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VIA CERTIFIED AND ELECTRONIC MAIL

The Honorable Gina McCarthy
Administrator
United States Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, DC 20460
McCarthy.Gina@Epa.gov

Re: Petition for Reconsideration of 40 C.F.R. § 80.1406 promulgated in EPA-HQ-OAR-2005-0161

Dear Administrator McCarthy:

Pursuant to Section 307(d)(7)(B) of the Clean Air Act ("CAA"), 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 Co.; and Wyoming Refining Company (hereinafter the "Small Refinery Owners Ad Hoc Coalition" or "Coalition"), hereby petition EPA to convene a proceeding to reconsider the definition of "obligated party" in 40 C.F.R. § 80.1406. Each member of the Coalition is an "obligated party" under 40 C.F.R. § 80.1406(a)(1) and a small refinery under 40 C.F.R. § 80.1401, responsible for ensuring that Congressionally mandated volumes of renewable fuel are blended into the transportation fuel they produce as required by the Renewable Fuel Standard.

The definition of "obligated party" was originally promulgated in 2007 under the original Renewable Fuel Standard Program ("RFS1")[1] and was re-promulgated under the 2010 Renewable Fuel Standard Program ("RFS2"),[2] which replaced RFS1. 75 Fed. Reg. 14,673. The same definition of obligated party was carried over into the final rule establishing the percentage standards for 2014, 2015, and 2016 and biomass-based diesel volume for 2017 ("2014-2016 final rule" or "final rule").[3]

In the 2014-2016 final rule, EPA used its general and cellulosic waiver authorities in CAA Sections 211(o)(7)(A) and 211(o)(7)(D)(i) to reduce the renewable fuel volume mandates in CAA Section 211(o)(2)(B)(i) based on new findings in the final rule and new analyses published with the final rule, for reasons related to the definition of obligated party. Specifically, EPA concluded that: (1) the statutory volume mandates could not be achieved, in part because exempt blenders and distributors were currently unwilling to invest in new blending and distribution infrastructure necessary to meet the statutory volumes and (2) high Renewable Identification Number ("RIN") prices were not, in the near term, expected to increase demand for high gasoline ethanol blends, like E85, because retailers chose to retain much of the RIN value to maximize their profits, rather than passing the RIN value through to consumers in the form of price discounts for E85. *Id*. at 77,459; 77,461.

[1] Regulation of Fuel and Fuel Additives: Renewable Fuel Standard Program, 72 Fed. Reg. 23,900 (May 1, 2007).
[2] Regulation of Fuels and Fuel Additives: Changes to the Renewable Fuel Standard Program, 75 Fed. Reg. 14,670 (Mar. 26, 2010).
[3] Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017, 80 Fed. Reg. 77,420 (Dec. 14, 2015).

EPA's use of its waiver authorities based on these new findings and analyses, which arose after the definition of "obligated party" was promulgated, but within the past 60 days, are evidence that the definition of obligated party is now arbitrary and capricious and must be reconsidered in accordance with CAA Section 307(d)(7)(B).

The following sections first explain the legal basis of this Petition and then outline why EPA's current approach to defining the "obligated party" has become arbitrary and capricious and must be re-examined.

I. The Legal Justification for Filing the Coalition Petition

This Petition rests on EPA's statements and analyses in the 2014-2016 Final Rule, which reopened the definition of obligated party in RFS2. In RFS1 and RFS2, EPA placed the compliance obligation on refiners and importers on the theory that the current definition of obligated party would work automatically through market mechanisms to increase the use of renewable fuels regardless of where the point of compliance was located. This was a key part of the justification for leaving the original definition unchanged when RFS2 replaced RFS1. EPA's decision in the 2014-2016 final rule to waive the statutorily mandated volumes acknowledged that placing the obligation on refiners and importers no longer ensures that Congress' statutory volumes can be achieved, which means that the definition of "obligated party" can no longer be justified and must be reconsidered. The Clean Air Act allows the filing of a petition for judicial review of an EPA rule outside the 60 day deadline that normally applies if that petition is based "solely on grounds arising after" that 60th day. CAA § 307(b)(1). Those new grounds arose for the definition of "obligated party" when EPA issued the 2014-2016 final rule and published its

new conclusions concerning market constraints caused by the definition of obligated party, which necessitated the use of the agency's waiver authority. The Coalition will file a petition for judicial review of the definition of "obligated party" in RFS2, within sixty days of the Federal Register publication of the 2014-2016 final rule.[4]

