



Submitted Via eRulemaking Portal

Administrator Andrew Wheeler
U.S. Environmental Protection Agency
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Mail Code 28221T
Washington, D.C. 20460

Attn: Docket ID No. EPA-HQ-OAR-2018-0775

**RE: Proposed Rule: Modifications to Fuel Regulations to Provide Flexibility for E15;
Modifications to RFS RIN Market Regulations**

Dear Administrator Wheeler:

The Valero Energy Corporation and its subsidiaries (collectively, “Valero”) submit these comments on EPA’s proposed rule for Modifications to Fuel Regulations to Provide Flexibility for E15 and Modifications to RFS RIN Market Regulations. Valero’s unique position as a refiner, importer, exporter, marketer and biodiesel and ethanol producer means that Valero views the RFS program from several perspectives that can be helpful to the U.S. Environmental Protection Agency (“EPA”) on the RIN market issues raised in the proposal. Valero urges EPA to consider its unique frame of reference in evaluating the views and recommendations presented in these comments.

As the world’s largest independent refiner, Valero employs approximately 10,000 employees and operates 15 petroleum refineries in the United States, Canada and the United Kingdom. Valero has a large RFS obligation but also provides the perspective of a merchant refiner. In addition, Valero is also a fuel importer, exporter, and a major fuel wholesaler. Important also is Valero’s experience as a biofuel producer. Valero was the first traditional petroleum refiner to enter the large-scale ethanol production market and has 14 state-of-the-art plants, making Valero one of the two largest ethanol producers in the United States. Finally, Valero’s investment in Diamond Green Diesel also makes Valero the largest renewable diesel producer in the country.

In response to EPA’s requests for comment throughout the preamble, Valero provides its views on several of EPA’s assessments and presumptions. Valero’s silence on any specific description in the background or other assessments should not be interpreted as agreement. In addition, in accordance with Valero’s diverse business interests described above, Valero is a member of several different trade associations that represent different aspects of the fuels sector. Any comments these associations submit on this proposal do not necessarily reflect Valero’s views, particularly to the extent that such comments conflict with the statements in this letter. However, Valero agrees with and incorporates as its own the comments submitted by American Fuel & Petrochemical Manufacturers in response to EPA’s proposal to adjust the volatility

requirements for E15 during the summer season. Valero submits its own comments regarding the RIN market and EPA's proposed reforms intended to address problems with that market.

I. Introduction and Summary

Valero has direct exposure to the structural issues with RIN trading and supports EPA's initiative to enhance the efficiency and integrity of the RIN market. While EPA has prioritized finalizing the E15 rule revisions, EPA must not delay adequately addressing the RIN market issues that have plagued the RFS program since 2013. EPA has been aware of RIN price volatility since 2013 and has received comments in annual rulemakings regarding RIN market dysfunction since 2015.¹ Furthermore, EPA requested comment on RIN market issues in annual rulemakings in 2017 and 2018. Valero and many parties submitted comments expressing concern about and analyzing the harms from the RIN market.²

EPA's proposed reforms fall short of effectively advancing the goals of enhancing the efficiency and integrity of the RIN market, most importantly because the proposals do not purport to address the market distortions demonstrated in numerous reports and comments. Valero engaged NERA Economic Consulting ("NERA") to study the RIN market to determine whether there are signs of market manipulation, hoarding, and market inefficiencies. NERA's report shows that, contrary to EPA's description in the preamble, there are conditions present in the RIN market that are not reflective of the fundamental forces of supply and demand.³ As further evidence of RIN hoarding, Valero observes that EPA's own database of RINs shows that a significant volume of RINs have been allowed to expire instead of being used for compliance.⁴ EPA acknowledges receipt of the NERA report through references in the docket for this rulemaking (see EPA-HQ-OAR-2018-0775-0024 and EPA-HQ-OAR-2018-0775-0054).⁵

¹ See, e.g., Valero Energy Corp. Comments on the Proposed 2014, 2015, and 2016 RFS Program Standards 6-7, 9-19, 25-31 (July 27, 2015), EPA-HQ-OAR-2015-0111-2765.

² See, e.g., Valero Energy Corp. Comments on the Proposed 2018 RFS Program Standards 14-18 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3988 (provided as Attachment 1 to these comments); Valero Energy Corp. Comments on Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation at 9, 15, 26 (Feb. 22, 2017), EPA-HQ-OAR-2016-0544-0274; Valero Energy Corp. Comments on the Proposed 2019 RFS Program Standards 1-3, 30-40 (Aug. 17, 2018), EPA-HQ-OAR-2018-0167-1041 (provided as Attachment 2 to these comments); Brattle Group, *A Framework for the Analysis of Market Manipulation* (2012), available at https://brattlefiles.blob.core.windows.net/files/6998_a_framework_for_the_analysis_of_market_manipulation_ledgerwood_carpenter_rev_law_econ_sep_2012.pdf.

³ NERA Econ. Consulting, *Ethanol RIN Market Analysis and Potential Reforms*, Prepared for Valero Services, Inc. (Oct. 18, 2018) (provided as Attachment 3 to these comments) (the "NERA Report").

⁴ Using EMTS data publicly available at <https://www.epa.gov/fuels-registration-reporting-and-compliance-help/available-rins>, Valero calculated the number of RINs that have expired without being used for compliance from 2010-2017. See Attachment 4, Expired RINs Spreadsheet (compiled based on data available as of April 23, 2019).

⁵ Valero notes that the report is not yet publicly available. Attached to Valero's comments is a new version of the report from which NERA has removed the copyright markings. No other changes have been made to this report since its completion October 18, 2018.

NERA's analysis indicates that RINs

- (1) are generally five to ten times more volatile than similar energy commodities like oil, ethanol, and natural gas futures;
- (2) are generally only about one tenth as liquid as comparable commodity futures;
- (3) have estimated economic transaction costs that peak five times higher than oil, ethanol, and natural gas futures; and
- (4) frequently transact at prices that defy rational pricing expectations.⁶

EPA, by contrast, states that it “ha[s] yet to see data-based evidence” of RIN market manipulation, and concludes that “historical RIN price data demonstrates that RIN prices generally follow expected market principles.” 84 Fed. Reg. 10584, 10586, 10606 (Mar. 21, 2019). However, EPA has not given full consideration to all facts material to its market reform proposals. EPA's description of RIN market behavior does not acknowledge the NERA report, let alone contest its conclusions or evince any awareness of the market aberrations detailed by NERA. EPA's analysis appears to rest on broad price trend data, in contrast to the more granular data assessed by NERA that reflects unusually high price volatility, low liquidity, high peak transaction costs or frequent periods of pricing at odds with rational pricing expectations. Unfortunately, EPA's view that the RIN market has performed broadly in accordance with market fundamentals has led to a set of proposed reforms that fall short of an effective response to RIN market conditions.

Valero requests that EPA make the NERA report, attached to these comments, publically available in the docket. Valero asks that EPA address the findings and recommendations in the report as it finalizes RIN market reforms. In the proposed rule preamble, EPA directly refers to concerns raised by the American Petroleum Institute in response to the NERA paper without directly discussing or evaluating NERA's work. *See* 84 Fed. Reg. at 10608. EPA must actively consider NERA's analysis and the reforms suggested in the report. Of particular importance are the following findings:

NERA analyzed RIN market data to determine whether there is evidence of market frictions, inefficiencies, or potential hoarding, and found evidence consistent with all three being present in the market. All three major price sources in the RIN market (EPA, Argus, and OPIS) show that RIN markets violated a fundamental economic expectation over dozens of weeks by pricing RINs closer to expiration above RINs with longer useful lives.

....

