (E10) and, contrarily, have a direct disincentive to facilitate expansion of infrastructure and blending (B5, E85), as meeting the mandate level decreases RIN profits generated from being a RIN-long party.⁴⁶

⁴⁴ Supplement to Valero Comments on Proposed Renewable Fuel Standards for 2014, 2015 and 2016 and Biomass-Based Diesel Volume at 3 (Oct. 16, 2015) (Docket ID No. EPA-HQ-OAR-2015-0111-3530), provided here as Attachment E.

⁴⁵ Minsk Letter, *supra* note 16, at 3 (citing Department of Energy, Alternative Fuel Data Center, E85 Fueling Station Locations by State, *available at* <http://www.afdc.energy.gov/data/10367>)).

⁴⁶ *Id.* at 6-7.

The issue of properly aligned incentives and the need for infrastructure is not limited to E85, of course. To blend biodiesel, a terminal must add significant infrastructure, including receipt and offloading equipment, dedicated storage tanks, heat traced transfer lines, rack injection meters, and rack automation control systems.⁴⁷ The installation of terminal injection infrastructure can cost millions of dollars,⁴⁸ and terminal owner/operators need the support and long-term financial commitment of all rack customers to proceed with the necessary capital investments.

While the NERA reports uses the term “blender,” NERA clearly defines it as the owner of the hydrocarbon when the blending occurs—that is, it has the same meaning as “Rack Seller” in this Petition. The NERA Report describes how the current RFS program discourages blending higher volumes of renewable fuel because the Rack Seller is not obligated.

The party who owns the petroleum blendstock when the blending occurs is called the blender. The blender can choose to hold, exchange, or sell the RIN. There is no requirement as to when the blender must make a transaction. The blender has no obligation to EPA to turn in any RINs as a result of its activity of mixing petroleum blendstocks with renewable fuels. It is the blender who sells the finished transportation fuel (E0, E10, E15 and E85 or ULSD B0 and B5-B20) and has the capability of stimulating the greater use of high renewable content fuels by consumers by adjusting the relative prices of the different types of finished gasoline.

Further, as the blender carries no exposure to the RFS obligation, it has less incentive to expand its blending infrastructure to allow for higher level blends (E85 and E15) or additional advanced renewable fuels (B5-B20). In fact, doing so would be contrary to the blenders’ financial interest, as the more renewable fuel the blender purchases and blends, the more RINs will be created and those excess RINs will decrease the value of RINs. Adding incremental renewable fuel blending requires the installation of infrastructure at third-party terminals where non-obligated blenders are the terminal operator’s primary customers....

If the third-party owner requires all parties holding capacity to contribute to such expansions, there will be high transaction costs to expanding the fueling infrastructure needed for high-ethanol or high-biodiesel blends. This is especially problematic when the industry confronts the blend wall and additional capital or marketing is required to generate RINs that would be necessary to achieve renewable fuel levels set in the statute. There are greatly asymmetric losses between an obligated party that needs new

⁴⁷ See, e.g., Michael Leister, Fuels Technology Manager, Marathon, *Biofuels Blending Infrastructure*, SAE Government and Industry Conference at 1, (May 13, 2008); EN Engineering, *Terminal Biodiesel Infrastructure Upgrade*, (May 15, 2014), available at <http://www.enengineering.com/projects/terminal-biodiesel-infrastructure-upgrade>.

⁴⁸ See, e.g., CALIFORNIA ENERGY COMMISSION, 2011-2012 INVESTMENT PLAN FOR THE ALTERNATIVE AND RENEWABLE FUEL AND VEHICLE TECHNOLOGY PROGRAM at 116 (Report CEC-600-2011-006-CTF) (Aug. 2011), available at <http://www.energy.ca.gov/2011publications/CEC-600-2011-006/CEC-600-2011-006-CMF.pdf>.

infrastructure to be in position to comply if EPA sets tighter requirements and a non-obligated party that is taking a risk on investing in infrastructure that might or might not be useful depending on EPA's decisions.⁴⁹

The RFS structure incentivizes market behavior that does not improve renewable fuel market penetration in multiple ways. Illustrative is the number of retailers that, while traditionally not owning gasoline or diesel at the rack, have taken positions above the rack (where renewable fuel is blended and RINs are separated) to obtain RINs.⁵⁰ Importantly, these positional moves result in *no* additional volumes of renewable fuel in the market, nor do they generate any additional RINs. Instead, merely the technical ownership of RINs changes. Since EPA has not corrected the system, several parties have become vested in the distorted program and now oppose any correction to the RFS that would remove the economic and competitive advantage of RIN revenue at the rack.

To be clear, for many of these companies, ownership of fuel at the rack is not critical to their business—these retailers' choice to own fuel at the rack is purely artificial, driven solely by the incentive structure of the current Point of Obligation definition.⁵¹ The primary advantage of their ownership at the rack is the ability to separate RINs⁵² and have the value of the RIN *without* the compliance obligation. Retailers in this position recognize that shifting the Point of Obligation will take away the windfall that they have found in this newly acquired revenue stream:

In recent months, independent refiners have filed litigation to change the way the Renewable Fuel Standard (RFS) is administered in an attempt to shift the burden for compliance from the refiners to blenders. Under the RFS, which requires an annually increasing amount of biofuels to be blended into the fuels used by U.S. drivers, refiners are obligated to obtain RINs either by blending biofuels into gasoline or through purchase on the open market. This litigation is attempting to shift that burden of having the RINs to the blender rather than the refiner. If this burden were to be shifted, the Company would potentially have to utilize the RINs it obtains through its blending activities to satisfy a new obligation and would be unable to sell the RINs to other obligated parties.⁵³

If Rack Sellers (including retailers that have voluntarily taken ownership of fuel at the rack) were obligated parties, the incentive to promote new renewable fuel at the retail level would be clear. These retailers would not be distracted from new blending by temptation to capture obligation-free existing RINs. Rather than treat RINs as commodities, they would be motivated to

⁴⁹ NERA Report, *supra* note 6, at 18-19.

⁵⁰ Valero has compiled a list of "rack sellers" identified from five sources, as of April 2016: (1) OPIS Terminal Price Posting; (2) OPIS Active Supplier List; (3) Valero's Market research on bulk and rack activity; (4) Review of federal excise tax forms (637S) obtained by Valero; and (5) Market information received in the course of discussing the RFS issues with others in the business. This "Master List of Rack Sellers" is provided here as Attachment D.

⁵¹ *Cf* Murphy USA, Inc., Form 10-K.

⁵² Andrew Clyde, President and CEO, Murphy USA, Presentation at Macquarie Consumer Focus Forum 10 (Mar. 21, 2016).

⁵³ Murphy USA, Inc., Form 10-K at 14.

blend renewable fuel to create RINs for their own compliance purposes. Further, the nested structure of the obligation would encourage Rack Sellers to further penetrate the blending of renewable fuel, increasing E85 and E15 or B5-B20 blends respectively, as they look to create excess RINs that can be sold to cover the cost of buying the other nested classes within the obligation. Accordingly, Mr. Minsk and the NERA authors suggest that moving the Point of Obligation would help achieve the statutory goals for advanced biofuels.⁵⁴

[I]f the obligation falls on the [Rack Seller], then regulators provide a direct incentive to produce higher level blends (E15 and E85) or additional advanced renewable fuel blends (B5-B20) as these fuels generate more RINs for the obligated party, namely the [Rack Sellers].⁵⁵

As a consequence of being invested in the promotion of renewable fuels as obligated parties, Rack Sellers will help resistant markets open up. For example, refiners are producing and selling bulk CBOB for distribution into Oklahoma markets expecting that it will be blended with ethanol. However, Rack Sellers are blending the CBOB with premium and selling clear regular gasoline to avoid ethanol. Because there is no obligation on the Rack Seller, there is no direct compliance obligation to add even the base 10% ethanol. In fact, they are making a premium on clear gasoline with no regulatory compliance pressure and increasing the shortage of RIN supply to increase the value of their surplus RINs. But if Rack Sellers were obligated, they would need to find offsetting RINs and would likely conform by blending ethanol wherever they could. The market, therefore, would not remain so resistant. With Rack Sellers promoting renewable fuels with favorable pricing and infrastructure investment, resistant markets would open up to renewable fuels. In turn, renewable fuel producers would have greater certainty about demand, allowing them to plan, invest, and market to a more receptive customer base.

Similar incentives would be created for blending additional biodiesel. Currently, because Rack Sellers are not obligated parties, there is not sufficient infrastructure for biodiesel blending at terminals. Biodiesel blending, thus, takes place largely downstream of the rack and RINs are generated by downstream blenders, who enjoy the RIN revenue, but this limits the amount of biodiesel that can be blended. Making Rack Sellers obligated would incentivize infrastructure at the terminals and increase the amount of biodiesel blended in all diesel sold in the U.S. Downstream blenders would still be able to benefit from RIN-generating downstream blending but biodiesel blending and consumption would increase overall. This will also result in more customers for biodiesel and advanced fuels and thus more competition and better pricing for their products.

E. The current Point of Obligation facilitates RIN speculation and fraud, while the proposed definition would eliminate many opportunities for fraud.

⁵⁴ *Oversight of the Renewable Fuel Standard, Hearing before the Sen. Comm. on Envt. and Public Works*, 114th Cong. 10 (Feb. 24, 2016) (written statement of Ronald E. Minsk), available at <http://www.epw.senate.gov/public/cache/files/a4545f2f-52df-4f3f-8a08-e5802950d8e5/rem-rfs-written-testimony.pdf> [hereinafter "Minsk Testimony"].

⁵⁵ NERA Report, *supra* note 6. at 33.

Even more sinister than the current system's failure to promote renewable fuels is its facilitation of speculation and fraud—features that affirmatively undermine the RFS program's core. As described above, the disparity between the Point of Obligation and the compliance point has led to RIN distribution that creates windfalls for some and extraordinary costs for others, resulting in huge wealth transfers—almost none of which helps biofuel producers or consumers. The system allows non-obligated parties to hold, buy, and sell RINs. Coupled with the previously identified perverse incentives, the lack of regulation and oversight of the RIN trading market has made the situation even worse—speculation has flourished and the system has become vulnerable to fraud. Both fraud and speculation have exacerbated the additional costs imposed on obligated parties, and operate as a deadweight loss for the system—they actually undercut biofuel producer pricing and increase consumer costs. NERA explains this trading system failure:

The purpose of environmental markets is not to promote trading *per se* but rather to achieve the environmental objective in the most cost-effective way.⁵⁶ The natural way to do this is to endow each of the parties responsible for the activity being regulated, in this case the sale of fuels containing a mixture of ethanol and gasoline, with credits equal to the physical requirement it must meet. Each party that meets the physical requirement will have no need to trade. Trading occurs only when it is more costly for one regulated party to comply than another, but each regulated party has control over the means of compliance. Thus even if the allowance market breaks down or is highly inefficient, the outcome is no worse than a uniform regulation without trading. This is an important safeguard.

The RIN system eliminates this safeguard, by necessitating trading by any regulated entity (obligated party in the RIN idiom) that does not also blend ethanol into gasoline. Data presented in this report demonstrate that a large percentage of obligated parties fall into this category. They have no physical capacity to comply with the requirement, and therefore must trade no matter how thin or distorted the market becomes. The problem of the blend wall that was not anticipated at the time the RIN system was devised has made the market dysfunctional, for the reasons we describe. Returning to the natural system of allocating allowances to the party with actual control of the compliance method removes these problems.⁵⁷

Since the parties that EPA requires to *have* RINs are often parties that cannot *create* RINs, a large volume of RINs is necessarily traded and attracts a trading business involving RIN speculation. The RIN market is one of the largest commodity markets in the nation. Because EPA opted to keep the RIN trading market open to third-parties who are neither renewable fuel producers nor obligated parties under the RFS program,⁵⁸ a significant number of third-party

⁵⁶ *Id.* at 35 (citing W. David Montgomery, MARKETS IN LICENSES AND EFFICIENT POLLUTION CONTROL PROGRAMS, 5 JOURNAL OF ECONOMIC THEORY 395-418 (1971), available at <http://www2.econ.iastate.edu/classes/econ581/herriges/Readings/Montgomery.pdf>).

⁵⁷ *Id.*

⁵⁸ 40 C.F.R. § 80.1450(e).

firms and individuals⁵⁹ with no market role *other than extracting profit from RIN trading* are registered on the list of entities that hold RINs and participate in speculative RIN purchasing. “There is a RINs trading desk at any major brokerage now.... There are people who are not refiners who are buying and selling RINs like a commodity. They treat it like something to be traded, to be day-traded.”⁶⁰ With the size of the RIN market, EPA should not take lightly its responsibility for creating disparities that lead to high levels of speculation, fraud and price volatility.

Unlike real commodities, which have value in and of themselves, RINs are a regulatory creation and have value only when those who own them can exploit the regulatory framework. Worse, unlike trading for most genuine commodities, the RIN market lacks conventional trading safeguards because it remains unregulated. The *New York Times* reported that “rules that apply to almost every other market—on transparency, disclosure and position limits, for example—are not imposed on the trade of RINs” and that “because the E.P.A. declines to disclose who actively trades the credits, or how much they trade, citing the confidentiality of refiners and other participants,” the market cannot function like other public trading markets.⁶¹

Indeed, conduct that would present serious civil and even criminal questions for any other commodity is openly tolerated so long as the trader is dealing in RINs. Fuel industry insiders who possess insider information, for example, can freely trade RINs. And unlike with traditional markets, no checks or safeguards prevent rank speculation, leaving RIN prices essentially “unbridled.”⁶² The lack of such safeguards breeds fraud in any industry, which is why those protections are needed. But such anti-fraud safeguards, deemed critical to the American economy for ordinary commodities, have oddly been regarded as dispensable for RINs—even though RINs were created for the crucial purpose of maximizing renewable fuels—a vital national energy and environmental interest. The lack of those safeguards, unsurprisingly, has caused the industry to incur additional compliance costs. These consequences appear unlikely to diminish, and in no way contribute to the RFS goals. They are yet another deadweight loss.

Fraud in the RIN market is no imaginary worry. As one example, several individuals responded to the systemic deficiencies by creating hundreds of millions of fraudulent RINs and sold them to obligated parties—both merchant and integrated refining companies (who purchased them solely to comply with EPA mandates). Moreover, despite being victims of fraud, EPA required affected obligated parties to purchase new valid RINs and pay penalties for their

⁵⁹ Mike Lux, *Wall Street Market Manipulation Example 3,78 : Ethanol*, HUFFINGTON POST (June 1, 2014), <http://www.huffingtonpost.com/mike-lux/wall-street-market-manipulation-example-378-ethanol>.

⁶⁰ Gretchen Morgenson and Robert Gebeloff, *Wall St. Exploits Ethanol Credits, and Prices Spike*, N.Y. TIMES, Sept. 14, 2013 at A1, available at <http://www.nytimes.com/2013/09/15/business/wall-st-exploits-ethanol-credits-and-prices-spike.html> (quoting Paul Niznik, Bio-fuels Manager, Hart Energy).

⁶¹ *Id.*

⁶² *Id.*

unknowing use of fake RINs. Thus, obligated parties paid twice for the RINs to fulfill their compliance obligation and in some cases paid a penalty as well.⁶³

Changing the Point of Obligation would greatly diminish the opportunity for these harmful consequences. It would reduce the program's dependence on purchasing separated RINs and thereby help stabilize RIN prices. Without price spikes, RIN speculation becomes less attractive for non-obligated third parties (like investment bankers) and creates a true environmental credit trading market which achieves the *environmental* objective in the most cost-effective way.⁶⁴ The revised RIN system, unburdened by price spikes, would likewise reduce the opportunity for extreme windfalls created by EPA's implementation of the program for some obligated and non-obligated parties within the fuel business.

Defining obligated party as Valero recommends by linking the Point of Obligation to the federal excise tax obligation would allow effective use of the federal excise tax records to curtail RIN fraud. This is also the answer to another current challenge facing the system—the difficulty in verification. Moving the Point of Obligation to the rack instantly eliminates that serious problem by giving EPA a cost-free, independent, third-party verification of obligated volumes. All parties engaged in the sale of fuels subject to the federal excise tax for gasoline and diesel would be subject to the RFS obligations in proportion to their federal excise tax obligations. The federal excise tax system is a robust, reliable, and time-tested system that has been in place since 1932. If EPA adjusts the Point of Obligation, it could readily use that system to verify the volumes of fuel that would be subject to the RVOs and even ensure that RINs separated by entities who blend fuels are actually owners of specific volumes of fuel at the time of blending.

Moving the Point of Obligation would not only achieve the primary benefits discussed above, therefore, but would also play a key role in reducing RIN fraud and speculation:

- Rack Sellers, as direct purchasers of the renewable fuel that comes with RINs, are more likely than refiners—especially merchant refiners—to be able to detect fraud.
- Aligning the obligation with the party that directly purchases and receives the renewable fuel for blending reduces the need for the spot purchase of separated RINs (where the greatest risk currently arises) as RINs would be created by the obligated parties' own blending activities.
- Prudent Rack Sellers would hold RINs for compliance rather than risk losing them in speculative trades.
- Fewer RINs in the market for speculation would reduce the effect of price spikes or the potential for sustained artificially high values because Rack Sellers could acquire more RINs by blending more renewable fuel, thereby eliminating or reducing the need to buy separated RINs.

⁶³ See Bryan Sims, *Biodiesel RIN fraud causes industry, obligated parties anxiety*, BIODIESEL MAGAZINE (Nov. 29, 2011), <http://www.biodieselmagazine.com/articles/8210/biodiesel-rin-fraud-causes-industry-obligated-parties-anxiety>.

⁶⁴ Montgomery, *MARKETS IN LICENSES AND EFFICIENT POLLUTION CONTROL PROGRAMS*, *supra* note 56.

- Lower RIN prices, less speculative RINs trading, and direct purchases of renewable fuel for blending activity will reduce the opportunity for RIN fraud.
- Finally, by using the federal excise tax definitions and records, the RFS program would also employ a robust system that would serve as independent verification.

The current system creates substantial risks for speculation and fraud, both of which undermine the underlying goals of the RFS program. Valero's proposal reduces those threats, which is another and independent basis for EPA to adopt it.

- F. The current Point of Obligation subsidizes non-renewable exports, while the proposed definition eliminates that unintended incentive.

Another flaw caused by the current Point of Obligation is that it "leads to this unintended consequence of subsidizing exports."⁶⁵ To reduce its compliance obligation, a refiner could opt to reduce its production of fuel or, alternatively, opt to export fuel. When faced with the structural disincentive created by the Point of Obligation and its direct limitation on the expansion and installation of blending infrastructure, investment in *export* infrastructure becomes desirable. The NERA Report describes how RIN subsidization of gasoline exports could increase gasoline costs to U.S. consumers without achieving any environmental benefits.⁶⁶ In addition, RIN subsidization of exports impacts infrastructure investment, which in turn impacts economic growth.

Not only are diesel and gasoline exports affected by the current design of RFS2, but so is the investment of capital. New infrastructure is being built in order to support the export of gasoline and diesel. To the extent that these capital investments are driven by the U.S. competitive advantage in supplying gasoline and diesel to foreign markets, these investments are good for U.S. economic growth. However, to the extent that these investments are made to support the exports of gasoline and diesel that are made to avoid RIN requirements of the RFS2 program, capital is being redirected away from its optimal mix resulting in a less efficient use of capital, which retards economic growth. So perverse is it that RIN-long parties may be importing fuel from abroad subsidized by their RIN-long positions and RIN-short parties will be exporting to avoid the obligation.

Some in-land refineries, with no access to the coasts, may not have the export option. Faced with high RIN prices, these refineries could have no choice but to curtail production or even shutdown. This is an example of one of the anti-competitive consequences of the current RFS.

With the suggested change to the Point of Obligation, refiners would not be driven to export or cut production to avoid the RIN obligation. In-land refiners will not face shutting down simply due to an inability to meet RFS obligations. Consumers will not be harmed by a reduction in competition among refiners.

⁶⁵ NERA Report, *supra* note 6, at 22.

⁶⁶ *Id.*

IV. Other markets participants are in accord with and will not be harmed by the proposed change.

- A. Renewable fuel producers and refiners have expressed support for placing the Point of Obligation at the rack.

In the past, renewable fuel producers and refiners have advocated for placing the Point of Obligation on the entity with control over blending. Due to misplaced fear, some entities simultaneously were concerned that placing the Point of Obligation on blenders would generate additional regulatory burden and discourage renewable fuel blending. Over time, unfortunately, some parties have exploited the market's dysfunction and have come to depend on it for revenue generation that is entirely disconnected from any RFS goal. True, the RFS system as currently structured has incentivized some income generating activities—but businesses that rely on these market distortions are not necessarily motivated or designed to increase renewable fuels in the market. They instead depend on the system's weaknesses to extract profits that are divorced from RFS advances. Thus, EPA should expect to hear opposition from some parties that might have initially preferred the placement of the Point of Obligation at the rack. In considering those views, EPA should account for the role of purely economic self-interests of those parties undermining the goals of the RFS.

In addition to comments submitted by small and independent refiners, comments supporting placing the Point of Obligation on the entity that controls blending at the rack include the following:

- While Poet Ethanol Products and the Renewable Fuel Producers we market for are not Obligated Parties, we would still like to take this opportunity to endorse altering the definition of an Obligated Party/Renewable Volume Obligations to say that the RVO is placed upon the party blending the finished gasoline or diesel. This modification would correct a fundamental weakness in the alignment of incentives for how RVO's were calculated under RFS1. This change would allow the RVO to rest on the shoulders of the party determining what type of transportation fuel is delivered to the consumer.⁶⁷
- Imposing the obligation on refiners and importers is unworkable due to the complicated four mandate structure of EISA. EPA should shift the obligation downstream to the parties that have the ability to choose which, and how much, of the various renewable fuels to blend.⁶⁸

⁶⁷ Bob White, CEO, Poet Ethanol Products, LLC, Comments on Notice of Proposed Rulemaking for RFS2 – Docket ID No. EPA-HQ-OAR-2005-0161 at 3 (Jul. 21, 2009), (Docket ID No. EPA-HQ-OAR-2005-0161-1033).

⁶⁸ John E. Reese, Fuels Product Management Advisor, US, Shell Oil Products US, Comments on The U.S. Environmental Protection Agency's Proposed Rule on Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program 74 Fed. Reg. 24904 (May 26, 2009) at 2 (Sep. 25, 2009) (Docket ID No. EPA-HQ-OAR-2005-0161-2505).

- In the absence of such a change, it will become increasingly difficult for refiners and importers to secure the requisite number of RINs to demonstrate compliance, particularly if their refinery production levels of gasoline or diesel exceed their downstream marketing volumes.⁶⁹
- To the extent the Agency does not believe the other options for regulatory flexibility under the RFS are substantial enough to maintain the statutory levels of biofuel volumes while addressing the challenges associated with the blendwall and infrastructure, it should consider extending the obligations for all gasoline and diesel to parties who supply finished transportation fuels to retail outlets or to wholesale purchaser-consumer facilities.⁷⁰
- Modifying the RFS to ensure across the board blending at all bulk fuel terminals would not require a fundamental change to the regulations. Rather, EPA would merely be changing the way the RFS is implemented to a structure where blending is taking place at each terminal, and thus all owners of petroleum based fuels at the terminals are positioned equally at the rack. We believe strongly that this creates the greatest potential for maximizing renewable fuel use while avoiding excessive RIN price spikes, and moves all of us closer to the market scenarios EPA envisioned.⁷¹

Valero agrees with these comments. It is interesting to note that when it was unclear who would be winners or losers, virtually all stakeholders supported putting the obligation at the blending point. Each year that goes by results in further market force distortion as the parties clamor to move into the Rack Seller position to control the ownership of the RINs. After all, it is natural for businesses to take advantage of legal revenue generating opportunities, even if they are created by a malfunction in a regulatory program. Unfortunately, this means that some parties naturally inclined to support changing the Point of Obligation have become compromised by new positions that extract benefit from the system's dysfunction but have nothing to do with—and indeed undermine—promoting renewable fuel.

Parties that are taking advantage of the market distortions to generate revenues that do not fully advance the goals of the RFS include: large retailers that are generating RIN revenues; formerly integrated refiners that have sold most of their refining capacity but maintain rack positions and retail positions and thus benefit from RIN generation and sales; and renewable fuel producers that leverage into the RIN market. For each party that exploits the revenue-generating capacity of the system dysfunction, there are additional parties that are significantly harmed.

⁶⁹ Steve P. Hart, Vice Pres., Planning and Project Execution, ExxonMobil Refining & Supply, Re: 40 CFR Part 80; Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program; Proposed Rule, 74 Fed. Reg. 24,904, May 26, 2009 at 1 (Sept. 24, 2009) (Docket ID No. EPA-HQ-OAR-2005-0161-2427).

⁷⁰ Letter from Brent Erickson, Exec. Vice Pres., Biotechnology Industry Organization to U.S. EPA, App'x I at 45 (Jan. 28, 2014) (Docket ID No. EPA-HQ-OAR-2013-0747-0093).

⁷¹ Harry Simpson, Pres., Crimson Renewable Energy, LP, Re: EPA-HQ-OAR-2015-0111, Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017; 80 Fed. Reg. 33,100 (June 10, 2015) at 6 (July 25, 2015) (Docket ID No. EPA-HQ-OAR-2015-0111-1823) [hereinafter "Crimson Renewable Energy Comments"].

Advanced biofuel and biodiesel producers have fewer customers and markets that can take their products under the current structure; small retailers will be harmed as the market distortions grow; and the consumer will be harmed by reducing competition among refiners, renewable fuel producers and retailers and the higher prices that necessarily follow. In the RFS rulemaking to date, no trade association that hasn't been heavily influenced by those that are dominant at the rack have represented these interests of small retailers, biofuel producers that are not major ethanol producers or commodity traders, and the consumer.

B. Making blenders obligated parties will not disrupt the renewable fuels market.

Many parties have asked EPA to place the Point of Obligation on blenders because it is the most appropriate point for blending decisions. Yet, some object to changing the Point of Obligation on the ground that "making blenders obligated parties would inject substantial disruptions into the renewable fuels market and impose significant burdens on its participants."⁷² These "significant burdens" are a perceived potential increase in the number of obligated parties and smaller entities' limited ability to absorb compliance costs. These concerns are misplaced. Rack Sellers are a sub-category of blenders, and placing the RFS obligation on them would mean only that (1) existing refiners that control blending and (2) other very large companies that choose to take Rack Seller positions would be subject to the obligation. True wholesale purchasers-consumers and retailers would not become obligated parties, as the change would not include below-the-rack and retail-level blenders. Indeed, as described further below, the number of obligated parties will not increase, and the change will not disrupt the renewable fuels market. Parties that have asked EPA to place the Point of Obligation on blenders recognized the distinction between the broad category of blenders and the more narrow category of blenders that control the blending decision above the rack.

Comments asking EPA to place the obligation on this small category of blenders were submitted by the Independent Fuel Terminal Operators Association ("IFTOA"), an association of independent marketers who own and/or operate deepwater terminals; its members import, blend, and market refined petroleum products, and as such are obligated parties (or hold RINs) under the current RFS. IFTOA urged EPA to implement the RFS "in a manner that facilitates greater availability of RINs and assists obligated parties to obtain a sufficient number to meet their obligations."⁷³ IFTOA advocated changing the obligated party to the entity that owns the petroleum product immediately prior to blending above the rack, thus making only blenders operating above the rack obligated parties. It stated that such a change would be consistent with the federal excise tax program for petroleum products.⁷⁴

Valero's proposed definition of "obligated party" addresses EPA's previous concern about the administration of the RFS program and increasing the number of obligated parties. To

⁷² Mark S. Morgan, Regulatory Counsel, Petroleum Marketers Association of America, Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017 at 3 (July 27, 2015) (EPA Docket ID # EPA-HQ-OAR-2015-0111-1921).

⁷³ Andrea Grant, Counsel, IFTOA, Comments on Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program at 1 (Sep. 25, 2009) (Docket ID No. EPA-HQ-OAR-2005-0161-2345).

⁷⁴ *Id.* at 1-2.

be clear, Valero does not support moving the Point of Obligation to Rack Buyers. Valero's proposed revision would only make entities obligated parties if they are Rack Sellers. EPA previously and accurately predicted that such parties (and others) would become regulated parties subject to recordkeeping and reporting—meaning demonstrating compliance after becoming an obligated party would impose only a small burden. Indeed, by making only Rack Sellers obligated parties (and not entities that might touch blending in lesser ways, whether as terminal service providers or blending below the rack), any added burden is vanishingly small. Valero analysis, describe further below, indicates that there will not be an increase in the administrative burden of the RFS; this is reflected in the fact that the number of obligated parties will not increase. EPA estimated that there are currently 200 obligated parties under the RFS. Valero evaluated the number of parties that would be obligated with the proposed change and found that there would not be more than 200.⁷⁵

- C. While small retailers will not become obligated parties under Valero's proposal, they will be harmed if RFS remains unchanged.

