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

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

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**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.<sup>1</sup> 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

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<sup>1</sup> 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”)<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> 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.<sup>5</sup> 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).<sup>6</sup> 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

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<sup>2</sup> 75 Fed. Reg. 14,670.

<sup>3</sup> 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.

<sup>4</sup> 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.”

<sup>5</sup> 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).

<sup>6</sup> 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.<sup>7</sup> 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.

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<sup>7</sup> 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.<sup>8</sup> 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

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<sup>8</sup> 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.<sup>9</sup> 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.<sup>10</sup> 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

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<sup>9</sup> 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.

<sup>10</sup> 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.”<sup>11</sup> 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.<sup>12</sup> 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.”<sup>13</sup>

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,

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

<sup>12</sup> 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.

<sup>13</sup> Id. at 55573.

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

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.<sup>15</sup>

Soon after establishing the final RFS1 regulations, Congress substantially amended the RFS program through the Energy Independence and Security Act of 2007.<sup>16</sup> 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.<sup>17</sup> 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,<sup>18</sup> 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

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<sup>14</sup> 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.

<sup>15</sup> 72 Fed. Reg. 23900.

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

<sup>17</sup> 74 Fed. Reg. 24904.

<sup>18</sup> 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.<sup>19</sup>

On March 26, 2010, EPA issued a final rule establishing the amended RFS program structure reflecting the EISA amendments.<sup>20</sup> 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.<sup>21</sup>

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.”<sup>22</sup>

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<sup>19</sup> 74 Fed Reg 24904, 24963.

<sup>20</sup> 75 Fed. Reg. 14,670.

<sup>21</sup> 75 Fed. Reg. 14,670.

<sup>22</sup> 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.<sup>23</sup> 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,<sup>24</sup> 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),<sup>25</sup> 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.<sup>26</sup>

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

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<sup>23</sup> 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.

<sup>24</sup> 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).

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

<sup>26</sup> 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.<sup>27</sup> 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.<sup>28</sup> 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.<sup>29</sup> 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.<sup>30</sup> 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.<sup>31</sup>

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

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<sup>27</sup> 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).

<sup>28</sup> 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.

<sup>29</sup> 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).

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

<sup>31</sup> 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 prices<sup>32</sup> observed in recent years are indicative of a dysfunctional RIN market.<sup>33</sup> 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.<sup>34</sup> 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.<sup>35</sup>

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

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<sup>32</sup> 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.

<sup>33</sup> 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.

<sup>34</sup> 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.

<sup>35</sup> 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.<sup>36</sup> 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.<sup>37</sup> External, non-EPA assessments similarly concluded that increased RIN prices had not had a significant impact on retail gasoline (E10) prices.<sup>38</sup> 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

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<sup>36</sup> Valero Petition for Rulemaking, June 13, 2016. Page 18.

<sup>37</sup> "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.

<sup>38</sup> 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.<sup>39</sup>

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).<sup>40</sup>

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.<sup>41</sup> 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

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<sup>39</sup> 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.

<sup>40</sup> 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.

<sup>41</sup> 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,<sup>42</sup> 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.<sup>43</sup> 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.<sup>44</sup> 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.”<sup>45</sup> They are purchasing petroleum blendstocks from refiners for a higher price than they can recover for this product when sold at the rack as

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<sup>42</sup> 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.

<sup>43</sup> For example, see Valero Petition for Rulemaking, June 13, 2016. Page 16.

<sup>44</sup> "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.

<sup>45</sup> 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.<sup>46</sup>

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.<sup>47</sup> 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,"<sup>48</sup> 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

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<sup>46</sup> "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>>.

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

<sup>48</sup> 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."<sup>49</sup> 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 million<sup>50</sup> were significantly higher than in 2012 (\$84 million), they were significantly less than net profits in 2011 (\$324 million).<sup>51</sup>

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.<sup>52</sup> 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,<sup>53</sup> 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.

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<sup>49</sup> 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) .

<sup>50</sup> 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.

<sup>51</sup> 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.

<sup>52</sup> *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>>.

<sup>53</sup> 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.<sup>54</sup> 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).<sup>55</sup> 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.<sup>56</sup>