NERA's analysis of the supply curve fundamentals and observed price changes in the RIN market is consistent with a supply curve step function such that small amounts of hoarding could shift the supply curve leftward enough to cause prices to jump up to much higher levels, creating a potential incentive for longs⁷ in the market to withhold supply. This too harms the natural forces of supply and demand that are the bedrock of a well-functioning market.

....

⁶ NERA Report at i.

⁷ The NERA Report refers to “shorts” as obligated parties that lack sufficient RIN origination capabilities to satisfy their yearly Renewable Volume Obligation (“RVO”), whereas “longs” are obligated parties, RIN originators, or other market participants that produce an excess supply of RINs relative to their RVO (which is zero for non-obligated parties).

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Absent data collection on forward transactions, the EPA may not have an accurate view of available supply in the RIN market, and may be unable to detect hoarding or attempted manipulation.⁸

EPA's proposed actions to increase data on the market are important steps but EPA has avoided taking on the issues that are most important to address, such as ensuring that RIN markets receive much-needed oversight (such as that provided to other commodity and futures markets by the U.S. Commodity Futures Trading Commission ("CFTC")), which creates structural issues and the potential for manipulation.

As described further in these comments, Valero requests that EPA set properly-sized position limits with hedge exemptions proportionate to each party's RVO on RIN holdings for all RIN types, for both obligated and non-obligated parties and for RINs held by corporate and contractual affiliates. This will prevent market participants from leveraging excessive market power for all RIN types. Properly-sized holding limits for aggregated RIN holdings should mitigate the need for non-obligated party purchase prohibitions and holding duration limits for separated RINs. Limits for holding separated RINs should apply to all RIN types not just D6 RINs.

Position limits of this sort should not present difficulties for members of the regulated community. Similar mechanisms are widely in use in diverse regulated commodity trading markets. Indeed, the most prominent feedstocks for biofuel production—including both corn and soybeans—are traded on futures markets governed by position limits.

Valero supports EPA's proposal to require obligated parties to demonstrate compliance with the RVO on a quarterly basis and the ways in which EPA proposes to increase transparency in the RIN market through improved and increased RIN data reporting. These reforms are necessary to discourage hoarding and encourage liquidity in the RIN market but it is not enough. More frequent RIN retirement obligations and increased reporting would increase information to regulators and to market participants. Yet without more timely reporting of large trader positions, it will be hard to effect market surveillance. In order for market surveillance to be effective, more current, comprehensive and standardized position information is critical.

Although quarterly compliance retirements, holding limits, position reporting/publication, and other regulations on the RIN market are important pieces of RFS reform, it is critical to recognize that such reforms do not address underlying problems with the RFS program. EPA can provide relief to independent refiners, small retailers, consumers, and others routinely harmed by the RFS by redefining "obligated party" in 40 C.F.R. § 80.1401 to mean "rack seller" or "position holder"—those parties that own gasoline or diesel immediately prior to the sale or removal from an IRS-registered terminal or refinery rack.⁹ EPA can also increase the supply of RINs in the market and provide additional RIN liquidity and RIN price stability if EPA changes the RFS to ensure that all renewable fuel produced in the United States for transportation fuel is available for compliance—including domestically produced renewable fuel that is exported.¹⁰

⁸ *Id.* at i-ii.

⁹ Valero Point of Obligation Comments 2.

¹⁰ *See, e.g.*, Attachment 1, Valero Comments on Proposed 2018 RFS Program Standards 18-28; Attachment 2, Valero Comments on Proposed 2019 RFS Standards 19-27.

These changes would have a positive impact on the RIN market because they would address structural problems with the RFS.

II. RIN Market Reforms

As background to the proposed reforms and request for comment, EPA describes its view of the RIN market and how it performs, including whether the market causes harm to any parties and whether there is evidence of market manipulation. 84 Fed. Reg. at 10604-07. Valero does not agree with EPA's description of how the market functions; EPA's conclusion that there is no evidence of market manipulation; EPA's assessment that no parties are harmed nor disadvantaged by the RIN market; nor EPA's presumption that EPA must protect expectations of parties under the current structure of the RFS program. RIN market issues are not new to EPA and in rulemakings over the past two years EPA has sought comment on RIN market performance and issues. Concerns about RIN market manipulation have been raised in numerous letters and papers submitted for EPA consideration including:

- Senators Ron Wyden (D-OR) and Lisa Murkowski (R-AK) (then chairman and ranking member of the Senate Energy and Natural Resources Subcommittee, respectively) exercised their oversight and asked EPA to provide information about RIN market volatility and trading irregularities observed in 2013.¹¹
- Senator Chuck Grassley (R-IA)—an original author of the RFS—also called upon EPA in 2013 “to modify the RIN credit market to eliminate manipulation and abusive trading practices like hoarding[.]”¹²
- Doug Parker, the former Director of EPA's Criminal Investigation Division, reported the costs that RIN fraud imposes on the RFS program in a white paper published in September 2016 and updated in February 2017.¹³
- In 2016, the Renewable Fuels Association asked the CFTC and EPA to investigate potential manipulation in the RIN market.¹⁴
- The head of the Renewable Fuels Association himself testified before EPA on August 1, 2017, that “market manipulation” is a “significant factor” driving up RIN prices. He

¹¹ Letter from Sens. Wyden and Murkowski to Robert Perciasepe, Acting EPA Administrator (Mar. 22, 2013), available at https://www.energy.senate.gov/public/index.cfm/files/serve?File_id=C983BDE3-BEDF-4A6D-B97B-4CB00FF4FB19.

¹² *Grassley Presses EPA to Increase Transparency and Address Reports that RIN Market is Being Exploited by Wall Street*, (Sept. 25, 2013), <https://www.grassley.senate.gov/news/news-releases/grassley-presses-epa-increase-transparency-and-address-reports-rin-market-being>.

¹³ Doug Parker, E&W Strategies, *White Paper Addressing Fraud in the Renewable Fuels Market and Regulatory Approaches to Reducing this Risk in the Future 2* (Sept. 4, 2016), EPA-HQ-OAR-2016-0544-0063 (“I believe the cost of these fraud schemes to victims and consumers, including taxpayers and obligated parties, is approaching \$1 billion.”); Doug Parker, E&W Strategies, *Update to: September 4, 2016 White Paper Addressing Fraud in the Renewable Fuels Market and Regulatory Approaches to Reducing this Risk in the Future 2* (Feb. 3, 2017), previously attached to Valero Point of Obligation Comments.

¹⁴ Letter from Bob Dineen, Pres. & CEO, Renewable Fuels Association, to Hon. Timothy G. Massad, Chairman, CFTC and Gina McCarthy, EPA Administrator (Aug. 1, 2016), available at https://ethanolrfa.org/wp-content/uploads/2016/08/RFA-Letter-to-CFTC-and-EPA_re_RIN-volatility.pdf.

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agreed with refiners that “high prices of RINs” is proof that “we are dealing with a manipulated and contrived market.”¹⁵

Valero and many others provided comments in response to EPA request for comments on the RIN market in annual rulemakings. Valero’s comments¹⁶ in response to EPA’s request for comment on the RIN market in 2017 provided a description of market issues, evidence and expert opinions regarding RIN market problems and the harm from such problems; comments included the following:

RIN market operational problems

In the proposal, EPA expressed interest “in further assessing whether and how the current trading structure provides an opportunity for market manipulation. To that effect, EPA seeks comment and input on potential changes to the RIN trading system that might help address these concerns.”¹⁷ EPA also said it “has continued to explore additional ways to increase program transparency in order to support the program and share data with all stakeholders.”¹⁸ EPA is “interested in providing more information, to the extent consistent with our obligations to protect confidential business information. EPA seeks comment on specific data elements and posting frequency that stakeholders believe would be useful to help with market transparency and liquidity.”¹⁹

Understanding the nature of the RIN market requires realization that the RIN market is virtually unregulated. This stands in stark contrast to trading markets for commodities and securities. A RIN is simply a representation of fuel that is blended; a RIN has no value outside of the RFS market. However, due to the structure of the RFS, obligated parties—particularly RIN short parties—are a captive market for RINs. They must purchase a government mandated and publicly known quantity of RINs every year regardless of the price. Thus, RIN-short obligated parties are captive buyers while sellers can dictate trade terms.

