American
Fuel & Petrochemical
Manufacturers

1667 K Street, NW
Suite 700
Washington, DC
20006

202.457.0480 office
202.457.0486 fax
afpm.org

Submitted via eRulemaking Portal

February 22, 2017

Scott Pruitt
Administrator
U.S. Environmental Protection Agency
1200 Pennsylvania Ave., NW
Mail Code 28221T
Washington, D.C. 20460

Re: Docket ID No. EPA-HQ-OAR-2016-0544

The American Fuel & Petrochemical Manufacturers ("AFPM")[1] submits these comments on the Environmental Protection Agency's ("EPA's") Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation.[2] The Renewable Fuel Standard ("RFS") has failed to achieve its statutory goals while creating market distortions that ultimately disadvantage consumers. For this reason, AFPM recommends the Administration work with Congress to reform, and ultimately end, this flawed program. However, as Congress continues its work to enact needed reforms, EPA bears the responsibility of implementing the RFS in a manner that minimizes costs and places the compliance burden equitably on obligated parties. Thus, for the reasons set forth in AFPM's original petition for rulemaking and below, EPA should grant AFPM's petition to move the point of obligation to better align the RFS obligation with the point of compliance.

I. Contrary to EPA's Assertions, the RFS/Renewable Identification Number ("RIN") Program is Not Operating as Intended and Moving the Point of Obligation will Address Some Harms

A. The RIN System is Not Increasing Domestic Production of Biofuels

In its proposed denial of AFPM's petition to move the point of obligation, EPA's central justification is 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

[1] AFPM is a trade association representing high-tech American manufacturers of virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of vital products in daily life.

[2] AFPM incorporates by reference the arguments and appendices included in its August 4, 2016 petition for rulemaking.

the RFS standards."[3] EPA goes on to cite the growth in the production and use of renewable fuels since 2010 as evidence that the RIN system is operating as intended. This assertion fails on several levels.

First, EPA ignores the fact that the percentage of ethanol in the gasoline supply has been virtually unchanged since 2013 largely due to the vehicle and refueling constraints known as the E10 blend wall.[4] The incremental volume of ethanol consumed from 2013-2016 was primarily the result of an additional 6.7 billion gallons of gasoline consumption allowing growth in the E10 market [see figure 1]. A mere fraction of the increase in ethanol consumption was the result of increased E85 or E15 consumption. In fact, E85 comprised less than 0.3 percent of gasoline sales last year.[5] As the price of RINs rose from 3 cents to more than a dollar, the amount of midlevel ethanol blends consumed failed to respond. Instead, much of the revenue related to RIN sales simply inured to the bottom line of unobligated blenders. In fact, in reviewing data from Iowa and Minnesota, two states with the most developed E85 infrastructure,[6] it is clear that consumer demand for E85 has remained flat despite high RIN prices and increasing mandates. In Minnesota, E85 consumption fell from 16.6 million gallons in 2010 to 13.1 million in 2016.[7] Additionally, the number of stations selling E85 decreased from 349 to 315.[8] In 2015, Iowa reported that a mere 396 out of 2,240 stations sold E15 or higher.[9] Finally, Iowa retailers only installed 55 additional E85 stations since 2011.[10]

[3] Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation, U.S. ENVT'L. PROT. AGENCY (Nov. 10, 2016), at 5 n. 4 [hereinafter "EPA Proposed Denial"] (for a list of the various petitions submitted to EPA seeking to change the point of obligation).
[4] The E10 blend wall refers to a blend of 10 percent ethanol and 90 percent gasoline, the amount of ethanol that can be used in existing infrastructure and engines.
[5] EPA estimated 200 million gallons of E85 would be sold in 2016 (80 Fed. Reg. 77462), compared to approximately 140 billion gallons of gasoline consumption in 2016 (80 Fed. Reg. 77511).
[6] With 711 stations, IA and MN combine for approximately 20 percent of U.S. E85 stations. The U.S. Dept. of Energy Alternative Fuel Data Center estimates that there are 3,152 stations selling E85 in the U.S. (accessed Feb. 22, 2017).
[7] *2016 Minnesota E85 + Mid-Blends Station Report*, MINN. DEP'T OF COMMERCE, DIV. OF ENERGY RES., http://mn.gov/commerce-stat/pdfs/e85-fuel-use-2016.pdf.
[8] *Id.*
[9] *2015 Retailers Fuel Gallons Annual Report*, IOWA DEP'T OF REVENUE (Apr. 2016), https://tax.iowa.gov/sites/files/idr/2015%20Retailers%20Fuel%20Gallons%20Annual%20Report.pdf.
[10] *Id.*