II. BACKGROUND

1. The Clean Air Act Requirements

Congress directed EPA to promulgate regulations to ensure that transportation fuel sold or introduced into commerce in the United States, on an annual average basis, contains at least the applicable volume of renewable fuel, advanced biofuel, cellulosic biofuel, and biomass-based diesel set by Congress for each calendar year. 42 U.S.C. § 7545(o)(2). To carry out that mandate, the statute requires EPA to promulgate regulations applicable to refineries, blenders, distributors, and importers, as appropriate, to ensure that the Congressionally mandated volumes of renewable fuel are blended. *Id*. § 7554(o)(2)(A)(iii). Congress emphasized that for **each calendar year**, EPA has a recurring obligation to: (1) determine the applicable volume percentage of transportation fuel sold or introduced into commerce in the United States; (2) determine to whom the renewable fuel obligation applies – refiners, blenders, and importers – as

[4] The Coalition believes that EPA had to consider whether the existing point of obligation properly served the statutory purposes when it determined that the required volumes of renewable fuel for the 2014-2016 compliance years could not be met. *Id*. at 77,420. That is true for several reasons, but most notably because Congress directed that the compliance obligation for each separate year apply to "refineries, blenders and importers, **as appropriate**" to ensure that the statutory volumes are met, thus directing periodic re-examination to ensure that the "appropriate party" was regulated. 42 U.S.C. § 7545(*o*)(3)(B)(ii)(I)(emphasis added). Though EPA has said this issue lies "outside the scope" of the 2014-2016 rulemaking, given the statutory language, it had no power to decline to consider the point of obligation. For this reason, the Coalition will also file a petition for judicial review of the 2014-2016 final rule. However, this Petition is not filed in support of that challenge because the Coalition believes that issue is ready for the courts to consider as it stands.

appropriate; and (3) determine a single applicable percentage that applies to the parties identified in (2) above, obligated parties. *See, Id.* § 7545(o)(3)(B)(ii).

2. EPA's Regulatory Response

In response to Congress' directive, EPA, in RFS1, decided to implement the renewable fuel mandate through a credit trading approach whereby those who are able to blend renewable fuel would be able to generate ("separate" under the rule), emission credits known as RINs that could then be freely traded and used to demonstrate compliance by those who are not able to blend renewable fuel. However, EPA did **not** place the compliance obligation on blenders – those best able to produce RINs needed for compliance. Rather, it placed the compliance obligation on refiners and importers, even though many of them, particularly small and merchant refineries, cannot blend to produce the RINs they need for compliance. EPA also chose to exempt blenders and distributors from any compliance obligations, even though they control the means of compliance – the ability to blend – and are best positioned to expand the renewable fuel blending and distribution infrastructure.

This asymmetry between those who can blend and generate the means of compliance (RINs) and those who have the compliance obligation but not the means to comply, raised the obvious prospect that those who generated RINs might not invest in generating more, since they had no compliance obligation, but would instead keep the money as profit or invest it in improving their own market position in ways with no relation to renewable fuels.

EPA recognized this asymmetry when it promulgated the definition of "obligated party" in RFS1, placing the compliance obligation on refiners and importers, rather than downstream blenders and distributors who controlled the means of compliance:

> . . . under this program the refiners and importers of gasoline are the parties obligated to comply with the renewable fuel requirements. At the same time, refiners and importers do not generally produce or blend renewable fuels at their facilities and so are dependent on the actions of others for the means of compliance. Unlike EPA's other fuel programs, the actions needed for compliance largely center on the production, distribution, and use of a product by parties other than refiners and importers.

72 Fed. Reg. 23,937.

In RFS2, EPA described its RFS1 decision to place the compliance obligation on refiners, even though they did not control the means of compliance, as driven by administrative convenience, regulating the relatively small number of already regulated refineries versus the relatively large number of downstream blenders and terminal operators. 75 Fed. Reg. 14,722.

When promulgating RFS2, the agency acknowledged that its reasons for placing the compliance obligation on refiners and importers and exempting downstream blenders and distributors in RFS1 was **no longer valid**. *Id*. However, EPA did not relocate the compliance obligation in RFS2 to include downstream blenders and terminal operators because the program appeared to be working and because EPA wanted to avoid disrupting the implementation of RFS2. *Id*. Therefore, EPA reviewed and then adopted the same definition of "obligated party" in RFS2. However, the agency acknowledged the need to revisit the definition in a subsequent rulemaking if the rule was not working:

> We will 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.