A fundamental characteristic of the RIN market is that a very small number of companies control the vast majority of unobligated RINs. Until 2013, the RIN market was relatively stable—RIN prices were low.²⁰ After 2013, when the RVO approached the level

¹⁵ Testimony of Bob Dineen, Pres. & CEO, Renewable Fuels Association, EPA Public Hearing on the Proposed 2018 RFS Program Standards (Aug. 1, 2017), available at <https://ethanolrfa.org/wp-content/uploads/2017/08/2018-RVO-Proposed-Rule-Comments.pdf>.

¹⁶ Attachment 1, Valero Comments on Proposed 2018 RFS Program Standards 14-18.

¹⁷ 82 Fed. Reg. 34206, 34211 (July 21, 2017).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Ronald E. Minsk, Comments on the Proposed 2014, 2015, and 2016 RFS Program Standards 2 (July 24, 2015), EPA-HQ-OAR-2015-0111-1307.

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that would begin to breach the blendwall, the market became vulnerable to price volatility²¹ and structural deficiencies became apparent.²² The structural deficiencies include:

- The RIN market is unregulated.
- The market is easily moved—by speculation, news, purchasing or selling efforts—causing price volatility.
- There are a small number of sophisticated market participants that control a large number of the surplus RINs—making the market extremely “thin” and illiquid.
- Among RIN-long parties, there is an ability to actively drive the market.
- There is not a centralized or uniform platform for trading.
- There are no limitations on who can participate in the market, resulting in pure speculative participants in the market.
- The market is not transparent—prices are not disclosed and there is no obligation to accurately report prices.
- As an environmental compliance trading mechanism, the market fails to provide the option to comply through blending rather than through purchasing of RINs. This is due to the placement of the obligation separate from the place of compliance and other market structure issues.²³

These issues continue unabated in the RIN market today. Valero urges EPA to consider (1) NERA’s conclusions regarding market manipulation; and (2) evidence of and assessments regarding harm related to structural disadvantages in the RIN market submitted in prior rulemakings, including those submitted to EPA in 2017 and in 2018 in response to EPA’s specific requests for comment.

One example of EPA’s apparent presumption of how the market functions is reflected in EPA’s request for comment on “the degree to which the reforms provide, or detract from symmetry in the marketplace, so that one set of actors is not advantaged at the expense of another set operating in the same market.” 84 Fed. Reg. at 10609. Consistent with EPA’s prior statements, EPA asserts again in this proposal that obligated parties recover RIN costs and thus, even if there was price manipulation of RINs, such manipulation would not cause harm because obligated parties are unaffected by RIN prices. *Id.* at 10607. Based on a wealth of real-world experience, and sophisticated analysis, Valero continues to disagree with EPA’s theory that RIN costs are equally recovered by all obligated parties.²⁴ Valero finds it difficult to believe that EPA

²¹ Numerous media outlets reported on this “RINsanity.” See e.g., Gretchen Morgenson, *Wall St. Exploits Ethanol Credits, and Prices Spike*, Wall St. Journal (Sept. 14, 2013), <https://www.nytimes.com/2013/09/15/business/wall-st-exploits-ethanol-credits-and-prices-spike.html> (“For now, companies like Valero say that they are eating the cost of high RIN prices, which are still eight times more expensive than they were in January.”).

²² NERA Economic Consulting, *Effects of Moving the Compliance Obligation under RFS2 to Suppliers of Finished Products* (July 27, 2015), previously submitted to EPA with Valero’s 2016 Petition for Rulemaking on the RFS Point of Obligation, EPA-HQ-OAR-2016-0544-0008.

²³ Unlike other trading programs administered by EPA for purposes of compliance, the *generation* of RINs falls to a different universe of actors than those parties obligated to *surrender* RINs.

²⁴ Valero Point of Obligation Comments 10-12, 39-42 (discussing pass-through of RINs); Valero Comments on the Proposed 2014, 2015, and 2016 RFS Program Standards 12-13, 18-19. In addition, Valero and others have provided multiple economic studies de-bunking EPA’s theory of pass-through. See, e.g., generally, Bernard L. Weinstein, Southern Methodist Univ., *Renewable Identification Numbers Trading Under the Renewable Fuels Program*:

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takes “claims of market manipulation seriously” and has fully investigated for market manipulation when EPA insists that there is no harm to any party subject to the RFS program. Furthermore, NERA’s assessment that “the RIN market in practice has an asymmetric position limit assessed at commercial end use (when demonstrating RVO compliance) that constrains only” obligated parties that must purchase RINs for compliance—i.e., RIN short parties—contradicts EPA’s assumption that there is “symmetry” in the market place.²⁵

EPA’s refusal to acknowledge the harms Valero, AFPM, other independent and small refiners, and small retailers have repeatedly reported is also apparent in the agency’s cost-benefit analysis of the proposal. In a short description of “RIN Market Reform Economic Impacts,” EPA provides only two brief paragraphs on benefits and costs and characterizes costs of the reforms to include harm to non-obligated parties, as follows:

We also anticipate some costs associated with prohibiting certain non-obligated parties from purchasing separated D6 RINs. Many of these parties have developed business models and entered into contracts that may require them to leverage the ability to purchase separated D6 RINs on spot markets. Prohibiting this practice would require that these parties adjust their business models. (84 Fed. Reg. at 10623)

When evaluating the potential impact of proposed RIN market reforms, Valero urges EPA not to assume that the current RFS program does not harm some obligated parties or to put undue weight on changes to the “symmetry” in the market that could result from such reforms. 84 Fed. Reg. at 10609. In previously submitted comments, Valero and others have informed

Continued Unintended Consequences for Small Fuel Retailers (Updated Report) (Feb. 2017) (discussing the harm to small retailers from the RFS); Charles River Associates (“CRA”), *Re-examining the Pass-through of RIN Prices to the Prices of Obligated Fuels* (Oct. 2016), EPA-HQ-OAR-2016-0544-0067 (finding incomplete RIN pass-through); CRA, *Review of Updated Pass-Through Analysis of Knittel, Meiselman and Stock* (Feb. 2017), previously attached to Valero Point of Obligation Comments (finding that pass-through is failing by 30% in gasoline, which equates to doubling the federal income tax on merchant refiners and giving the extra “tax” proceeds to their competitors); CRA, *Review of CARD Policy Brief 16-PB 20: Impact on Merchant Refiners and Blenders from Changing the RFS Point of Obligation* (Dec. 2016), previously attached to Valero Point of Obligation Comments (reviewing Iowa State Studies on the RIN market and determining that the studies relied on faulty premises and unsubstantiated assumptions); Alex Holcomb, *Market Analysis of the Proposed Change to the RFS Point of Obligation* (Feb. 21, 2017), previously attached to Valero Point of Obligation Comments (describing the limited pass-through of RINs and the economic impacts of EPA’s failure to ensure that the point of obligation is appropriately placed); CRA, *Evaluating the Response of Blender Margins to RIN Price Changes* (Feb. 2017), previously attached to Valero Point of Obligation Comments (“[I]f the RFS construct is working as intended, blenders would not see their margins change as RIN prices change, because all changes would be reflected in prices they pay the refiners for wholesale fuels.”); Christopher R. Knittel, Ben S. Meiselman, and James H. Stock, *The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuel Standard*, National Bureau of Economic Research (June 2015), EPA-HQ-OAR-2016-0544-0280 (describing the near absence of pass-through of RIN prices to retail E85 prices); Minsk Comments on the Proposed 2014, 2015, and 2016 RFS Program Standards (“without pump-on-pump pricing competition for E85 at the retail level, the value of the RIN is on average, not being passed through to the retail consumer, undermining the operation of the program by failing to use the value of RINs to lower the retail price of E85 [to make] it more attractive to consumers and build demand for the fuel”); Ronald E. Minsk, Comments on the Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation (Feb. 22, 2017) (reiterating that the RIN does not pass through to the retail price of E85).