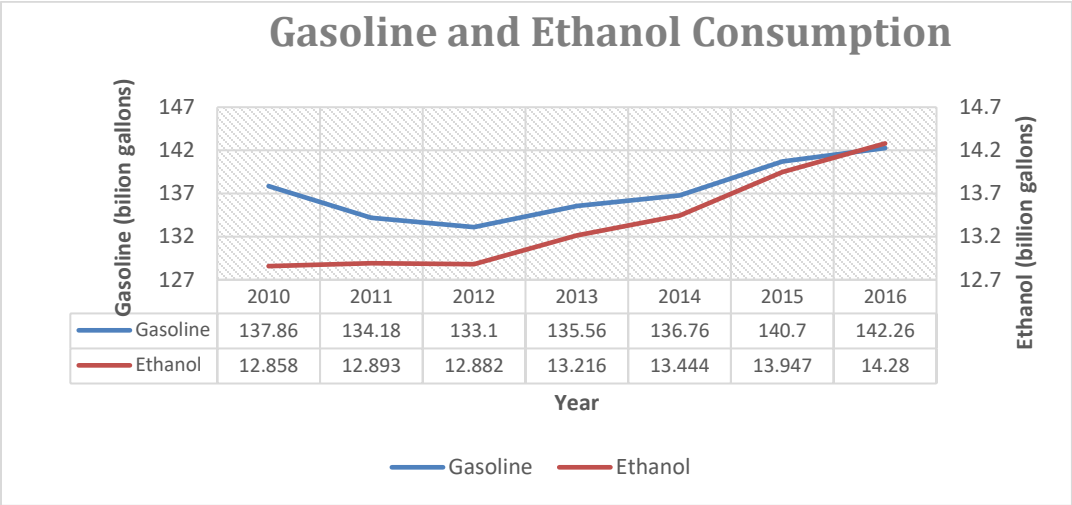

Figure 1

In addition to parties over-complying with the RFS in anticipation of the E10 blend wall, growth in ethanol consumption can be attributed to positive blending properties combined with favorable economics. These positive properties are a reason the U.S. would continue using 10 percent ethanol in absence of a mandate.

Second, EPA ignores the impact of imports in its assessment of the energy security impacts of the RFS. According to EIA, U.S. imports of renewable fuels increased from 23 million gallons in 2010 to 649 million gallons in 2015,[11] and a 2700 percent increase compared to an 11 percent increase in ethanol consumption. Since 2011, the U.S. has been a net exporter of finished petroleum products, meaning U.S. refineries have sufficient capacity to meet U.S. needs for petroleum products (i.e., gasoline, diesel, heating oil and jet fuel). In fact, the U.S. went from importing 1.4 million barrels of petroleum products per day in 2000 to exporting 3.6 million barrels per day. According to EIA, the RFS played only a small part in this shift.[12] Taken together, RFS-mandated reliance on imported biofuels is serving to displace U.S. produced fuel—hardly the goal of a program meant to enhance energy "independence and security." For EPA to argue that the RFS is meeting energy security needs, and therefore does not require revision, ignores important aspects of the way the program functions.

---

[11] *Annual Energy Outlook 2016*, U.S. ENERGY INFO. ADMIN. (June 28, 2016),

[12] *Oversight of the Renewable Fuel Standard: Hearing before S. Comm. on Environment and Public Works*, 114th Cong. (2016) (Testimony of Howard Gruenspect, Deputy Administrator, Energy Information Administration) ("biofuels volumes in response to the RFS program have played only a small part in reducing projected net import dependence given the expectation of continued use of ethanol as an octane and volume source independent of RFS program requirements.").

Finally, EPA incorrectly dismisses the link between the point of obligation and the development of cellulosic biofuels. AFPM acknowledges the significant technological and economic hurdles that have made the cellulosic mandates impossible a failure. Indeed, this is why AFPM continues to request that EPA take a more realistic approach to setting cellulosic volumes.[13] However, if cellulosic ethanol materializes in commercial volumes, it will face the same blend wall challenges that plague conventional ethanol. As described in other petitions, a closer alignment of incentives between obligation and compliance could help reduce some blend wall obstacles.

B. EPA Improperly Reinterprets its Justification for the RIN System

In addition to blurring important distinctions between growth in the renewable fuels market prior to 2013 and after 2013, EPA attempts to reinterpret the justification for the RIN program. In particular, in defense of RIN prices driving infrastructure investment to exceed the blend wall, EPA argues that "[i]n establishing the RFS program, Congress put in place a policy to effect a substantial transformation in the fuels market. . ."[14] The fact remains that RINs were never intended to drive the infrastructure investments.[15] In fact, in promulgating RFS2 regulations, EPA reiterated its rationale from the RFS1 rulemaking, stating:

> [The existing RIN system] met our goals of being straightforward, maximizing flexibility, ensuring that volumes are verifiable, and ***maintaining the existing system of fuel distribution and blending***. RINs represent the basic framework for ensuring that the statutorily required volumes of renewable fuel are used as transportation fuel in the U.S. Since the RIN-based system generally has been successful in meeting the statutory goals, we are maintaining much of its structure under RFS2.[16]