Id. (emphasis added).

3. Recent History

In 2013, RIN prices hit historic high levels. As it promised to do in RFS2, EPA studied the functionality of the RIN market and analyzed whether the increase in the price of RINs was "driving up prices for obligated parties and fuel prices for consumers" in a report published by EPA contemporaneous with the proposed 2014-2016 renewable fuel requirements ("Burkholder I").[5] EPA concluded in Burkholder I that refiners were generally recovering their RIN costs in the price of the petroleum fuels they produce and that higher RIN prices would drive investments in blending and distribution infrastructure and the use of higher ethanol blends, like E85. *Id*. at 2-3. Based on these findings, EPA adopted a policy to drive investment in blending and distribution infrastructure through higher RIN prices for obligated parties. *Id*. EPA did not examine whether shifting the point of obligation would increase the effectiveness of these market forces.

On December 14, 2015, EPA published the 2014-2016 final rule. In that rule, for the first time in the history of the RFS program, EPA exercised its waiver authority to reduce the Congressionally mandated volumes, recognizing that refiners and importers could no longer ensure that Congressionally mandated renewable fuel volumes would be blended into transportation fuel due to marketplace constraints. 80 Fed. Reg. 77,422-23.

[5] A Preliminary Assessment of RIN Market Dynamics, RIN Prices and Their Effects, Dallas Burkholder, Office of Transportation and Air Quality, US EPA, May 14, 2015.

Though EPA's decision to exercise its waiver authority to reduce the total annual volumes below the volumes set by Congress was necessary and correct, it was based on a reversal of the agency's decision that it could meaningfully impact the annual supply of biofuels in transportation fuel in the near term under the current definition of obligated party, by increasing the price that refiners and importers paid for RINs. The volume reduction, read together with the reasons that EPA gave for it, were a repudiation of Burkholder I and EPA's strategy to increase renewable fuel usage through higher RIN prices, which required EPA to re-examine its compliance approach including, in particular, the definition of obligated party. The agency's decision not to change the definition of obligated party in light of the agency's conclusions concerning the lack of investment in blending and distribution infrastructure and lack of RIN value passed through in the E85 market makes the definition of obligated party arbitrary and capricious.

The Coalition and others have addressed these issues, other than EPA's most recent findings published for the first time in the 2014-2016 final rule, in full detail in their comments on EPA's proposed 2014 -2016 rule.[6] We incorporate those comments and the documents they cite and on which they rely in this Petition. What follows is only an outline of the full case that

[6] Comments from the Small Refinery Owners Coalition ("the Coalition") on EPA's proposed rule "Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass-Based Diesel Volume for 2017," Docket ID No. EPA-HQ-OAR-2015-0111 ("Coalition Comments"); *see also*, Comments of The Valero Companies, EPA-HQ-OAR-2015-0111-2765 (July 25, 2015); Comments of Monroe Energy, LLC and Philadelphia Energy Solutions Refining and Marketing, LLC, EPA-HQ-OAR-2015-0111-2603 (July 25, 2015); Comments of American Fuel & Petrochemical Manufacturers and American Petroleum Institute, EPA-HQ-OAR-2015-0111-1948 (July 25, 2015); Comments of Crimson Renewable Energy LP, EPA-HQ-OAR-2015-0111-1823 (July 25, 2015); Comments of CVR Refining, LP, EPA-HQ-OAR-2015-0111-2500 (July 25, 2015); Comments of Holly Frontier Corporation, EPA-HQ-OAR-2015-0111-2257 (July 25, 2015); Comments of PBF Holding Company LLC, EPA-HQ-OAR-2015-0111-1724 (July 25, 2015).

could be made for a change in EPA's definition of obligated party. We look forward to making that full case when EPA grants this Petition.

III. WHY EPA'S DECISION IS ARBITRARY AND CAPRICIOUS

1. Exempting Blenders and Distributors From the Definition of Obligated Party Is Arbitrary and Capricious In Light of the Agency's Use of its Waiver Authorities

EPA's decision to place the compliance obligation on refiners and to exempt non-refining blenders and distributors has created a compliance loophole through which exempt blenders and distributors are reaping windfall profits selling RINs, with no obligation or financial incentive to reinvest their windfall profits in blending or distribution infrastructure. Although the loophole has existed since 2007, the harm has only been realized in recent years as rising RIN prices have not driven investment in blending and distribution infrastructure by the parties best positioned to do so – exempt blenders and distributors – who are now preventing EPA from meeting the statutory mandates.