#### 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

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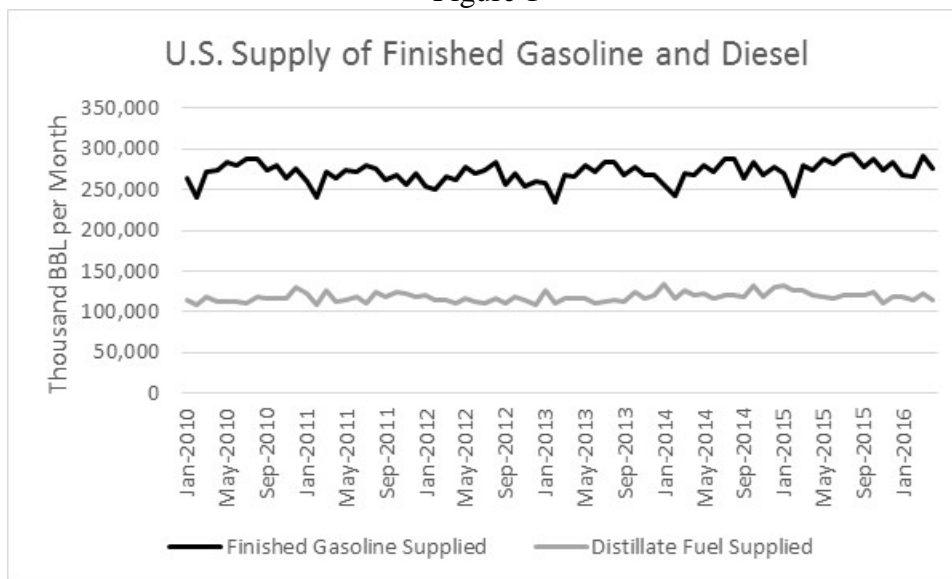
<sup>54</sup> Valero Petition for Rulemaking, June 13, 2016. Page 18.

<sup>55</sup> 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.

<sup>56</sup> 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](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 capacity<sup>57</sup> 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.<sup>58</sup> 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

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<sup>57</sup> 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.

<sup>58</sup> 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,<sup>59</sup> 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 producers<sup>60</sup> and associations representing renewable fuel producers<sup>61</sup> 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."<sup>62</sup> 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.<sup>63</sup>

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<sup>59</sup> 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.

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

<sup>61</sup> Letter from SIGMA and RFA to Congressmen Whitfield and Rush, June 30, 2016.

<sup>62</sup> CAA 211(o)(3)(B)(ii)(I).

<sup>63</sup> 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.<sup>64</sup> 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.”<sup>65</sup> 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.<sup>66</sup> 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 times<sup>67</sup> if the existing infrastructure resulted in loading delays for trucks at the rack.

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<sup>64</sup> 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.

<sup>65</sup> Valero Petition for Rulemaking, June 13, 2016.

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

<sup>67</sup> 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.<sup>68</sup> A review of publicly available information from OPIS suggests that approximately half of all terminals list prices for biodiesel and/or biodiesel blends.<sup>69</sup> 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.<sup>70</sup> 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.<sup>71</sup> 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.<sup>72</sup> 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

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<sup>68</sup> Magellan Meeting Notes, December 16, 2015.

<sup>69</sup> 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.

<sup>70</sup> See ASTM D 975.

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

<sup>72</sup> 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.<sup>73</sup> 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).<sup>74</sup> 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.<sup>75</sup> 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.<sup>76</sup> 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

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<sup>73</sup> Letter from Pilot Flying J to Administrator McCarthy, August 16, 2016.

<sup>74</sup> 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/>

<sup>75</sup> 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.

<sup>76</sup> 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.<sup>77</sup> 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

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<sup>77</sup> “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.<sup>78</sup> 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.<sup>79</sup> 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

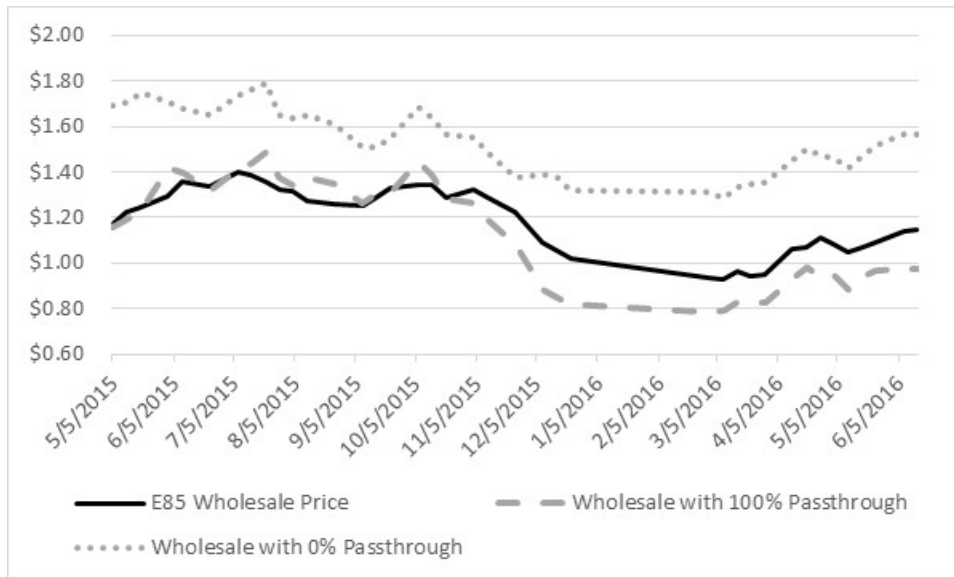
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<sup>78</sup> See Letter from Tim Columbus to Administrator McCarthy, August 15, 2016; Letter from QuikTrip to Administrator McCarthy, August 17, 2016; Letter from RaceTrac to Administrator McCarthy, August 17, 2016.