In doing so, however, EPA recognized that changes in the RFS and in the fuel market generally would change the dynamics of the RIN market. In particular, EPA observed that even prior to final implementation, the RFS2 volumes were already "resulting in changes to the demand for RINs and operation of the RIN market."[17] For example, EPA noted that "obligated

[13] See AFPM comments on EPA's proposal for 2017 RFS dated 7/11/16 in docket no. EPA-HQ-OAR-20126-0004.
[14] EPA Proposed Denial, *supra* note 3, at 12.
[15] Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program, 75 Fed. Reg. 14670, 14684 (Mar. 26, 2010) [hereinafter "RFS2 Final Rule"].
[16] *Id.*
[17] Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program, 74 Fed. Reg. 24904, 24963 (May 26, 2009) [hereinafter "RFS2 Proposed Rule"].

parties who have excess RINs are increasingly opting to retain rather than sell them to ensure they have a sufficient number for next year's compliance."[18] Of particular importance, EPA forecasted that the gasoline market would be virtually saturated with ethanol by 2013,[19] and refiners with marketing assets and those without would result in "*significant disparities between obligated parties in terms of opportunities to acquire RINs*."[20]

The current disparity in the ability of obligated parties and non-obligated blenders to acquire RINs is in direct contravention to EPA's stated goal of maintaining the existing fuel distribution system through use of the RIN system. Moreover, the disparity that EPA recognized in the RFS2 proposed rule is even more acute today as the overall burden borne by obligated parties has increased year-over-year.

In the final RFS2 rule, EPA also recognized that "the rationale in RFS1 for placing the obligation on just the upstream refiners and importers is no longer valid."[21] Despite the recognition, EPA maintained the previous point of obligation based on its belief that "the market will continue to provide opportunities for parties who are in need of RINs to acquire them from parties who have excess."[22] Notably, however, EPA stated that it would "continue to evaluate the functionality of the RIN market. Should 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."[23] It is now clear that the RIN market is not operating as intended, producing profits for unobligated blenders and creating an uneven playing field for refiners, some of whom have no access to blending facilities and whose very survival is threatened by EPA's failure to move the point of compliance closer to the point of blending.

C. The RIN Market is Not Operating as Intended, Driving up Costs Borne by Refiners

In its proposed denial of AFPM's petition, EPA argues that higher RIN prices are a function of the market signaling an increased demand for RINs needed to comply with mandates exceeding the E10 blend wall. AFPM agrees that this is the case, but disagrees that high RIN prices—regardless of reason—were an intended feature of the RFS program. In fact, during the RFS2 rulemaking, EPA noted that its approach in RFS1 was predicated on the belief "that there would be an excess of RINs ***at low cost***" and that the "ability of RINs to be traded freely between any parties once separated from renewable fuel would provide ample opportunity for parties who

[18] *Id.*
[19] *Id.*
[20] *Id.* (Emphasis added).
[21] RFS2 Final Rule, *supra* note 15, at 14722.
[22] *Id.*
[23] *Id.*

were in need of RINs to acquire them from parties who had excess."[24] EPA's current post-hoc rationalization for high RIN prices is simply unsupported in the regulatory history of the RFS that envisioned an "excess of RINs at low cost."

Assuming arguendo that high RIN prices were an intended feature of the RFS2 program meant to increase the consumption of renewable fuels, the RIN system has also failed that goal according to EPA's own analysis. In the Burkholder memo EPA cites, the author concludes that retail E85 prices do not reflect the discount that would be expected from the RIN cross-subsidy.[25] This can be attributed, among other factors, to the distance and competing tensions between the point of obligation and point of compliance. EPA did not address these issues in its proposed denial.

During the RFS2 rulemaking, EPA recognized that a closer alignment between the point of obligation and point of compliance would reduce the cost of RINs, and ultimately, the cost of the program to consumers. In particular, EPA noted that by placing the point of obligation closer *"to the points in the distribution system where RINs are made available, the overall market prices for RINs may be lowered and consequently the cost of the program to consumers may be reduced*."[26] (emphasis added). EPA also recognized:

> [I]f obligated parties seeking RINs cannot acquire a sufficient number, they can only carry a deficit into the following year, after which they would be in noncompliance if they could not acquire sufficient RINs. The result might be a much higher price for RINs (and fuel) in the marketplace than would be expected under a more liquid market.[27]

In many respects, EPA's forecast was correct. Obligated parties without access to downstream blending assets are subject to a volatile and opaque RIN market to comply with the RFS. EPA dismisses the concerns of parties reliant on the RIN market by alleging that the RIN is a "cross-subsidy," built into the wholesale price of gasoline and reflected in a discounted price of ethanol. In this frictionless "closed loop" model, the market for higher ethanol blends would reflect a RIN discount to offset the higher price of the petroleum blendstock. Although an interesting academic theory, the market is not frictionless and EPA has ample evidence before it that the current point of obligation is arbitrarily creating winners and losers in the fuels market.