In explaining the agency's use of its general and cellulosic waiver authorities in the 2014-2016 final rule, EPA acknowledges that in order to meet the statutorily mandated volumes, investments in blending and distribution infrastructure must occur. 80 Fed. Reg. 77,459. EPA also acknowledges it is using its waiver authorities because blenders and distributors have **chosen** not to make the necessary investments in blending and distribution infrastructure:

> **Fuel blenders and distributors must see sustained profit opportunities before they are <u>willing</u> to invest in new infrastructure to increase their capacity to blend and distribute renewable fuels. Market competition must increase before fuel blenders and distributors are <u>willing</u> to pass along all of the reduced effective price of renewable fuel (in essence, the value of RINs) to consumers at retail. New fueling**

> **infrastructure will need to be built to facilitate the growth in sales of fuels containing an increasing percentage of renewable fuel**. And as exposure to renewable fuels increases, it will take some time for consumers to learn to identify value in fuel blends containing higher proportions of renewable fuels, as well as their vehicle's ability to handle these fuel blends and where they are available for purchase. This suggests that while the RFS program can be effective at increasing the renewable content of transportation fuels over time, **it likely cannot substantially increase the available supply of renewable transportation fuels to consumers in the United States to the volumes envisioned by Congress in the short term**.

Id. at 77,459-60 (emphasis added).

"Fuel blenders and distributors" do not need to ". . . see sustained profit opportunities before they are willing to invest in new infrastructure to increase their capacity to blend and distribute renewable fuels." *Id*. They only need to see "blenders and distributors" defined as the "obligated party" under 40 C.F.R. § 80.1406 before they make these investments. The windfall RIN revenues flowing out of the program, and not being reinvested by exempt blenders, are described at length in the Coalition's comments on the 2014-2016 final rule, are well known to the agency, and are a matter of public record in the 10-Qs and 10-Ks of exempt blenders.

A very recent report indicates that blender/distributor Murphy USA made $117.5 million selling 218 million RINs at an average of 54 cents per RIN to obligated parties in 2015, "adding to the bottom line" and offsetting losses in other sectors of its business.[7] Murphy also reported adding 44 new retail stores in the fourth quarter of 2015, but did not report any new investments in renewable fuel blending or distribution infrastructure. *Id*.

[7] Murphy USA Inc. Press Release, Fourth Quarter 2015 Results (Feb. 3, 2016), available at: http://ir.corporate.murphyusa.com/phoenix.zhtml?c=251856&p=irol-news&nyo=0.

EPA claims that investments by Murphy and other exempt blenders will take time. But EPA is not at liberty to use its waiver authority in order to allow blenders and distributors time to enjoy sustained profits before they decide whether to make the investments that the statutory mandate requires. EPA has been directed to achieve the Congressionally mandated volumes each year and EPA may only exercise its waiver authorities in limited circumstances, which does not include continuing to exempt parties that are needed to meet the statute's mandates. The Congressional mandate does not allow EPA to grant a waiver based on "inadequate domestic supply" to the extent that EPA's own regulatory actions have created it.

Further, EPA's statements that blenders' RIN receipts should be used to incentivize investments in blending and distribution infrastructure are inappropriate. EPA has explained that RINs are a compliance mechanism, intended solely to facilitate compliance by obligated parties, not a wealth transfer device to exempt blenders. 72 Fed. Reg. 23,937. EPA's intent to exempt blenders and distributors in the hopes that they may generate enough profit to be incentivized to use refiners' RIN costs to build out their own blending and distribution infrastructure is an invalid use of the waiver authorities. In the proposed 2014-2016 rule, EPA claimed that high RIN prices paid by refiners would encourage blenders to make these investments. In response, the Coalition commented extensively on the fact that small refineries, in particular, could not and were never expected to make these investments because they lack the capital to do so.[8] The Coalition further explained that RINs were intended to be used as a compliance tool and not a

[8] *See* Small Refinery Exemption Study, An Investigation into Disproportionate Economic Hardship Office of Policy and International Affairs U.S. Department of Energy March 2011.

wealth transfer device by which refiners fund investments by blenders in their own infrastructure. EPA now contemplates RIN revenues from small refineries paying for blenders and distributors to invest in their own businesses.