Retailers become obligated parties only if they have acquired or contracted for positions *above the rack* and have thus become Rack Sellers. Marketers, wholesalers, jobbers, and retailers sometimes blend renewable fuel below the rack. But if they are not Rack Sellers, they will *not* become obligated parties merely by blending renewables at their retail store. EPA should be encouraging that kind of activity, after all, and moving the current Point of Obligation to the Rack Sellers in no way diminishes the incentives for blending downstream of the rack. Entities that only own fuel below the rack, or Rack Buyers, would, in short, not become obligated parties.

On the other hand, some large retailers with sufficiently large market power to acquire positions above the rack have done so, including to gain control of RINs that are being separated from the fuel they are distributing. Currently, larger retail and wholesale operators have been able to use their size to move up in the rack to capture existing RINs and competitive advantage. Smaller and independent retailers lack the scale and financial resources to undertake this effort; they, therefore, are competitively disadvantaged. Over time, with higher RIN prices or simply more revenue from RIN sales as large retailers acquire greater volumes at the rack, smaller independent retailers could be driven from the market—another negative and unintended consequence of the current RFS system that the change to the Point of Obligation can correct.

EPA should also recognize that large retailers tend to have larger facilities, a very large number of retail outlets, and thus, are the most capable of directly offering higher renewable fuel blends. Given their control over blending at the rack and below the rack, having large retailers that are Rack Sellers obligated under the RFS cannot hurt the goals of the RFS.

- D. Currently exempt small blenders will not become obligated parties; biodiesel producers will benefit from increased blending even if below the rack blenders see a reduction in RIN generation.

⁷⁵ See Attachment D.

Small renewable fuel blenders that have been exempt because they are blending downstream of the rack will continue to be exempt. The recommended Point of Obligation is at the rack *where the federal excise tax for gasoline or diesel is paid*. Small renewable fuel blenders that are only Rack Buyers and blend downstream of the rack would not be obligated parties. EPA currently allows renewable fuel blenders who handle and blend less than 125,000 gallons of renewable fuel per year to delegate their RIN-related responsibilities to the party directly upstream from them who supplied the renewable fuel for blending.⁷⁶ The change to the Point of Obligation and the definition of obligated party will not change this small blender provision.

Valero has learned that a few renewable fuel blenders — not producers — that blend downstream of the rack oppose moving the Point of Obligation because the change would likely lead to more rack blending which might decrease the volume of RINs that the downstream blenders could generate and might devalue the RINs they generate. These blenders include commodity traders and logistics and supply companies. In the same way that large retailers have benefited from creating RINs above the rack and below the rack, biodiesel blenders that blend below the rack have generated RIN revenue by maximizing blending of biodiesel below the rack. If Rack Sellers become obligated, Rack Sellers might begin or increase blending for their own compliance before the diesel reaches the downstream blenders. In such instances, those downstream blenders might have less incremental blending that would generate RINs. Valero understands that this is a market participant that will experience a loss in revenue from moving the Point of Obligation. To be clear, a biodiesel blender that takes ownership of fuel below the rack and blends additional biodiesel could continue to do so and would benefit from the creation of additional RINs. However, because Rack Sellers will also be motivated to blend renewable fuel, the amount of renewable fuel that can be blended downstream might decrease because Rack Sellers will want some control over blending for their own compliance. Downstream blenders that are efficient would still be able to buy diesel, blend biodiesel, and sell competitively in the market. Biodiesel *producers*, however, will realize *increased* sales because of the competition among Rack Sellers and downstream blenders that want to take advantage of any available RIN generation and the continued renewable fuel blending tax credit. However, the key result is that there will be an increase in renewable fuels in the market and more competition for renewable fuels.

V. Adjusting the Point of Obligation would bring additional incidental positive effects.

In addition to resolving the RFS' core structural flaw, moving the Point of Obligation would also resolve issues with the small refiner exemption, transmix, and butane blending. Each of these current fuel system anomalies creates a need for a separate regulatory fix under the current RFS structure. Each such fix would bring additional potential burdens and administrative complications. Moving the Point of Obligation, however, would resolve each problem *without* additional complications.

⁷⁶ 40 C.F.R. § 80.1440.

First, by making the renewable fuel obligation proportional to the volume of petroleum fuel sold across the rack, small refiners will find their obligation to be far more reasonable, as it would be based only on the volume that the refiner owns at the rack. This change would eliminate the need for any small refiner exemption.

Second, under the current Point of Obligation, transmix processing at refineries results in a double RVO on the same gallon of transportation fuel. The fuel incurs the first RVO as it leaves the refinery, moving into the fuels distribution network of pipelines and terminal. As the various grades of transportation fuels move through these systems, the point at which one grade or fuel type contacts another creates “transmix,” a mixture of the two fuels. Transmix is often returned to refineries for reprocessing, where it is separated back into its original components and incurs a second RVO when sent back out as transportation fuel. EPA has also had to create special transmix exemptions for non-refined transmix blenders.⁷⁷ By measuring the obligation at the rack just before it is loaded and sold to the wholesale customer, however, the obligation point is after the transmix point, and transmix is therefore not included in the obligation volumes. Moving the Point of Obligation renders the previously intractable transmix issue moot.

Third, butane blending into gasoline is a common practice to increase the volume of gasoline at a low cost. Pipeline companies and terminal owners and operators are taking advantage of the low cost of butane to increase the volume of gasoline. By doing so, the volumes of gasoline at terminals are greater than the volumes of gasoline leaving the refinery gate. To account for these additional volumes, butane blending is treated as refining and the compliance obligation is placed on the pipeline companies or terminal owners and operators for the increased volumes. If the Point of Obligation is moved to the rack, the RFS obligation will apply to all volumes of gasoline and diesel at the rack, including the incremental volume created by butane blending, without making pipeline companies and terminal owners obligated parties. Changing the Point of Obligation would ensure that all volumes of butane blended into finished transportation fuels receive an accurate and appropriate RVO.

VI. Other objections against the change have no merit.

After discussing its proposal to move the Point of Obligation with various parties, Valero has encountered several common objections but remains unaware of any valid objection to doing so. The following points are those most frequently raised. Among the objections are: (1) refiners, not blenders, control the product; (2) blenders will stop blending and avoid the RFS undermining the RFS; (3) refiners will stop selling blends compatible with renewable fuel blending; and (4) the change is a major change that will increase the burden of the rule. Valero addresses each objection below.

A. Rack Sellers, as blenders, control blending decisions.

Some opponents to changing the Point of Obligation have stated that “it is appropriate to make refiners and importers obligated parties because those entities control how product is

⁷⁷ 40 C.F.R. §80.1407(f)

introduced into commerce. Blenders, conversely, do not have such control because they are fundamentally buyers of refined products.” This statement does not describe reality. Compliance under the RFS is only achieved through blending renewable fuel into a product. Blenders, specifically Rack Sellers, are fundamentally refiners and buyers of product; as such, *they* control whether they buy refined petroleum product or renewable product. Refiners produce petroleum product and renewable fuel producers produce renewable product—but the Rack Seller alone decides how much of each is to be blended and sold as fuel. Yet Rack Sellers currently have no obligation to blend renewable products. Most refiners are also Rack Sellers, but under Valero’s proposal, their obligation would be directly proportional to whatever volume of fuel they introduce into commerce, not simply the volume of fuel refined.

B. The proposed definition eliminates any loopholes.

Some have argued that if EPA makes blenders the obligated parties, they could avoid the RFS obligation simply by avoiding blending. Among the deficiencies of this argument is that it mischaracterizes Valero’s proposed definition, which does not use the term “blender” and does not make all blenders as a group obligated parties; indeed, it does not even make actual blending critical. Instead, to focus on the single appropriate group of blenders (Rack Sellers), the definition refers to ownership of gasoline or diesel at the rack. This is the blending *opportunity point*. The obligation attaches whether a party actually blends or not, and thus there is no loophole here either.

Further, as discussed above, federal excise tax definitions are well established. The definition in this petition captures all gasoline and diesel going to consumers in the U.S., including additional volumes created by added butane. In addition, the federal excise tax would serve as a method of verification on the obligation. EPA need not rely on the IRS for federal excise tax records; it would simply mandate that obligated parties confirm volumes by demonstrating consistency with federal excise tax records. Federal law already requires that parties retain such federal excise tax records, which EPA can use as part of the annual attestation procedures to verify the obligation volumes and the RINs acquired.

Accordingly, Valero’s proposal will not *create* loopholes, but will *close* them. This verification system will improve compliance because, unlike the present system, it is backstopped by enforcement from at least two federal agencies.⁷⁸

C. Refiners will not stop selling blends compatible with blending renewable fuel.

Some opponents have argued that if blenders become obligated parties, refiners will stop providing blendstocks that are compatible with blending renewable fuel and thus, undermine the RFS program.⁷⁹ If refiners are no longer obligated parties merely because of their status as

⁷⁸ Different tax treatment for the various fuels for excise tax purposes does not change the obligation. The renewables mandate would apply to offroad diesel just as it does to regular ultralow sulfur diesel (“ULSD”).

⁷⁹ This concern has been raised by several parties but is reflected in one of the questions presented by Senator Deb Fischer (R-NE) to Ronald E. Minsk for the record as part of a recent hearing on the RFS. *Questions for the Record*

refiners, they would still have the same incentives to produce the necessary blendstocks. Contending that they would suddenly not need to do so is a complete red herring at odds with basic economics.

Refiners' entire business, after all, is producing and selling fuel. In the current fuel market, refiners have insufficient access to distribution systems and retail to sell product from the refinery directly without going through the wholesale market. It is far easier for retailers and distributors to move up to the rack than for refiners to move to the rack. Refiners can only stay in business if they continue to supply fuel blends that wholesale and retailers want and need so that they can produce the finished fuel that meets the octane requirements of today's vehicles and the requirements of the RFS. Refiners will continue to meet the needs of the market.

Nor would it even be possible, much less legal given the comprehensive regulation of fuel formulation, for refiners to simply "reformulate" gasoline and diesel as to be incompatible with renewable fuels. Nor would there be a market for this type of fuel, as the Rack Sellers are the refiners or the refiners' customers and would only purchase fuels suitable for blending to meet the state and federal specifications.

Refiners would continue to produce Blendstocks for Oxygenate Blending ("BOBs") that can be blended with ethanol to get the required octane, because ethanol is the most economical source of octane, and blending ethanol and BOBs is the most economical way to produce finished fuel. Ethanol is expected to remain the most economical source of octane well into the future.

Moreover, refiners will need BOBs for their own use as well. Because almost all refiners blend some fuel, if only to sell at distribution racks at refineries, they will need BOBs to blend with ethanol for the fuel that they sell themselves. Refiners will also continue to produce BOBs because the gasoline distribution system infrastructure is not capable of handling both BOB's and full octane (E0) gasoline, as shown by entire markets shifting from full octane (E0) to BOB's produced for E10 blending due to infrastructure limitations.

Finally, even if blending BOBs with ethanol was not the lowest cost approach to producing finished fuel that meets the octane specifications for today's fuels, it would still be needed for compliance with the RFS, both for refiners' wholesales customers and refiners themselves. Ultimately, refiners respond to basic economic incentives, and will have to produce the fuel that their customers need, that meets state and federal specifications and is thus compatible with renewables.

D. The proposed action is neither burdensome nor complicated.

Although EPA can expect those who stand to lose from a change to the current dysfunctional system to assert that any change would be difficult, such objections are meritless. The ease of administering this change has been described as follows:

for Ronald Minsk, Oversight of the Renewable Fuel Standard, Hearing before the Sen. Envt. and Public Works Comm. 114th Cong. at #4 (Feb. 24, 2016).

EPA is already regulating [Rack Sellers] under the RFS program. All RIN related transactions must be executed via the EPA Moderated Transaction System (“EMTS”), which requires transactional, quarterly, and annual reports for all registered users. As such, moving the Point of Obligation to the rack does not introduce any new parties to the system. According to EPA’s recently released EMTS data, the great majority of RINs are separated by currently obligated parties. By moving the obligation to the rack, refiners will still be the predominant obligated parties....⁸⁰

According to EPA’s recently released EMTS data, over 80% of RINs are separated by currently obligated parties⁸¹—these obligated parties are also Rack Sellers. The administrative burden will be inconsequential to these already-obligated parties; far more importantly, however, the incentives to blend and invest in renewable fuel infrastructure will radically change. This minor language change to the regulation would bring the substantial benefits described earlier in this Petition, including eliminating the adverse impacts of the current Point of Obligation, reducing RIN speculation and market disparity, and reversing a disincentive for infrastructure investment.

Valero and others have completed extensive analysis to better estimate whether moving the Point of Obligation as proposed herein would increase the number of obligated parties. No analysis has found that moving the Point of Obligation as Valero suggests 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.

In October 2015, for example, Valero provided EPA with analysis of the number of obligated parties under the current RFS structure compared to the number of obligated parties under a RFS revised as recommended.⁸² This analysis concludes that the number of obligated parties will decrease with a revision to the Point of Obligation, directly contrary to EPA’s 2010 speculation that thousands of additional parties would be drawn into the program. Valero completed additional analysis utilizing available federal excise tax registration and found that the federal excise tax point does not include more entities than the current Point of Obligation.⁸³ Thus, contrary to the 2010 expectation of ballooning numbers, changing the Point of Obligation to the Rack Seller will not increase the administrative burden.⁸⁴ Regardless, EPA can propose a

⁸⁰ Minsk Letter, *supra* note 16, at 8.

⁸¹ Minsk Testimony, *supra* note 54, at 17.

⁸² See Attachment E.

⁸³ See Attachment D. Valero identified less than 200 entities registered for federal excise tax purposes conducting RFS relevant transportation fuels related business with Valero. Although Valero recognizes that their transactional activity is a proxy for the market and assumes that there are some entities that might not have been captured in this count, the number of entities registered for federal excise tax on RFS relevant transportation fuels at the rack cannot be substantially more than 200. The Master List of Rack Sellers in this attachment was compiled from several sources as described in the attachment. EPA can obtain more accurate information from public comment to confirm Valero’s findings.

⁸⁴“When the RFS1 regulations were drafted, the obligations were placed on the relatively small number of refiners

rule for public comment and seek input from regulated and interested parties to obtain information to verify the potential change in the number of obligated parties and the potential burden on any new parties.

Nor does the suggested change—a simple adjustment to the language and the compliance burden—require additional lead time. If this change is made, there would be no adverse impact to the RIN system itself, as there will be a clear demarcation for RINs (and how they are used) for compliance under the rule in 2015 versus the form of the rule in 2016. No transitional issues associated with RIN generation or trading associated with a change of the obligated parties to the rack are likely. RINs banked by obligated parties in prior years may be retained and used in 2016 without impact to the overall program, thus preserving market liquidity. Finally, Valero is aware of no plausible adverse downstream (i.e., below the rack) impacts from the implementation of its proposal that could prevent or delay the expeditious implementation of these revisions for calendar year 2016.

VII. EPA has acknowledged the problem, and the statute imposes a duty on EPA to act.

In mandating the RFS program, Congress gave EPA statutory authority to regulate refiners, blenders, distributors, and importers. But EPA's implementing regulations must further—not impede—the goals Congress established. EPA acknowledges that under the RFS's current structure, the market has structural limitations that have resulted in the inadequate supply of domestic renewable fuel to consumers.⁸⁵ As a result, EPA utilized its general waiver authority in the 2015 RVO Rule to revise the 2014, 2015, and 2016 RVOs, and now proposes for 2017 volumes, to account for current market constraints but also ostensibly to push the market forward.⁸⁶ The CAA directs EPA to design a program to *ensure* that renewable fuel enters the market by regulating the entities *as appropriate*. Where EPA has determined that the RFS program is not functioning to maximize incentives necessary for renewable fuels to penetrate the fuel market, EPA must evaluate its regulations and undertake rulemaking to remove artificial barriers created by the structure of the rule. EPA must not ignore a market constraint created by the design of its own regulations.

Indeed, EPA concluded that consideration of the scope of “inadequate domestic supply of renewable fuel” should include “the full range of constraints that could result in an inadequate supply of renewable fuel to the ultimate consumers, including fuel infrastructure and other constraints.”⁸⁷ Considering “the full range of constraints” necessarily includes the Point of Obligation in the RFS program. EPA has stated that the “supply of renewable fuel can reasonably be judged in terms of availability for use by the ultimate consumer, including consideration of the

and importers rather than on the relatively large number of downstream blenders and terminals.” 75 Fed. Reg. 14,670, 14,722 (Mar. 26, 2010).

⁸⁵ See, e.g., 80 Fed. Reg. at 77,433, 77,435, 77,437, 77,449, 77,450.

⁸⁶ “The fundamental objective of the RFS provisions under the Clean Air Act is clear: To increase the use of renewable fuels in the U.S. transportation system every year through at least 2022. . . .” *Id.* at 77,421.

⁸⁷ *Id.* at 77,435.

capacity to distribute the product to the ultimate consumer.”⁸⁸ The current RFS Point of Obligation deters investment in critical infrastructure needed to distribute and blend renewable fuels and thus limits the market’s capacity to deliver renewable fuel to consumers.

Valero supports the use of EPA’s waiver authority for 2014, 2015, and 2016 and as proposed for 2017, but EPA must move the RFS Point of Obligation so that supply constraints are lifted, enabling the fuel market to comply with the increased volume mandates. In the 2015 RVO Rule, EPA said:

While economic theory and the illustrations above [in the final rule preamble] support the idea that RINs can serve as a mechanism to increase the production, distribution, and consumption of renewable fuels, it is important to note that this result is dependent on the marketplace working both efficiently and quickly.⁸⁹

With the current Point of Obligation continuing as a market constraint, the marketplace cannot work efficiently and quickly to respond to the increased mandates. Rather, the current Point of Obligation is a barrier to renewable fuels penetrating the market in the quantities included in the final rule for 2016 or any increased volumes in rules for 2017 and beyond.

A. The CAA requires that EPA regulate entities as appropriate to ensure renewable fuel penetrates the market.

CAA §211(o)(2)(A)(iii) requires EPA to issue regulations for the renewable fuel volumes set forth under section 211(o) and the regulation “shall contain compliance provisions applicable to refineries, blenders, distributors and importers, *as appropriate*, to ensure that the requirements” of the section are met.⁹⁰ The section mandates that EPA issue “regulations to ensure that transportation fuel sold or introduced into commerce in the United States (except in noncontiguous States or territories), on an annual average basis, contains at least the applicable volume of renewable fuel, advanced biofuel, cellulosic biofuel, and biomass-based diesel, determined in accordance with subparagraph (B)” of CAA § 211(o)(2).

The Act directs that “the renewable fuel obligation determined for a calendar year under clause (i) shall—(I) be applicable to refineries, blenders, and importers, *as appropriate*....”⁹¹ Thus, for each regulation setting forth the RFS obligation volumes for the year, EPA must determine which obligated parties are “appropriate.” The Act does not mandate that EPA impose the obligation on refiners and importers. Instead, it requires EPA to regulate entities “as appropriate” to ensure that the applicable volumes are met.

The U.S. Supreme Court recently expressed its view of the term “appropriate”:

⁸⁸ *Id.* at 77,437.

⁸⁹ *Id.* at 77,459.

⁹⁰ CAA § 211(o)(2)(A)(iii) (emphasis added).

⁹¹ CAA § 211(o)(3)(B)(ii) (emphasis added).

One does not need to open up a dictionary in order to realize the capaciousness of this phrase. In particular, “appropriate” is “the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors.” Although this term leaves agencies with flexibility, an agency may not “entirely fail[] to consider an important aspect of the problem” when deciding whether regulation is appropriate.⁹²

Regardless whether previous definitions of obligated party were appropriate when setting earlier RVOs, now that EPA has used its statutory waiver authority, it must consider whether a regulatory change to the Point of Obligation could improve incentives and increase the probability of meeting statutory volume mandates.

B. EPA committed to revisiting the Point of Obligation if the RIN market was not operating as intended.

In the final RFS rule published on March 26, 2010, EPA committed to reconsidering the Point of Obligation in future rulemaking if “the RIN market is not operating as intended.”⁹³ At that time, EPA justified not changing the Point of Obligation because “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.”⁹⁴ In that rulemaking, EPA considered two options for changing the Point of Obligation: (1) to place the obligation on parties that made finished gasoline or diesel, including all parties that blended ethanol into gasoline or (2) to place the obligation on “parties that supply finished transportation fuels to retail outlets or to wholesale purchaser-consumer facilities.”⁹⁵ Despite recognizing that the second option would mean that “these blenders would become directly responsible for ensuring that the volume requirements of the RFS program are met, and the cost of meeting the standard would be more evenly distributed,” with the result that “overall market prices for RINs may be lowered and consequently the cost of the program to consumers may be reduced,” EPA declined to make the change.⁹⁶ When EPA made this decision, EPA assumed incorrectly that a change under either option would significantly increase the number of obligated parties and disrupt the transition from RFS1 to RFS2. The transition from RFS1 to RFS2, however, is now accomplished. The RIN market has not been operating as intended⁹⁷ and a change to the Point of Obligation will not disrupt the operation of the RFS program. Rather, this change will improve the program’s operation.

⁹² *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (quoting *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 43 (1983) (internal citation omitted)).

⁹³ 75 Fed. Reg. at 14,722.

⁹⁴ *Id.*

⁹⁵ 74 Fed. Reg. at 24,963.

⁹⁶ *Id.* at 24,964.

⁹⁷ Numerous reports and studies have concluded that the RFS system is not performing as intended. *See, e.g.*, Stock, *supra* note 43.

EPA acknowledged in the 2015 RVO Rule that the renewable fuel market is very different now than it was in the early part of the RFS program. EPA contends that in the early stages of the RFS program, compliance with the volume mandates was readily achievable by increased blending of renewable fuel.⁹⁸ But over the last several years, structural market constraints have been impeding renewable fuel market penetration. EPA used its waiver authority to address these market constraints but EPA must also revisit the Point of Obligation to eliminate the programmatic dysfunction. EPA's failure to do so now will have long term consequences, as EPA has already issued a waiver that impacts 2016 volumes, proposes to use it for 2017 and will likely use it in the future.

C. Use of the waiver authority must be considered together with “appropriate” regulations.

EPA acknowledged in the 2015 RVO Rule that “the statutory volumes cannot be met according to the schedule reflected in the statute.”⁹⁹ In the 2015 RVO Rule, EPA claimed to be “using the waiver authorities only to the extent necessary” to set volumes that “reflect the maximum supply that can reasonably expected to be produced and consumed by a market that is responsive to the RFS standards.”¹⁰⁰ EPA also stated that

the current constraints on growth in supply mean that each additional supply increment is likely to be more difficult to achieve than previous increments, and likely require more time to overcome than past constraints.¹⁰¹

While recognizing that the market can respond to the standards by increasing supply, EPA also conceded that “the market is not unlimited in its ability to respond.”¹⁰² Thus, it is apparent that EPA intends to adjust volume mandates for future years, using the waiver authority. In light of these facts and the statutory mandates, EPA must ensure that the rule itself does not reduce the market's ability to supply renewable fuel and respond to the RFS standards. To accomplish EPA's stated goal of setting regulations that reflect the “power of the market to respond to the standards,”¹⁰³ EPA must also consider the improvements that can come from changing the structure of the regulation itself, and specifically changing the Point of Obligation. In a rulemaking proceeding, EPA would explore options, including Valero's suggestion that Rack Sellers are the appropriate obligated party. Rack Sellers ultimately decide if renewable fuels will be blended, are closer to and more responsive to market signals, and thus define the market. Only after correcting the RFS by eliminating the constraint imposed by the current placement of the Point of Obligation can EPA accurately base any further use of its waiver authority on market power and use the waiver only to the extent necessary based on real market conditions rather than artificial market barriers.

⁹⁸ See 80 Fed. Reg. at 77,423.

⁹⁹ *Id.* at 77,456.

¹⁰⁰ *Id.* at 77,426.

¹⁰¹ *Id.* at 77,481.

¹⁰² *Id.*

¹⁰³ *Id.* at 77,449.

This situation is similar to the one the Supreme Court addressed in *UARG*, when it cautioned that “[a]gencies are not free to ‘adopt . . . unreasonable interpretations of statutory provisions and then edit other statutory provisions to mitigate the unreasonableness.’”¹⁰⁴ In *UARG*, the Court ruled that a long-standing interpretation of the Act for stationary sources was neither compelled by the statute nor reasonable as it applied to new regulation of greenhouse gas emissions, particularly when EPA turned to extraordinary legal doctrines to resolve problems created by the long-standing interpretation. In other words, when EPA has a statutory mandate, writes a rule to meet the mandate and then finds that the rule is an obstacle to meeting the mandate, EPA must not waive the statutory mandate instead of fixing the rule. Precisely applied to the RFS mandates, EPA cannot misplace the point of obligation, and acknowledge it is an issue, and then elect to waive the mandates but not address the structural impediments of its own creation. EPA must address market constraints created by EPA regulations in order to properly rely on extraordinary legal measures such as waiving statutory volumes.

D. The effectiveness of the proper placement of the obligation is demonstrated by the California Greenhouse Gas Regulations.

EPA should consider the experience of the California Air Resources Board (“CARB”) in implementing two distinct regulatory programs designed to reduce greenhouse gas emissions in the state to 1990 levels by 2020.¹⁰⁵ The CARB Cap-and-Trade program is designed to use market mechanisms to allocate the cost of carbon through trading of compliance instruments that reflect reductions in carbon emissions, while the CARB Low Carbon Fuel Standard (“LCFS”) promotes use of fuels and blend stocks with lower lifecycle carbon intensity. Both programs have recognized the key role played by Rack Sellers in affecting the changes necessary to drive reductions.

Under CARB’s Cap-and-Trade program,¹⁰⁶ fuel suppliers are required to surrender allowances or offsets for CO₂ emissions attributable to the regulated fuels¹⁰⁷ they sell into the California market. Specifically, CARB imposes this obligation on the entity that owns title to the product at the rack.¹⁰⁸ In explaining its rationale for establishing the reporting and compliance obligation at the rack rather than with refiners and importers, CARB staff noted that “the refinery is not a workable point of regulation for purpose of fuel supplier reporting for cap-and-trade for

¹⁰⁴ *UARG v. EPA*, 134 S. Ct. 2427, 2446 (2014).

¹⁰⁵ See California Global Warming Solutions Act of 2006 (Assembly Bill 32); Governor’s Executive Order S-01-07 (Jan. 18, 2007).

¹⁰⁶ 17 C.C.R. §§ 95800 *et seq.*

¹⁰⁷ Fuels subject to cap-and-trade obligations include liquefied petroleum gas and natural gas, as well as gasoline and diesel. 17 C.C.F. § 95811(e), (g).

¹⁰⁸ The “covered entity” subject to cap-and-trade obligations for gasoline and distillate fuels is the “Position Holder,” defined as “an entity that holds an inventory position in motor vehicle fuel or diesel fuel in its terminal. ‘Position Holder’ does not include inventory held outside of a terminal, fuel jobbers (unless directly holding inventory at the terminal), retail establishments, or other fuel suppliers not holding inventory at a fuel terminal.” 17 C.C.R. §§ 95802(a)(277), 95811(d).

most of the fuel delivered, since refineries are often not aware of the final destination of fuels they produce.”¹⁰⁹

These regulations are a successful example of how the marketing aspects of regulating fuels are best managed from the rack level. These regulations apply to the majority of stationary emitters and transportation fuels, requiring that all volumes of transportation fuels (gasoline and diesel) be converted into “carbon equivalent” CO₂ emission rates and reported to the state. This information forms the basis of the GHG obligation under the cap-and-trade regulations, where carbon allowances must be purchased to cover each ton of carbon emitted from the combustion of transportation fuels.

CARB supported the decision to regulate at the rack as follows:

In the U.S. EPA [greenhouse gas mandatory reporting rule], the reporter is the fuel refiner. After consultation with refiners and other industry stakeholders, staff determined the refinery is not a workable point of regulation for purposes of fuel supplier reporting for cap-and-trade for most of the fuel delivered, since refineries are often not aware of the final destination of fuels they produce. After consultation with position holders and California Board of Equalization (BOE) staff we determined that BOE already requires reporting for taxation purposes of most of the needed data, including volumes of fuel imported below the terminal rack and delivered across the rack (CA BOE 2010c). We consulted with position holders and enterers (the majority of which are subsidiaries of or related to companies that own or are related to refineries), and determined that emissions reporting would not be a significant additional burden for them. Therefore, we chose position holders at the terminal rack and enterers importing below the rack as appropriate reporters for the proposed revised regulation.¹¹⁰

The LCFS¹¹¹ similarly illustrates that placing the obligation at the rack effectively incentivizes market penetration of renewable fuels. Although the LCFS regulation initially designates producers and importers of gasoline, diesel, and liquid blend stocks as “regulated parties” responsible for demonstrating compliance with the rule,¹¹² the regulation provides flexibility for that burden to be transferred to owners of the fuel at the rack by contractual agreements. In practice, compliance at the rack, rather than the refinery, has become the rule, as it has become the ubiquitous practice for purchasers of blend stocks to assume the LCFS obligation corresponding to the product they purchase.