²⁵ NERA Report at 31.

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EPA of harm under the current program to both obligated and non-obligated parties.²⁶ EPA has before it recent evidence that RINs cause harm and distort the fuel market in the form of filings in the Philadelphia Energy Services (“PES”) bankruptcy proceeding,²⁷ severe economic waiver requests by four governors,²⁸ analysis by Charles River Associates,²⁹ comments filed by small retailers,³⁰ comments filed by merchant refiners,³¹ exemptions granted to small refineries,³² and

²⁶ See, e.g., Attachment 1, Valero Comments on the Proposed 2018 RFS Program Standards 28-35; Valero Comments on Notice of Availability of Supplemental Information 8-11 (Oct. 19, 2017), EPA-HQ-OAR-2017-0091-4885.

²⁷ Disclosure Statement for the Joint Prepackaged Chapter 11 Plan of Reorganization of PES Holdings, LLC and Its Debtor Affiliates at 1, 24-25, *In re PES Holdings, LLC*, No. 18-10122-KG (Bankr. D. Del. Jan. 22, 2018), ECF #10. Within two months after the disclosure statement was filed, EPA formally agreed to excuse PES from RFS requirements, waiving hundreds of millions of gallons of renewable-fuel obligations. Consent Decree and Environmental Settlement Agreement, *In re PES Holdings, LLC*, No. 18-10122-KG (Bankr. D. Del. Mar. 21, 2018), ECF #244-1. In that agreement, EPA tacitly acknowledged the severe harm imposed by the RFS obligations described in PES’s comments. Settlement Agreement 5 (“[T]he United States has reviewed financial information submitted by Debtors and determined that PESRM has limited ability to comply with its pre-Effective Date RVOs ...”). The bankruptcy and settlement were intended to “resolve [PES’s] obligations under the Clean Air Act Renewable Fuel Standard (RFS) program,” EPA, *PES Holdings, LLC, et al. Bankruptcy Renewable*

²⁸ See Letters from Gov. Tom Wolf (Pennsylvania) (Nov. 2, 2017), Gov. Susana Martinez (New Mexico) (Nov. 22, 2017), Gov. Greg Abbott (Texas) (Dec. 1, 2017), Gov. John Carney (Delaware) (Jan. 30, 2018), *available at* <https://www.epa.gov/renewable-fuel-standard-program/learn-more-about-letters-seeking-additional-information-related>.

²⁹ See generally, the CRA reports listed in note 24 above.

³⁰ Comments of the Small Retailers Coalition on the Proposed 2017 RFS Program Standards (July 28, 2016), EPA-HQ-OAR-2016-0004-3574; Comments of the Small Retailers Coalition on the Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation (Feb. 20, 2017), EPA-HQ-OAR-2016-0544-0570; Comments of the Small Retailers Coalition on the Notice of Availability of Supplemental Information (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4687; see also Weinstein report, *supra* note 24 (discussing harm to small retailers).

³¹ Attachment 1, Valero Comments on the Proposed 2018 RFS Program Standards 4-5, 13, 24, 28-35; Valero Comments on the Notice of Supplemental Information 3, 7-11; PES Comments on the Proposed 2018 RFS Program Standards 3-5, 7-8, 20-23 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3887; PES Comments on the Notice of Availability of Supplemental Information 1-6 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4884; HollyFrontier Comments on the Proposed 2018 RFS Program Standards 1, 8-11, 13-14, 16 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-2547; HollyFrontier Comments on the Notice of Availability of Supplemental Information 1, 11-16 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4713; Monroe Energy Comments on the Proposed 2018 RFS Program Standards v-vi, 13, 17-23 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3649; Monroe Energy Comments on the Notice of Availability of Supplemental Information 17-22 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4645; Small Refiners Coalition Comments 4-5, (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3105; Small Refiners Coalition Comments on the Notice of Availability of Supplemental Information 1-5 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4709; AFPM Comments on the Notice of Availability of Supplemental Information 9, 14-19 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4703; PBF Energy Comments on the Proposed 2018 RFS Program Standards 1-7, 11-12 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3429; PBF Energy Comments on the Notice of Availability of Supplemental Information 1, 5-10 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4702; AFPM & API Joint Comments on the Proposed 2018 RFS Program Standards 1, 15, 20, 26, 29-31 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3645; Coffeyville Resources Refining & Marketing, LLC Comments on the Proposed 2018 RFS Program Standards 1, 4-5 (Aug. 31, 2017), EPA-HQ-OAR-2017-0091-3106; Coffeyville Resources Refining & Marketing, LLC Comments on the Notice of Availability of Supplemental Information 1-8, 10 (Oct. 20, 2017), EPA-HQ-OAR-2017-0091-4888.

³² EPA has granted these exemptions on the basis of each small refinery demonstrating that compliance with the RFS causes it “disproportionate economic hardship.” A total of 54 exemptions were issued for 2016 and 2017. See <https://www.epa.gov/fuels-registration-reporting-and-compliance-help/rfs-small-refinery-exemptions>.

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other expert reports.³³ Creating and supporting this kind of distortion—competitive advantages to some refining businesses—in the fuel market provides no benefit to renewable fuels and serves no statutory goal.

EPA notes in the proposal “that simply making a profit on the RIN market is not manipulative or anti-competitive behavior.” 84 Fed. Reg. at 10619. However, EPA should consider that the ability for some obligated parties to profit on the RIN market at the expense of other obligated parties demonstrates that RIN costs are not simply passed through and that the RIN market as structured reduces competition. In weighing the costs and benefits of RIN market reforms, EPA places a thumb on the scale in favor of business models designed to take advantage of flaws in the RFS program at the expense of other regulated entities in the fuel sector. EPA should instead weigh the benefits of reducing the harms described in comments and reports and the benefits of eliminating the market distortion and unfair competitive advantage created by the RFS program.