---

[24] RFS2 Proposed Rule, *supra* note 17, at 24963.
[25] Dallas Burkholder, *An Assessment of the Impact of RIN Prices on the Retail Price of E85*, U.S. EPA OFFICE OF TRANSP. & AIR QUALITY (Nov. 2015) [hereinafter "Burkholder Memo"].
[26] RFS2 Proposed Rule, *supra* note 17, at 24963-64.
[27] *Id.*

EPA argues further that changing the point of obligation will not return RIN prices to those observed in 2012 or earlier. As an initial matter, it bears noting that neither AFPM nor any other party has argued that moving the point of obligation would result in RINs retreating to pre-2012 and pre-blend wall prices. Rather, we have argued that it would make the program more equitable by more closely aligning the point of obligation with the point of compliance and ensuring non-obligated blenders are not unfairly advantaged. In addition, it would ensure that refiners are responsible for acquiring RINs representing the amount of hydrocarbons they own at the point of taxation, while non-obligated blenders are prevented from profiting from RIN sales without any responsibility for complying with the RFS mandates. Eliminating this "disconnect" would go a long way towards improving the implementation of the RFS." Second, more recent analysis of market data shows that RIN prices are not fully reflected in the wholesale price of gasoline.[28]

The impact of RIN prices on many refiners is not hypothetical. In September 2016, Philadelphia Energy Solutions ("PES")[29] informed employees that as a result of its RFS compliance obligations, it would cut pension and health care benefits, delay maintenance and other capital expenditures, and offer buyouts to employees.[30] PES's situation is not unique. For example, PBF Energy recently reported to investors that a part of their compliance strategy is to increase their level of exports.[31] These refineries are critical national security assets, supplying the U.S. with a reliable and affordable supply of domestically produced fuel for cars, shipping, air travel, and heating. The U.S. is reminded of this when there is a supply disruption due to a hurricane[32] or issues with pipeline deliveries.[33] East coast refineries provide critical supply during these disruptions, an important factor in the bipartisan support for these assets.[34] Due to

[28] AFPM is aware of other comments that address this question more fully.
[29] Philadelphia Energy Solutions operates the largest refinery on the East Coast, with a capacity of 350,000 barrels per day.
[30] Barbara Powell, *Layoffs Planned for Philadelphia Refinery*, THE PHILA. INQUIRER (Sept. 9, 2016, 3:01 AM), http://www.philly.com/philly/business/20160909_Layoffs_planned_for_Philadelphia_refinery.html.
[31] *PBF Energy (PBF) CEO Tom Nimbley on Q3 2016 Results – Earnings Call Transcript*, SEEKING ALPHA (Oct. 29, 2016), http://seekingalpha.com/article/4016607-pbf-energy-pbf-ceo-tom-nimbley-q3-2016-results-earnings-call-transcript ("In the third quarter, we increased our level of product exports and are continuing to debottleneck our logistics to further increase our capability. This should increase our presence in a new market for PBF and at the same time provide some relief from the crushing burden of RINs. Exports are not something that PBF has done a lot of in the past and with the current market on RINs we feel that this is something PBF frankly needs and will expand upon.").
[32] *How Hurricane Sandy Affected the Fuels Industry*, THE ASS'N FOR CONVENIENCE & FUEL RETAILING, http://www.nacsonline.com/YourBusiness/FuelsReports/GasPrices_2013/Pages/How-Hurricane-Sandy-Affected-the-Fuels-Industry.aspx.
[33] Alison Sider & Nicole Friedman, *Colonial Pipeline Issues Likely to Disrupt Gas Supply on East Coast*, THE WALL ST. J. (Sept. 15, 2016, 6:31 PM), https://www.wsj.com/articles/colonial-pipeline-issues-likely-to-disrupt-gas-supply-on-east-coast-1473978662.
[34] Steven Mufson, *Carlyle Group, Sunoco and Politicians' Joint Venture to Rescue Philadelphia Refinery*, WASH. POST (Dec. 22, 2012), https://www.washingtonpost.com/business/economy/carlyle-group-sunoco-and-politicians-

logistical and cost issues, the loss of an east coast refinery will almost certainly result in an increased reliance on imported gasoline by east coast consumers. The RFS program places aspects of the U.S. gasoline supply at risk.