¹⁰⁹ California Air Resources Board, INITIAL STATEMENT OF REASONS FOR RULEMAKING: REVISIONS TO THE REGULATION FOR MANDATORY REPORTING OF GREENHOUSE GAS EMISSIONS PURSUANT TO THE CALIFORNIA GLOBAL WARMING SOLUTIONS ACT OF 2006 at 69 (Oct. 28, 2010).

¹¹⁰ *Id.*

¹¹¹ 17 C.C.R. §§ 95480 *et seq.* The LCFS program is designed to reduce the carbon intensity of transportation fuels sold in the state by requiring providers to demonstrate that the mix of fuels they supply meet the applicable LCFS carbon intensity standards for each compliance period, based on a lifecycle analysis of the carbon emission associated with both the production and the consumption of the fuel.

¹¹² 17 C.C.R. § 95484(a).

These programs predictably have created a powerful incentive to invest in and expand the infrastructure for blending renewable fuels. As evidence of the incentive created by the obligation at the rack, reporting parties generated a net total of 3.5 million metric tons of excess LCFS credits through the end of the second quarter of 2014. The Point of Obligation has been central to allowing renewable fuels to gain early and wide access to these racks. Crimson Renewable Energy submitted comments to EPA in July 2015 describing the incentives created by California's structure compared to the RFS:

[T]he requirement for blending at the bulk fuel terminals has created an environment that has allowed our biodiesel to gain wide access to these terminals. In fact, Crimson has had an easier time marketing our renewable fuels and optimizing our fuel price and usage in California than would be possible in other states due to how LCFS is implemented at the bulk fuel terminals. We would contrast that to the RFS program, where we, and the industry, still find difficulty penetrating several markets.

To summarize, EPA has repeatedly stated on the record that one of the primary goals of the RFS program is to increase the production and consumption of renewable fuels. Yet the current structure of the RFS has not led to maximization infrastructure investment and renewable fuel penetration, and indeed in some ways (i.e. how the RFS obligation is structured) may actually be an obstacle to achieving the stated goals.¹¹³

VIII. Conclusion

A. The current system is no longer appropriate.

The circumstances around the RFS have changed considerably since 2010 when EPA deferred a change to the Point of Obligation. It is now time for EPA to change the RFS structure to ensure the viability of the program. EPA's acknowledgement of supply constraints to justify use of the statutory waiver compels EPA to correct the structural flaw in the RFS program that itself is a supply constraint.

B. Placing the obligation on Rack Sellers is appropriate and necessary to ensure the statutory requirements for renewable fuels are met.

The CAA requires EPA to develop appropriate regulations to ensure that renewable fuels are available in the market for consumers. EPA's current RFS structure is not appropriate. To comply with its statutory duties, EPA must modify the RFS program by placing the obligation at the rack to ensure that EPA's rules do not continue to create an EPA-induced barrier to renewable fuel market penetration.

¹¹³ Crimson Renewable Energy Comments, *supra* note 71, at 5-6.

- C. Changing the Point of Obligation will improve renewable fuel supply to consumers by increasing investment in needed infrastructure.

As numerous parties have reported to EPA and as EPA has recognized, greater market penetration is needed to meet the statutory volume mandates. To ensure greater market penetration, EPA must move the RFS obligation downstream to Rack Sellers, who then become more responsive to pricing and better able to respond to and push consumer demand for renewable fuel. Moving the obligation to Rack Sellers would have multiple benefits.

1. Improves Market Competition and Elimination of Market Disparities.

A better alignment between the obligation and the RIN system will reduce the market disparity that the RFS created and will ensure ongoing competition in the transportation fuel market. Many refiners, including Valero, will continue to be obligated parties, but that obligation will be proportional to that party's rack sales.

2. Reduces Opportunities for RIN Fraud and Speculation.

Better alignment between the RFS obligation and the RIN system will reduce opportunities for RIN fraud and speculation. RIN fraud and speculation resulted in unnecessary costs to the industry and did not benefit consumers or increase renewable fuel. Moving the obligation to the point of RIN generation minimizes the risks created by the under-regulated RIN market and better enables diligence over the integrity of RIN generation.

3. Eliminates Disincentives from Installation of Renewable Fuels Blending Infrastructure.

Moving the Point of Obligation will improve market penetration of renewable fuels via the installation and expansion of terminal blending infrastructure. By aligning the incentive to blend renewable fuels with the obligation to blend renewable fuels (at the point of blending), all terminal customers will be incentivized to support terminal blending infrastructure capital projects. The alignment of its customers will provide the necessary consensus for terminal owners/service providers to invest in the required terminal infrastructure. This will only occur if all of the terminal customers (Rack Sellers) are proportionally obligated for the volumes they sell, enabling the terminal owner to recognize uniform demand for investment in blending infrastructure, ensuring access to project economy of scale, and improving market competition by leveling the playing field at the terminal.

4. Long-Term Investment in Infrastructure Will No Longer Depend on RIN Prices.

RIN prices are more likely to track renewable fuel prices if Rack Sellers make decisions about blending based on renewable fuel prices and their renewable fuel obligations. Rather than depending on RIN prices to motivate unobligated parties to make long-term investments in renewable fuels, the RFS can motivate Rack Sellers to invest as obligated parties; they would invest based on transportation fuel prices and would include renewable fuel blending as a component of the transportation fuel business. Subsequently, Rack Sellers would use excess RINs

as protection against renewable fuel price increases rather than as a means for windfall profits. Downstream blenders would continue to have opportunities to generate revenue from RINs by performing additional or more efficient blending downstream of the rack.

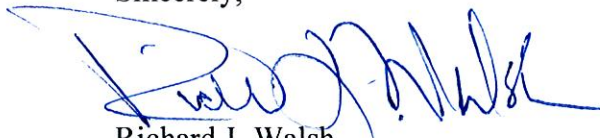
D. With this change to the Point of Obligation, the RFS will more closely achieve EPA's goals.

As EPA recognized in 2009, moving the Point of Obligation to the rack creates better alignment between the regulatory obligation and the actual ability to blend. As Former White House Advisor Ron Minsk pointed out in his comments on the 2015 proposed rule, "by moving the Point of Obligation to the rack, refiners will still be the predominant obligated parties, however the proportionality of the obligation will correspond to their blending capability and thus incentivize them to push as much renewable fuel as possible."¹¹⁴ EPA's goal is to promote the production and consumption of renewable fuel. The statutory mandates drive EPA's goal. Yet various market barriers—including those based on technology, such as the blend wall and inadequate blending infrastructure—impede the ease of renewable fuel market penetration.¹¹⁵ By removing the barrier created by EPA's regulations, EPA can reduce the degree to which other barriers impede market penetration of renewable fuels.

The regulatory change to improve the RFS structure will stabilize the RIN system by stabilizing prices and increasing transparency. A stable RFS program will result in investment in infrastructure and increased quantities and types of renewable fuel products for consumers. "Obligated parties would now be able to compete on an even playing field as the RFS drafters envisioned. With all of the major parties competing for E85 market share, consumer prices have the best opportunity to be competitive with E10 and gain penetration into the market."¹¹⁶

Valero is committed to working with EPA in a constructive way that will further the goals of the RFS program. We look forward to your response. I am available at your convenience to discuss this Petition for Rulemaking. Please contact me at (210) 345-2000 should you have any questions.

Sincerely,



Richard J. Walsh
Senior Vice President and Deputy General Counsel
Valero Energy Corporation

¹¹⁴ Minsk Letter, *supra* note 16, at 8.

¹¹⁵ See Burkholder Memo, *supra* note 4 at 12.

¹¹⁶ *Oversight of the Renewable Fuel Standard, Hearing before the Sen. Comm. on Envt. and Public Works*, 114th Cong. 2 (Feb. 24, 2016) (Key Points from the Written Testimony of Ronald E. Minsk).

cc: Janet McCabe
Chris Grundler
Ben Hengst

EXHIBIT B

Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation

Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation

Assessment and Standards Division
Office of Transportation and Air Quality
U.S. Environmental Protection Agency

Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation
November 10, 2016

Executive Summary

The Environmental Protection Agency (EPA) has received several petitions requesting that EPA initiate a rulemaking process to reconsider or change the regulations identifying refiners and importers of gasoline and diesel fuel as the entities responsible for complying with the annual percentage standards adopted under the Renewable Fuel Standard (RFS) program.¹ This “point of obligation” for the RFS program was established through a notice-and-comment rulemaking in 2010 based on the statutory direction in Section 211(o)(3)(B)(ii)(I) and (C) of the Clean Air Act (CAA) to impose the renewable fuel obligation on “refineries, blenders and importers, as appropriate,” while also “prevent[ing] the imposition of redundant obligations.”

The petitioners all seek to have the point of obligation shifted from refiners and importers, but differ somewhat in their suggestions for alternatives. Some request that EPA shift the point of obligation from refiners and importers to those parties that blend renewable fuel into transportation fuel. Others suggest that it be shifted to those parties that hold title to the gasoline or diesel fuel immediately prior to the sale of these fuels at the terminal (these parties are commonly called the position holders), or to “blenders and distributors”. All petitioners argue, among other things, that shifting the point of obligation to parties downstream of refiners and importers in the fuel distribution system would align compliance responsibilities with the parties best positioned to make decisions on how much renewable fuel is blended into the transportation fuel supply in the United States. Some of the petitioners further claim that changing the point of obligation would result in an increase in the production, distribution, and use of renewable fuels in the United States and would reduce the cost of transportation fuel to consumers.

After careful consideration of all relevant information available to EPA on the issue, including information submitted by petitioners, available fuels market data, and information gathered by EPA from multiple market participants and interested parties, EPA is proposing to deny requests to initiate a rulemaking process to reconsider or change the regulations at 40 CFR 80.1406. However, as an initial step, EPA believes it appropriate to open a public comment process on the requests for reconsideration or change to the point of obligation in the RFS program.

In this document, we present our rationale for proposing to deny the requests to initiate a rulemaking process to reconsider or change the regulations. We believe that the current structure of the RFS program is working to incentivize the production, distribution, and use of renewable transportation fuels in the United States, while providing obligated parties a number of options for acquiring the RINs they need to comply with the RFS standards. We do not believe that the petitioners have demonstrated that changing the point of obligation would likely result in increased use of renewable fuels. Changing the point of obligation would not address challenges associated with commercializing cellulosic biofuel technologies and the marketplace dynamics that inhibit the greater use of fuels containing higher levels of ethanol, two of the primary issues

¹ The current regulations can be found at 40 CFR 80.1406.

that inhibit the rate of growth in the supply of renewable fuels today. Changing the point of obligation could also disrupt investments reasonably made by participants in the fuels industry in reliance on the regulatory structure the agency established in 2007 and confirmed in 2010. Any programmatic advantages to making such a change would need to be certain and substantial in light of the expected impacts on the program, discussed in more detail below. While we do not anticipate a benefit from changing the point of obligation, we do believe that such a change would significantly increase the complexity of the RFS program, which could negatively impact its effectiveness. In the short term we believe that initiating a rulemaking process to reconsider or change the point of obligation could work to counter the program's goals by causing significant confusion and uncertainty in the fuels marketplace. Such a dynamic would likely cause delays to the investments necessary to expand the supply of renewable fuels in the United States, particularly investments in cellulosic biofuels, the category of renewable fuels from which much the majority of the statutory volume increases in future years is expected.

In addition, changing the point of obligation could cause restructuring of the fuels marketplace as newly obligated parties alter their business practices to purchase fuel under contract "below the rack" instead of "above the rack" to avoid the overhead compliance costs associated with being an obligated party under the RFS program. We believe these changes would have no beneficial impact on the RFS program or renewable fuel volumes and would decrease competition among parties that buy and sell transportation fuels at the rack, potentially increasing fuel prices for consumers and profit margins for refiners, especially those not involved in fuel marketing. EPA is also not persuaded, based on our analysis of available data, including that supplied by petitioners, by their arguments that they are disadvantaged compared to integrated refiners in terms of their costs of compliance, nor that other stakeholders such as unobligated blenders are receiving windfall profits.

In light of the considerable public interest in this matter, EPA is requesting comment on the petitions and our proposed denial of the requests to initiate a rulemaking process to reconsider or to change the RFS point of obligation.

There has already been considerable interest expressed in these requests across a wide variety of stakeholders and EPA has already received a substantial amount of input, including policy arguments and data-based comments. We have had in person meetings with numerous stakeholders as well.

We believe that the public comment process we are initiating with this document will benefit from making EPA's initial thinking on the issues available to the public. EPA will consider the comments we receive carefully.

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I. Introduction

On March 26, 2010, the Environmental Protection Agency (“EPA”) issued a final rule (the “RFS2 Rule”)² establishing regulatory amendments to the renewable fuel standards (“RFS”) program regulations to reflect statutory amendments to Section 211(o) of the Clean Air Act (“CAA” or “the Act”) enacted as part of the Energy Independence and Security Act of 2007. These amended regulations included 40 CFR 80.1406, imposing the obligation for compliance with the RFS annual standards on refiners and importers of gasoline and diesel fuel.³ These entities are referred to in the RFS regulations as “obligated parties.” Beginning in 2014, some obligated parties and other stakeholders have questioned whether 40 CFR 80.1406 should be amended, and a number of them have filed formal petitions for reconsideration or revision of the definition of “obligated party” in 40 CFR 80.1406, or petitions for rulemaking to amend the provision.⁴ Those parties filing petitions for reconsideration also initiated legal challenges of the 2010 rule, alleging that new grounds have arisen enabling them to do so notwithstanding expiration of the 60-day time period generally provided under CAA 307(d) for challenges to CAA rules.⁵ These suits have been stayed pending final action by EPA on the administrative petitions for reconsideration.

It appears that the petitions for reconsideration of 40 CFR 80.1406 do not meet the statutory criteria for such petitions set forth in CAA 307(d)(7)(B).⁶ However, we will treat all petitions suggesting a change in the RFS point of obligation as petitions for a rulemaking to accomplish the change(s) requested, and we are initiating a public comment process to aid us in evaluating

² 75 Fed. Reg. 14,670.

³ In imposing the fundamental RFS compliance obligation on refiners and importers, the 2010 rule simply continued the practice established under the original RFS program regulations adopted in 2007. See 72 Fed. Reg. 23900 (adopting 40 CFR 80.1106). However the 2010 rule broadened the number of regulatory parties somewhat to reflect the new EISA requirement imposing blending requirements on diesel fuel, in addition to gasoline, that is used as transportation fuel.

⁴ On January 27, 2014, Monroe Energy LCC (“Monroe”) filed a “petition to revise” 40 CFR 80.1406 to change the RFS point of obligation, and on January 28, 2016, Monroe filed a “petition for reconsideration” of the regulation. On February 11, 2016, Alon Refining Krotz Springs, Inc.; American Refining Group, Inc.; Calumet Specialty Products Partners, L.P.; Lion Oil Company; Ergon-West Virginia, Inc.; Hunt Refining Company; Placid Refining Company LLC; U.S. Oil & Refining Company (the “Small Refinery Owners Ad Hoc Coalition” or “Coalition”) filed a petition for reconsideration of 40 CFR 80.1406. On February 12, 2016, Valero Energy Corporation and its subsidiaries (“Valero”) filed a “petition to reconsider and revise” the rule. On June 13, 2016, Valero submitted a petition for rulemaking to change the definition of “obligated party.” On August 4, 2016, the American Fuel and Petrochemical Manufacturers (“AFPM”) filed a petition for rulemaking to change the definition of “obligated party.” On September 2, 2016, Holly Frontier also filed a petition for rulemaking to change the definition of “obligated party.” These parties are collectively referred to herein as “the Petitioners.”

⁵ See *Monroe Energy LLC v. EPA*, #14-1014. (D.C.Cir. 2014); *Monroe Energy LLC v. EPA*, #16-1032. (D.C.Cir. 2016); *Alon Refining Krotz Springs, Inc. et al v. EPA*, #16-1052. (D.C.Cir. 2016); *Valero Energy Cooperation v. EPA*, #16-1055 (D.C.Cir. 2016).

⁶ Petitioners had an opportunity to submit comments on the point of obligation in both the 2007 and 2010 rulemakings when the current approach was adopted. The possible impact of this decision on incentivizing growth in renewable fuel use, including incentivizing growth after the clearly anticipated widespread use of ethanol at E10 levels, could have been raised in comments on those rules. Furthermore, to the extent the petitions are based on grounds arising more than 60 days after promulgation of the rule, such grounds are not a proper basis for a petition for reconsideration under CAA 307(d)(7)(B).

the issue.⁷ This evaluation will be used as a basis for a consolidated response to all petitions (however styled) and other requests we have received that seek a change in the RFS point of obligation. For the reasons stated herein, we are proposing to deny all requests to change the current regulation, and we seek public comment on this proposed denial.

In considering the petitions to change the point of obligation in the RFS program, EPA has reviewed the large amount of information submitted by the petitioners and has met with them and other interested parties on numerous occasions. EPA has also met, and heard from, other participants in the RFS program, including other obligated parties, manufacturers of renewable fuel, and fuel retailers, who are opposed to revising the regulations. This is a very controversial issue that raises complex questions about the appropriate structure of the RFS program. The various parties present a wide range of different information and analyses, and offer different interpretations of the same information and analyses. We lay out our assessment of the information in this document.

EPA's primary consideration here is whether or not the requested change would improve the effectiveness of the program to achieve Congress's goals, which are to increase energy security and reduce emissions of air pollutants contributing to climate change by requiring increasing percentages of the nation's transportation fuel be made from renewable fuels. Each of the individual elements discussed in the analysis below, such as the number and nature of the parties that would become obligated if EPA were to grant the petitioners' requests, are considered in light of how each of these elements are expected to contribute towards or detract from the overall effectiveness of the program. As described in more detail below, we believe that changing the point of obligation as proposed by petitioners and other stakeholders would likely significantly increase the number of obligated parties in the RFS program. Many of these newly obligated parties would be smaller companies, many of whom may be unfamiliar with the requirements of obligated parties under the RFS program. The administrative compliance burden of RFS obligations would also represent a proportionally greater burden to these smaller companies than they currently do for refiners and importers of gasoline and diesel who employ engineers, traders, accountants, attorneys, and auditors to demonstrate and verify compliance. It would also increase the burden associated with administering the RFS program, and would likely inhibit EPA's enforcement abilities while at the same time opening up new opportunities for additional types of fraudulent behavior in a program that has already seen instances of fraud. Additionally, while petitioners generally claim that changing the point of obligation would result in the increased production, distribution, and use of renewable fuels in the United States, we believe that changing the point of obligation would at best result in a negligible increase in the production, distribution, and use of renewable fuels in the United States, and would more likely result in a decrease in the production, distribution, and use of these fuels, particularly in the near term. EPA is also not persuaded, based on our analysis of available data, including that supplied by petitioners, by their arguments that they are disadvantaged compared to integrated refiners in terms of their costs of compliance, nor that other stakeholders are receiving windfall profits.

⁷ We take no position at this time on whether petitions associated with judicial challenges to the RFS2 rule satisfy the criterion in CAA 307(b)(1) that they be "based solely on grounds arising after" the 60-day period following notice of promulgation of CAA rules, or whether the petitions for review were filed within 60 days after new grounds arose. We intend to consider the substance of the administrative petitions filed with the Agency whether or not the criteria specified in CAA 307(b)(1) for late challenges to Agency rules are satisfied.

Finally, changing the point of obligation would do nothing to incentivize the research, development, and commercialization of cellulosic biofuel technologies critical for the growth of the RFS program in future years. Each of these issues is discussed in greater detail below. In light of the considerable public interest in this matter, EPA will provide an opportunity for a 60-day period following issuance of this proposal for the submission of public comments, and will review these comments before taking a final action. We welcome comment on all aspects of our analysis and discussion, and particularly welcome the submission of data to support commenters' statements.

A. Relevant Parties in the Fuel Market

Gasoline and diesel fuel are produced at domestic refineries or imported to the United States. There are a wide variety of paths and associated business models by which fuel reaches consumers. Refineries distribute some of the fuel they produce by truck directly from the refinery's loading rack. Refineries generally distribute their remaining production through pipeline, barge, or rail, in which case the fuel goes through one or more distribution terminals. This fuel may be sold by the refinery when it leaves the "refinery gate" or at a location downstream from the refinery on its distribution path. All transportation fuel moves through the "rack." The "rack" refers to the truck loading facility at a distribution terminal or refinery. Generally, wholesale purchasers, marketers or distributors receive fuel at the refinery or terminal rack and distribute that fuel to end users or retailers.⁸ These parties may purchase fuel upstream of the terminal rack (e.g., directly from the refinery) and handle the logistics of fuel distribution themselves. They may instead purchase fuel at product terminals (either above or below the rack), relying on the refiner or other entity to handle all of the logistics and blending requirements, generally under contract. A "rack seller" is a party who owns fuel immediately before "the rack." The Internal Revenue Service collects excise tax from rack sellers, and refers to them as "position holders." While these terms can be used interchangeably, we have elected in this document to refer to these parties as "position holders."

Some refiners are involved in fuel distribution, blending, and/or marketing as well as refining, and these entities are referred to as "integrated refiners." In contrast, "merchant refiners" are those that market only a small portion the fuels they refine (and in some cases do not market any fuel), often selling the fuel to other parties at the refinery gate for distribution and marketing. Most refiners do both, marketing only a portion of their refined products. Choices on which market segments to participate in and to what degree continually evolve over time in the industry, as profits among the various market segments likewise vary considerably over time.

"Downstream blenders" refers to parties who blend renewable fuel into gasoline or diesel fuel after the fuel has left the refinery. Downstream blending may occur at fuel terminals, bulk storage facilities, and at retail stations; in addition, renewable fuel can be "splash blended" into trucks. Blending of renewable fuel can also occur at the refinery, and this is often referred to as

⁸ Fuel marketers generally refers to parties that sell fuel to distributors or end users at the rack. Fuel wholesalers refers to parties that buy fuel in bulk, generally above the rack, and sell this fuel to retail station owners or end users, or distribute the fuel to retail stations they own. Fuel distributors refers to parties that transport fuel from the rack (either at terminals or refineries) to retail stations. Many different parties, including refiners, can operate as marketers, wholesales, and/or distributors depending on market conditions.

“upstream blending.” The term “blender” can also be used to describe parties that combine non-renewable blendstocks downstream of the petroleum refinery to create finished gasoline.

B. Overview of RFS Obligations and Compliance

Each year, to ensure that required volumes of renewable fuel are met, EPA calculates and establishes percentage standards based on the volume targets established in the CAA (which are adjusted by EPA as appropriate using its waiver authorities), and projections from the Department of Energy of gasoline and diesel consumption for the coming year. To comply, obligated parties can purchase and blend the requisite volumes of renewable fuels into the petroleum derived transportation fuels they produce. However, to allow the market to function more efficiently and avoid market disruption, in implementing the statutorily-required credit program, and assist obligated parties in meeting their individual renewable fuel volume obligations (“RVOs”), EPA established, through a transparent public rulemaking process, a system for the generation and use of Renewable Identification Numbers (“RINs”). RINs are effectively credits that are generated upon production of qualifying renewable fuel and ultimately used by obligated parties for compliance. Renewable fuel producers generate and assign RINs to the renewable fuel they produce, and the RINs specify by a “D-code” the renewable fuel category applicable to the fuel, as determined by the feedstock used, fuel type produced and GHG emissions of the fuel, among other characteristics.⁹ The assigned RINs accompany the fuel sold by renewable fuel producers, and can only be separated from the fuel by a subsequent owner of the fuel who is an obligated party or a renewable fuel blender. Once separated, the RINs can be freely traded as a separate commodity from the renewable fuel. Obligated parties accumulate RINs over the course of the year, either by buying renewable fuel with assigned RINs that they separate and retain for compliance, or by buying RINs that others have separated on the open market.

The annual RVOs for a given obligated party are calculated by multiplying the obligated party’s total annual production and import of gasoline and diesel fuel by the four annual percent standards.¹⁰ Each obligated party must obtain sufficient RINs of each category to demonstrate compliance with its individual RVOs for the four annual standards. Compliance is accomplished on an annual average basis, through a single annual compliance report to EPA identifying the RINs acquired and retired for that year’s compliance. Thus, compliance under the RFS program requires the obligated parties to understand how to calculate their individual obligations based on

⁹ There are 5 different D-Codes for RINs in the RFS program. D3 RINs can be generated for cellulosic biofuel, which must be produced from cellulosic biomass and achieve a GHG reduction of at least 60%. D4 RINs can be generated for biomass-based diesel (including both biodiesel and renewable diesel) and must achieve a GHG reduction of at least 50%. D5 RINs can be generated for advanced biofuels, which are any renewable fuel that achieves a GHG reduction of at least 50%. D6 RINs can be generated for conventional renewable fuels (primarily corn ethanol) and must achieve a GHG reduction of at least 20%, unless the production facility is grandfathered. D7 RINs can be generated for cellulosic diesel, which is any fuel that meets the requirements for both cellulosic biofuel and biomass-based diesel.

¹⁰ There are separate, but nested, standards for cellulosic biofuel, biomass-based diesel, advanced biofuel, and renewable fuel.

the four standards, and then to plan for their annual compliance demonstration through RIN acquisition, through trading or through blending, over the course of the year. There are also associated registration, reporting and recordkeeping requirements.

C. Statutory and Regulatory History of the Point of Obligation

On July 29, 2005, Congress passed the Energy Policy Act of 2005, amending the Clean Air Act to create a statutory obligation for the use of renewable fuel in gasoline. The statute envisioned EPA adoption of annual percentage standards designed to increase renewable fuel use over time, and specified that the obligation for compliance with those standards would fall on “refineries, blenders, and importers, as appropriate.” PL 109-58 August 8, 2005 and CAA 211(o)(3)(B)(ii)(I). Although the program was expanded to apply to diesel fuel and otherwise significantly modified in 2007 through the Energy and Independence Security Act (“EISA”), this component of the statute remained unchanged. In enacting EISA, Congress stated that the goals of the statute include moving the United States toward “greater energy independence and security,” and increasing “production of clean renewable fuels.”¹¹ The amended statute established greenhouse gas emission reduction requirements for qualifying renewable fuels, and increasing annual renewable fuel volume targets to be achieved through application of annual percentage standards by EPA that also take into account the expected consumption of gasoline and diesel fuel. The statute required EPA to establish a regulatory program, and specified that the program must include a number of program flexibilities, including a credit program for those who over-comply with the annual standards, and a temporary exemption for small refineries (through 2010) that could be extended by EPA on a case-by-case basis upon demonstration by a small refinery of disproportionate economic hardship.

On September 22, 2006, EPA published a proposed rule to establish the regulatory framework to implement the RFS program. EPA proposed that obligated parties responsible for compliance with the annual percentage standards would be parties producing or importing gasoline: i.e., refiners and importers. EPA specified that those blenders who only added renewable fuel to gasoline would not be obligated parties.¹² EPA noted that there were approximately 1,200 ethanol blenders, as compared to 100-200 refiners and importers and stated that adding these ethanol blenders as obligated parties would “greatly expand the number of regulated parties and increase the complexity of the RFS program beyond that which is necessary to carry out the renewable fuels mandate under the Act.”¹³

EPA received comments supportive of EPA’s proposed definition of obligated parties from the Society of Independent Gasoline Marketers of American and the National Association of Convenience Stores (SIGMA/NACS), ExxonMobil, Baker Commodities, Griffin Industries,

¹¹ Energy Independence and Security Act of 2007, PL 110-140, December 19, 2007.

¹² 71 Fed. Reg. 55552, 55573-4. Blenders who produce gasoline through combining blendstocks are considered refiners under EPA regulations and would therefore be obligated parties.

¹³ Id. at 55573.

Methanol Institute (MI), and API. EPA did not receive any comments suggesting a different approach.¹⁴

On May 1, 2007, EPA published a final rule establishing the regulatory RFS program. This rule, generally referred to as “RFS1”, finalized the proposed definition of “obligated party” as refiners and importers of gasoline.¹⁵

Soon after establishing the final RFS1 regulations, Congress substantially amended the RFS program through the Energy Independence and Security Act of 2007.¹⁶ Notably, Congress did not alter the provision specifying that compliance with the RFS percentage standards would be the responsibility of “refineries, blenders and importers, as appropriate.” Congress did, however, expand the program to cover diesel fuels, increased the categories of renewable fuels to four, and specified additional environmental attributes for qualifying fuels, including required reductions in lifecycle greenhouse gas emissions.