While EPA is correct that it will take time for the necessary blending and distribution infrastructure to be built, and a waiver of statutorily mandated renewable fuel volumes is necessary in the meantime, for the reasons stated above, EPA must obligate blenders and marketers now in order to encourage the start of the investments necessary to meet the statutory mandates.

2. EPA's New Conclusion in the 2014-2016 Rule That High RIN Prices May Not Incentivize Increased Renewable Fuel Usage Requires A Change to the Definition of Obligated Party

In Burkholder I,[9] EPA concluded that higher RIN prices could significantly impact renewable fuel usage by subsidizing the retail price of high-ethanol gasoline blends such as E85, departing from its earlier conclusion that RINs were **solely** a means of compliance for obligated parties. EPA surmised in Burkholder I that the value of the RIN received by blenders and retailers would be passed to customers in the form of reduced consumer prices for E85, encouraging the growth of the market for E85. EPA's theory was the foundation for EPA's decision in the 2014-2016 to incentivize investments through higher RIN prices.[10]

[9] *See* supra, note 4.
[10] EPA claims that it did not reopen the obligated party definition in the 2014-2016 final rule. As described above, the Coalition contends that it was required by law to do so. Moreover, the Burkholder I report had no other purpose than to examine anew the policy justification for that definition. The Burkholder I report either (or both) examined the reopeners in the 2010 rule – increasing compliance costs for obligated parties and fuel prices for consumers – or assessed whether the existing rule structure, with refiners and importers as obligated parties, prevented the volume mandates from being achieved.

In a second report by Dallas Burkholder ("Burkholder II"),[11] however, EPA rejected its conclusion that E85 use would grow in the near term as a result of RIN value being passed on to consumerss. Instead, EPA observed that ". . . a significant portion of this RIN value is being, and likely will continue to be, withheld by E85 wholesalers and retailers in order to maximize their profits" rather than seeking to maximize E85 sales volumes. Burkholder II at 10. In other words, the RIN value was instead taken as profit by blenders or retailers and not passed on to retail customers to encourage renewable fuel consumption.

In the 2014-2016 final rule, EPA found for the first time that marketplace realities did not reflect its theoretical model, stating that "the RIN is currently an inefficient mechanism for reducing the price for higher level ethanol blends at retail, and therefore unlikely to be able to significantly impact the supply of ethanol in the United States in 2016." 80 Fed. Reg. 77,457. In effect, the agency concluded that because blenders are not obligated parties, RIN values "likely cannot substantially increase the available supply of renewable transportation fuels to consumers in the United States to the volumes envisioned by Congress in the short term." *Id.* at 77,460.

The conclusions in Burkholder II confirm that blenders and distributors, exempt from any obligation to comply, will choose profits over expanding the usage of renewable fuels. In light of these new findings, EPA can no longer regard it as "appropriate" under 42 U.S.C. § 7545(o)(2) to place the compliance obligation on refiners and importers, rather than blenders and distributors.

[11] 80 Fed. Reg. at 77,459 n.84, *citing* An Assessment of the Impact of RIN Prices on the Retail Price of E85, Dallas Burkholder, Office of Transportation of Air Quality, US EPA, November 2015. Burkholder II, although dated November 2015, was not publicly available until it was uploaded to the docket contemporaneous with the publication of the 2014-2016 final rule.

IV. CONCLUSION

The Clean Air Act requires EPA to promulgate and then revise the RFS regulations to ensure that applicable volumes of renewable fuel are blended into transportation fuel sold in the United States. 42 U.S.C. § 7545(o)(2)(a)(i). Each year, the regulations must contain compliance provisions "applicable to refineries, blenders, distributors, and importers, as appropriate" to ensure that the renewable fuel volume mandates are met. 42 U.S.C. § 7545(a)(3)(B)(ii)(I). Continuing to exempt non-refining "blenders and distributors" while exercising the agency's waiver authorities does not ensure that transportation fuels sold in the United States contain "applicable volumes of renewable fuel." Therefore, EPA's definition of obligated party is arbitrary and capricious and EPA should reconsider the definition of "obligated party" in 40 C.F.R. § 80.1406 and impose the RFS compliance obligation on blenders, as required by 42 U.S.C. §§ 7545(o)(2)(A)(iii), (3)(B)(ii)(I).

Thank you for your consideration of the Coalition's petition.

Sincerely,

LeAnn Johnson Koch
Counsel to the Coalition

cc: EPA Docket Center (via overnight mail and email)
Ms. Janet McCabe (via email)
Ms. Julia MacAllister (via email)

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