In addition to NERA’s analysis of the indicators of likely market power abuse, EPA’s own data includes evidence indicating RIN hoarding and an increasing level of RIN hoarding. EMTS data shows that over 82 million 2017 D6 RINs and nearly 29 million 2017 D4 RINs were generated, but not retired, suggesting they were allowed to expire by parties holding those positions. In total, 112 million total 2017 RINs were generated, but not used for compliance. This is over four times greater than the number of 2016 RINs that were allowed to expire, and

³³ See, e.g., Comments of the National Black Caucus of State Legislators on the Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation (Feb. 21, 2017), EPA-HQ-OAR-2016-0544-0166 (explaining that the RFS impacts small and mid-size minority-owned gas station owners, consumers, and communities nationwide); Weinstein report, *supra* note 24 (discussing the RIN market’s serious implications for the long-term survival of small retailers); Bernard L. Weinstein, Southern Methodist Univ., *Renewable Identification Numbers Trading Under the Renewable Fuels Program: Continued Unintended Consequences for Small Fuel Retailers* (Aug. 2016) (describing how small retailers do not have the capital or the market leverage to “game” the system under the RFS the way large retailers do); Alex Holcomb, *Market Analysis of the Proposed Change to the RFS Point of Obligation* (Feb. 21, 2017) (describing the limited pass-through of RINs and the economic impacts of EPA’s failure to ensure that the point of obligation is appropriately placed); Ramon M. Benavides, Global Renewable Strategies and Consulting, LLC, *The U.S. Renewable Identification Number: RINs Trading Market* (Aug. 2016) (describing how RIN speculation and volatility increase competitive disadvantages for small and independent refiners and small retailers); Ramon M. Benavides, Global Renewable Strategies and Consulting, LLC, *Renewable Fuel Incentives: Estimation of Large Retailers’ Margins* (Feb. 2017) (demonstrating that small retailers do not have the ability to enjoy the same excess margins); Daryl Bassett, Chair., Empower Consumers, EPA, *Please Fix the Renewable Fuel Standard!* (Nov. 22, 2016) (“Eliminating that gap between refineries and fuel blenders” by having “fuel blenders abide by the RFS and turn in RINs they generate” would “knock out the middle-man market for RINs, which has given rise to an alarming number of cases of fraud and speculation by opportunists attracted to the high prices those pieces of paper fetch on the market.”) CRA, *RINs Market Frictions and the RFS Point of Obligation* (Feb. 2017) (explaining that placing the point of obligation at the rack will mean far fewer RIN transactions in the RINs market and substantially reduced administrative costs related to the RFS program); Acadian Consulting, *Economic Impact and Re-employment Assessment of PES Philadelphia Refining Complex* (Aug. 31, 2017) (quantifying the substantial economic impact to the Philadelphia area and to Pennsylvania if PES’s refinery were to close); NERA, *Analysis of RFS2 RIN Market* (Oct. 15, 2013) (concluding that an inadequate supply of RINs hurts refiners relative to speculators and Merchant Refiners relative to other refiners); Center for Workforce Information and Analysis, *Analysis of Impact of ConocoPhillips and Sonoco Closing* (Jan. 9, 2012) (describing the effects of refinery layoffs effecting 400 hundred workers); James Stock, *The Renewable Fuel Standard - A Path Forward* (Apr. 2015) (advocating for changing the point of obligation to improve pass-through and avoid net RIN deficits that cause merchant refiners to go to the market.).

six times greater than the number of 2015 RINs that were allowed to expire.³⁴ EPA should look more objectively at the evidence or engage a third party to provide a more objective analysis of the RIN market to determine whether and to what extent there is market power abuse in the RIN market.

Valero provides comments on each separate proposed reform and also responds to EPA's request for comment regarding "how the various reforms might work in combination." 84 Fed. Reg. at 10609.

A. Public Disclosure if RIN Holdings Exceed Certain Threshold

Valero appreciates EPA's effort in evaluating other programs to identify mechanisms used to prevent excessive market power. However, EPA proposes only a public disclosure threshold which EPA admits is not as effective as a holding limit. The proposed quarterly disclosure requirement would provide information concerning RIN holding (position) concentrations that is backward-looking and would be readily circumvented by any intelligent market manipulator. And this proposal does not provide adequate protection to market participants or sufficiently timely information to regulators and the public. Moreover, it is unclear that EPA would have sufficient tools to identify any reporting failure or impose any significant consequence to the non-reporting party. EPA states that if a party reports that it has exceeded a threshold, "public disclosure would alert market participants and where appropriate prompt a closer review of the circumstances by EPA," and EPA "could then consider further actions to investigate for anti-competitive behavior and help prevent similar behavior in the future." 84 Fed. Reg. at 10609. To provide these benefits, EPA should require public disclosure *at the time the threshold is exceeded*, rather than at quarter-end, and EPA should employ a penalty system to further disincentivize such behavior.

EPA proposes that parties would report at the end of each quarter whether the party exceeded the proposed thresholds on any day in the quarter. Although EPA also proposes quarterly reporting of additional information regarding the number of RINs separated, purchased, sold and retired by each party in a quarter, EPA does not propose reporting of information specific to the amounts or dates when a party exceeds the holding thresholds. Without specific information and more timely reporting of large trader positions, it will be hard to effect market surveillance. Without effective market surveillance, EPA will not be able to act to prevent or respond to market power abuse. In order for market surveillance to be effective, more current, comprehensive and standardized position information is critical.

According to EPA, the purpose of the public disclosures is to provide transparency in the market regarding how often certain RIN position thresholds are reached or exceeded. EPA suggests that public disclosure "could disincentivize parties from gaining market power, signal potentially harmful behavior to competitors, regulators, and policy makers and be used to justify stronger preventative actions." 84 Fed. Reg. at 10610. However, EPA has made no effort to assess the effectiveness of public disclosure as a disincentive. Nor will the yes/no reporting

³⁴ See Attachment 4.

obligation provide sufficient transparency regarding how often RIN position thresholds are reached or exceeded.

EPA claims that there is insufficient evidence of harm from excessive market power and suggests that it could follow up with more restrictive measures later if warranted. 84 Fed. Reg. at 10610. Before EPA can do so, however, it must define “excessive market power,” which it admits it has not done. Neither has EPA proposed any action that would be triggered by a party exceeding a public disclosure threshold, nor committed to investigate holdings that exceed any threshold.

EPA requests comment on what further actions might entail, “including actions to address concerns within the broader RIN market generally.” 84 Fed. Reg. at 10609. If EPA chooses not to implement properly-sized position limits with RVO-based hedge exemptions, Valero recommends that EPA incorporate a “trigger” that automatically establishes position limits for parties that exceed public disclosure limits. In other words, the public disclosure threshold could apply as the trigger threshold. If a party exceeds the public disclosure threshold in one quarter, a holding threshold applies to that party for the next two quarters.

1. Properly-sized position limits with hedge exemptions proportionate to each party’s RVO will deter excessive market power; public disclosure will not.

Because public disclosure will not effectively deter hoarding, a more effective solution is to adopt a RIN holdings limit. A holdings limit, breach of which subjects the market participant to significant penalties, would create substantial incentive for compliance and could draw on other position limit regimes to define the scope of position limit duties, including exemptions for hedging and other commercially legitimate arrangements. Valero urges EPA to set holding limits on all RIN types at levels appropriate to limit excessive market share.

EPA’s reluctance to set holding limits is based on the assumptions that such a reform could “have detrimental effects” and “unnecessarily compromise market efficiency and liquidity and interfere with obligated parties’ ability to comply with regulations by disincentivizing them from holding the necessary quantity of RINs to meet their RVO.” 84 Fed. Reg. at 10610. EPA is wrong. According to NERA, “concerns about position limits affecting trader flexibility and market liquidity” are

less relevant in the RIN market due to RINs’ distinguishing features as regulatory compliance instruments, particularly (1) RINs’ single commercial end use as a means to demonstrate compliance and (2) the RIN market’s structure resulting in a number of long entities producing substantially more RINs than they can possibly use to meet their RVOs.³⁵

EPA’s concerns are unfounded. NERA concludes that position limits or holding limits “have the potential to increase RIN market liquidity rather than decrease it.”³⁶ Furthermore,

the CFTC has indicated that “position limits would help to diminish or prevent unreasonable fluctuations or unwarranted changes in the price of a commodity” by limiting “the market power that often typifies excessive speculation,” since properly-designed position limits

³⁵ NERA Report at 30.