On May 26, 2009, EPA proposed amendments to the RFS program regulations to reflect the significant statutory changes enacted as part of EISA.¹⁷ EPA proposed to retain the same approach to the RFS point of obligation as had been used in RFS1, but to expand it to include diesel producers and importers as obligated parties, consistent with EISA’s addition of diesel fuel as an obligated fuel. EPA also solicited comment on two possible alternatives: (1) making blenders who add oxygenate to RBOB and CBOB obligated parties with respect to those fuels rather than the refiners and importers of RBOB and CBOB,¹⁸ and (2) moving the point of obligation for all gasoline and diesel to parties who supply finished transportation fuels to retail outlets or wholesale purchaser-consumer facilities. In raising these issues for public comment, EPA noted that the approach adopted under RFS1 was based on an expectation that there would be an excess of RINs at low cost, and that they would be freely traded between parties needing them such that obligated parties would have ample opportunity to acquire them. EPA also explained that in adopting the approach under RFS1 EPA had found that the designation of ethanol blenders as obligated parties would have greatly expanded the number of regulated parties and increased the complexity of the program beyond that which was necessary to carry out the fuels mandate required by the program. EPA questioned whether, with the expanded mandates required under EISA, parties with excess RINs would tend to retain them for future compliance rather than sell them freely, and also hypothesized that most or all blenders would be regulated as RIN holders under the new program and questioned whether also making them

¹⁴ SIGMA/NACS commented that in the final rule EPA should clearly distinguish between “blenders” and “oxygenate blenders” to avoid confusion or misinterpretation as to which parties have renewable volume obligations, and also urged EPA to clarify that blending biodiesel into diesel fuel is not considered a “blender” which has an RVO. In response to this comment, EPA pointed to its regulations which clearly only placed the obligation on refiners and importers that produce gasoline or import gasoline, including the limited subset of blenders who blend petroleum blendstocks into finished gasoline. Regulation of Fuel and Fuel Additives: Renewable Fuel Standard Program Summary and Analysis of Comments. EPA420-R-07-006, 2-13—2-14.

¹⁵ 72 Fed. Reg. 23900.

¹⁶ Energy Independence and Security Act of 2007, PL 110-140, December 19, 2007.

¹⁷ 74 Fed. Reg. 24904.

¹⁸ Conventional blendstock for oxygenate blending (CBOB) and reformulated blendstock for oxygenate blending (RBOB) are produced by refineries and can be blended with 10% ethanol to produce finished conventional and reformulated gasoline respectively.

responsible for compliance with the percentage standards would be only a small additional burden. EPA indicated that under the expanded program, there might be disparities in the ability of merchant and integrated refiners to acquire RINs. As a result of these considerations, although proposing to retain the definition of obligated party (refiners and importers) from RFS1, EPA also solicited comment on whether a change in that definition might be appropriate, and would more evenly align a party's access to RINs with that party's obligations under the RFS2 program.¹⁹

On March 26, 2010, EPA issued a final rule establishing the amended RFS program structure reflecting the EISA amendments.²⁰ EPA summarized the comments it had received on the point of obligation issue, noting that some refiners favored a change from the proposed approach of retaining the obligation on refiners and importers, while others did not. In contrast to the RFS1 proposal, EPA received many differing comments from interested stakeholders on this issue. Several parties suggested that blenders or other downstream parties should become obligated parties because they control blending and that without such a change refiners and importers would find it difficult to acquire RINs. Still others suggested that the obligation should be placed on parties who supply finished transportation fuels. Downstream blenders and other downstream parties, as well as renewable fuel producers and some members of the petroleum industry, generally opposed a change, citing the burden such a change would pose to small businesses, and the added unnecessary complexity it would add to the RFS program. EPA concluded that the concerns expressed in the NPRM and in comments suggesting a change in the definition of obligated party, did not, on balance, warrant a change, stating:

We continue to believe that the market will provide opportunities for parties who are in need of RINs to acquire them from parties who have excess. Refiners who market considerably less gasoline or diesel than they produce can establish contracts with splash blenders to purchase RINs. Such refiners can also purchase ethanol from producers directly, separate the RINs and then sell the ethanol without RINs to blenders. Since the RFS program is based upon ownership of RINs rather than custody of volume, refiners need never take custody of the ethanol in order to separate RINs from volumes that they own. 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 RFS2.²¹

Nevertheless, because concerns over the liquidity of the RIN market still existed at the time, EPA also stated that “[w]e will continue to evaluate the functionality of the RIN market [and] [s]hould we determine that the RIN market is not operating as intended, driving up prices for obligated parties and fuel prices for consumers, we will consider revisiting this provision in future regulatory efforts.”²²

¹⁹ 74 Fed Reg 24904, 24963.

²⁰ 75 Fed. Reg. 14,670.

²¹ 75 Fed. Reg. 14,670.

²² Id.

EPA promulgated 40 CFR 80.1406 stating that “[a]n obligated party is any refiner that produces gasoline or diesel fuel within the 48 contiguous states or Hawaii, or any importer that imports gasoline or diesel fuel into the 48 contiguous states or Hawaii during a compliance period.”

As mentioned above, in requesting that EPA reconsider the point of obligation for the RFS program, petitioners claim that the justifications given by EPA in the final 2007 and 2010 rules that placed the point of obligation on the refiners and importers of gasoline and diesel are no longer valid. For the reasons described below, we disagree.

In establishing the RFS program, Congress put in place a policy to effect a substantial transformation in the fuels market; stakeholders on all sides have strongly held views on whether and how that transformation should occur. However, nearly all stakeholders have communicated to EPA about the desire for greater certainty and stability in the RFS program. As discussed further below, EPA believes that a change in the point of obligation would be a substantial disruption that has the potential to undermine the success of the RFS program simply as a result of increasing instability and uncertainty in programmatic obligations, and therefore the proponents of such a change bear the burden of demonstrating that the benefits are sufficiently large and likely that the disruption associated with such a transition would be worthwhile.

II. The Current Program Structure Appears to Be Working to Achieve the Goals of the RFS Program

In their petitions requesting that EPA change the point of obligation in the RFS program, the petitioners discuss several perceived shortcomings of the RFS program. The petitioners generally attribute these shortcomings, in whole or in part, to EPA’s decision to place the point of obligation on the refiners and importers of gasoline and diesel fuel, rather than parties downstream of the refiners and importers. These claimed shortcomings include, among others, the failure of the RFS program to achieve the statutory volumes of renewable fuel (requiring the use of EPA’s waiver authorities) and higher than anticipated RIN prices leading to higher fuel prices for consumers, negative impacts on merchant refiners, and windfall profits for unobligated blenders of renewable fuel. The petitioners conclude that the RIN market, and by extension the RFS program, is not operating as intended, and therefore EPA should re-visit the point of obligation in the RFS program.

After reviewing the information submitted by the petitioners, along with additional information gathered by EPA, we disagree with a number of the factual assertions and arguments put forward by the petitioners, and do not agree with their policy arguments that changing the point of obligation would enhance the effectiveness of the RFS program to achieve Congress’s goals. Evidence suggests that despite the necessary use of EPA’s waiver authorities in recent years, the RIN market, and the RFS program as a whole, are generally working to increase supplies of renewable fuel, albeit at a pace slower than Congress established, and that a change in the point of obligation is not likely to enhance the achievement of the program’s goals. The RFS program is providing a significant incentive for the continued growth in the production, distribution, and use of renewable fuels in the transportation fuel market in the United States, and changing the point of obligation would not enhance that incentive. With the exception of cellulosic biofuels, renewable fuel production and use in the United States have increased significantly, and are

projected to reach 99.3% of the statutory volume for non-cellulosic biofuels in 2016. RIN prices themselves have not resulted in higher transportation fuel prices for consumers or disproportionate harm for merchant refiners.²³ Finally, there is no evidence that merchant refiners have resorted to the extreme measures suggested by the petitioners, such as decreasing fuel production or exporting the fuel they produce,²⁴ in an effort to minimize their RFS obligations. We believe that RINs are currently available to meet compliance needs, and we see no reason to indicate that this dynamic will change in the future.

A. RINs are Providing an Incentive for Increasing Renewable Fuel Production, Distribution, and Use

Since the adoption of the current RFS regulations in 2010, the RFS program has provided a significant incentive for growth in the production, distribution, and use of renewable transportation fuels in the United States. While some commenters cited EPA's use of our waiver authorities to reduce the required volumes of renewable fuel in 2014-2016, as well as our proposed use of similar authorities with respect to required volumes for 2017, as evidence that the RFS program is not working effectively to achieve its stated goals, we believe that the RFS program has been generally successful at achieving these goals. As discussed in more detail in Section III below, we do not believe that changing the point of obligation would result in an increase in the production, distribution, or use of renewable fuels. Based on data collected through the EPA Moderated Transaction System (EMTS),²⁵ the production and import of renewable transportation fuel in the United States has increased from approximately 7 billion ethanol-equivalent gallons in 2010 to almost 18 billion ethanol-equivalent gallons in 2015, the most recent year for which data are available. This represents an increase of over 150% in just five years. While there are many factors that have contributed to the growth of renewable transportation fuel production and imports in the United States in recent years, including federal and state tax credits for certain types of renewable fuels and federal grants and loan guarantees for advanced biofuel production facilities, many stakeholders have regularly cited the RFS program as a primary reason for making investments in both the production and distribution of renewable fuels.²⁶

Despite these successes, in our recent final rule establishing annual RFS percentage standards for 2014-2016, EPA exercised the statutory waiver authorities to reduce the required renewable fuel

²³ While RIN prices are expected to impact the price of fuels with relatively greater or lesser renewable content (increasing the price of fuels with low renewable content such as E0 or B0 and decreasing the price of fuels with high renewable content such as E85 or B20), on balance they are not expected to increase the total cost of fuel to consumers.

²⁴ While gasoline and diesel exports have increased in recent years we believe that these increases are attributable to favorable crude oil and natural gas prices in the United States relative to the rest of the world, rather than an effort to avoid RIN costs. We note that despite these higher export volumes, the supply of gasoline and diesel to the United States has not changed (see Section II.D below).

²⁵ RIN generation data are available publicly at <https://www.epa.gov/fuels-registration-reporting-and-compliance-help/public-data-renewable-fuel-standard>.

²⁶ For example, see comments on the proposed RFS standards for 2017 from the National Biodiesel Board (EPA-HQ-OAR-2016-0004-2904) and Dana Gustafson of Marquis Energy (EPA-HQ-OAR-2016-0004-3498) and a Letter from RaceTrac to Administrator McCarthy, received August 17, 2016.

volumes from those specified in the statute due in part to an anticipated inadequate domestic supply of qualifying renewable transportation fuels.²⁷ The shortfall in the supply of renewable fuels, as compared to the statutory volume targets, is primarily a result of lower than expected production of cellulosic biofuels due to the challenges experienced with the development and commercialization of cellulosic biofuel production technologies, as well as challenges associated with increasing the supply of renewable fuel to consumers associated with distribution and use of renewable fuels. The petitioners generally focused on the limitations to the distribution and use of renewable fuels, claiming that changing the point of obligation would address these limitations and allow for greater volumes of renewable fuels to be used. They did not address the impacts that such a change would be likely to have on the production of cellulosic biofuels. The expected production and use of cellulosic biofuel in 2016, however, is just 5.4% of the statutory volume (i.e., 230 million ethanol-equivalent gallons expected production compared to a statutory volume of 4.25 billion gallons), while the expected production and use of non-cellulosic renewable transportation fuels in 2016 is 99.3% of the volume envisioned by Congress in EISA.²⁸ Required biodiesel volumes for 2016 are 90% greater than the statutory prescribed minimum volume, and for 2017 the required volume is 100% greater than the statutory minimum.²⁹ The RFS program, operating under the existing regulations, has been demonstrably effective at making significant progress towards achieving the statutory goals, and in some cases exceeding these goals. The challenges to further growth in the commercial scale production of cellulosic biofuels and the infrastructure necessary to facilitate additional biofuel use are not related to the point of obligation under the RFS program, but rather are the result of research, development, and production challenges described in detail in the final rule establishing the standards for 2014-2016 and in the proposed rule to establish standards for 2017.³⁰ Beyond 2016, over 85% of the growth in the statutory RFS volumes is intended to be cellulosic biofuel. With their access to capital and expertise in developing and commercializing fuel production on a large scale, we believe the current obligated parties are better positioned to address the ongoing challenges of commercializing cellulosic biofuel production than downstream parties. Changing the point of obligation of the RFS program would do nothing to address the significant challenges associated with the commercialization of cellulosic biofuel, nor would it be expected to benefit the production, distribution, and use of non-cellulosic transportation fuel in the United States, as detailed further below.³¹

B. Current RIN Prices Are Not Indicative of a Dysfunctional RIN Market, Nor Are They Increasing the Cost of Gasoline (E10) to Consumers

²⁷ For a full discussion of EPA's waiver authorities see the Final Rule establishing the 2014-2016 RFS standards (80 FR 77,420, Dec. 14, 2015).

²⁸ The statutory volumes for total renewable fuel and cellulosic biofuel in 2016 are 22.25 and 4.25 billion gallons respectively, with a difference of 18 billion gallons that may be satisfied by non-cellulosic biofuels. The volumes established by EPA in our December 2015 final rule for 2016 for total renewable fuel and cellulosic biofuel are 18.11 and 0.23 billion gallons respectively, with a difference of 17.88 billion gallons that may be satisfied by non-cellulosic biofuels.

²⁹ Compare CAA 211(o)(2)(B)(v)(1 billion gallon minimum) with 75 FR at 77496, Table III.D.5-1 (specifying volume requirements of 1.9 and 2.0 billion gallons for 2016 and 2017).

³⁰ 80 FR 77,420 (Dec., 14, 2015) and 81 FR 34778 (May 31, 2016).

³¹ As discussed in more detail in Section III.C below, changing the point of obligation is also not expected to impact the market dynamics currently limiting the distribution and use of E85.

One of the issues cited by the petitioners as evidence that the RIN market, and more generally the existing RFS regulations, are not operating as intended is the current price of RINs, which some petitioners have characterized as being indicative of a dysfunctional RIN market. While a low RIN price may be perceived as advantageous, especially to parties with obligations to acquire RINs, the RFS program was designed to effect a fundamental change in the fuels marketplace. The incentives provided by the price of RINs is the mechanism used to effect this change, and therefore RIN prices that effect the intended change are beneficial to program success rather than an indication of dysfunction. As discussed in a memorandum prepared in support of the proposed RFS annual standards for 2014-2016, EPA does not believe that the D6 RIN prices³² observed in recent years are indicative of a dysfunctional RIN market.³³ Rather, there are structural reasons why D6 RIN prices increased. In 2013 the required volumes under EPA's RFS standards exceeded levels that could met via the relatively simple blending of 10% ethanol into gasoline (in addition to the blending of other biofuels such as biodiesel). Increased demand for RINs (due to higher standards), and the comparative difficulty of increasing the supply of RINs through the blending of ethanol at levels *beyond* 10% (or alternatively the purchase of more expensive non-ethanol renewable fuels) drove D6 RIN prices higher. Fuels such as biodiesel and E85 require a greater financial incentive to be offered at attractive prices to consumers, and the RFS program was designed to provide this incentive. Rather than reflecting a dysfunctional RIN market, higher RIN prices simply reflect the increasing cost of supplying additional renewable fuels to the marketplace through higher level ethanol blends and/or non-ethanol renewable fuels along with the increasing demand for RINs that results from higher RFS standards.³⁴ In other words, higher RIN prices reflect the greater degree of difficulty (and cost) of getting ever-greater volumes of renewable fuel into the transportation fuel pool – the explicit goal of the RFS program.³⁵

EPA does not believe that changing the point of obligation would significantly impact the economics of selling E85 or non-ethanol renewable fuels, nor would it significantly impact the supply of available RINs (for reasons discussed below). We therefore do not believe that changing the point of obligation is likely to result in the lower D6 RIN prices observed in 2012 or earlier. The price of RINs will continue to vary in the marketplace in response to a variety of

³² Renewable fuel producers generate different types of RINs, depending on a number of factors including the feedstocks and production processes they use to produce renewable fuels, the type of fuel they produce, and the GHG reductions for these fuels relative to the gasoline and diesel fuel they replace. D6 RINs are generated for conventional biofuel, the vast majority of which is corn ethanol, with some additional D6 RINs being generated for biodiesel from grandfathered facilities and other fuels. Prior to 2013, D6 RIN prices were generally less than 5 cents per RIN. D6 RIN prices rose significantly in 2013, and have remained higher than the prices observed prior to 2013.

³³ See "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA, May 14, 2015, and Letter from API to EPA Administrator McCarthy, August 18, 2016.

³⁴ Uncertainty, whether related to the level of the RFS standards for any given year or the RFS program as a whole, can further serve to increase the volatility of RIN prices in the market. Some volatility may be inevitable, but excessive volatility may, as discussed further below, increasing uncertainty related to the RFS program could be one likely outcome of changing the point of obligation.

³⁵ We note that RIN prices are influenced by a variety of factors, including underlying commodity market prices such as corn, ethanol, oil, and gasoline prices. Another factor influencing their price, as described, is the level of the standard and the ease with which higher-level ethanol blends can be produced and used in the market.

factors. A return to the D6 RIN prices observed in 2012 would only be expected in the near term if the required volumes of renewable fuel were dramatically reduced to volumes that do not exceed those which can be satisfied by blending ethanol into gasoline to produce E10 blends.

One petitioner also implies that higher RIN prices lead to higher fuel prices for consumers.³⁶ When D6 RIN prices first rose substantially in 2013, attention turned to whether and how such RIN price increases affect consumer fuel prices. EPA assessed this issue using available data and concluded that while increasing RFS standards may increase transportation fuel prices if renewable fuels are more expensive than the petroleum fuels they replace on an energy-equivalent basis, *RIN prices themselves* were not expected to have a significant impact on retail fuel prices.³⁷ External, non-EPA assessments similarly concluded that increased RIN prices had not had a significant impact on retail gasoline (E10) prices.³⁸ When RIN prices rise, the price of the petroleum blendstocks produced by refineries also rise to cover the increased RIN costs, in much the same way as they would rise in response to higher crude oil prices. The effective price of renewable fuels (the price of the renewable fuel with attached RIN minus the RIN price), however, *decreases* as RIN prices increase. When renewable fuels are blended into petroleum fuels these two price impacts generally offset one another for fuel blends such as E10 with a renewable content approximately equal to the required renewable fuel percentage standard. Higher RIN prices also generally result in higher prices for fuels with lower renewable content (such as E0 or petroleum diesel) and lower prices for fuels with higher renewable content (such as E85 or B20). The cost of the RIN therefore serves as a cross-subsidy, reducing the price of renewable fuels and increasing the price of petroleum based fuels in transportation fuel blends, thus incentivizing increased blending of renewable fuels into the transportation fuel pool. In this way the RINs also help provide a price signal to consumers to help achieve the Congressional goals of greater renewable fuel production and use. Fuels with higher renewable content are relatively cheaper to consumers, while fuels with lower renewable content are relatively more expensive. The higher the RIN prices are, the more significant the potential price discounts for fuels with higher renewable content. This retail price discount for fuels with a relatively high renewable content is enabled by higher prices for fuel blends with little or no renewable fuel content.

C. The Current Regulations do not Appear to Disproportionately Impact Merchant Refiners or Provide Windfall Profits for Unobligated Blenders

In requesting that EPA change the point of obligation petitioners claim that the current point of obligation negatively impacts refiners that do not blend renewable fuels and/or do not sell fuel at the rack. They generally claim that this negative impact is due to these refiners incurring a high cost for RINs purchased to comply with their RFS obligations. They contrast this with what they say is the situation facing integrated refiners, whom they state are acquiring RINs for free by

³⁶ Valero Petition for Rulemaking, June 13, 2016. Page 18.

³⁷ "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA. May 14, 2015.

³⁸ Knittel, Christopher R., Ben S. Meiselman, and James H. Stock. The Passthrough of RIN Prices to Wholesale and Retail Fuels Under the Renewable Fuel Standard. Working Paper 21343. NBER Working Paper Series. Available online <<http://www.nber.org/papers/w21343.pdf>>.

blending renewable fuels. Petitioners also argue that unobligated fuel blenders (such as large retail fuel chains or fuel distributors and refiners that market more fuel at the rack than they refine) are selling excess RINs and generating windfall profits. Several other parties have submitted documents to EPA disputing these claims.³⁹

We have assessed the data available on this issue and believe that the data do not support the petitioners' arguments. We believe that merchant refiners are generally not uniquely adversely impacted (relative to integrated refiners).⁴⁰

To understand why this is the case, we must consider the fundamental argument about cost disparities that petitioners and merchant refiners present to EPA. Merchant refiners argue that due to their position in the market as refiners with little or no blending and/or sales of fuel at the rack, their sole RFS compliance option is to purchase unattached RINs (that is, RINs that have already been separated from renewable fuel). Merchant refiners typically purchase these RINs on the market and retire them for compliance purposes; a large merchant refiner can spend considerable sums to purchase these RINs, and they typically point to these sums as an expenditure that represents a net cost to the company.⁴¹ Some merchant refiners then argue that their integrated refiner competitors, by contrast, do not face such costs, arguing that integrated refiners acquire RINs "for free" when they purchase renewable fuel with an attached RIN. They argue that this dynamic results in a fundamental inequity between two types of RFS obligated parties: those that pay large sums to acquire RINs on the open market, and those that obtain RINs "for free." Moving the point of obligation, petitioners argue, would help address this inequity. To understand why this argument is flawed, it is helpful to examine the underlying market dynamics in more detail.

It is indeed the case that merchant refiners generally acquire the RINs necessary for compliance with their RFS obligations by purchasing separated RINs, rather than purchasing renewable fuel with assigned RINs. Because of this, merchant refiners are therefore able to directly track the costs associated with acquiring the RINs they need for compliance and cite these costs in their financial and accounting statements. When RIN prices are relatively high these apparent costs can be significant, especially for merchant refiners that refine large volumes of obligated fuels.

Less obviously apparent, however, is *the impact of the RFS program on the market price for the petroleum blendstocks that merchant refiners sell*. As discussed further below, all refiners and importers of gasoline and diesel fuel incur costs to comply with RFS obligations. This is true whether the refiners and importers acquire RINs by blending renewable fuels or purchasing separated RINs – meaning no fundamental inequity exists. Moreover, because all refiners and importers have RFS obligations in proportion to the fuels they produce or import, they all have similar costs of compliance related to the RFS program, and they all seek to recover those costs

³⁹ See Letter from RaceTrac to Administrator McCarthy, August 17, 2016; Letter from QuikTrip to Administrator McCarthy, August 17, 2016; Presentation from Murphy USA to EPA, August 16, 2016.

⁴⁰ Our reasons for not believing that merchant refiners are uniquely impacted by the RFS program are summarized below. For further detail see "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA. May 14, 2015.

⁴¹ For example, see comments from CVR Energy on the 2017 RFS standards proposed rule (EPA-HQ-OAR-2016-0004-0213).

through the pricing of their product. Stated another way: merchant refiners can indeed expend significant funds to purchase RINs needed to demonstrate compliance with the RFS program, but the cost is offset by a corresponding increase in the price of the fuel they sell. That market price reflects the cost of RINs. The same dynamic applies to both merchant and integrated refiners.

In their petition, Valero, while generally acknowledging their efforts to recover RIN costs through higher prices for their petroleum blendstocks,⁴² nevertheless claims that the RFS program leaves them at a disadvantage relative to integrated refiners. They argue that while both merchant and integrated refiners receive higher prices for their petroleum blendstocks as a result of the RFS obligations, merchant refiners must use this additional income to purchase RINs for compliance while integrated refiners acquire the RINs they need for compliance “for free” by blending renewable fuels.⁴³ This argument is illogical as it simply ignores the cost that integrated refiners pay to acquire RINs.

Unlike merchant refiners, integrated refiners generally acquire most of their RINs by purchasing renewable fuel with attached RINs. After blending the renewable fuel with petroleum blendstocks to produce finished transportation fuel, integrated refiners separate the RINs and keep them to demonstrate compliance, or in some cases sell excess RINs to other obligated parties.

While the integrated refiners generally do not purchase RINs directly, it is not the case that they acquire these RINs for free. They no more receive the RIN for free than one receives an engine for free when purchasing a car. In examining wholesale prices for gasoline blendstocks, ethanol, and blended E10, EPA found that the listed prices for blended E10 were consistently lower than the price that would be expected based on the selling prices of the component fuels.⁴⁴ In other words if we were to ignore the RIN revenue, parties that produce E10 by blending gasoline blendstocks with ethanol would be losing money on every gallon of E10 they produce. A gallon of E10 is generally produced by blending 0.9 gallons of gasoline blendstock (usually CBOB or RBOB) with 0.1 gallons of ethanol. The listed price for E10, however, was lower than the price of 0.9 gallons of gasoline blendstock plus 0.1 gallons of ethanol. Thus integrated refiners are selling blended E10 for a lower price than they could receive for the component fuels (petroleum blendstock and ethanol) to acquire the RINs that can be separated and retained if they sell blended E10. Integrated refiners therefore experience the cost of acquiring RINs when they sell blended fuels for a lower price than the blend components, while merchant refiners experience RIN costs when they purchase separated RINs. In each case there is a cost to the refiners to acquire RINs, and in each case they recover this cost through higher petroleum blendstock prices. In a presentation to EPA, Murphy USA discussed this market reality, stating that the RIN prices supported a negative “spot-to-rack margin.”⁴⁵ They are purchasing petroleum blendstocks from refiners for a higher price than they can recover for this product when sold at the rack as

⁴² For example, see Valero Petition for Rulemaking, June 13, 2016. Page 18. In more recent communications with EPA Valero has questioned the ability for merchant refiners to recover the full cost of the RIN through the price of their petroleum blendstocks under current market conditions.

⁴³ For example, see Valero Petition for Rulemaking, June 13, 2016. Page 16.

⁴⁴ "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA. May 14, 2015.

⁴⁵ See Presentation from Murphy USA to EPA, August 16, 2016.

blended E10 but maintaining profitability through RIN sales. This observed market practice supports the findings by EPA and other parties that despite the higher prices of petroleum blendstocks resulting from higher RIN prices, the costs of transportation fuel to consumers have not increased as Valero has claimed.⁴⁶

While EPA continues to believe that refiners, including merchant refiners, are generally able to recover the cost of RINs through the prices they receive for the petroleum blendstocks they sell, we also acknowledge that there are many diverse factors that impact each individual refiner's profitability and their ability to recover their full cost of production (including crude oil costs, labor costs, capital costs, regulatory and compliance costs, etc.). These factors include, but are not limited to, the refinery's location, their access to various types of crude oil, the local demand and competition for refined products. In recent years a number of factors have led to an oversupply of refined gasoline and diesel in the United States. In such a market we would expect significant pressure on refining margins as the supply of refined products outpaces demand and refiners compete with one another to find markets for their products (potentially including exports) and maintain market share. These market conditions are expected to result in reduced profit margins for refiners, and in some cases refiners may struggle to remain profitable. In evaluating whether or not to change the point of obligation, however, it is important to consider whether these challenges are caused by the current point of obligation in the RFS program (rather than more broad market conditions), and whether changing the point of obligation would be expected to address these challenges. Based on the information discussed above, we do not believe the challenges faced by some refiners in the current market are the direct result of their designation as obligated parties in the RFS program.

EPA also examined claims made by the petitioners that unobligated blenders were reporting windfall profits by selling RINs. The petitioners primarily supported these claims by referencing the financial statements of companies that acquire RINs by blending renewable fuels and who sell these RINs to obligated parties, but are not obligated parties themselves.⁴⁷ EPA does not believe that the information presented by the petitioners substantiates their claims that unobligated blenders are generating windfall profits from RIN sales. First, we note that the fact that companies report income for RIN sales does not indicate that these companies are receiving a windfall from the RFS program. This is equivalent to claiming a company's reported sales are equivalent to their profits, while ignoring their expenses to acquire the good sold. While it is true that for companies such as Murphy USA who sell a significant number of RINs their "revenues are impacted by [their] ability to generate revenues from activities such as blending bulk fuel with ethanol and bio-diesel to capture and subsequently sell Renewable Identification Numbers,"⁴⁸ this does not mean that these companies receive a windfall profit from RIN sales. Such an assessment ignores costs that the company realized in order to acquire these RINs, such as lower fuel margins than would have been realized if the party did not blend renewable fuels

⁴⁶ "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA. May 14, 2015 and Knittel, Christopher R., Ben S. Meiselman, and James H. Stock. The Passthrough of RIN Prices to Wholesale and Retail Fuels Under the Renewable Fuel Standard. Working Paper 21343. NBER Working Paper Series. Available online <<http://www.nber.org/papers/w21343.pdf>>.

⁴⁷ The parties most commonly cited by the petitioners are Murphy USA and Casey's General Stores.

⁴⁸ Murphy USA, Inc., U.S. SEC Form 10-K for the financial year ended December 31, 2015.

and any investments in infrastructure that the company has made to enable them to blend renewable fuels and distribute these fuel blends. Statements from Murphy USA cited in the AFPM petition to support AFPM's claim that non-obligated blenders are realizing windfall profits from RIN sales in fact support EPA's views of the market. In a recent earnings call the President of Murphy USA stated "if you add the combination of the gross margin from product supply and wholesale and the RINs and divide over the total retail gallons sold, you actually see a fairly consistent incremental \$0.025 per gallon over the past two years."⁴⁹ In other words, overall fuel supply margins (including RIN sales) have been relatively consistent despite the significant increase in RIN prices. This supports EPA's view that RIN costs and revenues must be viewed in combination with other product supply and wholesaling margins.