<sup>79</sup> [http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices\\_2013/Pages/WhoSellsGas.aspx](http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices_2013/Pages/WhoSellsGas.aspx)

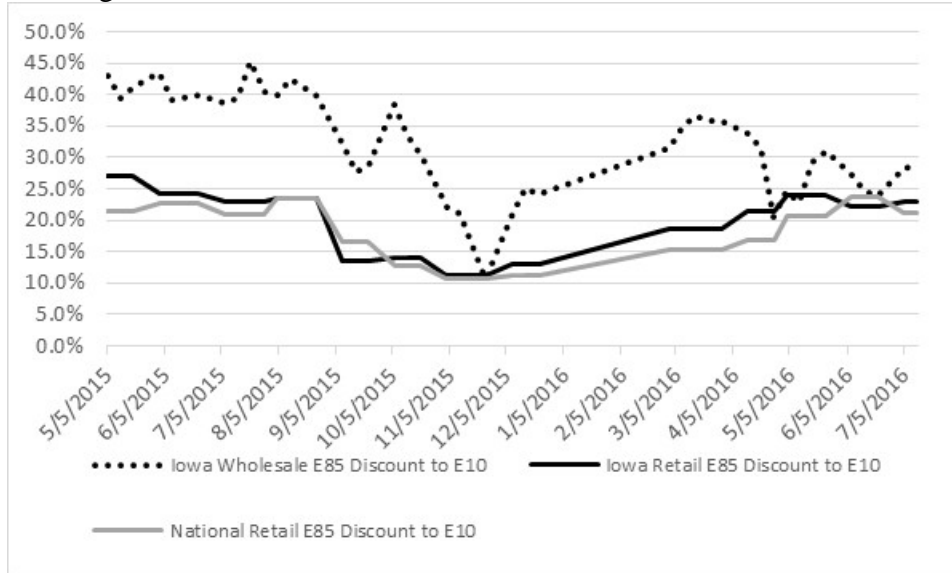
further support the view that changing the point of obligation in the RFS program is unlikely to result in a greater portion of the RIN value being reflected in the wholesale price of E85, and ultimately the retail price of E85, and will not be an effective mechanism for increasing E85 sales volumes.

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.<sup>80</sup> 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.<sup>81</sup>

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,<sup>82</sup> 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

<sup>80</sup> 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.

<sup>81</sup> 80 FR 77,420 (Dec., 14, 2015).

<sup>82</sup> 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.<sup>83</sup> 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.<sup>84</sup>

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.<sup>85</sup> Large retail chains and other unbranded stations are not currently obligated parties.<sup>86</sup> 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

<sup>83</sup> [http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices\\_2013/Pages/WhoSellsGas.aspx](http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices_2013/Pages/WhoSellsGas.aspx)

<sup>84</sup> Ibid.

<sup>85</sup> 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.

<sup>86</sup> 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).<sup>87</sup> 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.

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<sup>87</sup> 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.<sup>88</sup> 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.

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<sup>88</sup> 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.<sup>89</sup> 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.<sup>90</sup> 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,<sup>91</sup> 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.

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<sup>89</sup> 75 Fed. Reg. 14721 (March 26, 2010).

<sup>90</sup> Id, RFS2 Summary and Analysis of Comments, at 3-216.

<sup>91</sup> 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”<sup>92</sup> for gasoline and diesel fuels at all terminals in the United States.<sup>93</sup> 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.<sup>94</sup> Based on this approach, Valero found that roughly 100 entities showed up both as regulated parties

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<sup>92</sup> 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.

<sup>93</sup> 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.

<sup>94</sup>EPA 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.<sup>95</sup> 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).<sup>96</sup> 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.<sup>97</sup> 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.<sup>98</sup> These parties' estimates of the likely number of position holders ranged from 350 to over 1,000.<sup>99</sup> 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

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

<sup>96</sup> See memo to the docket, titled "Emails and Data from OPIS."

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

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

<sup>99</sup> 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.<sup>100</sup>

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.<sup>101</sup>

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,<sup>102</sup> 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 biodiesel<sup>103</sup> 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.<sup>104</sup> 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.

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<sup>100</sup> 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.

<sup>101</sup> Monroe 2016 Petition at 14.

<sup>102</sup> Unless these parties also blend oxygenates into reformulated gasoline.

<sup>103</sup> 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.

<sup>104</sup> 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 parties<sup>105</sup>, of which 37 parties reported taxable gallons.<sup>106</sup> Of those 37 parties, we determined that 25 (65%) were not registered under the RFS program.<sup>107</sup> 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.<sup>108</sup> 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

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<sup>105</sup> 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.

<sup>106</sup> 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](https://www.boe.ca.gov/sptaxprog/reports/Mar-16_MVF_Distribution_Report.pdf)

<sup>107</sup> 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>.

<sup>108</sup> [http://www.tax.ohio.gov/excise/motor\\_fuel/motor\\_fuel\\_dealers.aspx](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.<sup>109</sup> 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.<sup>110</sup>

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

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<sup>109</sup> 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.

<sup>110</sup> 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.<sup>111</sup> 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,

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<sup>111</sup> 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.