³⁶ *Id.*

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would prevent any market participant from accumulating “an unusually large speculative position [that] could exert unreasonable market power.”³⁷

EPA has numerous options on how to implement holding limits including modeling those limits on regulations in similar environmental trading regimes that include appropriate exemptions. As noted above, biofuel feedstocks are already subject to holding limits. As EPA acknowledges in the proposal, other environmental trading programs (such as those administered by the California Air Resources Board, Regional Greenhouse Gas Initiative and Canada’s Federal Renewable Fuels Regulations) have holding limits. As NERA’s analysis shows, the RIN Market is directly analogous to the California Greenhouse Gas Emissions Cap-and-Trade Market.³⁸ The California Greenhouse Gas Emissions Cap-and-Trade Market maintains holding limits that were modeled in part on CFTC position limits and was designed to “prevent market participants from taking unilateral actions to move” prices and profit from price changes.³⁹ Based on EPA’s calculations, California’s Cap-and-Trade program has a holding limit of approximately three percent.⁴⁰ However, a more restrictive limit of one percent, proportional to the harm many obligated parties experience as a result of the RIN market, is appropriate here.

While establishing properly-sized position limits and hedge exemptions is the most effective method of addressing structural issues in RIN markets, an alternative, as suggested above, is to establish holding limits that are automatically triggered if a party exceeds a disclosure threshold for a specified period of time. For example, a party that exceeds disclosure thresholds for more than three (3) consecutive trading days in one quarter would be subject to a holding limit in the next two quarters. Such alternatives could be more complicated than setting holding limits with appropriate exemptions but they would be far more effective than a disclosure requirement alone. This would apply to both obligated parties and non-obligated parties. An obligated party that exceeds both thresholds (percent of the total RVO and percent of the party’s obligation) for three consecutive trading days in one quarter would be subject to a holding limit equal to those thresholds for the next two quarters; a non-obligated party would become subject to the holding limit if it exceeds the initial threshold for three consecutive trading days in a quarter.

2. Setting a properly-sized holding limit

In determining the level of the disclosure threshold, EPA stated that an obligated party may have legitimate RIN holdings even at levels close to or exceeding the thresholds being considered. EPA said also that “non-obligated parties have no RVO and require a different threshold methodology...so we believe their threshold should generally be set lower.” 84 Fed. Reg. at 10610. Thus, EPA set one threshold that covers everyone and a second that is adjusted for obligated parties based on compliance needs. According to EPA, 13 out of 126 obligated parties and none of the 280 non-obligated parties held separated D6 RINs exceeding the three percent threshold. *Id.* at 10611. However, EPA’s analysis does not account for possible

³⁷ *Id.* at 31.

³⁸ *Id.* at 33.

³⁹ *Id.*

⁴⁰ Barbora Master, EPA Office of Transportation & Air Quality (Mar. 6, 2019), *California and Quebec Holding Limit Percentages*, EPA-HQ-OAR-2018-0775-0039.

corporate affiliations of non-obligated parties that might show higher levels of aggregated holdings.⁴¹ Nor does the analysis account for contractual affiliations that might indicate higher levels of market share by obligated parties. As a result, EPA cannot presume that its analysis of RIN holdings accurately reflects whether any parties held an excessive market share in the past. To be an effective limit or indicator of market power, the threshold must apply to RINs held by a party's corporate and contractual affiliates.

EPA must determine the level of the disclosure or holding limit on the basis of the compliance obligations. Some obligated parties have annual RVO obligations exceeding 450 million RINs; thus, they would certainly hold at least 450 million RINs in order to comply with the annual RVO. If EPA finalizes the quarterly retirement requirements as proposed, obligated parties would not need to hold as much as 130% of their annual RVO after the first quarter retirements. And non-obligated parties should have no reason to hold large volumes of RINs for extended periods in any quarter.

EPA must set RIN holding limits or public disclosure thresholds below the level at which hoarding can change prices. As NERA found, even "small amounts of hoarding can...cause prices to jump."⁴² And, if EPA finalizes quarterly compliance and thus, quarterly RIN retirement, EPA must consider what threshold or limit would be meaningful under such a requirement. EPA recognized this in the preamble: "a smaller stockpile of RINs in a party's account relative to a smaller pool of available RINs can still result in market power." 84 Fed. Reg. at 10615.

The CFTC regulations applicable to limits on positions, 17 C.F.R. § 150.5, prescribe how to set the level for position limits and includes specific exemptions for *bona fide* hedging transactions. Under these rules, traders must apply for exemptions but an exemption for *bona fide* hedging is available. EPA should use these rules as a guide for setting holding limits and relevant regulations for holding limits. Valero recommends EPA implement properly-sized position limits and hedge exemptions, following the methodology that CFTC currently employs in commodities markets. EPA has already identified some of the obligated parties who are likely to exceed disclosure thresholds and can already consider what type of exemptions might apply if the thresholds were set as holding limits. With quarterly retirement requirements for obligated parties and RIN holdings aggregated for corporate and contractual affiliates, independent non-obligated parties should have no reason for holding limit exemptions.

However, if EPA chooses not to follow the CFTC methodology, Valero recommends that EPA set initial holding limits for all RIN types at one percent (1%) of the annual RVO, and for obligated parties that exceed that threshold, a secondary holding limit of 130% of the parties'

⁴¹ "Since we do not currently require parties to report affiliations or to aggregate RIN holdings based on affiliations, we currently have no way of knowing whether these parties are affiliated with other parties that hold D6 RINs, nor are we able to conduct such an analysis. Due to this limitation, some non-obligated parties could exceed the proposed primary threshold when affiliate RIN holdings are considered." Robert Anderson, Office of Transportation and Air Quality, EPA, *Threshold Calculations for D6 RIN Holding Parties* 4 (Mar. 7, 2019), EPA-HQ-OAR-2018-0775-0069.

⁴² NERA Report at i.

obligation. Valero explains further below why EPA should set the initial threshold at one percent.

3. Holding Limits for Non-obligated Parties

EPA requests comments on whether to propose a lower threshold for non-obligated parties. EPA suggests that a lower holding threshold “could potentially meet the objectives [described for the other proposed reforms] in a simplified and more streamlined way than the various reforms proposed.” 84 Fed. Reg. at 10612. Valero agrees. EPA’s proposed initial disclosure threshold of 3 percent is the only threshold EPA proposes to apply to non-obligated parties. EPA already proposes a higher threshold for obligated parties with the secondary threshold of 130% of the party’s RVO.

Valero generally agrees that EPA should set more stringent or lower holding limits or public disclosure thresholds for non-obligated parties. Differentiating between obligated and non-obligated parties is rational because a non-blending non-obligated party need not hold high volumes of RINs. A non-obligated party that blends fuel might have a legitimate need to hold more than 450 million RINs (that would-be three percent threshold based on the volumes set by EPA for 2019) as they acquire RINs through separation and place the RINs into the market but they have no compliance reason to retain such holdings for extended periods of time. Non-obligated parties who are under contract with obligated parties might also hold high volumes of RINs at times but have no reason to hold such high volumes for long periods of time. However, if RINs will be retired on a quarterly basis, non-obligated parties might not have a legitimate need to hold high volumes of RINs for more time than it takes to sell them.

It is important that EPA limit the holdings of non-obligated parties to levels that are unlikely to impact RIN prices. Since non-obligated parties acquire RINs only to provide RINs to obligated parties, non-obligated parties need not retain large volumes of RINs for long periods of time. NERA’s analysis concluded that even with holdings just over five percent of total RIN supply, “it is possible for non-obligated parties to withhold and release RINs in a manner which moves supply across hypothesized supply curve steps, resulting in jumps in price disproportionate to the change in available RINs.”⁴³

If approximately one-quarter of the RVO is retired every quarter, for conventional ethanol, that equates to approximately 3.75 billion D6 RINs. A quarterly holding threshold of three percent of the *annual* D6 RVO means that a party can hold nearly 450 million D6 RINs before triggering the proposed reporting obligation. However, those same 450 million RINs represent control over 12% of the possible RIN retirement obligation for the *quarter* on any given day without being required to report its holdings to EPA. Thus, the proposed 3 percent threshold RVO provides an opportunity for market manipulation without any check by EPA.