EPA recognizes that there are many factors that affect the profitability of participants in the fuels market, and disagrees that the available information supports a conclusion that RIN revenues are leading to windfall profits. In 2014 and 2015 Murphy USA reported RIN sale revenues of \$93 million and \$118 million respectively. If this income represented windfall profit we would expect that the net income of Murphy USA would be approximately \$100 million per year higher than it was prior to the significant increase in RIN prices in 2013. In fact, while Murphy USA's profits in 2014 and 2015 of \$244 million and \$176 million⁵⁰ were significantly higher than in 2012 (\$84 million), they were significantly less than net profits in 2011 (\$324 million).⁵¹

Further, statements from Casey's General Stores and Murphy USA contradict the notion that RIN sales represent windfall profits for unobligated blenders. Murphy USA reported that in the third quarter of 2014 income received from RIN sales offset negative product supply and wholesale margins.⁵² This statement is in line with statements from Murphy USA cited above and EPA's view of the market explained in the preceding paragraph, that companies which blend renewable fuels with petroleum blendstocks to produce finished transportation fuel must purchase petroleum blendstocks at a higher price that reflects the cost of the RIN, and sell blended transportation fuel at a lower price that reflects their ability to separate and sell the RINs associated with the renewable fuel, to offer finished fuel at a competitive price. In effect, these parties sell the finished transportation fuel at a loss (or a much smaller margin than would be sustainable in a market without RIN obligations) in order to obtain RINs. In their annual report filed in June 2015, Casey's General Stores directly stated that their general pricing practice is to price to their competition,⁵³ a practice EPA has repeatedly stated we expect is the general practice in competitive markets. We believe this competitive pricing behavior is incompatible with the windfall profits suggested by the petitioners.

⁴⁹ Transcript of Murphy USA First Quarter Earnings Call, Andrew Clyde, President, Murphy USA, Thompson Reuters (Feb. 4, 2016). Citation from AFPM's petition for rulemaking, August 4, 2016. (page 15) .

⁵⁰ Murphy USA net profit numbers for 2014 and 2015 from Murphy USA, Inc., U.S. SEC Form 10-K for the financial year ended December 31, 2015.

⁵¹ Murphy USA net profit numbers for 2011 and 2012 from Murphy USA, Inc., U.S. SEC Form 10-K for the financial year ended December 31, 2013.

⁵² *Murphy USA Inc. Reports Third Quarter 2014 Results*. Yahoo! Finance, November 5, 2014. Available online <<http://finance.yahoo.com/news/murphy-usa-inc-reports-third-220006760.html>>.

⁵³ Casey's General Stores, Inc., Annual Report (Form 10-K) (June 26, 2015).

EPA also examined the available data to assess whether or not obligated parties that acquire RINs by purchasing separated RINs, rather than blending renewable fuels, are able to recover the cost of these RINs in the price of the petroleum blendstocks they sell. In their petition, Valero acknowledges this ability for refiners to recover the cost of acquiring RINs through higher prices for gasoline and diesel they produce than would be the case with lower RIN prices.⁵⁴ Empirical data also support this argument. Data clearly show higher market prices for RFS-obligated fuels (gasoline and diesel blendstocks sold for use in the United States) when compared to those of unobligated fuels that are very similar (such as gasoline and diesel sold for export, or heating oil and jet fuel).⁵⁵ Before accounting for any potential RIN price impacts, one would expect obligated and unobligated fuels to have very similar market prices because of their very similar fuel properties. Gasoline is nearly identical whether used domestically or sold for export, and heating oil and diesel are very similar save the fact that diesel fuel carries a RIN obligation. However, in recent years, as RIN prices have become elevated, data show a gap opening up between the price of domestic gasoline and exported gasoline, and between the price of diesel and heating oil. The price of the obligated fuels is higher and the gap corresponds, for the most part, with RIN prices. Obligated parties – whether they are merchant refiners or integrated—are charging more for domestic gasoline and diesel to ensure they recoup the costs associated with RIN prices. So while a merchant refiner is directly paying for the RINs they buy on the market, they are passing that cost along in the form of higher wholesale gasoline prices.

We believe that it is unlikely that any party, including both unobligated blenders and integrated refiners, would be able to realize windfall profits from RIN sales in the highly competitive fuel sales markets in the United States. Because we believe the cost of RINs is recovered by all obligated parties, whether they purchase separated RINs or acquire RINs along with renewable fuels they produce or purchase, we do not believe increased prices for RINs lead to competitive imbalances among different obligated parties, as suggested by petitioners.⁵⁶

D. EPA Has Not Seen Evidence That High RIN Prices Have or Will Force Merchant Refiners to Decrease Production or Increase Exports of Obligated Fuels

In their petition, Valero suggested that if EPA does not change the point of obligation of the RFS program it could lead to obligated parties, particularly merchant refiners, decreasing their production of obligated fuels or increasing their exports of refined products in an effort to minimize the RFS obligations. This is not a new idea, as obligated parties have been suggesting that this could be a potential outcome of increasing RFS standards since the beginning of the program. Despite these warnings, and even with increasing vehicle fuel efficiency in the United States in previous years, the significant increase in both the RFS standards and RIN prices have not resulted in obligated parties taking these actions, as seen in the following graph. Were high

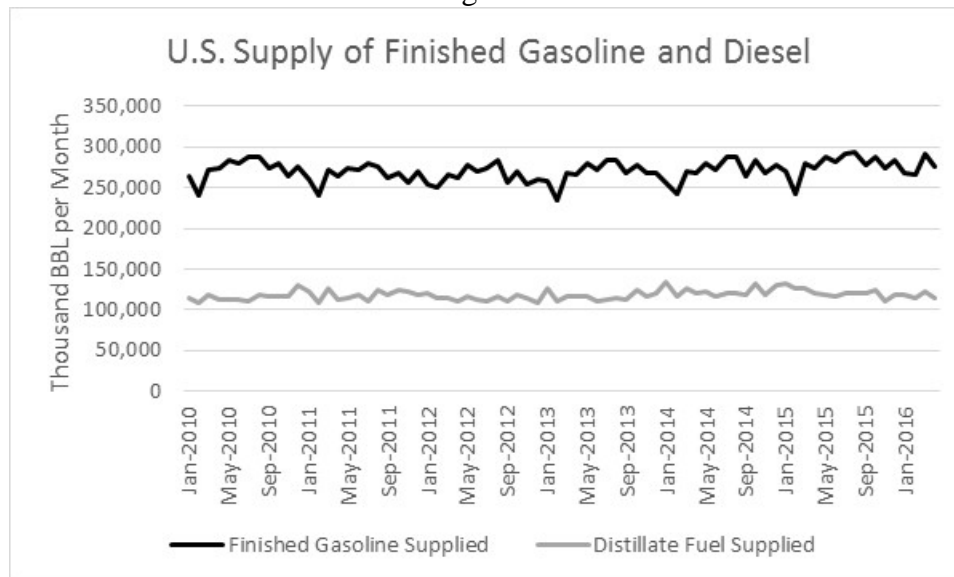
⁵⁴ Valero Petition for Rulemaking, June 13, 2016. Page 18.

⁵⁵ See "A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effect," Dallas Burkholder, Office of Transportation and Air Quality, US EPA. May 14, 2015 and Letter from QuikTrip to Administrator McCarthy, August 17, 2016.

⁵⁶ We also note that profitability for parties that blend renewable fuels is not necessarily an undesirable result of the RFS program, as long as this profitability is not at odds with the general goals of increased renewable fuel supply in the United States.

RIN prices to have this effect, one would expect to see a drop in fuel supply beginning in 2013, when RIN prices spiked.

Figure 1



Data from EIA. Available at http://www.eia.gov/dnav/pet/pet_cons_psup_dc_nus_mbbbl_m.htm

The lack of any impact on finished gasoline and diesel supply to the United States is not surprising, since as was discussed in Section III.B.2 above, data reviewed by EPA show that obligated parties are generally receiving higher prices for fuels they produce that are subject to an RFS obligation (gasoline and diesel fuel sold for use in the United States), which offsets the cost of compliance with the RFS program. By contrast, if they export the gasoline and diesel fuel, they would not receive the higher value resulting from the compliance costs associated with the RFS program. Companies make decisions about which market segments to participate in for a variety of reasons, but we believe the demand for transportation fuel in the United States is strong enough that refineries and importers will continue to meet demand on a competitive basis, even if participating in the market incurs RFS obligations.

E. A Relatively Small Number of Obligated Parties is Generally Advantageous

In the 2007 RFS1 rule, EPA indicated that it considered it preferable to place the point of obligation on a smaller number of refiners and importers rather than on a larger number of downstream blenders. This is primarily because placing the obligation on a smaller number of parties with significant assets generally results in a more efficient, and therefore more effective program. In the proposed RFS2 rule we noted that blenders would likely be regulated as RIN holders under the expanded program, and questioned whether also making them obligated parties would significantly increase their regulatory burden. After considering comments, we chose in the final RFS2 rule to maintain the RFS1 approach, noting, among other reasons, that changing the point of obligation to include blenders could lead to disruption of the program in the transition of RFS1 to RFS2. We have evaluated this issue anew in light of additional experience

implementing the program. Under the current system, it is renewable fuel producers who generate RINs, and it is the refiners and importers of gasoline and diesel fuel who must use them to demonstrate compliance. Obligated parties have an incentive to ensure the validity of the RINs they purchase, since if they are subsequently found to be invalid, the obligated parties may face civil penalties as well as an obligation to purchase and retire an equal volume of substitute valid RINs. While EPA is engaged in compliance and enforcement activities to ensure the validity of RINs in the marketplace, the sheer volume of RINs and RIN transactions makes it critical to also leverage the participation of obligated parties in policing the RIN market. In practice, the “buyer beware” RFS program relies considerably on the ability and commitment of obligated parties to assess the validity of RINs and each obligated party depends on the ability of the other obligated parties to assure credible RINs since the RINs can be, and often are, separated from the renewable fuel for which they were generated. In addition, refiners have significant compliance requirements related to environmental, safety, and health concerns, and the expertise they have developed in maintaining compliance contributes to the success of the RFS program.

Refiners and importers generally have greater resources that enable them to provide oversight of the RIN generators to help ensure that the RINs being traded in the marketplace are valid. They have invested significantly since the finalization of the RFS regulations to develop compliance processes and expertise in these markets. Changing the point of obligation would potentially disrupt the systems developed by these parties, and would require that newly obligated parties make the necessary investments to enable compliance with their new RFS obligations. This could take a significant amount of time and represent a significant financial burden to the new obligated parties, especially as we expect that many would be smaller companies with fewer resources than the existing obligated parties.

In contrast, we believe that many position holders and blenders are relatively small entities without the personnel or expertise available to fill the role currently played by obligated parties in policing the validity of the RINs in the market. While it is possible that they would develop this expertise over time, the relatively small size of many of these entities may mean that the important market-policing function currently performed by obligated parties could be largely compromised by changing the point of obligation. This result is more likely considering that the current obligated parties tend to have larger assets that could be put at risk from non-compliance, and therefore take compliance with the RFS very seriously. Placing the RFS compliance obligations on refiners and importers also reduces the overall cost associated with the RFS program, as these parties benefit from economies of scale and can better spread the costs associated with RIN acquisition and oversight over greater quantities of RINs.

In addition to these benefits to the program, a smaller number of obligated parties significantly decreases EPA’s resource requirements associated with the administration of the RFS program. It reduces the number of annual compliance reports that must be reviewed by EPA each year, and reduces the complexity associated with determining the volumes of non-renewable fuel for which each obligated party is responsible. This allows for more effective implementation and enforcement of the RFS program. In addition, we believe it is preferable to place the RFS

obligation on larger companies with greater resources who are better positioned to comply with the RFS standards.

We note that if we had compelling evidence in front of us that placing the RFS obligation on a larger number of renewable fuel blenders or position holders would increase the production, distribution, and use of renewable fuels, then a potentially higher number of obligated parties on its own would not be a reason to retain the current point of obligation. In light of the reasons discussed above, however, and because we don't think shifting the point of obligation would lead to higher renewable fuel production and use, we believe that placing the obligation on a smaller number of refiners and importers is preferable.

F. The Current Program Structure Does Not Require Market Repositioning to Achieve Compliance

One of the petitions EPA received requesting a change in the point of obligation in the RFS program took issue with language in previously published EPA documents suggesting that one potential avenue for obligated parties to acquire RINs is the purchase or construction of downstream blending assets. The petitioner emphasized the challenges associated with the acquisition of such assets. They further claimed that this suggestion reflects a lack of understanding of the complexities of the fuel market, and implicitly suggests that investment in blending infrastructure is the only solution for merchant refiners to comply with the RFS.

EPA strongly disagrees with the petitioner's assessments of EPA's previous statements. In the document referenced by the petitioner, EPA notes that the acquisition of downstream assets is merely one option open to obligated parties who seek an alternative to purchasing separated RINs necessary for compliance. The fact that ownership of positions at terminals and access to pipeline capacity⁵⁷ has continually changed over time suggests that similar changes are possible in the future, if parties were motivated to pursue these options. Most importantly, however, EPA disagrees with the statement that our suggestion that acquiring downstream assets as one possible option open to obligated parties implies that ownership of these assets, as well as ownership of hydrocarbon at the time when renewable fuel is blended (generally at the rack), is the only option for acquiring the RINs needed for compliance with the RFS obligations. EPA created the RIN system in accordance with Congressional direction to allow for the generation and use of credits in the RFS program.⁵⁸ Purchasing separated RINs remains an option available for all parties to acquire the RINs that are needed by obligated parties. The active market for RINs, which includes a significant stock of carryover RINs, demonstrates that RINs are available to parties who wish to purchase them. We firmly believe that the RIN market is capably fulfilling this intended purpose of creating an avenue for obligated parties to comply with their RFS obligations by purchasing RINs, rather than requiring the acquisition of distribution and blending infrastructure and/or ownership of petroleum fuels at the rack. In this way, the RIN market enables compliance with RFS obligation without disrupting the fuels marketplace. Rather than a

⁵⁷ While the ownership of positions at terminals and pipeline capacity are not necessary to enable ownership of gasoline or diesel blendstocks at the rack, ownership of these assets is one way for obligated parties to retain ownership of petroleum blendstock to the rack, where it can be blended with renewable fuels.

⁵⁸ See CAA 211(o)(5).

necessity, the acquisition of downstream infrastructure to enable direct access to RINs through the blending of renewable fuels at the rack remains one of several options. Parties may also purchase separated RINs in the RIN market, enter into contracts with other parties that blend renewable fuels to obtain RINs, and purchase renewable fuel with attached RINs, separate the RINs, and resell the renewable fuel without RINs in order to acquire the RINs needed to comply with the RFS standards.

III. Changing the Point of Obligation in the RFS Program Is Not Expected to Result in the Increased Production, Distribution, and Use of Renewable Fuels

We have discussed in the previous section several significant concerns about the impact changing the point of obligation would have on the RFS program. Given these concerns, and our overall obligation to implement the RFS program in a way that most fully achieves Congress's goal of increasing renewable fuel use, the evidence that changing the point of obligation would substantially benefit the program should be compelling to support a change. As we discuss in this section, it is not.

In their petitions submitted to EPA requesting a change to the point of obligation in the RFS program the petitioners claim that changing the point of obligation could result in greater production, distribution, and use of renewable fuels in the United States. The petitioners suggest that changing the point of obligation could therefore reduce or even eliminate the need for EPA to exercise our waiver authorities. The petitioners generally offer only theoretical arguments to support these claims. In this section we describe our evaluation of petitioners' claims that changing the point of obligation would increase the production, distribution, and use of renewable transportation fuels in the United States.

The use of EPA's waiver authorities to reduce the required volume obligations from the statutory levels in recent years is primarily the result of the delay in the commercialization of cellulosic biofuels and subsequent shortfall in cellulosic biofuel production volumes relative to the statutory requirements. In addition to the shortfall in cellulosic biofuel production, EPA also noted challenges associated with increasing the supply of renewable fuel to consumers associated with distribution and use of renewable fuels, particularly ethanol and biodiesel in its rule establishing the RFS standards for 2014-2016 and its proposed rule for 2017. In their petitions, the parties requesting that EPA change the point of obligation did not address how changing the point of obligation might impact the shortfall in cellulosic biofuel production, but instead narrowly focus on the impacts on the distribution and use of renewable fuels, particularly ethanol and biodiesel that they believe would result from changing the point of obligation. The petitioners argue that changing the point of obligation could increase the supply of renewable fuel to consumers by increasing the blending infrastructure for renewable fuels, improving the retail pricing of fuel blends with higher renewable fuel content relative to those with lower renewable fuel content, and increasing the availability of transportation fuels with higher level blends of renewable fuels at the retail level. After reviewing the petition submissions, other available data and letters opposing changing the point of obligation from companies and associations involved in the renewable fuel production, fuel distribution and renewable fuel

blending industries,⁵⁹ we believe that the benefits to renewable fuel blending claimed by the petitioners are highly unlikely to occur, as explained below. Notably, while we have received comments from large renewable fuel producers⁶⁰ and associations representing renewable fuel producers⁶¹ opposing changing the point of obligation, no renewable fuel producers or associations have expressed any support for changing the point of obligation to date. Contrary to the petitioners' claims, EPA believes that the production, distribution, and use of renewable transportation fuels is unlikely to be positively impacted by changing the point of obligation in the RFS program.

Before assessing the potential impacts on renewable fuel production, distribution, and use in the subsections that follow we first address EPA's statutory authority to place the point of obligation on various suggested parties.

A. The Proposed Changes to the Point of Obligation May Be Outside EPA's Statutory Authority

In its petition for reconsideration, the Coalition recommends that EPA move the point of obligation to "blenders and distributors" without addressing EPA's authority to do so consistent with CAA 211(o)(3). See Coalition Petition, p. 14. In its petition, the Coalition cites text from CAA 211(o)(2)(A)(iii) indicating that the regulations EPA establishes to implement the RFS program "shall contain compliance provisions applicable to refineries, blenders, distributors, and importers, as appropriate." The Coalition suggests that including "distributors" in this list of entities regarding which compliance provisions may be established would authorize EPA to establish the point of obligation for compliance with the RFS annual standards on distributors. However, the Act includes a different provision specifically identifying the parties that may be required to comply with the annual percentage standards. CAA 211(o)(3) describes the requirement for EPA to establish annual standards under the Act, and provides that "[t]he renewable fuel obligation . . . shall . . . be applicable to refineries, blenders, and importers, as appropriate."⁶² Distributors are excluded from this list. Reading these two provisions together, it is unclear whether EPA has authority under the Act to establish the point of obligation for the percentage standards on distributors, and this provides an additional reason we propose to deny this aspect of the Coalition's petition.⁶³

⁵⁹ See Presentation from Murphy USA to EPA, August 16, 2016; Letter from RaceTrac to Administrator McCarthy, August 17, 2016; Letter from QuikTrip to Administrator McCarthy, August 17, 2016; Letter from Tim Columbus to Administrator McCarthy, August 15, 2016; Letter from Pilot Flying J to Administrator McCarthy, August 16, 2016; Letter from SIGMA and RFA to Congressmen Whitfield and Rush, June 30, 2016.

⁶⁰ Comments from REG on the proposed RFS standards for 2017 and the biomass based diesel standard for 2018 (EPA-HQ-OAR-2016-0004-3477).

⁶¹ Letter from SIGMA and RFA to Congressmen Whitfield and Rush, June 30, 2016.

⁶² CAA 211(o)(3)(B)(ii)(I).

⁶³ We believe that moving the point of obligation to distributors in addition to, or in the alternative to, blenders and position holders, would result in imposition of the obligation on a large number of new parties, including small businesses. As discussed in Sections II.E. and IV, we believe that this would be a generally undesirable result, unless it could clearly be demonstrated that such a change would result in the increased production, distribution and use of renewable fuels. However, for the same reasons discussed in Sections III.B.-E., we do not believe that this would be the case.

In its petition for reconsideration and petition for rulemaking, Valero suggests that the point of obligation be placed on position holders.⁶⁴ Valero explains that position holders may or may not be blenders, but they argue that because all position holders could be blenders, EPA has the authority to impose the point of obligation on them. They propose that the “obligation [would attach] whether a party actually blends or not,” and explains that their proposed definition of obligated party “does not even make actual blending critical.”⁶⁵ It is unclear whether EPA has statutory authority to place the point of obligation on position holders who are not in fact refiners, importers, or blenders. Nevertheless, we have evaluated the merits of Valero’s proposal, as described below, and believe that the merits do not support its adoption.

B. Renewable Fuel Production, Distribution, and Use Does Not Appear to Be Significantly Limited By Blending Infrastructure

One of the ways that the petitioners claim renewable fuel production, distribution, and use could be positively impacted by changing the point of obligation in the RFS program is by increasing the incentive for the installation and expansion of renewable fuel blending infrastructure, especially at terminals. The petitioners claim that the current point of obligation results in a number of position holders and/or renewable fuel blenders that are either “naturally long on RINs” (because they market more fuel than they refine or import) or are not obligated parties under the RFS program. According to the petitioners, these parties have an incentive to oppose the installation and expansion of infrastructure needed to increase the blending of renewable fuels into transportation fuel in an effort to restrict RIN availability and drive up RIN prices.

EPA spoke with several terminal owners/operators to assess the current status of renewable fuel blending infrastructure at terminals.⁶⁶ Currently all, or nearly all, terminals contain the necessary infrastructure for the onsite storage and blending ethanol with gasoline. This infrastructure is generally used to blend petroleum blendstocks with 10% ethanol by volume to produce a finished E10 blend. Some terminals have invested in additional infrastructure, such as additional ethanol storage capacity and/or larger capacity lines and nozzles, to more readily accommodate the production of fuel blends that contain a higher proportion of ethanol, such as E85. Even without this additional infrastructure, however, all of the terminal owners/operators communicated to EPA that they were capable of producing fuel blends that contain a higher proportion of ethanol with their existing equipment. They also expressed a willingness to make the relatively modest changes necessary to accommodate faster loading times⁶⁷ if the existing infrastructure resulted in loading delays for trucks at the rack.

⁶⁴ In its petition, Valero uses the term “rack sellers” to represent those parties who own fuel above the rack. As mentioned above, we have chosen instead to use the term “position holders” to describe these parties.

⁶⁵ Valero Petition for Rulemaking, June 13, 2016.

⁶⁶ See Magellan Meeting Notes, December 16, 2015; Independent Fuel Terminal Owners Association meeting notes, January 8, 2016; Kinder Morgan meeting notes, January 22, 2016.

⁶⁷ Because most ethanol blending infrastructure is currently designed to produce E10 blends, producing higher level blends using the existing infrastructure can require longer loading times.

Biodiesel blending infrastructure at terminals is less universal than ethanol blending infrastructure. While we were unable to determine precisely what percentage of terminals have biodiesel blending infrastructure, the terminal owners/operators generally communicated that they were willing to install biodiesel blending infrastructure at terminals in situations where biodiesel is available and they could reasonably expect a return on these investments.⁶⁸ A review of publicly available information from OPIS suggests that approximately half of all terminals list prices for biodiesel and/or biodiesel blends.⁶⁹ This may in fact under-estimate the actual availability of biodiesel blends at terminals as diesel fuel containing up to 5% biodiesel is not required to be labeled as a biodiesel blend.⁷⁰ In situations where biodiesel blending infrastructure is not present at terminals, other parties have invested in alternative blending infrastructure to produce biodiesel blends downstream of terminals, further increasing the availability of biodiesel blends. Similarly, “jobbers” may take diesel fuel from bulk terminals and blend it with biodiesel before subsequent distribution, providing another opportunity for biodiesel blending.⁷¹ Furthermore, several large truck stop chains, driven by a desire to offer their customers lower priced biodiesel blends, have invested in infrastructure at retail locations to provide biodiesel blends for that location, and in some cases at other nearby retail stations.⁷² In these cases it is unclear what impact, if any, changing the point of obligation would have on the availability of biodiesel blends as the current regulations appear to be providing a substantial incentive for parties to invest in biodiesel infrastructure, both at terminals and at other downstream locations. As noted earlier, the required volume of biomass based diesel for 2017 is 100% greater than the statutory minimum volume. To the extent that renewable fuel use may be currently constrained by insufficient blending infrastructure we do not believe that changing the point of obligation would result in the additional investments claimed by the petitioners, as many of the parties that would become obligated if the petitioners’ requests were granted are already investing in blending infrastructure. While EPA continues to believe that there may be parts of the country that have limited or no access to biodiesel or biodiesel blends, this is generally the result of the higher expense and logistical complications associated with transporting biodiesel or biodiesel blends long distances to areas with little or no local biodiesel production, rather than an inability or unwillingness to invest in the necessary blending infrastructure, either at or downstream of the terminals. Furthermore, such cases continue to decline as a result of the continuing investment in biodiesel distribution infrastructure.

Based on the above information, it appears that renewable fuels and renewable fuel blends are currently widely available across the United States. Ethanol is available at all or nearly all terminals and while much of the blending infrastructure may not currently be optimized to produce higher level ethanol blends, it is capable of doing so. Biodiesel blending infrastructure is more varied, with many terminals having blending infrastructure on-site, some receiving pre-blended biodiesel, and others having access to downstream blending infrastructure. Where biodiesel blending infrastructure does not exist we believe it is primarily the result of the higher

⁶⁸ Magellan Meeting Notes, December 16, 2015.

⁶⁹ See OPIS Rack City List (<http://www.opisnet.com/resources/rackcode.aspx#biodiesel>). Approximation made by comparing the number of cities for which OPIS lists gasoline and diesel prices to the number of cities for which OPIS lists biodiesel prices.

⁷⁰ See ASTM D 975.

⁷¹ See National Biodiesel Board comments on 2017 Annual Standards Rule; Attachment 6 (EPA-HQ-OAR-2016-0004-2904).

⁷² Ibid.

expense associated with transporting biodiesel to locations with limited or no local biodiesel production.

In any case, no parties we spoke with (other than the petitioners) listed the lack of proper incentives to expand blending infrastructure as a factor limiting the blending of renewable fuels into transportation fuel. Given the observed sufficiency of blending infrastructure it does not appear that changing the point of obligation would result in increased use of renewable fuels in the United States as a result of additional blending infrastructure.

C. Changing the Point of Obligation Is Not Expected to Significantly Impact the Retail Pricing of Fuel Blends with High Renewable Content

One of the factors affecting the expansion of renewable fuel blending in the United States, identified both by EPA and the parties requesting a change to the point of obligation, is the retail pricing of fuel blends that contain higher concentrations of renewable fuel, such as E85. This is primarily an issue for fuels blended with ethanol. Biodiesel blends tend to be offered at a discount to petroleum based diesel fuel and this discount, which is significantly enabled by the value of the RINs associated with the biodiesel and the biodiesel blenders' tax credit, is regularly large enough to offset the very small impacts that biodiesel blends have on fuel economy. Retailers have often noted the ability to offer biodiesel blends at a discount to petroleum diesel fuel, and the consumer demand for lower priced biodiesel blends, as a primary reason for offering these fuels for retail sale.⁷³ The relatively high degree of competition among diesel fuel retailers and favorable pricing for biodiesel blends, together with the RFS mandates, are contributing to increasing demand for biodiesel blends and growth in biodiesel production, distribution, and use well beyond the statutory volumes.

The current retail availability and pricing for E85, however, is significantly different. E85 is currently offered for sale at approximately 3100 stations across the United States (approximately 2% of all retail fuel stations).⁷⁴ The low energy density of E85, relative to E10, means that consumers must purchase a significantly greater volume of E85 than E10, and refill their fuel tanks more frequently, to travel the same distance. While individual stations have offered E85 at a price that more than accounts for the difference in energy density between E85 and E10, this favorable pricing has not been seen for sustained time periods at a nationwide level.⁷⁵ This is despite the fact that in 2015 the relative prices of gasoline blendstocks, ethanol, and D6 RINs, as well as the limited wholesale E85 pricing information available, suggested that E85 could be offered at a price discount greater than the energy content difference between E85 and E10.⁷⁶ In a supporting document for the final rule establishing the RFS percentage standards for 2014-2016 EPA examined the potential for higher RFS standards, and the higher RIN prices that

⁷³ Letter from Pilot Flying J to Administrator McCarthy, August 16, 2016.

⁷⁴ E85 station count from the U.S. Department of Energy Alternative Fuels Data Center Alternative Fueling Station Locator. Available online at <http://www.afdc.energy.gov/locator/stations/>

⁷⁵ See E85 pricing information available at E85prices.com. E85 generally requires a minimum 22% price discount relative to E10 to be an equal cost fuel for consumers on a cost per mile traveled basis.

⁷⁶ See discussion in the final rule establishing the RFS standards for 2014-2016 (80 FR 77,420, Dec., 14, 2015).

would likely be the result, to incentivize lower E85 retail prices and higher sales volumes.⁷⁷ In this document we concluded that a lack of competition among E85 retail stations limited the ability for RIN prices to effectively impact retail E85 prices, ultimately limiting the ability of the RFS standards to incentivize a significantly greater supply of E85 to consumers in the near term.