EPA's discussion regarding the relative profitability of unobligated blenders is similarly misleading. For example, EPA argues that because Murphy USA's profits for the years 2014 and 2015 were less than net profits in 2011, it is evidence that the company is not profiting from the RIN. Not only is this contrary to the company's own financial statements, but in this simplistic example, EPA ignored the $0.45 per gallon Volumetric Ethanol Excise Tax Credit that was in place in 2011 and expired at the end of that year. EPA fails to acknowledge that in 2013, Murphy reported to investors that it "benefited from [its] ability to attain RINs and sell them at favorable prices in the market" and goes on to identify lower RIN prices as a factor that could "adversely affect our results of operations, and the impact could be material."[35]

In addition to its selective reading of Murphy USA's financial reports, EPA makes the argument that increased RIN prices offset the higher cost of wholesale gasoline driven by refiners' attempts to recoup RIN costs. This circular argument omits two important points and ignores the real world impact on fuel retailers that must compete against non-obligated blenders. First, not all downstream marketers have the same ability to generate RIN sales as major marketing companies. For example, the Small Retailers Coalition makes the case that the current point of obligation places small retailers at a disadvantage to large blenders with retail assets.[36] This is largely due to the fact that smaller retailers pay the same, higher cost for wholesale gasoline, but do not separate (and sell) RINs to help offset some of the cost. Non-obligated blenders with retail stations may utilize the revenue from the sale of RINs to undercut the price of retailers that do not own the hydrocarbon at the rack. Moving the point of obligation would result in the blender separating the RIN and surrendering it to EPA for compliance, rather than selling it and using the proceeds to drive their competitors out of business. Murphy alluded to this this dynamic in its 2013 financial reports, reporting to investors that its shipper status on major pipeline systems and ability to generate incremental revenue by capturing and selling RINs "via [its] capability to source bulk fuel and subsequently blend ethanol and biodiesel at the terminal level" advantaged its fuel supply.[37] Smaller retailers, and indeed some refiners, do not share these advantages at the terminal level. The second issue is that although Murphy bears some cost in generating separated RINs, it can not be the case that the full RIN cost is needed to provide incremental amounts of renewable fuel. Rather, unobligated blenders are pocketing at least some of the value of the RIN at the expense of refiners, without any corresponding benefit

joint-venture-to-rescue-philadelphia-refinery/2012/12/21/b71aa998-4879-11e2-ad54-580638ede391_story.html?utm_term=.c9d47c805f14.

[35] Murphy USA Inc., Annual Report (Form 10-K) (Feb. 28, 2014).

[36] Letter from Bill Douglass, Chairman, Small Retailers Coalition, to EPA Acting Assistant Administrator, EPA Office of Air and Radiation (July 28, 2016) [hereinafter "Small Retailers Coalition Letter"].

[37] Murphy USA Inc., Annual Report (Form 10-K) (Feb. 28, 2014).

to the consumer. Without explanation, EPA assumes that unless the whole value of the RIN is being reported as profit, none of the RIN value is profit. For example, EPA estimates 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."[38] This wrongly assumes Murphy USA reports all RIN value as profit. Murphy is an example of this dynamic, but is certainly not unique. For instance, Casey's General Stores reported that RINs added a "$0.03 per gallon improvement to the fuel margin" during their second quarter fiscal year 2017 financial performance.[39] The fact is the RIN cannot be simultaneously used to provide excess profit to a marketer and discount blended fuel.

Retailers' arguments emphasizing their lack of ability to control consumer demand reinforces the need for legislative reform of the RFS program, not as support for retaining the current point of obligation. AFPM is not indifferent to these concerns, and indeed shares them, but is puzzled by retailers' belief that upstream fuel manufacturers have greater control over consumer choice than retailers. If anything, large retailers with blending operations are in a better position to make infrastructure investments and respond to consumer preferences.

II. Better Aligning the Point of Obligation with the Point of Compliance is Reasonable, Will Create a More Equitable Distribution of the Compliance Burden, and Reduce Fraud

In addition to providing unsupported and specious arguments about wholesale gasoline markets, EPA provides only thinly supported arguments that moving the point of obligation will increase complexity or otherwise make the RFS program more difficult to administer.

A. Moving the Point of Obligation will not Increase the Number of Obligated Parties or Increase Non-Compliance

As an initial matter, EPA repeats its assertion that the number of obligated parties would increase under a changed definition of obligated party. To support its claim, EPA cites to electronic mail correspondence with the Oil Price Information Service ("OPIS") regarding Valero's petition. EPA reviewed an initial 2015 data set provided by Valero but ignored supplemental information that addressed many of the questions EPA raised in the proposed denial.[40] In addition, EPA failed to respond to, or even acknowledge, the expert IHS report AFPM submitted as an Appendix to its petition showing that the number of obligated parties

[38] Proposed Denial, *supra* note 3 at 12.
[39] *Casey's (CASY) CEO Terry Handley on Q2 2017 Results – Earnings Call Transcript*, SEEKING ALPHA (Dec. 8, 2016), http://seekingalpha.com/article/4029330-caseys-casy-ceo-terry-handley-q2-2017-results-earnings-call-transcript.
[40] For more information, *see* Valero Comments to Proposed Denial (Feb. 22, 2017).

would remain substantially similar under AFPM's proposed definition. The data provided supports the conclusion that the number of obligated parties would not increase with the suggested alignment. EPA's proposed denial is arbitrary in that it does not address the information submitted to EPA.