Three percent is too high as a holding threshold for non-obligated parties, since holdings of 450 million RINs are likely to equate to sufficient market share to affect RIN prices, under the right market conditions. Based on NERA’s assessment that holdings even just over five percent of total RIN supply—or 185 million RINs—on a given day can affect the market, a holding limit

⁴³ NERA Report at 26.

of one percent (or 150 million) D6 RINs is more appropriate for non-obligated parties. If EPA does not impose any other reforms for non-obligated parties, Valero urges EPA to set a holding limit for non-obligated parties equal to one percent of the applicable RVO for April 1 to December 31 and equal to one percent of 125 percent of the applicable RVO for January 1 to March 31.

If EPA finalizes the quarterly compliance reform for obligated parties, RINs will be needed for compliance on a quarterly basis and non-obligated parties can sell RINs and reduce holdings as they acquire RINs. A holding limit of one percent of the RVO should not impose any burden on non-obligated parties when obligated parties are required to retire RINs on a quarterly basis.

As previously stated, properly-sized holding limits for non-obligated parties might be more easily implemented than a duration limit or a prohibition on purchasing separated RINs. At a minimum, to forgo the duration limit and the purchasing prohibition, Valero recommends that EPA set a holding limit that is triggered by a non-obligated party that exceeds the disclosure threshold for more than three consecutive trading days during a given quarter. The holding limit should apply for two quarters following the quarter in which the disclosure threshold is exceeded.

EPA requests comment on potential gaming by parties becoming obligated to avoid the prohibitions. Properly-sized position limits and hedge exemptions, for all RIN market participants, would reduce any potential for parties to profit by gaming EPA's trading restrictions. EPA can also minimize gaming by requiring RIN holding aggregation for corporate and contractual affiliates. If EPA finalizes the quarterly compliance obligation or holding limits for all participants, a party that becomes obligated merely to increase RIN holdings will become subject to additional requirements, including RIN retirement for compliance, that should serve as a disincentive for becoming an obligated party just to hold greater volumes of RINs. In any case, such actions should not harm the RFS program or the RIN market.

Valero urges EPA to monitor the RIN market, evaluate how the market responds to initial thresholds, and consider adjusting, as appropriate, holding thresholds for all RIN types. However, EPA must not delay setting initial thresholds for all RIN types while EPA undertakes the evaluation to adjust the thresholds as appropriate for the market. Given the different nature of each RIN type (the different volumes, generators, and RIN holders), EPA might find it appropriate to set different holding thresholds or limits for each RIN type.

4. Aggregate RIN holdings

EPA proposes to require calculating RIN holdings for all corporate affiliates of a party. EPA considered including RIN holdings of all contractual affiliates but believes that it would be too complicated and result in double counting of RINs. EPA's proposed approach for aggregation of RIN holdings for comparison to the threshold would enable ready evasion of the disclosure requirement because it would not require aggregation of holdings among parties with a contractual relationship. If an obligated party wished to avoid disclosure, it could make use of a contractual relationship to park RINs with another party while still maintaining control over the

RINs. Valero urges EPA to require RIN holdings be aggregated based on both corporate and contractual affiliation and such aggregated holdings would be subject to the holding limits.

5. Deficits

EPA proposes “that an obligated party that fell short of its quarterly RIN retirement requirement in the current year would not be able to incur a deficit in its next year annual RVO.” 84 Fed. Reg. at 10586. While Valero understands that the rules should not allow obligated parties to run a deficit year after year, Valero urges EPA not to change the current rules as they apply for annual RVO compliance and annual deficits. The annual deficit rules should remain the same; the deficit rules for quarterly retirement requirements should not impact the annual RVO deficit rules.

B. RFS Compliance Frequency

EPA proposes to require obligated parties to retire RINs for each calendar quarter equal to 80 percent of an obligated party’s RVO for the party’s cumulative gasoline and diesel production and import volume. 84 Fed. Reg. at 10617. EPA seeks comment on whether this reform should be a holding requirement rather than a retirement requirement. If properly-sized position limits and hedge exemptions are not established for all RIN market participants, Valero recommends that this reform should be a retirement requirement. EPA proposes to require retirements of RINs for all nested RVOs. Valero recommends that quarterly retirement requirements should be limited to conventional (D6) RINs only, as there are seasonal variances in production of other RIN types.

C. Limiting Who Can Purchase Separated RINs

Valero supports EPA’s proposal to allow only obligated parties and exporters to purchase separated D6 RINs. 84 Fed. Reg. at 10618. However, EPA proposes to exempt non-obligated parties from this prohibition if they are a corporate affiliate or a contractual affiliate of an obligated party. *Id.* This exemption would swallow the general rule.

By permitting non-obligated parties who are corporate affiliates or contractual affiliates to purchase separated RINs, the proposed rule would in fact permit non-obligated parties to purchase separated RINs on behalf of another party. As drafted, the proposed rule would not even specify that contractual affiliates must be affiliated with an obligated party. *See* proposed 40 C.F.R. § 80.1401 definition of “contractual affiliate” and proposed 40 C.F.R. § 80.1428(b)(2). However, even if this drafting error were corrected, the definitional requirement that a contractual affiliate have “an explicit or implicit agreement in place” to purchase or hold RINs on behalf of the other or to deliver RINs to the other would permit large concentrations of RIN holdings through loose contractual relationships with otherwise unconnected parties.

EPA proposes, as an alternative approach, imposing a D6 holding limit on non-obligated parties that can be lower than the three percent threshold proposed for obligated parties. 84 Fed. Reg. at 10620. As described above, Valero agrees that a properly-sized holding limit, not simply a reporting threshold, is more effective and easier to implement than implementing a purchase prohibition with exceptions that could swallow the rule. Valero requests that EPA set holding limits for all RIN types for non-obligated parties.

EPA requests comment on potential gaming by parties becoming obligated to avoid the prohibitions. Properly-sized holding limits for all RIN types, for both obligated and non-obligated parties, with appropriate aggregation rules and hedge exemptions should minimize gaming opportunities and any benefit from changing obligation status.

D. Limiting Duration of RIN Holdings by Non-obligated Parties

EPA proposes to require non-obligated parties to sell or retire as many RINs as it obtained in a quarter by the quarter's end. 84 Fed. Reg. at 10620. Valero agrees with EPA that this reform is unnecessary if EPA sets a properly-sized holding limit for non-obligated parties. Quarterly compliance obligations would encourage non-obligated parties to sell RINs to obligated parties more regularly and not hold RINs for long periods. However, if EPA does not finalize a properly-sized holding limit for non-obligated parties but instead sets a duration limit for holding RINs, the limit should apply to all RIN types.

E. Enhancing EPA's Market Monitoring Capabilities

NERA recommends that EPA increase the amount of data reported to EPA regarding the RIN market so that EPA can better understand the RIN market.⁴⁴ Valero agrees that EPA needs more information to better understand the RIN market.

EPA has no reliable way of determining whether any market participants are engaging in hoarding or potentially manipulative behaviors through such transactions. This is a significant regulatory blind spot: although transfers of title may be transparent to the EPA and may display indicia of efficient markets, problematic indicia in forwards and other derivatives may go undetected by the EPA in the absence of relevant regulatory data collection. Moreover, the data that the EPA does collect is made available to the public only in broad aggregates, and private data vendors offer little more than the daily range of prices and volumes volunteered by a subset of the market.⁴⁵

Valero recommends that EPA finalize the proposed changes to gather additional data on the RIN market.