In their requests to change the point of obligation of the RFS program, the petitioners argue that if EPA changed the point of obligation the RFS standards would have a greater ability to impact the retail price of E85 and incentivize greater use of this fuel. We find no basis for the claim that changing the point of obligation would have the results suggested by the petitioners. Rather we believe changing the point of obligation would be unlikely to impact the retail pricing of E85. We believe the primary factors inhibiting the RFS program from significantly increasing the supply of E85 to consumers are the limited number of retail stations selling E85 and the relative pricing of E85 versus E10. Further, we believe that the generally poor pricing of E85 at retail is not due to the poor pricing of E85 at the wholesale level, but is instead the result of the non-competitive retail market for E85. This non-competitive market often results in an E85 pricing strategy by retail stations that seeks to maximize fuel margins through withholding RIN value leading to greater profitability, rather than a strategy that seeks to maximize sales volumes through lower retail prices by passing a greater portion of the RIN value through to consumers. Changing the point of obligation to renewable fuel blenders or position holders at the rack is not expected to affect these underlying market fundamentals at retail stations.

One of the arguments made by the petitioners for changing the point of obligation in the RFS program is that the current point of obligation creates a dis-incentive for parties with excess RINs (parties that sell more gasoline and diesel fuel at the rack than they refine or import and un-obligated blenders) to increase the use of renewable fuels by offering fuel blends with high renewable content at attractive pricing. They argue that because these parties profit from selling RINs they are incentivized to keep the RIN prices as high as possible by restricting the blending of additional renewable fuel and/or pricing fuels with higher renewable content such as E85 at levels that are unattractive to consumers, thereby restricting the supply of RINs. According to the petitioners, if EPA were to change the point of obligation in such a way that RFS obligations were proportional to the volume of gasoline and diesel fuel that a party blends with renewable fuel and/or sells at the rack, rather than the volume of gasoline and diesel a party refines or imports, these parties would have a greater incentive to pass the RIN value through to retail station owners, who would then pass the value on to E85 consumers, ultimately reducing the retail price of E85 and increasing E85 sales.

EPA believes this argument is flawed. Because parties that blend renewable fuels or sell fuel at the rack cannot dictate the retail price of the fuels they sell (unless they also own the retail stations), changing the point of obligation of the RFS program would only be expected to directly impact the wholesale pricing of fuels such as E15 and E85, and could only impact the retail pricing of these fuels indirectly. While some of the parties that would become obligated if EPA were to change the point of obligation according to the petitions we have received (the blenders or position holders) own retail stations, many do not. Parties that do not own retail stations, or own very few, primarily impact the retail price of E85, or any fuel, through the prices

⁷⁷ “An Assessment of the Impact of RIN Prices on the Retail Price of E85,” Dallas Burkholder, Office of Transportation and Air Quality, US EPA. November 2015.

at which they offer the fuel at the wholesale level. Wholesale pricing data for E85 are currently very limited. However, what information is available, such as the wholesale E85 pricing published by the Iowa Renewable Fuels Association, shows that in Iowa the wholesale price of E85 already largely reflects the discount enabled by the RIN value associated with this fuel (See Figures 2 and 3 below for wholesale pricing for E85 and E10 in Iowa). This is consistent with letters EPA has received from fuel blenders who told EPA that it is their practice to price all the fuel they sell at the wholesale level, including E85, at a level that reflects the discount enabled by the RIN value in an effort to offer competitively priced fuel.⁷⁸ The petitioners did not provide any information that would suggest that a significant portion of the RIN value was being withheld by the wholesale providers of E85. If the RIN value is already being largely reflected in the wholesale price of E85, changing the point of obligation to parties that determine the wholesale pricing of E85 would not be expected to result in improved pricing of E85 at the wholesale level.

Even if changing the point of obligation as requested by the petitioners were to result in improved pricing of E85 at the wholesale level, we believe it is highly uncertain that this would result in improved pricing at the retail level. If pricing for E85 at retail stations does not improve, the constraint on E85 supply to consumers attributable to retail pricing will not be remedied, hindering the likelihood that sales volumes of E85 will increase significantly. The majority of retail stations (56.6%) are owned by parties who own only a single store.⁷⁹ These parties rarely, if ever, blend their own fuel or purchase fuel above the rack and therefore will not become obligated parties even if the point of obligation is changed as requested by the petitioners. They would therefore have no more of an incentive to offer E85 at discounted pricing than they do currently. Information reviewed by EPA for the state of Iowa shows that even in situations where E85 is available at a significant discount to E10 at the wholesale level, the retail pricing of E85 does not reflect this discount.

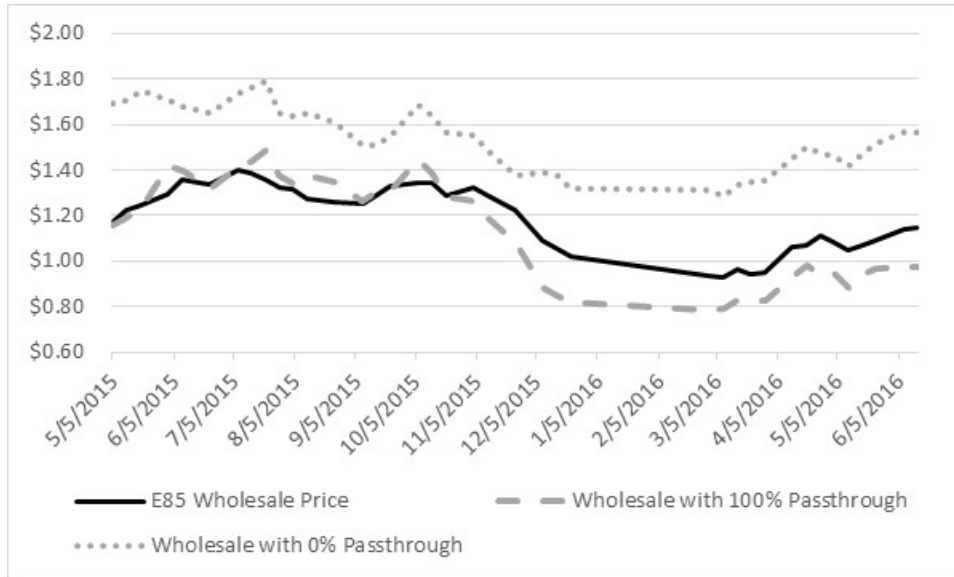
The data on wholesale and retail pricing of E85 in Iowa, shown in Figures 2 and 3 below, strongly suggest that the relatively small observed discount for E85 relative to E10 at the retail level is not a result of there being a small discount between these fuels at the wholesale level, and would not necessarily be expected to be improved by changing the point of obligation. It is worth noting that the average retail price discount for E85 relative to E10 in Iowa was very similar to the national average retail price discount, even with the significantly larger price discount for E85 relative to E10 at the wholesale level in Iowa (See Figure 3 below). The average retail price discount for E85 was less than the discount needed to make up for the lower energy content per gallon of E85 relative to E10 (approximately 22%) during much of this time period. If the wholesale E85 pricing data collected in Iowa are representative of the wholesale pricing for E85 nationwide, which we believe is likely, then the wholesale prices for E85 already reflect the majority of the RIN value and there is very little to no additional RIN value to be passed through at the wholesale level. Even if the nationwide wholesale E85 pricing generally does not reflect the RIN value, and changing the point of obligation could improve the pricing of E85 at wholesale, the data collected from Iowa suggest that significant discounts at the wholesale level would not necessarily be expected to be passed on to the retail level. The available data

⁷⁸ See Letter from Tim Columbus to Administrator McCarthy, August 15, 2016; Letter from QuikTrip to Administrator McCarthy, August 17, 2016; Letter from RaceTrac to Administrator McCarthy, August 17, 2016.

⁷⁹ http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices_2013/Pages/WhoSellsGas.aspx

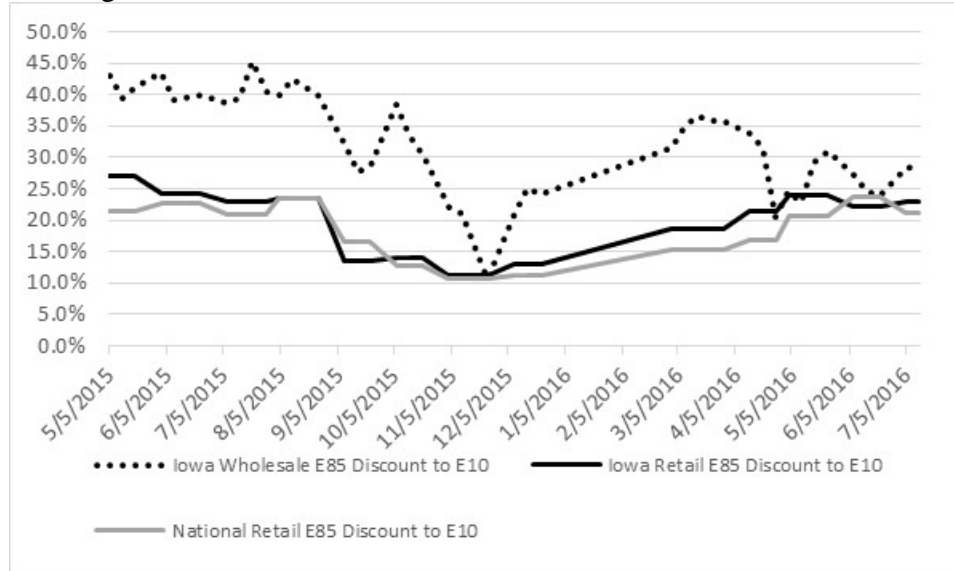
further support the view that changing the point of obligation in the RFS program is unlikely to result in a greater portion of the RIN value being reflected in the wholesale price of E85, and ultimately the retail price of E85, and will not be an effective mechanism for increasing E85 sales volumes.

Figure 2
Observed vs. Theoretical E85 Wholesale Price



E85 and E10 wholesale prices are the average price of all wholesale sellers reported by the Iowa Renewable Fuel Association (Available online at <http://iowarfa.org/retailer-center/iowa-wholesale-e85-price-listing-services/>) Ethanol price from Agricultural Marketing Resource Center (<http://www.agmrc.org/renewable-energy/ethanol/midwest-ethanol-cash-prices-basis-data-and-charts-for-selected-states/>) RIN Prices from OPIS and Argus Wholesale prices with 100% and 0% passthrough calculated using E10 and ethanol prices from the above sources and assuming the effective ethanol price is discounted by 100% and 0% of the RIN value respectively

Figure 3
E85 Pricing: Iowa Wholesale and Retail Price and National Retail Price Averages



E85 and E10 wholesale prices are the average price of all wholesale sellers reported by the Iowa Renewable Fuel Association (Available online at <http://iowarfa.org/retailer-center/iowa-wholesale-e85-price-listing-services/>) National and Iowa E10 and E85 average prices (used to calculate the national and Iowa discounts for E85 relative to E10) obtained from E85prices.com

Further, the petitioners rely on a faulty assumption when they argue that un-obligated blenders are incentivized to restrict RIN availability (by restricting renewable fuel blending) in an effort to keep RIN prices high. They assume that the overall price of RINs could be significantly reduced as a result of the increase in the supply of RINs that they claim would result from a greater proportion of the discount enabled by the RIN value being reflected in the retail price of E85.⁸⁰ The petitioners provide no evidence to support this argument. EPA estimates that total E85 sales were approximately 150 million gallons in 2014. In our final rule establishing the RVOs for 2014-2016 EPA estimated, based on available E85 price and sales volume data, that even if E85 were to be sold at retail at a 50% discount to E10 on a nationwide level, a discount more than twice the current national average, E85 sales would be expected to be just under 300 million gallons.⁸¹

Even if we assume an optimistic scenario, that if parties that are able to acquire excess RINs with the current point of obligation were able to double E85 sales to 300 million gallons per year by passing through a greater proportion of the RIN value, this would represent an opportunity to generate an additional 110 million RINs per year,⁸² or less than one percent of the total number of RINs projected to be generated in 2016. We believe this number provides a perspective on the likelihood that the additional RINs that might be able to be generated by additional sales of E85

⁸⁰ In this section EPA has primarily focused on E85, rather than other ethanol blends such as E15 or E30. This is in response to the petitions we have received, which generally focus on E85. Further, there is much more market experience with E85, relative to E15 or E30, better allowing for the types of analyses shown here.

⁸¹ 80 FR 77,420 (Dec., 14, 2015).

⁸² An additional 150 million gallons of E85 contain approximately 110 million gallons of ethanol (assuming an average ethanol content of 74% for E85) and would therefore generate approximately 110 million RINs.

would significantly reduce the overall price of RINs. Petitioners provided no information to support the claim that additional RINs would depress the overall price, and we believe it would be unlikely, as the required volumes would still be above the E10 blendwall, and over time any additional renewable volume potential would be reflected in EPA's annual required volumes. Also, if any additional RINs supplied to the market through increased sales volumes of E85 are not expected to significantly reduce the market price of RINs, then any parties that profit from E85 and/or RIN sales would maximize their profit by selling as much E85 (and the associated RINs) as possible. This appears to be the case in the current market place; parties currently separating RINs in excess of their RFS obligations are seeking to acquire as many RINs as possible as long as the cost of doing so is less than the value they can recover through the sale of the RIN. Although EPA does not believe that RIN sales by un-obligated blenders lead to windfall profits, to the extent petitioners believe otherwise their own logic would suggest that these parties should be currently be incentivized to undertake efforts to increase the sale of renewable fuel blends to increase the number of RINs sold at a profit. If this were the case, changing the point of obligation to blenders could therefore reduce such sales, since blenders would retain RINs for compliance, thereby removing an incentive for them to increase renewable fuel sales and profits.

In summary, EPA does not find the arguments made by the petitioners compelling, as they do not address what we believe to be the fundamental challenges to significantly increasing the use of renewable fuels in the near term. EPA sees no evidence that changing the point of obligation would result in greater availability or price discounts for biodiesel blends. On the other hand, supply of E85 to consumers is currently inhibited by the number of retail stations selling E85, the geographic distribution of these stations, and the relative pricing of E85 versus E10 at the retail level. For the reasons discussed in this section, EPA finds no evidence to support the position that changing the point of obligation would address the relative pricing of E85 versus E10. In the next section we discuss why EPA does not believe that data support the position that changing the point of obligation would increase the availability of E85 at retail stations.

D. Changing the Point of Obligation Is Not Expected to Significantly Impact the Availability to Consumers of Fuel Blends With Higher Renewable Content

In requesting that EPA change the point of obligation in the RFS program, some parties argue that this would result in an increase in the number of retail stations offering higher level blends of renewable fuel such as E85. They generally argue that the renewable fuel blenders and/or position holders have greater influence over the decisions made by the retail station owners, either through direct ownership or through contractual relationships. If EPA were to place the point of obligation on the blenders or position holders, the petitioners argue, they would use their influence with their retail partners to increase the number of stations offering fuel blends such as E85 in an effort to increase their access to the RINs needed for compliance.

While this argument is generally consistent with the principle that the closer the point of regulation is to the party whose behavior the regulation is intended to impact (in this case the retail station owner) the more effective the regulation is, in this case it ignores the complicated relationships that exist in the fuels marketplace as well as observations from the current

marketers of E85. Currently less than 0.5% of all fueling stations are owned by a major oil company, while approximately 50% are branded stations, selling fuel under the brand of a refiner.⁸³ It is unlikely that blenders and position holders would be more effective at encouraging retail stations to offer E85 than the refiners and importers of gasoline and diesel fuel who are affiliated with these stations. This is especially true for the nearly 60% of retail stations owned by single-store owners who are likely to face difficulties raising the capital required to install the equipment necessary to enable the sale of these fuels.⁸⁴

EPA also assessed the current affiliation of stations selling E85. We found that of the approximately 3100 stations selling E85 in the United States at the end of 2015, approximately 24% of them were branded stations (stations affiliated with a refiner) despite the fact that approximately 50% of all retail fuel stations are branded. Conversely, approximately 38% of all stations selling E85 were affiliated with a large retail chain, 27% appeared to be parties that owned only a few stations or a single retail station, and the remaining 10% were private stations or stations owned by a federal, state, or local organization.⁸⁵ Large retail chains and other unbranded stations are not currently obligated parties.⁸⁶ These data appear to contradict claims that moving the point of obligation in the RFS program would result in a greater number of stations selling fuels with higher levels of renewable fuel, such as E85. If it were the case that an RFS obligation made a party more effective in encouraging their affiliated retail stations to offer fuels containing higher levels of renewable fuel such as E85 we would expect that the stations affiliated with parties with an obligation under the current RFS regulations would have proportionally more stations offering E85 than parties who are not affiliated with a party with an RFS obligation. Instead, we find that while 50% of all retail fuel stations are branded (affiliated with a refiner), only 24% of all stations that sell E85 are branded stations. While large retail chains often directly own retail stations, thus giving them control of the fuel offerings at the stations they own, the fact that a significantly higher proportion of these stations offer E85 relative to branded stations suggests that the current point of obligation provides significant incentives for these stations to offer E85 under the right market conditions.

Table 1
Retail Fuel Stations and E85 Stations by Affiliation

	Branded Stations (affiliated with refiners)	Unbranded Stations (not affiliated with refiner)	Private Stations
All Retail Fuel Stations	50%	50%	Unknown
E85 Retail Stations	24%	66%	10%

Furthermore, while only 50% of all retail fuel stations are not affiliated with refiners, 76% of all E85 stations are not affiliated with refiners. An unbranded station is therefore approximately 3

⁸³ http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices_2013/Pages/WhoSellsGas.aspx

⁸⁴ Ibid.

⁸⁵ E85 station ownership throughout this paragraph is from EPA assessment of data from AFDC on stations offering E85 for sale. Data retrieved on 12/29/2016.

⁸⁶ Large retail chains could become obligated parties if the point of obligation were changed to the renewable fuel blender and/or the position holder. These parties may purchase fuel above or below the rack depending on the logistics and economics of fuel purchasing at various locations.

times more likely to offer E85 for sale than a branded station (Unbranded stations are approximately 2.5 times more likely to offer E85 than branded stations if we exclude consideration of private stations).⁸⁷ Parties requesting a change in the point of obligation in the RFS program have claimed that such a change would result in an increasing number of retail stations offering E85 for sale. The data does not bear this out, as E85 is offered for sale at a significantly higher rate at unbranded retail fuel stations relative to retail fuel stations that are affiliated with obligated parties. There is no evidence to suggest that the point of obligation is a significant factor in a retail station's decision whether or not to offer E85.

E. The RFS Program Continues to Create a Significant Incentive for Parties to Invest in the Infrastructure Necessary to Enable Growth in the Use of Renewable Fuels

We believe that the RFS as currently structured provides significant incentives for further growth in the use of these fuels and, as discussed elsewhere, we do not believe that the incentives for renewable fuel production, distribution, and use would be greater if we were to change the point of obligation. The value of the RIN that is generated when renewable fuels are produced allows fuel blends that contain renewable fuels to be sold at lower prices than would otherwise be possible in the absence of the RFS program. Terminal owners and operators, as well as parties that blend renewable fuels downstream of terminals, are already incentivized to invest in blending infrastructure in an effort to offer their customers the lowest cost fuels possible. Retailers are similarly incentivized to invest in the equipment necessary to offer renewable fuel blends to enable them to offer the widest range of fuel choices. In cases where a lack of competition may inhibit the full value of the RIN from being reflected in the retail price of the fuel, the RIN value can instead provide higher profit margins to the retail station owner to offset their investment in expanding renewable fuel infrastructure. This may ultimately result in more competing retail stations investing in the equipment necessary to offer E85, and with the increased competition retail prices for E85 would be expected to decrease (relative to E10) over time.

Despite the incentives provided by the RFS program, in the most recent rule establishing annual renewable volume obligations EPA determined it was necessary to exercise our waiver authority due to an inadequate domestic supply of renewable fuel. The primary factors contributing to this inadequate domestic supply of renewable fuels, such as low production volumes of cellulosic biofuel and a limited number of stations offering E85 for sale at prices competitive with E10 on an energy equivalent basis, are unlikely to be addressed by changing the point of obligation in the RFS program.

⁸⁷ Some parties have used this information to argue that refiners are actively discouraging the installation of E85 infrastructure at their branded stations in an effort to discourage renewable fuel penetration. In examining the data from AFDC, however, EPA notes that the majority of the E85 stations at unbranded fuel retail station are owned by large companies, rather than single store owners. We believe that the greater access to capital that the stations owned by large companies have relative to single store owners is likely to be a larger factor in the higher rate of adoption of E85 infrastructure at unbranded stations than any influence by refiners or the RFS point of obligation.

F. Changing the Point of Obligation Would Not Be Expected to Increase Cellulosic Biofuel Production

While there continue to be challenges related to the distribution and use of renewable fuels in the United States, the largest single challenge to meeting the RFS program's statutory volumes is the shortfall in cellulosic biofuel production. As noted above, we expect that in 2016 the supply of non-cellulosic biofuels in the United States will be 99.3% of volume envisioned by Congress in EISA, while the supply of cellulosic biofuel will be only 5.4% of the statutory volume for these fuels. The importance of cellulosic biofuels to achieving the overall goals of the RFS program only increases in future years, as over 85% of the growth in the statutory volumes from 2016 to 2022 is expected to come from cellulosic biofuel. Changing the point of obligation would not be expected to address the current research, development, and commercialization challenges that will need to be overcome to enable the production of significant volumes of cellulosic biofuel in future years. Instead, changing the point of obligation from refiners, who have significant financial resources and experience in commercializing new fuel production technologies on a large scale, to smaller downstream parties may negatively impact the ability of the cellulosic biofuels industry overcome these challenges to the degree that it reduces the incentive of the refiners to participate in the commercialization of cellulosic biofuels. Additionally, we believe that the uncertainty surrounding the RFS program that would likely result from a change in the point of obligation would discourage potential investors from investing in new cellulosic biofuel production technologies and commercial scale production facilities at a time when many cellulosic technologies are nearing commercial-scale production.

IV. Changing the Point of Obligation Would Significantly Increase the Complexity of the RFS Program

In order to minimize the number of regulated parties and reduce programmatic complexity, EPA in the RFS1 regulations placed the RFS point of obligation on the relatively small number of refiners and importers rather than on the relatively large number of downstream blenders. We noted then that the designation of downstream ethanol blenders as obligated parties would have unnecessarily greatly expanded the number of regulated parties and increased the complexity of the RFS program.⁸⁸ The same is true now. For example, consider the current point of obligation: refiners and importers. Identifying on a continuing basis those entities who produce or import gasoline and diesel fuel is relatively straightforward, as their businesses tend to operate from fixed physical locations that change infrequently, and ownership of the companies and assets also change relatively infrequently. In addition, identification and tracking of these entities is facilitated by our regulation of them under other (non-RFS) regulatory programs. However, the situation "downstream" of refiners and importers becomes much more complicated. There are a wide variety and large number of market participants, business practices, and contract mechanisms downstream of refiners and importers and the parties, practices, and ownerships among entities downstream of refiners and importers are much more variable over time. All of these factors would make imposition of the RFS point of obligation on some subset (e.g.

⁸⁸ 72 Fed. Reg. at 23923.

blenders or position holders) of parties downstream of refiners and importers substantially more complex than the current system.

In the RFS2 proposal, we requested comment on whether EPA should move the obligation downstream of refineries and importers to those parties who blend and supply finished transportation fuels to retail outlets or to wholesale purchaser-consumer facilities. In response to the proposal, stakeholders differed significantly. A few refiners, including Valero, expressed support for moving the obligations to downstream parties, while other refiners preferred to maintain the current approach. Blenders and other downstream parties generally expressed opposition to a change, citing the additional burden of demonstrating compliance with the standards, especially for small businesses. They also pointed to the need to implement new systems for determining and reporting compliance, the short lead time for doing so, and the fewer resources that smaller downstream companies have to manage such work in comparison to much larger entities such as refiners. We considered the comments received and concluded based upon the comments and information available to us that it was appropriate to maintain refiners and importers of gasoline and diesel as obligated parties under the amended RFS2 program. In explaining our reasoning, we noted that changing the point of obligation would likely result in significant increase in the number of obligated parties under the program.

Several of the petitions received by EPA cite text from the 2010 Final Rule acknowledging that one of the initial justifications given for placing the obligation on refiners and importers of gasoline and diesel, rather than on parties that are “downstream” of the refineries, was a desire to minimize the number of regulated parties in the RFS program.⁸⁹ As EPA stated in the 2010 Final Rule and Summary and Analysis of Comments, as a matter of regulatory design and implementation, it is desirable both to limit the number of obligated parties, and to limit burdening small businesses.⁹⁰ These considerations favored placing the point of obligation on the limited number of refiners and importers, rather than the larger number of blenders.

Additionally, as EPA projected in the proposed RFS2 rule, virtually all downstream blenders are currently subject to RFS registration, recordkeeping and reporting requirements associated with their role as RIN owners. EPA asked in that proposal whether, in light of this fact, it would be difficult administratively to move the obligation to these parties. The petitioners generally argue that moving the point of obligation to downstream parties would not be difficult. However, while it is likely the case that all, or nearly all downstream blenders are now regulated parties under the RFS program due to the increased blending of renewable fuels required by the RFS program,⁹¹ the majority of these downstream parties are not refiners or importers and therefore are currently not obligated parties under the RFS program. There is a significant distinction between being a “regulated party” and being an “obligated party” under the RFS program.

⁸⁹ 75 Fed. Reg. 14721 (March 26, 2010).

⁹⁰ Id, RFS2 Summary and Analysis of Comments, at 3-216.

⁹¹ Downstream blenders who blend renewable fuel into transportation fuel are subject to our recordkeeping and reporting requirements under 40 CFR 80.1451 and 80.1454. They must register with the EPA under 80.1450. Small blenders can also shift the compliance burdens if they qualify under 40 CFR 80.1440. In contrast, obligated parties must purchase the appropriate number of RINs in the market, practicing due diligence to ensure their validity, file annual compliance reports demonstrating compliance, and maintain records to that effect.

A. The Number of Obligated Parties Would Likely Increase if the Point of Obligation was shifted to “Position Holders” or “Blenders”

Valero proposes to change the point of obligation to positions holders and argues that doing so would actually reduce the number of obligated parties as compared to the number of obligated party refiners and importers that exist today. Valero provided EPA with an analysis to support their argument. Valero argues that this proposed change will be relatively easy to implement because the number of obligated parties will remain relatively the same. But as discussed in more detail below, we believe that Valero’s suggested change would result in a significant increase in the number of obligated parties. More importantly, we believe that the type of parties Valero seeks to shift the point of obligation to, and their experience level and available resources indicate that implementing Valero’s proposed change would result in a less effective RFS program that would be more difficult for EPA to implement and enforce.

As discussed above, EPA believes that all else being equal, placing the point of obligation on a smaller number of relatively large obligated parties is preferable to placing it on a larger number of relatively small entities. This approach facilitates program effectiveness by limiting the number of entities EPA must interact with to provide guidance and to ensure compliance, and it also places the burden on the larger, more sophisticated entities that are more likely to have the personnel and systems in place to enable compliance. Valero presented an argument that shifting the point of obligation would reduce the number of obligated parties relative to today’s number, and provided an analysis to support that claim.

We have reviewed Valero’s analysis, and we believe it to be flawed, due principally to their reliance on an incomplete data set (obtained from the Oil Price Information Service (OPIS)). Valero’s analysis attempts to quantify the number of obligated parties under their proposed change by identifying the entities who supply gasoline and diesel fuel for sale at wholesale rack terminals that post “wholesale rack prices”⁹² for gasoline and diesel fuels at all terminals in the United States.⁹³ They cross-referenced OPIS wholesale rack list with a list of the parties registered with EPA under Title 40 CFR Part 80 to check if these parties were the same.⁹⁴ Based on this approach, Valero found that roughly 100 entities showed up both as regulated parties

⁹² Wholesale rack price is the price at which gasoline or diesel is sold to wholesalers, typically at a terminal or truck rack. The rack price could include the cost of the gas itself, as well as transportation, overhead and profit costs, among other factors such as whether the fuel is branded or unbranded. The price can vary from terminal to terminal and depends on the cost of crude and related refining costs.

⁹³ In Valero’s July 13, 2016 Petition for Rulemaking, they compiled a the list of “rack sellers” from five sources, as of April 2016: (1) OPIS Terminal Price Posting; (2) OPIS Active Supplier List; (3) Valero’s Market research on bulk and rack activity; (4) Review of federal excise tax forms (637S) obtained by Valero; and (5) Market information received in the course of discussing the RFS issues with others in the business.

⁹⁴EPA publishes a list of all companies and facilities registered to participate in EPA’s Fuel Programs under 40 CFR Part 80 that includes gasoline, diesel fuel and RFS programs. The list can be located at <https://www.epa.gov/fuels-registration-reporting-and-compliance-help/registered-companies-and-facilities-fuel-programs>.

under EPA's RFS program and as suppliers of wholesale rack price data to OPIS.⁹⁵ They assumed that this approach identified the full list of parties that would be regulated as obligated parties if the point of obligation were shifted to position holders.