Rather than responding to robust and expert data provided by various petitioners, or even consulting with the author of the IHS report, EPA relies on unsubstantiated data from conversations with blenders that occurred before AFPM submitted its petition for rulemaking.[41] In sum, EPA proposes to deny AFPM's petition on the basis of conversations with commercially interested parties, who provided data to EPA that AFPM has not had the opportunity to review or respond to.

In addition to its failure to consider or respond to data provided by AFPM, EPA repeats its view that "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."[42] To support this, EPA conflates "facilities" with "entities" and concludes that because more facilities may be obligated, more entities will obligated. EPA's argument ignores the reality that a single entity typically owns and operates more than one facility. When considering the actual number of entities required to submit IRS Form 720 to report for fuel excise tax purposes, it is apparent that moving the point of obligation will not result in an increase in the number of obligated parties.

Additionally, despite EPA's stated desire to place the RFS obligation on large entities that have the resources to ensure compliance with the RFS, EPA criticizes Valero's data for failing to include some entities that break bulk, including some of the largest companies (e.g. Costco, Walmart) in the U.S., if not the world. These companies employ accountants and lawyers to ensure they are paying the IRS their federal excise tax for fuel. Contrary to EPA's discussion of the matter, these are sophisticated companies with the same lawyers, accountants, and other resources to track obligations and create necessary reports.

As evidence for its argument that the number of obligated parties will increase under AFPM's proposed definition, EPA cites federal excise tax registrations from California. In California, EPA identified 37 parties that reported taxable gallons to the sixth largest economy in the world. Of those 37 parties, several are businesses already owned by parties registered with EPA. Others provide products (aviation fuel, heating oil) not subject to the RFS. The remaining companies are sophisticated market participants that have systems in place to track excise tax requirements for the large amounts of fuel that move through their systems.

[41] EPA Proposed Denial, *supra* note 3, at 40 n. 98-99.
[42] *Id.* at 22.

In fact, a deeper review of California's data actually supports AFPM and other petitioners' arguments. There are 46 petroleum fuel suppliers (refiners and importers) reporting under subpart MM of EPA's GHG Reporting Rule in California. These numbers do not include small importers exempted from California's greenhouse gas reporting requirements. Therefore, even if EPA's calculation that 37 California entities paid federal fuel excise tax is correct, it demonstrates that the number of RFS obligated parties would actually decrease in California—precisely APFM's argument.

B. Moving the Point of Obligation will not Unduly Increase Complexity

EPA makes further unsupported assumptions that moving the point of obligation will increase complexity of the program and reduce competition.

First, EPA overstates potential issues created by the need to address RIN carryovers and company deficits. In the proposed denial, EPA relies on an argument that the RIN market is functioning as intended. AFPM disagrees with this assessment, but if EPA believes the RIN market is liquid and sufficiently transparent, then the market will react to any change in the point of obligation and ultimately balance.

In addition to overstating the potential short-term impacts on a RIN market that will necessarily evolve, EPA similarly overstates the impacts on the EPA Moderated Transaction System (EMTS). For example, EPA repeats its assertion that 1,100 or more entities could become obligated parties, thereby creating more complexity. In addition, EPA sets up a straw man argument that it "may" need to institute additional reporting to ensure compliance. EPA either failed to discuss, or apparently even consider, the fact that position holders already file quarterly reports with the IRS that could easily serve as independent validation of reported obligations to EPA. Similarly, EPA can, and does, make changes to the EMTS when necessary, as it is doing in the ongoing Renewables Enhancement and Growth Support rulemaking.[43] In moving the point of obligation, EPA can and should make changes to the EMTS to increase transparency and liquidity to help facilitate the transition.

Finally, in its focus on competition at terminal racks, EPA ignores other market forces and discounts competitive harm resulting from the current point of obligation. As an initial matter, the correspondence EPA cites as justification for its concern that certain marketers will move below the rack to avoid RFS obligations acknowledges that there are many reasons these parties are at the rack to begin with, including the "ability to purchase fuel in bulk at a slight

[43] Renewables Enhancement and Growth Support Rule, 81 Fed. Reg. 80828 (proposed Nov. 16, 2016).

discount, the ability to better control their fuel supply, and advantages related to the collection of taxes."[44] There is little reason to believe that the small number of large marketers that would become obligated parties will turn their back on the economic advantages they receive from owning hydrocarbons at the rack. In contrast, EPA gives little to no consideration to competition below the rack, where consumers are most affected. In fact, a coalition of small retailers raised this precise concern—that large, unobligated marketers are using the RIN value to undercut competition at the retail level.[45] Because a majority of retailers are single store operators,[46] EPA should give additional weight to their concerns about retail competition.