1. Annual attest engagements to include corporate and contractual affiliates in the compliance year.

EPA says "given the complexity of contracts and RIN transactions, it is very challenging for EPA to confirm whether parties have common ownership and whether any group of corporate affiliates reached a level of aggregated D6 RIN holdings in a compliance year that would trigger the thresholds" proposed. 84 Fed. Reg. at 10622. EPA also acknowledges that parties may control additional market share through contractual affiliations. *Id.* Thus, EPA's proposal to collect corporate and contractual affiliate information is important to better understanding the RIN market. EPA should collect corporate and contractual affiliates information involved in purchases and holdings of all RIN types, not just D6 RINs. However, annual reporting is not sufficient to allow for effective market surveillance and would not be effective in preventing abuse of market power. Without more timely reporting of large trader positions, it will be hard to

⁴⁴ NERA Report at 27-29.

⁴⁵ *Id.* at 27.

effect market surveillance. In order for market surveillance to be effective, more current, comprehensive and standardized position information is critical.

2. Rule changes for RIN prices entered into EMTS

EPA proposes a rule change to require reporting true RIN price and limit when \$0.00 can be entered as the price. 84 Fed. Reg. at 10623. EPA proposes a rule change to require reporting whether the transaction is a spot trade or from a term contract. 84 Fed. Reg. at 10623. Valero applauds EPA's efforts to improve capabilities to provide effective oversight of the RIN market and reduce the potential for market manipulation.

3. Third-party market monitoring

EPA requests comment on whether EPA should employ third-party monitoring of the RIN market. 84 Fed. Reg. at 10623. In 2018 comments, Valero provided EPA recommendations to improve transparency including additional data reporting to allow EPA to monitor large trader activity like the CFTC does.⁴⁶ Engaging a third-party market monitor may be an efficient and effective way to utilize the additional data that EPA is gathering as well as to determine what additional data is needed to adequately monitor the market and reduce risks for market manipulation or excess market power.

F. Combining Reforms

As EPA acknowledged, properly-sized holding limits and hedge exemptions might meet the goals EPA has set for the RIN market reforms. However, if EPA does not set holding limits or if EPA does not require obligated parties to demonstrate compliance quarterly, EPA should limit the duration that unobligated parties can hold RINs. EPA should also monitor closely who is buying and selling separated RINs. Without appropriately stringent holding limits, EPA should employ a third-party monitor to objectively evaluate the market and report to EPA and to the public.

EPA proposes for all the reforms that a non-obligated party would be allowed to "maintain the RIN holdings it would have on the day before the effective date of th[e] reform[s]." 84 Fed. Reg. at 10622. Valero recommends that all parties should be expected to fully comply with the regulations governing RIN markets on the date reforms become effective. Market participants will have the ability to adjust holding positions, if required, prior to new reforms going into effect.

G. Additional Market Reforms

EPA requests comment on "actions to address concerns within the broader RIN market generally." 84 Fed. Reg. at 10609.

Valero requests that EPA consider additional reforms that can improve the RIN market. Valero urges EPA to consider means to keep RIN costs low since the original intent of the program was keeping RFS compliance costs low. In several rulemakings, EPA acknowledged

⁴⁶ See Attachment 2, Valero Comments on the Proposed 2019 RFS Program Standards 30-40.

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that a well-functioning RFS market should mean low RIN prices.⁴⁷ As Valero has previously argued, low RIN costs are likely the best solution for controlling market manipulation/hoarding behavior by removing incentives for that behavior.⁴⁸

NERA recommends a central repository for RINs that holds periodic auctions could help improve liquidity, mitigate market fragmentation, and provide a centralized forum for periodic price discovery.⁴⁹ In 2018 comments, Valero also recommended a central RIN repository for excess carryover RINs.⁵⁰ A central repository for periodic auctions for all RINs or for excess RINs held by obligated parties are options to keep RINs available for purchase and to keep RIN prices low.

Another option that would help meet the RFS's policy goals while keeping RIN prices low is a well-designed price containment mechanism, such as a D6 waiver credit. Price containment mechanisms have proven effective in a variety of other compliance credit markets, such as the Renewable Portfolio Standards and carbon emissions policies in many states and regions. As Charles River Associates has explained, “[a] price containment mechanism in the RFS could lead to greater ethanol consumption in the long term if it includes redirecting the new government revenue stream to expanding higher ethanol blend fuel consumption.”⁵¹ Waiver credits could be offered for sale by the EPA as an alternative compliance mechanism for obligated parties. Like the cellulosic waiver credit, this would be effective at providing RIN-short parties cost certainty and it would help to contain hoarding behavior.

Finally, Valero must remind EPA that two significant structural flaws in the RFS program contribute to RIN market distortions as well as unnecessary constraints on the supply of RINs for compliance purposes. The first structural flaw is the separation of the point of obligation from the point of compliance. As Valero and others have argued in several rulemakings, EPA can reduce the opportunities for abuse of excessive market power in the RIN market and provide relief to independent refiners, small retailers, consumers, and others routinely harmed by the RFS by redefining “obligated party” in 40 C.F.R. § 80.1401 to mean “rack seller” or “position holder”—those parties that own gasoline or diesel immediately prior to the sale or removal from an IRS-registered terminal or refinery rack.

⁴⁷ For example, when EPA in 2007 defined obligated parties as refiners and importers, but not blenders, it did so “based on an expectation that there would be an excess of RINs at low cost, and they would be freely traded between parties needing them such that obligated parties would have ample opportunity to acquire them.” Denial of Petitions for Rulemaking to Change the RFS Point of Obligation, EPA, Office of Transportation & Air Quality, EPA-420-R-17-008, at 12-13; *see also* 75 Fed. Reg. 14,670, 14,722 (Mar. 26, 2010) (“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.”).

⁴⁸ *See* Attachment 1, Valero Comments on the Proposed 2018 RFS Program Standards 14-18.

⁴⁹ NERA Report at 35-36.

⁵⁰ *See* Attachment 2, Valero Comments on the Proposed 2019 RFS Program Standards 33.

⁵¹ CRA, *Ethanol RIN Waiver Credits: Improving Outcomes of the Renewable Fuels Standard through a Price Containment Mechanism* 1 (Mar. 2018), available at http://www.fuelingusjobs.com/library/public/CRA_RIN_PriceContainment_March_2018.pdf.

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The second structural flaw is the unavailability of compliance credit for exported renewable fuel. As explained in comments submitted by Valero,⁵² the regulations conflict with the statutory mandate to credit for compliance all renewable fuel produced in the United States. The statutory mandate is for increasing volumes of renewable fuel in transportation fuel entered into commerce in the United States. Since renewable fuel produced for sale as transportation fuel in the United States, even if exported, enters into commerce, the RFS conflicts with the statute by denying compliance credit for renewable fuel exports. By changing the RFS to ensure that all renewable fuel produced in the U.S. for transportation fuel is available for compliance, EPA would also increase the supply of RINs in the market and provide additional RIN liquidity and RIN price stability. These changes would have a positive impact on the RIN market because they would address structural problems with the RFS.

Valero is committed to working with EPA in a constructive way that will further the goals of the RFS program. I am available at your convenience to discuss the issues raised in these comments and recommendations. Please contact me at (202) 560-5858 should you have any questions.

Sincerely,



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⁵² See, e.g., Attachment 1, Valero Energy Corp. Comments on Proposed 2019 RFS Standards 19-27; Attachment 4, Valero Comments on Proposed 2018 RFS Program Standards 18-28.