EPA independently contacted OPIS, who could not provide independent verification of Valero's estimate and further cautioned that using their client list of who posts wholesale rack price to estimate a count of position holders would likely be an underestimation because their client list only represents those parties who publicly report fuel prices at terminals (and not parties that sell fuel at the rack without publicly posting prices or who purchase fuel above the rack for their own use rather than for resale).⁹⁶ OPIS provided EPA their client list of conventional gasoline suppliers who are rack sellers. There were 77 suppliers on this list. This list does not include suppliers of reformulated gasoline or diesel.⁹⁷ The information from OPIS confirms that their client list should not be used as the sole source of information to account for all potential parties that sell fuel at the rack, and that could become potential obligated parties if the point of obligation were moved. Further, Valero's count does not include many parties that purchase fuel above the rack, but do not offer this fuel for re-sale at the rack. For example, there are hundreds of end users (e.g., railroads, delivery truck fleets), big store chains (e.g., Costco, Walmart), or retailers (e.g., Sheets, WaWa, Costco, Quiktrip) that purchase bulk fuel from refiners for use in their own fleets, or for sale at retail that would not be posting wholesale rack price and therefore would not be counted in the OPIS rack seller list. There are many other smaller parties such as fuel retailers and traders that also purchase fuel from refiners for one-off transactions. Each of these parties would become obligated parties if the obligation was placed on position holders, but would not be captured in Valero's count because their data source is OPIS rack sellers. Based on this, EPA believes Valero's estimated count of potential obligated parties under their proposed change is incomplete, and significantly underestimates the true count

In addition to assessing the OPIS data relied on by Valero, EPA conducted further analysis to determine how the number of obligated parties under the RFS program might change were we to shift the point of obligation as Valero proposes. For example, we reached out to a number of terminal operators and terminal associations, whom we believe are in a good position to understand the type and number of parties that sell, buy and blend fuel at the terminal rack since they either own/operate a terminal, or have members within their association that do.⁹⁸ These parties' estimates of the likely number of position holders ranged from 350 to over 1,000.⁹⁹ These parties stated that none of them would likely have comprehensive data to formulate an accurate count due to anti-trust regulations. The fact that the terminal operators/associations

⁹⁵ Using this approach Valero found very few parties that posted wholesale rack prices who were not registered under Title 40 CFR Part 80.

⁹⁶ See memo to the docket, titled "Emails and Data from OPIS."

⁹⁷ See memo to the docket, titled "Emails and Data from OPIS."⁹⁸ See Magellan Meeting Notes, December 16, 2015; Independent Fuel Terminal Owners Association meeting notes, January 8, 2016; Kinder Morgan meeting notes, January 22, 2016.

⁹⁸ See Magellan Meeting Notes, December 16, 2015; Independent Fuel Terminal Owners Association meeting notes, January 8, 2016; Kinder Morgan meeting notes, January 22, 2016.

⁹⁹ Ibid

estimate a much higher count than Valero's estimate of position holders indicates that Valero has significantly underestimated the total count. Both the potentially large number of position holders, and the potential variability from year to year in the parties performing these functions, suggests that they are not ideal entities, from a program implementation standpoint, on whom to place the point of obligation, and that relying on these parties to meet their compliance obligations could undermine the effectiveness of the RFS program.¹⁰⁰

Similarly, Monroe proposes to move the point of obligation downstream from refiners and importers to "blenders." Monroe does not provide data to support their argument that shifting the obligation to blenders would not create an administrative burden, but refers to Valero's preliminary analysis suggesting that the number of obligated parties may decrease depending on how EPA exercises its discretion to shift the obligation away from refiners and importers.¹⁰¹

EPA has not been able to identify an independent data source that provides a reliable estimate of the number of renewable fuel blenders and so we attempted to formulate an estimate of blenders based on data that are available to us through registrations and reported information under EPA's Part 79 and 80 fuels and fuel additives programs.

For gasoline, this data set includes parties who have registered as one or more business activities that include gasoline refiners, gasoline importers, oxygenate blenders, oxygenate producers, oxygenate importers, certified denaturant producers, certified denaturant importers and pentane producers/importers. From this data set, we estimate there are over 1,100 facilities registered as oxygenate blenders for reformulated gasoline. This count does not include entities that blend renewable fuels into conventional gasoline or diesel fuel,¹⁰² nor does it include entities that are not oxygenate blenders who are pentane blenders, butane blenders, transmix blenders, and other entities that have blending pumps that allow for on-site blending downstream of the terminals. Such parties could also be considered fuel "blenders" under a broad interpretation of the term. This count also does not include facilities that blend biodiesel¹⁰³ at terminals or at locations downstream of terminals, or facilities who currently may not be required to register under Part 79 or 80 fuels programs but who would be newly required to do so under the petitioners' proposed change. Due to the complexity of how parties register and report refining and blending operations, and due to the lack of available data from industry and other agencies, EPA is unable to provide a total count of blenders at this time.¹⁰⁴ However, based on our preliminary analysis, we believe that the number of blenders is substantially larger than the number of refiners/importers currently obligated under the RFS.

¹⁰⁰ In addition to program implementation concerns, we also note that parties who may or may not be obligated parties in any given year are unlikely to make the types of investments in the growth of renewable fuel infrastructure that EPA, and petitioners, seek.

¹⁰¹ Monroe 2016 Petition at 14.

¹⁰² Unless these parties also blend oxygenates into reformulated gasoline.

¹⁰³ EPA does not have reliable data from which to estimate the number of diesel blenders. One reason for the paucity of data is that biodiesel blenders are not required to report if they blend 5% or less into diesel.

¹⁰⁴ Our difficulty in identifying a number of blenders is one indication of the challenge that we would face if we were to attempt to shift the point of obligation to "blenders." The shifting nature of these parties and would create difficulty in assessing who the obligated parties may be.

For the 2013 compliance year, there were a total of 142 obligated parties (refiners and importers of gasoline and diesel) registered under the RFS program. Valero claims the number of obligated parties would be reduced to about 100 obligated parties under their proposed change to shift the obligation to position holders. EPA's data set shows there are over 1,100 facilities registered as reformulated gasoline oxygenate blenders (without the additional count of biodiesel blenders, and blenders of ethanol into CBOB), which appears to disprove Monroe's claims that the existing count of obligated parties would not increase (or possibly decrease), if the point of obligation was shifted to blenders. As discussed above, it is very difficult to obtain a comprehensive list of all position holders and blenders. Based on the facts before us, EPA believes shifting the obligation to either the position holder or to blenders would likely significantly increase the number of obligated parties and would result in a significant increase in administrative burden for EPA to implement and enforce the RFS program. As discussed further below, the administrative burden on EPA could be more acute than the larger numbers alone would suggest, in light of the different type of parties that could be regulated, and possible challenges they may face complying with RFS program requirements.

B. The Potential for Noncompliance would Likely Increase if the Point of Obligation is Changed

Currently, many of the obligated parties are large entities with sufficient resources, staff, expertise and tools to comply with registration, reporting and recordkeeping requirements under the RFS program. EPA is concerned that moving the point of obligation as proposed by the petitioners could bring in many small entities that may not have the resources or expertise to comply. To investigate the possibility that parties without RFS expertise would be newly regulated, we were able to locate a selection of states' public list of parties registered to sell fuel at the rack (and which of these parties had reported taxable gallons) and to cross reference these lists against EPA's Title 40 CFR Part 80 registered list. In the state of California alone, during the reported period of March 2016, there were 147 registered parties¹⁰⁵, of which 37 parties reported taxable gallons.¹⁰⁶ Of those 37 parties, we determined that 25 (65%) were not registered under the RFS program.¹⁰⁷ A second check with Ohio's public list for fuel excise tax provided similar results. For Ohio during the reported period of February 2016, there were 215 parties that reported taxable gallons, of which 198 (93%) were not registered under the RFS/fuels program.¹⁰⁸ The high percentage of businesses on California's and Ohio's list of position holders that are not currently registered under the RFS/fuels program indicates that a great many position

¹⁰⁵ Each of the 147 registered parties are potential position holders (or rack sellers), however only the 37 parties that reported taxable gallons operated as position holders in March 2016.

¹⁰⁶ In California, the motor vehicle fuel tax is imposed upon each gallon of fuel entered, or removed from a refinery or terminal rack in this state. https://www.boe.ca.gov/sptaxprog/reports/Mar-16_MVF_Distribution_Report.pdf

¹⁰⁷ In Ohio, an excise tax applies to all dealers of motor vehicle fuel on the use, distribution or sale within Ohio of fuel used to generate power for the operation of motor vehicles. Motor vehicle fuel wholesale dealers remit the tax. <https://www.epa.gov/fuels-registration-reporting-and-compliance-help/registered-companies-and-facilities-fuel-programs>.

¹⁰⁸ http://www.tax.ohio.gov/excise/motor_fuel/motor_fuel_dealers.aspx

holders are not renewable fuel blenders, and also suggests that these parties may have little practical experience with or understanding of the RFS program. The addition of a number of small entities with relatively less regulatory experience and expertise, could lead to increased overall noncompliance with RFS requirements. Overall, this could be seen as increasing the burden on the entities due to an influx of more parties (many of which may be small businesses) that have little or no familiarity with the RFS program and it would likely also increase the administrative burden on EPA to help educate these entities to help them comply, and to ensure their compliance.

Further, in any rulemaking to modify the RFS point of obligation, EPA would need to consider impacts to small entities, as it did in its prior rulemakings. Congress itself considered the relief appropriate for small refineries that are obligated parties, exempting them through 2010 and then allowing for an extension of their exemption if warranted by a DOE study or through EPA's review of small refinery petitions alleging that their compliance would result in disproportionate economic hardship. EPA used its discretion in the 2010 RFS2 rule to extend similar relief to the few additional small refiners that did not qualify as small refineries. EPA convened a Panel under the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) to consider whether additional relief to small refiners or refineries was warranted. Were we to propose changing the point of obligation, we would need to ensure that small businesses were aware of this proposed change and potential impact to their business by re-engaging in the SBREFA process. Since the statute contains no specific provisions providing relief for small entities that are position holders or blenders, EPA's analysis in considering the need for, and fashioning appropriate relief would potentially be more complex. The SBREFA process includes a number of steps and would take some time to implement properly. For example, before beginning the formal SBREFA process, EPA would need to engage in outreach with entities that would potentially be affected by the proposed change and provide the small businesses with an early opportunity to ask questions and discuss their concerns with the upcoming rulemaking. Furthermore, we reasonably expect that there would be strong interest from some stakeholders to exempt small businesses from RFS obligations. If exempted, these parties could have a (potentially significant) financial advantage over parties that do have RFS obligations and this dynamic could result in an increasing number of small businesses entering this market. Regardless of the outcome of the SBREFA process, it is clear that the RFS market would experience significant uncertainty in such a transition.

We expect there would be more non-compliance if we changed the point of obligation because blenders and position holders are likely to have less experience and less resources to be able to comply with the registration, reporting and recordkeeping requirements under the national RFS program. Further, we believe the number of obligated parties would dramatically increase, which would place greater strain on limited resources to ensure compliance and conduct program oversight. While current obligated parties typically have significant assets that could potentially be used to pay civil penalties and to purchase RINs to replace any determined to be fraudulent it is reasonable to assume that position holders and blenders have relatively fewer tangible assets or real property. It is possible that companies with few tangible assets could violate the RFS

standards, make a quick profit, and shut down or leave the country without being brought to justice for their actions. Even if we were able to locate these parties and prevailed in the civil or criminal proceedings, these parties could file for bankruptcy and never have to purchase replacement RINs or pay penalties associated with noncompliance. This could lead to less renewable fuel use than intended, and could unfairly disadvantage other obligated parties that meet their RFS obligations. The increased potential for EPA to not be able to ensure through enforcement actions that the RIN system is made whole for any noncompliance would negatively impact the integrity of the RFS program, and introduce more uncertainty into the RIN market.

C. EPA Would Need to Address Carry-Over RINs and RIN Deficits

The current RFS regulations allow parties to satisfy up to 20% of any given RVO with RINs generated in the previous year, effectively allowing parties to “carry over” a limited number of RINs for use towards satisfying their compliance obligations the following year. Similarly, obligated parties that have an insufficient number of RINs to demonstrate compliance at the compliance deadline may carry forward the deficit into the following year without penalty, provided they satisfy both their deficit and full RVO the following year. Compliance data submitted to EPA suggests that in aggregate parties carried over approximately 1.8 billion 2013 RINs into 2014. Since EPA established the 2014 and 2015 standards equal to the number of RINs generated in these years we expect that a similar number of carry over RINs will be available for use in 2016. While much smaller in magnitude, a number of parties also carried forward deficits from 2013 into 2014.

If EPA changed the point of obligation to the fuel blenders or position holders we would also impact the RVOs for obligated parties in future years relative to what they would have reasonably anticipated under the existing point of obligation. In some cases these changes could be significant. Refiners and importers with significantly lower RVOs under the new point of obligation may find themselves in possession of significantly more RINs, including carryover RINs, than they desire or can use. Conversely, parties with a significantly higher RVO under the new point of obligation may find themselves with lower balances than they would desire to protect themselves against shortfalls in RIN availability or RIN price volatility. Unlike the current situation, where the number of carryover RINs held by an obligated party is primarily the result of the decisions made by that party under a consistent regulatory structure, the change in the size of each obligated party’s RIN holdings relative to its obligations under the RFS program would be the result in a change in the definition of the obligated parties many years after the point of obligation was established through a notice and comment rulemaking.

The tradable nature of the RINs in the RFS program would help to mitigate these potential negative impacts. Parties with excess RINs could recover some or all of the costs associated with acquiring these RINs, or potentially make a profit, by selling them to newly obligated parties or those who desire to acquire a bank of carryover RINs to protect themselves from future RIN shortfalls or market volatility. The ability for parties that possess excess carryover RINs to recover the cost of the RINs they hold by selling them to other parties, however, will be largely impacted by the effect changing the point of obligation has on the price of RINs. If, as some of

the petitioners have suggested, as a feasible or desirable outcome of changing the point of obligation the price of RINs were to fall dramatically, then this change could have a significant negative financial impact on parties that find themselves in the possession of excess RINs due to a change in the point of obligation. Allowing sufficient notice and lead time for any change in the point of obligation could allow parties impacted by the change sufficient time to purchase or sell the RINs needed to better align their RIN holdings with their RFS obligations, but price impacts could be realized quickly after announcing the change to the point of obligation. Even if, as EPA believes, changing the point of obligation provides no benefit to the overall supply of renewable fuel used as transportation fuel, and therefore no reduction in the price of RINs, significant market volatility could result, and steps to mitigate market volatility (e.g. providing significant lead time) would likely be in tension with the objectives for changing the point of obligation.

D. Changing the Point of Obligation Would Require Significant Changes to EMTS and Other Electronic Systems

A change in the point of obligation would necessitate changes to the Agency's registration and reporting systems. This would result in adding complexity and stress to already complex systems. It could potentially lead to degradation in service and reduced availability to all system users. For any given compliance year since 2010, between 1,300 – 1,500 parties participate in the RFS program as renewable fuel producers, RIN owners or obligated parties. Currently, EMTS averages about 23,000 transactions daily.

As discussed previously, shifting the point of obligation downstream could result in 1,100 or more obligated parties in EMTS. This could result in an increase in EMTS transactions (transfers, separations and retirements) as RINs change hands between a greater number of obligated parties, without any increase to the total number of RINs in the system. The OTAQReg registration system would need to be modified to reflect the new definition of obligated party, and both existing blenders and new participants would need to register/re-register. Rights and access controls to EMTS would need to be revised to ensure proper reporting and oversight of RIN transactions.

In addition to changes to reflect the additional numbers and roles of registrants in EMTS, changing the point of obligation may require additional functionality for EMTS to take account of changes in business practices and additional potential for non-compliance, including avoiding compliance obligations, failure to identify as an obligated party, or not understanding RFS requirements. EPA may find that the additional potential for non-compliance requires additional reporting of information not currently tracked in EMTS, such as accounting movements of physical volumes of gasoline and diesel fuel between potential obligated parties similar to a designate-and-track system to ensure that RFS obligations are assigned to the proper parties. Such a system would include additional reporting by parties such as refiners, marketers, and blenders to ensure RFS goals are being met. Ancillary reports such as quarterly and annual compliance reports submitted to CDX and annual attest engagements would also increase in volume and complexity.

V. Changing the Point of Obligation Could Cause Significant Market Disruption

In the petitions EPA has received requesting a change to the point of obligation in the RFS program, the petitioners generally characterize their proposed changes to the point of obligation as minor or simple. EPA disagrees with these characterizations and believes that changing the point of obligation would be a significant change for the RFS program, and would likely lead to significant changes in the fuels marketplace more generally.

A. Market Participants Have Made Significant Decisions on the Basis of the Existing Regulations

When EPA first instituted the RFS program in 2007, and again when EPA significantly revised the RFS regulations in 2010 in response to the EISA amendments EPA requested and received many comments related to the point of obligation of the RFS program. These comments were carefully considered and EPA specifically sought the input of the refining industry. The decision to place the point of obligation on refiners and importers in 2007, and to uphold that decision in 2010, was made with the support of much of the refining industry.

Since then all parties regulated in the RFS program have made significant investments and decisions about their participation in the program and their position in the market on the basis of the existing regulations, including the definition of obligated parties. Some parties sought to increase their access to RINs acquired by blending renewable fuels by expanding their presence at terminals where renewable fuels are blended, or investing in blending infrastructure downstream of terminals. Other parties entered into contracts to purchase renewable fuel with attached RINs and/or separated RINS to satisfy their own needs or for re-sale to obligated parties, while yet others became major renewable fuel suppliers as well. Each year obligated parties decided how to best satisfy current and future RIN obligations, including whether or not to carry over RIN deficits or excess RINs into future years.

Each of these decisions was made with the expectation that each party's RFS obligation in future years would continue to be proportional to the volume of gasoline and diesel fuel they refine or import, as is the case under the current RFS regulations. If EPA were to change the point of obligation as requested by the petitioners, RFS obligations would instead be proportional to the volume of gasoline or diesel fuel that parties blend with renewable fuel, or the volume of gasoline and diesel fuel sold by parties immediately above the rack. This would substantially impact the relative size of many parties' RFS obligations and would very likely result in efforts to reposition themselves in the marketplace, either by renegotiating contracts or even seeking to buy or sell assets associated with the blending of renewable fuels. If changing the point of obligation of the RFS program were reasonably likely to result in a significant increase in the amount of renewable fuel that was produced, distributed, and used in the United States relative to the current point of obligation such a change may be justified; however since any increase in renewable fuel production, distribution, and use that results from changing the point of obligation is likely to be minimal at best, these impacts are important to consider.

B. If the Point of Obligation is Changed, Parties Would be Expected To Reposition Themselves to Avoid RFS Obligations

One of the desired outcomes of changing the point of obligation in the RFS program expressed by the petitioners is to shift the obligation to renewable fuel blenders or position holders that have access to RINs through the blending of renewable fuels. While assessing these petitions EPA received letters from a number of independent fuel marketers and parties that owned a large number of retail fueling stations.¹⁰⁹ These parties are generally not currently obligated parties (because they do not typically refine gasoline or diesel fuel, however on occasion some import gasoline and/or diesel fuel), but would likely become obligated parties if EPA changed the point of obligation as requested by the petitioners as they blend renewable fuels and/or are position holders at terminals. In addition to questioning many of the benefits of changing the point of obligation claimed by the petitioners, these parties stated that if EPA changed the point of obligation they would likely adjust their business practices in an effort to avoid becoming obligated parties, either by purchasing fuels already blended with transportation fuel and/or purchasing fuel below the rack.¹¹⁰

In their letters to EPA, these parties acknowledged that by moving below the rack they may give up a number of advantages that contribute to their profitability, such as the ability to purchase fuel in bulk at a slight discount, the ability to better control their fuel supply, and advantages related to the collection of taxes. Nevertheless, these parties stated that the costs associated with becoming obligated parties, primarily the costs associated with developing expertise necessary to manage their new RFS obligations and the documentation requirements, may very well outweigh any benefits currently experienced in their position as renewable fuel blenders and/or position holders. In their arguments these parties referenced their experience with California's LCFS program, which allows compliance obligations to be passed on to the position holders. They stated that this has resulted in less competitive markets at the rack, as many parties sought to purchase fuel below the rack, rather than above the rack, to avoid LCFS obligations. They claimed that this would be especially true for the many small entities currently engaged in the gasoline and diesel fuel spot markets. EPA primarily spoke to larger businesses that are currently blenders of renewable fuels and/or position holders, however any overhead costs associated with being an obligated party would likely be proportionally more significant for small businesses.

If parties that would become obligated parties for the first time if EPA were to change the point of obligation as requested by the petitioners react as they have claimed in discussions with EPA, by adjusting their business practices to avoid becoming obligated parties under the new definition, this would significantly impact the expected results of such a change. Some of the concerns raised by EPA, such as the large number of new parties that would become obligated parties under the new definition and the relatively small nature of these parties, would be

¹⁰⁹ See Letter from Tim Columbus to Administrator McCarthy, August 15, 2016; Letter from RaceTrac to Administrator McCarthy, August 17, 2016; Letter from QuikTrip to Administrator McCarthy, August 17, 2016; Letter from Pilot Flying J to Administrator McCarthy, August 16, 2016.

¹¹⁰ Ibid.

mitigated, as these parties likely would adjust their businesses to avoid becoming obligated parties under the new definition. However, many of the benefits the petitioners claim would result from changing the point of obligation would also be significantly reduced. These benefits are dependent on the change in the definition of obligated parties reallocating the RFS obligation among the various participants in the fuels marketplace.

While it is uncertain which parties would ultimately have increased obligations if EPA were to change the point of obligation as requested by the petitioners, it is possible that as independent fuel marketers and retail station owners exit their current market positions as renewable fuel blenders and position holders, the current obligated parties (the refiners and importers of gasoline and diesel fuel), would take up these positions in an effort to find consumers for the fuel they produce and import. If this were to happen, the end result of this significant market restructuring would be that the RFS obligations would not substantially change from what they are under the current definition of obligated parties. Refiners and importers would likely take on terminal positions and the role of blending renewable fuels abandoned by the parties who currently satisfy these roles in the market. Ultimately we believe that the RFS obligations may not be substantially different in this scenario than they are today, and if this were the case the benefits claimed by the petitioners would not be realized. During the time period when EPA went through the rulemaking process to change the point of obligation, however, and as the fuels marketplace adjusted to the realities of the change in the point of obligation there would be significant market uncertainty and potential turmoil. To the degree that EPA invests significant agency resources to enable the change in the point of obligation and fuels industry participants withhold significant investment decisions until EPA's final decision and the fallout from the decision are known, this could have a significant negative impact on achieving the goals of the RFS program.

While changing the point of obligation in the RFS program would be unlikely to better achieve the goals of the RFS program, especially if many of the fuel blenders, independent marketers, and retail station owners change their business practices to avoid becoming obligated parties, these changes could have broader negative impacts in the fuels marketplace. If the independent marketers and retail station owners cease to be position holders, we believe the market positions they vacate are likely to be taken up by existing refiners. This could start to reverse the fuel industry's transition over the last decade to move away from the integrated model in which refiners disinvested from downstream infrastructure at wholesale and retail. The integrated model has previously caused concerns regarding price impacts and manipulation in the market. We believe that changing the point of obligation could provide an incentive for a shift in control to a relatively few large parties upstream and remove choices and flexibilities that downstream businesses have negotiated over the years in order to hold a position in what is currently a highly competitive fuels market. Changing the point of obligation as requested by the petitioners could result in greater market concentration in certain markets. For example, if independent marketers and retailers give up their positions at terminals in an effort to avoid becoming obligated parties it is possible that some terminals could become dominated by a small number of refiners, or in an extreme situation a single refiner. This reduction in competition could result in higher fuel prices for the retail stations that purchase fuel from these terminals, and ultimately for their consumers. The absence of independent marketer and retail station owners at terminals may also negatively impact the ability for retail station owners to purchase fuel on the spot market, instead forcing

them to rely on longer term contracts with refiners to a greater degree. This would further limit the retailers' options to purchase the lowest cost fuel. These are just examples of the negative impacts that could result from broader market restructuring if EPA were to change the point of obligation of the RFS program as requested by the petitioners.

VI. Conclusion

Congress authorized EPA to require "refiners, importers, and blenders, as appropriate" to be obligated parties in the RFS program.¹¹¹ After reviewing the petitions EPA has received requesting changes to the point of obligation in the RFS program, assessing the relevant data available to EPA, and speaking with numerous other parties that would likely be impacted by the requested change, EPA does not believe there is a sufficient basis to support changing the point of obligation at this time. We believe that the parties requesting this change significantly underestimate the scope and impacts of the changes that would result from the number and nature of additional parties that would become obligated parties if the point of obligation were changed. Most importantly, we do not believe the petitioners have presented sufficient evidence that the changes they have requested would result in additional production, distribution, and use of renewable fuels as transportation fuel in the United States. If anything we believe it could negatively impact renewable fuel volumes, especially during the substantial transition that would be required. EPA has evaluated the functionality of the RIN market and believes that the RIN program provides a generally efficient and equitable means for all obligated parties to meet their compliance obligations, and that the shortfalls in renewable fuels to date are attributable to broader market forces that would be unaffected by merely changing the point of obligation. Finally, we believe that it is likely that if the changes requested by the petitioners were made, many of the parties that would become obligated parties as a result of the change in the definition of obligated parties would reposition themselves in an effort to avoid or minimize their obligations under the RFS program. Such market repositioning would likely minimize any long term impacts of the proposed change on the production, distribution, and use of renewable fuel, but may also have far-reaching negative consequences across the fuels marketplace, and increase fuel prices for consumers. In these circumstances, EPA believes the point of obligation should be retained to promote stability and regulatory certainty, and because the program is more likely to succeed with the current set of obligated parties.

Nevertheless, we remain committed to the long term success of the RFS program. To this end, we desire to give full consideration to regulatory changes that may enhance the ability for the RFS program to achieve the goals of greater production, distribution, and use of renewable fuels as transportation fuel in the United States. We are therefore opening a docket to formally receive comments on the petitions submitted to EPA to change the point of obligation in the RFS program from the refiners and importers of gasoline and diesel fuel to other parties, such as blenders or position holders of these fuels. This docket will remain open for 60 days. Following the close of the comment period, EPA will review the comments we have received and determine whether or not to proceed with a proposed rule to change the point of obligation in the RFS program. EPA specifically requests comments that address whether or not changing the point of obligation in the RFS program would be likely to significantly increase the production,

¹¹¹ CAA Section 211(o)(3)(B)(ii)(I).

distribution, and use of renewable fuels as transportation fuel in the United States, as well as any data that can substantiate such claims. We also seek comment on any of the issues discussed here, including EPA's authority to place the point of obligation on distributors and position holders; the significance of limiting the number and nature of obligated parties; the number of parties that are currently blenders or position holders; the extent to which blenders and position holders may be small businesses for whom designation as an obligated party would be particularly burdensome; whether it is likely that renewable fuel blenders and/or position holders would reposition themselves in the market to avoid RFS obligations and the likely impact of such repositioning; the significance of transitional issues and potential regulatory uncertainty that would result from changing the point of obligation; and the extent to which a change in the point of obligation could lead to unintended market changes or consequences.

EXHIBIT C



November 3, 2016

Certified #7012 1010 0000 6146 1565

VIA CERTIFIED MAIL

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

Re: Notice of Intent to Sue

Dear Administrator McCarthy:

Earlier this year, Valero Energy Corporation and its subsidiaries (“Valero”) submitted a petition for a rulemaking to EPA requesting that EPA initiate a rulemaking to correct a flaw in the Renewable Fuel Standard (“RFS”) program, specifically the Point of Obligation in the RFS (the “Petition”). Valero has worked tirelessly to provide EPA data and all information relevant to the Point of Obligation and the requested revision. Valero will continue to fully cooperate with EPA regarding any information EPA might need to evaluate the Petition and the issue. However, Valero must pursue all legal avenues available to promote a change in the RFS program that Valero believes is necessary for the program’s success.

Litigation is not Valero’s preferred means of resolving this regulatory issue. We consider it now only because of the dire situation created by the current misalignment of the Point of Compliance and the Point of Obligation. Under the Clean Air Act (“CAA”), Congress authorized aggrieved parties to challenge EPA action or inaction. To proceed with litigation, the CAA requires advance notice of the intent to bring such action. Therefore, pursuant to the CAA’s citizen-suit provision, 42 U.S.C. § 7604(b)(2), Valero hereby notifies you of Valero’s intent to file suit against EPA for failing “to perform [an] act or duty under [the] [Clean Air] Act which is not discretionary with the Administrator.” 42 U.S.C. § 7604(a)(2). This Notice of Intent to Sue provides the necessary notice required before such actions can be filed with a court, which may occur sixty (60) days from the date of this notice. 42 U.S.C. § 7604. Alternatively, this letter also serves as Valero’s notice of intent to file suit for agency action unreasonably delayed under Section 304(a)(3) of the CAA. 42 U.S.C. § 7604(a); *see* 40 C.F.R. § 54.

Specifically, EPA has failed under the Act to perform these non-discretionary duties, which relate to defining the obligated party for Renewable Fuel Standards (“RFS”):

- To “determine and publish” a regulation “that ensures that the requirements of” the CAA’s RFS program are met, as required by CAA § 211(o)(3)(B). *See* 42 U.S.C. § 7545(o)(3)(B).