C. Moving the Point of Obligation will Reduce Opportunities for Fraud

A decade after the program began and nearly three years after EPA finalized its Quality Assurance Program ("QAP"), EPA continues to announce settlement agreements for fraudulent RINs. In 2016 alone, EPA announced settlement agreements or Notices of Violation for at least 121 million fraudulent RINs.[47] In early 2017, EPA announced its Notice of Intent to revoke the ability of Genscape, a company recommended by the biodiesel industry,[48] to provide RIN validation services under EPA's Quality Assurance Plan.[49]

According to Doug Parker, the former Director of EPA's Criminal Investigation Division, the "cost of these fraud schemes to victims and consumers, including taxpayers and obligated parties, is approaching $1 billion."[50] Mr. Parker is in a unique position to comment on RIN fraud, as he "oversaw the initiation and execution of a nationwide law enforcement effort aimed at curbing the burgeoning fraud in the RFS program. . ."[51] As a result of his experience, Mr. Parker concludes that the RIN market is opaque and was enacted without appropriate safeguards, leaving refiners and importers with little ability to conduct appropriate oversight over the RIN chain of custody due to the number of intermediate parties between the RIN separation and obligated purchase. He concludes that even the QAP program, designed to help verify RINs, is not an effective substitute for structural changes to the regulations. Indeed, EPA's

---

[44] EPA Proposed Denial, *supra* note 3, at 47, n. 109.
[45] Small Retailers Coalition Letter, *supra* note 36.
[46] *2016 Retail Fuels Report*, NAT'L ASS'N OF CONVENIENCE STORES at 3, *available at* http://www.nacsonline.com/YourBusiness/FuelsCenter/Documents/2016/2016-Retail-Fuels-Report.pdf.
[47] *Civil Enforcement of the Renewable Fuel Standard Program*, U.S. ENVT'L PROT. AGENCY, https://www.epa.gov/enforcement/civil-enforcement-renewable-fuel-standard-program.
[48] *RIN Integrity*, BIODIESEL, http://biodiesel.org/policy/rin-integrity.
[49] *Fuels Registration, Reporting, and Compliance Help*, U.S. ENVT'L PROT. AGENCY, https://www.epa.gov/fuels-registration-reporting-and-compliance-help/notice-intent-revoke-ability-genscape-verify-rins.
[50] Doug Parker, *White Paper Addressing Fraud in the Renewable Fuels Market and Regulatory Approaches to Reducing this Risk in the Future*, E&W STRATEGIES (Sept. 4, 2016) at 4, *available at* http://www.earthandwatergroup.com/wp-content/uploads/2016/09/Expert-Report-Fraud-in-the-RFS-9-4-16-.pdf.
[51] *Id.*

proposed revocation of Genscape's status validates Mr. Parker's conclusions. Importantly, Mr. Parker argues that misaligned incentives created by the current point of obligation causes blenders not to conduct due diligence because they bear no regulatory risk.[52] He recommends realigning the point of obligation with the point of compliance as has been successfully accomplished in other EPA programs such as the acid rain trading program.[53]

In addition to reducing the *opportunity* for fraud by shortening the RIN chain of custody between the point of compliance and the point of obligation, moving the point of obligation will also reduce the *incentive* for fraud. In particular, by moving the point of obligation and making necessary changes to the EMTS, EPA can reduce dysfunction in the RIN market, lowering the price of RINs, and ultimately reducing the financial incentive for criminals to attempt defrauding AFPM's members.

III. EPA has the Authority and Imperative to Move the Point of Obligation

In the proposed denial, EPA states that it is "unclear" whether it may establish the point of obligation for percentage standards on "position holders who are not in fact refiners, importers or blenders."[54] While not explicitly citing CAA §211(o)(3), EPA asserts that obligated parties may "in fact" need to be "refiners, importers or blenders" before an annual obligation to comply with renewable fuel obligations can apply.

Despite EPA's professed belief that its authority is unclear on this issue, even a narrow reading of the statutory language allows, and arguably compels, EPA to include position holders within the definition of refiners and/or blenders. However, even assuming arguendo that the definition of "refiners" and "blenders" is unclear, including position holders in the definition is the most reasonable interpretation of the statute. Conversely, a narrower interpretation is unreasonable, as it leads to an absurd result when applied to merchant refiners unable to exercise control over blending decisions.

The Agency has the inherent ability (and indeed an obligation) to reasonably define "refineries, blenders, and importers" as inclusive of "rack sellers" or "position holders."[55] Rack sellers/position holders are a vital link in the supply of transportation fuel to end users, and their actions result in (and, in many cases, are necessary to ensure) that renewable fuel is blended into transportation fuel. Thus, EPA may properly consider such parties either to be refiners or

[52] *Id.* at 6.
[53] *Id.* at 12.
[54] EPA Proposed Denial, *supra* note 3, at 26-27.
[55] *See id.* at nt. 64 (In the proposed denial, EPA uses the term "position holders" to describe parties who were called "rack sellers" in AFPM's petition for rulemaking and Valero's petition for reconsideration).

blenders or acting as or in association with refiners/blenders, thus incurring an annual obligation to comply with renewable fuel volume requirements.