- To conduct “periodic reviews of . . . the feasibility of achieving compliance with the requirements” and of “the impacts of the requirements . . . on each individual and entity” regulated under the program “[t]o allow for appropriate adjustment” of the statutory volumes, as required by CAA § 211(o)(11). *See* 42 U.S.C. § 7545(o)(11).
- To regulate entities, as appropriate, to ensure that EPA’s own rule does not contribute to the necessary use of the statute’s waiver authority to address the inadequate supply of renewable fuel. *See* 42 U.S.C. § 7545(o)(2)(A), (o)(3)(B).

The CAA and EPA regulations compel EPA to fulfill these duties within sufficient time to publish a final rule every November. CAA § 211(o)(3)(B)(i); 40 C.F.R. § 80.1405(b). Alternatively, if these duties are found to be discretionary, EPA has unreasonably delayed fulfilling these duties.

The harms flowing from these omissions are exacerbated by the continuing constraint on the supply of renewable fuel to consumers, a constraint that EPA has correctly acknowledged. 80 Fed. Reg. at 77,457. To address the renewable fuel supply constraint, on December 14, 2015, EPA relied on statutory waiver authority to adjust renewable fuel volumes below statutorily mandated levels for the renewable fuel obligation (“RVO”) for calendar years 2014, 2015, and 2016 (the “2015 RVO Rule”). EPA nonetheless has failed to consider and address through rulemaking its determination of the appropriate party obligated to satisfy the RFS volumes. The current Point of Obligation itself (i) functions as a renewable fuel supply constraint and (ii) imposes unjustifiable and disproportionate impacts among obligated refiners.

Valero is directly and indirectly harmed by EPA’s failure to fulfill its statutory duties. The market inefficiencies associated with the misplaced Point of Obligation harm Valero both as a refiner and a renewable fuel producer. As a refiner, Valero is an obligated party under the RFS rules and must comply with the RFS volume mandates. As a renewable fuel producer, Valero is harmed by any constraint on the renewable fuel market that fails to ensure that transportation fuels contain at least the minimum statutorily specified volumes of renewable fuel. Relief is particularly important when harms, like this one, are created by EPA’s RFS rule and are within EPA’s authority to correct.

Worse than harming the affected parties, however, the market inefficiencies created by the current RFS in no way advance the CAA’s renewable fuel goals and, in fact, affirmatively undermine them. Under the CAA and fundamental principles of administrative law, EPA is duty-bound to investigate the impacts of its regulatory requirements and to appropriately adjust its regulations to ensure that they support the growth of the renewable fuel market. These failings can be addressed through a rulemaking pursuant to the Clean Air Act and the Administrative Procedure Act.

Valero has petitioned EPA to conduct a rulemaking that would satisfy these mandatory duties and would provide the forum for EPA's thorough consideration of adjusting the Point of Obligation to maximize the supply of renewable fuels in the market. Although EPA ultimately has discretion to determine whether the rule revision is appropriate and has discretion as to the substance of the rule, that discretion does not "convert this mandatory duty to a discretionary one, as '[i]t is rudimentary administrative law that discretion as to the substance of the ultimate decision does not confer discretion to ignore the required procedures of decisionmaking.'"¹

Background

In the 2015 RVO Rule, EPA increased renewable fuel volume mandates for 2014, 2015, and 2016. However, EPA adjusted the volume mandates to below statutorily mandated levels by relying on the statutory general waiver authority and EPA's determination that there is an inadequate domestic supply of renewable fuels. 80 Fed. Reg. 77,420 (Dec. 14, 2015). The 2015 RVO Rule was EPA's first use of the RFS general waiver authority. It was also EPA's first acknowledgement of supply constraints, including the blendwall, that impact the total RFS volumes. EPA's basis for using the general waiver authority underscores the need for EPA to satisfy several mandatory duties within prescribed timeframes when setting (and considering adjustments to) the renewable fuel volumes.

In the proposed 2015 RVO rule, EPA asserted that its broad interpretation of "inadequate domestic supply" encompasses "the full range of constraints that could result in an inadequate supply of renewable fuel to the ultimate consumers, including fuel infrastructure and other constraints." 80 Fed. Reg. at 33,111. Valero's comments on the proposed rule established that the Point of Obligation is a constraint on supply that EPA must address, because EPA otherwise could not ensure that the market would increase the supply of available renewable fuels to consumers. Valero also emphasized that, unless EPA corrected the Point of Obligation constraint, the market would not function properly, seriously undermining the CAA's express goal of expanding the availability of renewable fuels. EPA rejected Valero's comments related to the Point of Obligation solely because, in EPA's view, the issue was beyond the scope of the rule.² EPA's refusal to explore the supply ramifications of obligating refiners and importers to comply with the volume mandate is at odds with EPA's insistence in the Rule that all supply constraints were under review.

When EPA adopted the 2014-2016 RVOs, it failed to comply with its non-discretionary duties related to appropriate regulations under CAA § 211(o)(3)(B)(ii)(I). As explained below,

¹ *Appalachian Voices v. McCarthy*, 989 F. Supp. 2d 30, 54 (D.D.C. 2013) (quoting *Sierra Club v. Leavitt*, 355 F. Supp. 2d 544, 550 (D.D.C.2005) (Walton, J.) (quoting *Bennett*, 520 U.S. at 172)).

² Valero does not agree that the issue is outside the scope of the rule and preserves its arguments related to Valero's Petition for Review of the rule. EPA's characterization of the Point of Obligation as outside the scope of proposal of the 2015 RVO Rule, however, also indicates that EPA did not consider Valero's comments and, as a result, EPA failed to respond substantively to Valero's comments in the 2015 RVO Rule. Valero preserves arguments regarding EPA's obligation to consider and respond to significant comments for the Petition for Review; this NOI is not intended to address EPA's obligations related to Valero's comments on the 2015 RVO Rule.

EPA's nondiscretionary duties did not end when it promulgated the Point of Obligation regulations that still apply today. Nothing in the Act mandates that EPA must meet its obligation within the RVO rule itself rather than through a separate rulemaking. Thus, EPA remains obligated to promptly fulfill its continuing, nondiscretionary duties that Congress imposed on it, even though the 2016 RVOs were set in the 2015 RVO Rule.

The statute also requires EPA to periodically evaluate the RFS program's impact on individuals and entities subject to it as obligated parties. *See* CAA § 211(o)(11). EPA acknowledged in the preamble to the 2015 RVO Rule that the RFS program is at a critical transition stage. 80 Fed. Reg. at 77,423. EPA has not undertaken the statutorily mandated evaluations, which are specifically designed to generate appropriate adjustments to the RFS program to "ensure" that specified minimum volumes of renewable fuel enter the market. EPA, therefore, must complete the evaluations and make appropriate adjustments to the RFS program.

This notice and Valero's Petition for Rulemaking seek a rulemaking applicable to calendar years 2016 and thereafter. EPA action is necessary for 2016 and 2017 to prevent further harm resulting from an already-distorted renewable fuel market. Absent a change to the Point of Obligation, EPA will adversely affect the renewable fuel market beyond the adjustment to the statutory mandates for 2014, 2015, and 2016. By using only its general waiver authority and failing to consider the effect of an improperly placed Point of Obligation, EPA ensures supply constraints will be magnified. This result is far worse than not advancing the statutory goal—it affirmatively *impedes* the CAA's purpose of ensuring adequate supply in the coming years. This EPA-induced constraint on supply will annually undermine the goal of the RFS program and will result in EPA's serial use of waiver authority for RVOs through 2022 to set volumes that do not reflect a properly functioning market.

Additionally, because of the current structure of the RFS program, to comply with the 2016 mandated volumes, obligated parties that lack control at the Point of Compliance will use carry-over RINs and will draw down the RIN credits made available in the RIN bank from prior years. Without a change in the Point of Obligation, those obligated parties will face excessive compliance costs because they have no control over the means of compliance. EPA should undertake the required analyses as soon as possible to fully explore these troubling outcomes.

I. EPA has failed to perform mandatory duties that ensure that statutory volumes of renewable fuel are met.

Through the RFS program, Congress mandated the introduction of increasing volumes of renewable fuel into the pool of transportation fuel. CAA § 211(o)(2)(A)(i). EPA unequivocally embraces this goal: "the fundamental objective of the RFS provisions under the CAA is clear: To increase the use of renewable fuel in the U.S. transportation system every year through at least 2022 in order to reduce greenhouse gases (GHGs) and increase energy security." 80 Fed. Reg. at 77,421. EPA must implement the mandates of the statute—including the *continuing* duties the statute imposes—consistent with this objective.

Congress imposed two specific continuing obligations on EPA relevant to the Point of Obligation; EPA has satisfied neither. Congress also established the timeframe for these duties. EPA has invoked its waiver authority to change the minimum volume requirements, but use of that authority should be informed by the continuing duties that EPA has thus far ignored. Valero addresses these three points in turn.

A. The CAA imposes two continuing nondiscretionary duties on EPA, neither of which EPA has satisfied.

1. EPA must annually evaluate and adjust the rules—including the definition of obligated party—to ensure that they are “appropriate.”

The CAA requires EPA to promulgate regulations that appropriately regulate parties to ensure that gasoline and diesel introduced into commerce contain renewable fuel. CAA § 211(o)(2)(A)(iii). This was not a one-time requirement. Rather, by statute, EPA has an annual nondiscretionary duty to evaluate whether the appropriate parties are regulated. That threshold decision is indispensable to EPA’s continuing obligation to ensure that the renewable fuel mandates can be met. This annual obligation arises under the following provisions:

- Not later than November 30 of each calendar year, EPA “shall determine and publish ... the renewable fuel obligation that *ensures* the requirements of paragraph (2) are met.” CAA § 211(o)(3)(B)(i) (emphasis added).
- The renewable fuel obligation shall “be applicable to refineries, blenders, and importers, *as appropriate.*” CAA § 211(o)(3)(B)(ii)(I) (emphasis added).

To ensure the renewable volumes are met, the statute mandates that EPA develop regulations that apply to entities *as appropriate*—not as appropriate at one point in time. EPA must fulfill this obligation each year in conjunction with setting the RVO. EPA was not relieved of this statutory mandate by having set an initial design for the program in 2010 pursuant to § 211(o)(2)(a)(iii). EPA must consider that question anew whenever it evaluates the basis for setting or adjusting the renewable fuel volume. Only in this way may EPA give proper consideration to changing market conditions and parties’ responses to market signals. If the regulatory structure of the Point of Obligation may affect the market’s ability to meet the volume mandates for that calendar year, EPA must take that factor into consideration when determining volumes for compliance years.

The CAA does not mandate that refineries be a location at which EPA imposes the obligation. Rather, the obligation must be set on the *appropriate* party or parties. The U.S. Supreme Court recently expressed its view on the term “appropriate”:

One does not need to open up a dictionary in order to realize the capaciousness of this phrase. In particular, “appropriate” is “the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors.” Although this term leaves agencies with flexibility, an agency may not “entirely fai[l] to consider an important aspect of the problem” when deciding whether regulation is appropriate.³

The choice of *which* entity and where in the supply system it is obligated to comply is “an important aspect” of ensuring that the renewable fuel volumes are met. Thus, every year when EPA determines the renewable fuel obligation, EPA lacks authority to ignore the constraints that were created by its own rule’s design.

Nor can EPA ignore an irrational rule’s manifest flaws that implicate the Due Process Clause of the Fifth Amendment to the U.S. Constitution. The current Point of Obligation fails that test because it lacks any rational relationship with the RFS program’s purpose—to “ensure” adequate volumes of renewable fuels in the American fuel supply. 42 U.S.C. § 7545(o)(2)(A)(i). Indeed, the current Point of Obligation is directly *at odds* with that legitimate government interest. Therefore, at best, leaving the Point of Obligation on refiners and importers (rather than owners of gasoline and diesel at the blending point) raises a serious question of rationality—and, therefore, of constitutionality.

EPA must consider whether its regulations avoid absurd results and unnecessary harm. To overcome certain market barriers, EPA has suggested that refiners invest in the downstream portion of the fuel market by adding blending facilities; this amounts to suggesting that because some refiners have no control over the compliance point, they should acquire the compliance point—blending facilities. The suggested investment is far more complicated, costly, burdensome, and disruptive—perhaps even unlawful, given antitrust concerns—than moving the Point of Obligation to that compliance point. EPA has discretion to revise this regulation to remove the market barriers without forcing market participants to undertake absurdly burdensome steps to restructure the entire petroleum market. Indeed, EPA’s suggestion is an implicit acknowledgment that the current obligation point is irrational.

EPA’s choice of the Point of Obligation labors under more particularized due-process problems because some obligated parties do not have meaningful control over compliance. Whether current obligated parties (fuel owners at the refining stage, before blending) are able to comply with the annual RVO depends on activity by third-parties (fuel owners at the blending point). The fuel owners at the blending point are often different parties than the owners at the refining stage, and some obligated parties exercise no control over the fuel owners at the blending rack. Yet the CAA penalizes obligated parties if they fail to meet the annual RVO. *See e.g.*, 42

³ *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (quoting *Motor Vehicle Mfrs. Ass’n of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 43 (1983)) (internal citation omitted).

U.S.C. § 7545(d)(1). Nonsensical arrangements like this one that punish one party for the actions of another over which it has no control raise serious Due Process concerns.

To comply with the statutory mandate that the RFS rule apply to entities “as appropriate,” EPA must review the RFS, including the Point of Obligation, to ensure those provisions avoid serious constitutional violations and comply with the Due Process Clause, the CAA, and the Administrative Procedure Act.

2. EPA must complete the periodic review mandated by the statute to allow for the appropriate adjustment of the requirements.

Related to the § 211(o)(3)(B) duty to appropriately assign compliance obligations, CAA § 211(o)(11) makes clear that EPA has a mandatory duty to review the impact of EPA’s renewable fuel volume decisions:

To allow for appropriate adjustment of the requirements described in subparagraph (B) of paragraph (2), the administrator shall conduct periodic reviews of –

- (A) existing technologies;
- (B) the feasibility of achieving compliance with the requirements; and
- (C) the impacts of the requirements described in subsection (a)(2) of this section on each individual and entity described in paragraph (2).

Under these provisions, the appropriateness of changes to renewable fuel volumes must be informed by EPA’s analysis of whether the volumes can be met and the impact of the volumes on “each individual” refiner, blender, and importer. Per the plain text of the statute, this periodic review is directly associated with volume adjustments.

EPA considered in general terms whether to change the Point of Obligation in the 2010 rulemaking but deferred changing it. EPA acknowledged in the proposed and final 2015 RVO rule that the RFS program is materially different today than it was in 2010.

As the gasoline market became saturated with E10 in 2013 and 2014, the constraints on the supply of ethanol began to change. . . . In order for the supply of ethanol to increase it now needs to be sold in higher level blends, such as E15 and E85.

80 Fed. Reg. at 77,456. EPA has expressly acknowledged that the RFS program is at a critical stage. 80 Fed. Reg. at 77,423. At this critical juncture, the statutorily required review of the feasibility of compliance and impacts of the requirements on each individual and entity that are obligated parties are essential to “appropriate adjustment of the requirements.” CAA § 211(o)(11). EPA has a duty to investigate and understand precisely how the RFS program creates incentives and disincentives, what compliance challenges it presents, how its current form distorts the renewable fuel market, and how it affects any party that EPA could obligate to comply with the fuel volumes. Feasibility of compliance and impacts on potentially obligated parties are related to

the impacts of RIN prices on fuel. EPA did study how RIN prices affect consumer fuel prices,⁴ but this research does not satisfy the statutory mandates for evaluating feasibility of compliance and impacts on regulated entities and individuals. The statute compels EPA to learn how the Point of Obligation interacts with the legal and structural constraints that EPA itself identified in the 2015 RVO Rule as justifying the waiver.

B. Statutory Deadlines Require Immediate Action by EPA.

Congress set a deadline of November 30 of each year for EPA to set renewable fuel volumes for the following year:

Not later than November 30 of each calendar years 2005 through 2021 . . . , [EPA] shall determine and publish . . . the renewable fuel obligation that *ensures* that the requirements of paragraph (2) are met.

CAA § 211(o)(3)(B)(i) (emphasis added).

Congress also established substantive requirements for the volume decision: it must *ensure* that statutory amounts of fuel are blended (CAA § 211(o)(3)(B)(i)) and the *appropriate* party must be obligated to satisfy those volumes (CAA § 211(o)(3)(B)(ii)). In addition, if EPA adjusts the volumes, the adjustment must be demonstrably *appropriate*; EPA must have considered the feasibility of compliance and the impacts on each refiner, blender, and importer (CAA § 211(o)(11)).

These substantive requirements demand—if nothing else—that EPA study the compliance structure of the rule in a timeframe relevant for compliance with the RVO rules. EPA has already missed this deadline in all prior RVO rules where EPA has not performed these analyses. However, a change to the Point of Obligation would be relevant for 2016 volumes at least through the end of 2016.⁵ As evidenced by the 2015 RVO Rule, EPA has retroactively established RFS obligations (the 2015 RVO Rule published December 14, 2015 set the standards for 2014 and 2015).

C. EPA's use of the waiver authority itself indicates that it is necessary to consider an adjustment to the definition of obligated parties.

Congress gave EPA authority to waive the statutory volumes in certain limited circumstances:

⁴ Memorandum from Dallas Burkholder, Office of Transportation & Air Quality, U.S. EPA, A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effects at 12 (May 14, 2015); Memorandum from Dallas Burkholder, Office of Transportation & Air Quality, U.S. EPA, An Assessment of the Impact of RIN Prices on the Retail Price of E85 (Nov. 2015).

⁵ Immediately commencing a CAA § 211(o)(11) review is also critical if EPA plans to reset the statutory volumes as required within one year of triggering the statutory reset obligation in CAA § 211(o)(7)(F).

EPA may waive the statutory volumes based on a determination that there is an inadequate domestic supply.

CAA § 211(o)(7)(A)(ii). In the 2015 RVO Rule, EPA waived the total renewable volume for the first time.

The fact that EPA has responded to an acknowledged problem with the RFS program by using its waiver authority only emphasizes how EPA's failure to undertake its nondiscretionary duties has exacerbated the problem. The waiver authority—by which EPA actually rewrites statutory volumes—is available only when anterior measures within EPA's control are unable to mitigate inadequate supply. But EPA has not yet undertaken the effort to resolve known problems in the RFS program, including the Point of Obligation. Surely, when EPA considers whether it is necessary to reduce Congress's renewable volumes based on inadequate domestic supply, EPA must complete a review under CAA § 211(o)(11) of the compliance feasibility and impacts of the RFS program on potentially obligated parties to ensure that EPA's own rules are not contributing to the inadequate supply.

EPA acknowledged in the 2015 RVO Rule that “the statutory volumes cannot be met according to the schedule reflected in the statute.” 80 Fed. Reg. at 77,456. EPA then downgraded the statutory volumes without even conducting the evaluations Congress requires before *setting* volumes, much less before *downgrading* volumes.

EPA has also presaged future supply constraints and downward adjustments to the statutory volumes: “the current constraints on growth in supply mean that each additional supply increment is likely to be more difficult to achieve than previous increments, and likely require more time to overcome than past constraints.” 80 Fed. Reg. at 77,481. Thus, it is apparent that EPA intends to adjust volume mandates for future years, using its waiver authority as it has proposed to do for 2017 volumes. With foreknowledge that it expects to downgrade Congress's volume mandates again, EPA can legitimize such decisions only through completion of the mandatory § 211(o)(3) and (11) analyses.

According to EPA, in developing future RVO rules, EPA will consider the “ability of the RFS to spur growth” in renewable volumes:

In future years, we would expect to use the most up-to-date information available to project the growth that can realistically be achieved considering the ability of the RFS to spur growth in the volume of ethanol, biodiesel, and other renewable fuels that can be supplied and consumed by vehicles.

80 Fed. Reg. at 77,431. Such an analysis is highly relevant to—but does not supplant—the comprehensive, in-depth analyses already required of EPA. In EPA's study, the ability of the RFS program to spur growth is a factor to consider in anticipated future reductions of statutory volumes. The congressionally mandated studies require EPA to explore the *elements* of the RFS program and expose root causes of its *inability* to spur growth. EPA's

study is directed at justifying any *reversal* of Congress's volumes. By contrast, Congress directed EPA to find the appropriate structure for *achieving* those volumes.

EPA admits that the task of predicting how the market will respond is very challenging. *See* 80 Fed. Reg. at 77,426.

Whether the market will respond to the standards we set by increasing the use of E15 – E85 is unclear, as it is a function of actions taken by various fuel market participants, including obligated parties, renewable fuel producers, distributors and marketers, gasoline and diesel retailers and consumers.

80 Fed. Reg. at 77,457.

Valero and others have provided EPA with information related to improving incentives for the various fuel market participants that EPA identifies as key to a responsive market. Congress has directed EPA not to merely stand by and passively observe the market to determine whether the volume standards alone can push growth in the market. Instead, EPA must conduct the review that provides the basis for adjusting the regulatory framework of the RFS to more appropriately and directly link the standards to the market participants that need incentives to act.

In light of EPA's use of its waiver authority to address inadequate supply and the statutory mandates, EPA must ensure that the RFS regulatory framework does not reduce the market's ability to supply renewable fuel. But to use the waiver "only to the extent necessary," as EPA committed to do, EPA must address constraints with less extraordinary measures where it can: i.e., by making a simple but critical modification to the Point of Obligation under the program.

The U.S. Supreme Court has rejected previous EPA attempts to gerrymander plain statutory commands to address harms resulting from the agency's unreasonable interpretation of *other* statutory commands. EPA may not, that is, forego a reasonable application of an ambiguous term while choosing to stretch the meaning of an unambiguous term: "Agencies are not free to 'adopt . . . unreasonable interpretations of statutory provisions and then edit other statutory provisions to mitigate the unreasonableness.'"⁶ In *UARG*, the Court ruled that a long-standing interpretation of the Act for stationary sources was neither compelled by the statute nor reasonable as it applied to new regulation of greenhouse gas emissions. In other words, EPA could not correct a problem created by EPA's own interpretation and administrative action by resorting to the legal doctrine of "administrative necessity."

Likewise, without addressing the Point of Obligation, EPA cannot use the general waiver authority to reduce the volumes below the statutorily mandated levels to make up for the volumes of renewable fuel that *EPA's own regulatory framework* keeps from the market. In light of the various barriers for renewable fuels in the market that EPA has little or no ability to address, EPA must consider the barriers created by its own regulations when it uses its waiver authority to

⁶ *UARG v. EPA*, 134 S. Ct. 2427, 2446 (2014) (citation omitted).

U.S. Environmental Protection Agency

November 3, 2016

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address constrained renewable fuel market conditions that are in substantial part attributable to EPA's own actions.

As explained further in Valero's Petition for Rulemaking, many of the market barriers EPA identified in the 2015 RVO Rulemaking and on which EPA bases its decision to use the waiver authority result directly from the misplaced Point of Obligation. EPA cannot continue to use its limited waiver authority to mask the dysfunction it has caused by ignoring its essential duties in administering the RFS program. Rather, EPA must correct the flaw in the framework that constrains supply so that adjustments made under the reset provisions and the waiver authority are made only to the extent necessary based on factors external to the regulatory framework.

Again, litigation is not our first choice. Valero is committed to working with EPA to resolve the concerns outlined above in a constructive manner that will further the goals of the RFS program. I am available at your convenience to discuss Valero's views on the point of obligation. Please contact me at (210) 345-2000 should you have any questions.

Sincerely,


for

Richard J. Walsh
Senior Vice President and Deputy General Counsel
The Valero Companies

cc: Janet McCabe
Chris Grundler
Ben Hengst

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<p>1. Article Addressed to:</p> <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>Gina McCarthy Administrator U.S. Environmental Protection Agency 1200 Pennsylvania Ave., NW Washington, D.C. 20460</p> </div>	<p>B. Received by (<i>Printed Name</i>) C. Date of Delivery</p> <hr/> <p>D. Is delivery address different from item 1? <input type="checkbox"/> Yes If YES, enter delivery address below: <input type="checkbox"/> No</p>
<p>2. Article Number (<i>Transfer from service label</i>)</p>	<p>3. Service Type</p> <p><input checked="" type="checkbox"/> Certified Mail <input type="checkbox"/> Express Mail</p> <p><input type="checkbox"/> Registered <input checked="" type="checkbox"/> Return Receipt for Merchandise</p> <p><input type="checkbox"/> Insured Mail <input type="checkbox"/> C.O.D.</p>
<p>PS Form 3811, February 2004</p>	<p>4. Restricted Delivery? (<i>Extra Fee</i>) <input type="checkbox"/> Yes</p>
<p>7012 1010 0000 6146 1565</p>	
<p>Domestic Return Receipt 102595-02-M-1540</p>	

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. (SEE INSTRUCTIONS ON NEXT PAGE OF THIS FORM.)

I. (a) PLAINTIFFS

(b) County of Residence of First Listed Plaintiff (EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorneys (Firm Name, Address, and Telephone Number)

DEFENDANTS

County of Residence of First Listed Defendant (IN U.S. PLAINTIFF CASES ONLY)

NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED.

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an "X" in One Box Only)

- 1 U.S. Government Plaintiff, 2 U.S. Government Defendant, 3 Federal Question, 4 Diversity

III. CITIZENSHIP OF PRINCIPAL PARTIES (Place an "X" in One Box for Plaintiff and One Box for Defendant)

- Citizen of This State, Citizen of Another State, Citizen or Subject of a Foreign Country, PTF DEF, Incorporated or Principal Place of Business In This State, Incorporated and Principal Place of Business In Another State, Foreign Nation

IV. NATURE OF SUIT (Place an "X" in One Box Only)

Click here for: Nature of Suit Code Descriptions.

Table with 5 columns: CONTRACT, REAL PROPERTY, TORTS, CIVIL RIGHTS, PRISONER PETITIONS, FORFEITURE/PENALTY, LABOR, IMMIGRATION, BANKRUPTCY, SOCIAL SECURITY, FEDERAL TAX SUITS, OTHER STATUTES.

V. ORIGIN (Place an "X" in One Box Only)

- 1 Original Proceeding, 2 Removed from State Court, 3 Remanded from Appellate Court, 4 Reinstated or Reopened, 5 Transferred from Another District, 6 Multidistrict Litigation - Transfer, 8 Multidistrict Litigation - Direct File

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing (Do not cite jurisdictional statutes unless diversity); Brief description of cause:

VII. REQUESTED IN COMPLAINT:

CHECK IF THIS IS A CLASS ACTION UNDER RULE 23, F.R.Cv.P. DEMAND \$ injunctive and declaratory relief CHECK YES only if demanded in complaint: JURY DEMAND: Yes No

VIII. RELATED CASE(S) IF ANY

(See instructions): JUDGE DOCKET NUMBER

DATE SIGNATURE OF ATTORNEY OF RECORD

FOR OFFICE USE ONLY

RECEIPT # AMOUNT APPLYING IFP JUDGE MAG. JUDGE

ATTACHMENT – ADDITIONAL ATTORNEYS FOR PLAINTIFF

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Clara Poffenberger Environmental Law and Policy LLC

Clara Poffenberger
(703) 231-5251

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
WICHITA FALLS DIVISION

VALERO ENERGY CORPORATION)
and its subsidiaries,)
)
Plaintiff,)
)
v.)
)
UNITED STATES ENVIRONMENTAL)
PROTECTION AGENCY)
)
and)
)
REGINA MCCARTHY, in her Official)
Capacity as Administrator,)
United States Environmental Protection)
Agency,)
)
Defendants.)
_____)

CERTIFICATE OF INTERESTED PERSONS

Pursuant to Fed. R. Civ. P. 7.1 and LR 3.1(c), LR 3.2(e), LR 7.4, LR 81.1(a)(4)(D), and LR 81.2, Valero Energy Corporation and certain of its subsidiaries provide the following information:

1. For a nongovernmental corporate party, the name of its parent corporation and any publicly held corporation that owns 10% or more of its stock:

Valero Energy Corporation is a publicly held corporation and is the ultimate parent corporation of the following non-publicly traded subsidiaries: Valero Refining - Texas, L.P.; Diamond Shamrock Refining Company, L.P.; The Premcor Refining Group Inc.; Ultramar Inc.; Valero Refining Company – California; Valero Refining Company – Oklahoma; Valero Refining - New Orleans, L.L.C.; Valero Refining - Meraux LLC; Valero Refining Company - Tennessee, L.L.C.; Valero Renewable Fuels Company, LLC; and Valero Marketing and Supply Company.

2. A complete list of all persons, associations of persons, firms, partnerships, corporations, guarantors, insurers, affiliates, parent or subsidiary corporations, or other legal entities that are financially interested in the outcome of the case:

Valero Energy Corporation (publicly traded); Valero Refining - Texas, L.P.; Diamond Shamrock Refining Company, L.P.; The Premcor Refining Group Inc.; Ultramar Inc.; Valero Refining Company – California; Valero Refining Company – Oklahoma; Valero Refining - New Orleans, L.L.C.; Valero Refining - Meraux LLC; Valero Refining Company - Tennessee, L.L.C.; Valero Renewable Fuels Company, LLC; and Valero Marketing and Supply Company.

Respectfully submitted,

/s/ Christopher L. Dodson

Christopher L. Dodson

Attorney-of-Record

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Counsel for Plaintiff Valero Energy Corp. and its subsidiaries