In promulgating regulations to implement the RFS 1 and RFS 2 programs (40 C.F.R. Part 80, Subparts K and M), EPA never explicitly defined a "refiner," "blender," or "distributor" for purposes of the RFS program.[56] Instead, EPA provided that the preexisting definitions in 40 C.F.R. §80.2 applied for the purposes of Subparts K and M.[57] This regulation defines "refiners," but does not define "blender" or "distributor."

EPA could reasonably interpret the term "blender" as including rack sellers/position holders. As defined in IRS regulations (40 C.F.R. §48.4081-1), an entity that holds title to gasoline and diesel fuel prior to sale from a bulk transfer/terminal system is required to report federal excise tax liability for such gasoline and diesel. Since by virtue of owning fuel or blendstock rack sellers/position holders control the decision as to when and where gasoline or diesel proceeds downstream to a wholesaler, retailer, or customer – including specifically whether such gasoline or diesel or blendstock will be blended with renewable fuel – EPA may properly consider such parties as "blenders" for purposes of the RFS.

Alternatively, EPA did define "refiner" in 40 C.F.R. §80.2 for the purposes of Subparts K and M. In particular, a "refiner" is defined in 40 C.F.R.§80.2 as "any person who owns, leases, operates, controls or supervises a refinery."[58] A refinery is also a defined term and "means any facility, including but not limited to, a plant, a tanker truck, or vessel where gasoline or diesel fuel is produced, *including any facility at which blendstocks are combined to produce gasoline or diesel fuel*, or at which blendstock is added to gasoline or diesel fuel."[59]

Using these existing definitions of "refiner" and "refinery," EPA could reasonably interpret that a rack seller/position holder is a subset of the term "refiner" since they are a person who "controls" a facility at which gasoline or diesel is produced by virtue of owning the hydrocarbons used in gasoline and diesel at the point of blending and producing gasoline and diesel. Thus, rack sellers/position holders can be considered to qualify as a "refiner" under the definition of 40 C.F.R. §80.2, and EPA could permissibly limit the refiners who are considered to be obligated parties under the RFS to this subset of refiners.[60]

---

[56] An "importer" was defined for purposes of both the RFS1 and RFS2 programs, but this definition is not relevant to these comments.
[57] *See* 40 C.F.R. §§1101, 1401.
[58] 40 C.F.R. §80.2.
[59] *Id*.
[60] *See* Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program 72 Fed. Reg. 23900, 23924 (May 1, 2007) (It is not necessary to include all possible "refiners" as obligated parties. Indeed, EPA has considered that the definitions of "refiner" and "blender" overlap such that a refiner can include "any blender who produces gasoline by combining blendstocks or blending blendstocks into finished gasoline subject to the renewable fuels obligation.").

More broadly, as EPA noted when it promulgated regulations for the original RFS1 program, the Agency "has discretion under [the statute] to determine the renewable fuels obligation applicable to parties 'as appropriate.'"[61] EPA previously proposed that this authority was expansive enough so as to "shift the obligation for all gasoline from refiners and importers to ethanol blenders . . . [and also] to move the obligations for all gasoline and diesel downstream to *parties who supply finished transportation fuels* to retail outlets or to wholesale purchaser-consumer facilities."[62] Thus, if parties who merely supply transportation fuel to retail outlets can be obligated parties, parties who control the transportation fuel supplied can most certainly be regulated as obligated parties.

As a final alternative, EPA could interpret its authority to impose renewable fuel obligations on "refiners" and "blenders" to be inclusive of parties who act in conjunction with a "refiner" or "blender" in the supply of transportation fuels to the market. As noted above, EPA has used its general authority to implement the RFS program to impose obligations on numerous other parties who are not refiners, blenders, or importers or who may, in some cases, only hold legal title to RINs. If EPA's authority indeed sweeps so broadly, EPA may properly recognize that a rack seller/position holder is integral to the refining and blending of transportation fuel, including the utilization of renewable fuels. Therefore, EPA may properly require a party directly associated with the sale or introduction of transportation fuel into commerce to be an obligated party.

Conclusion

EPA has both sufficient justification and authority to grant AFPM's petition to move the point of obligation to the position holder at the rack. Doing so will make the RFS program more equitable, ease the administrative burden on EPA, and combat fraud. For the foregoing reasons, as well as those set forth in AFPM's original petition, EPA should move the RFS point of obligation to the position holder.

[61] *Id.*
[62] RFS2 Proposed Rule, *supra* note 17, at 24963 (emphasis added); *see also* 75 Fed. Reg. at 14,721.