

Pennsylvania's RFS Waiver Request: Separating Fact from Fiction

On November 2, 2017, Pennsylvania Gov. Tom Wolf submitted a letter to Environmental Protection Agency (EPA) Administrator Scott Pruitt asking that the 2017 and 2018 Renewable Fuel Standard (RFS) requirements for conventional renewable fuel be limited to no more than 9.7% of annual gasoline demand. Gov. Wolf's letter asks for the waiver "to provide relief to refiners in Pennsylvania and elsewhere," expresses concern about "the high cost of compliance," and suggests the RFS threatens to "severely harm" the economy.¹ The waiver request follows a letter Gov. Wolf sent to President Trump on October 20, 2017, requesting that the President direct EPA to "...waive the renewable volume obligation for Northeast refiners until or unless the market prices [for RINs] deflate."²

Gov. Wolf continues to overlook a number of important realities regarding RIN credits and the gasoline market, factors affecting profitability in the Northeast refining sector, and the burden of proof associated with demonstrating "severe harm" and securing a waiver of RFS requirements. When these facts are properly taken into consideration, it is clear that EPA has no choice but to deny Gov. Wolf's request for a waiver of the RFS requirements.

➤ Merchant refiners recoup their RIN costs through wholesale gasoline prices.

- Numerous studies—including some funded by the oil industry—have shown that **merchant refiners recover their RIN costs** by slightly marking up the price of gasoline blendstock sold into the wholesale market.
 - According to a study by Iowa State University, "...added refiner costs from complying with the RFS are **passed on to blenders** through higher [wholesale] gasoline prices."³
 - Another study authored by economists from Harvard University, the University of Michigan, and MIT states that its "...main finding for bulk petroleum fuels is that **RIN prices were passed through one-for-one in the prices of bulk petroleum fuels.**"⁴ The MIT economist has advised Delta Airlines (owner of the Monroe Energy refinery in Pennsylvania) on RIN markets and the RFS.

¹ Letter from the Honorable Tom Wolf, Governor of the Commonwealth of Pennsylvania, to the Honorable Scott Pruitt, Administrator, U.S. Environmental Protection Agency. November 2, 2017

² Letter from the Honorable Tom Wolf, Governor of the Commonwealth of Pennsylvania, to the Honorable Donald J. Trump, President of the United States. October 20, 2017. "RINs" are Renewable Identification Credits, which are used to demonstrate compliance with the Renewable Fuel Standard. (See "[RINs and RVOs are used to implement the Renewable Fuel Standard](#)", EIA, June 2013).

³ Babcock, Lade, and Pouliot (December 2016). "Impact on Merchant Refiners and Blenders from Changing the RFS Point of Obligation." CARD Policy Brief 16-PB 20. Iowa State University Center for Agricultural and Rural Development.

⁴ Knittel, Meiselman, and Stock (November 23, 2016). "The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuel Standard: Analysis of Post-March 2015 Data." (Knittel has disclosed that he "advised Delta Airlines on the economics of RIN markets and the pass-through of RIN prices to wholesale gasoline prices).

- Even merchant refiner Tesoro (now Andeavor) acknowledges that **“RIN costs are passed through at the bulk finished product sales points** and provide refiners with coverage of their exposure to them.”⁵
- The slightly higher wholesale gasoline prices are then equally offset at the terminal rack when ethanol is blended to make a finished fuel (e.g., E10). This offset occurs because the blender’s effective cost for ethanol is reduced by the value of the RIN. In other words, the RIN-induced slightly higher price for wholesale gasoline is cancelled out by the RIN-induced slightly lower price for ethanol. **Thus, retail gasoline prices paid by consumers are unaffected by RIN prices.**
 - According to the Iowa State University economists, **“...the net effect on the [retail] price of E10 of high RIN prices is zero:** higher gasoline prices are offset by lower ethanol blending costs and the price of E10 remains constant.”⁶
 - Similarly, the Harvard, Michigan, and MIT economists found **“...no statistical evidence linking changes in RIN prices to changes in E10 prices.”**⁷
 - Most recently, an analysis by Informa Agribusiness Consulting found **“...changes in RIN prices did not ‘cause’ the changes that occurred in retail gasoline prices** in 2013, and this has continued to be the case through the summer of 2017.”⁸

➤ **Merchant refiners have taken steps to increase their ethanol blending capacity and reduce the number of RINs they purchase on the secondary market.**

Gov. Wolf’s first letter states that merchant refiners with “limited blending capacity...must purchase RINs on the secondary market.” This is incorrect. In fact, rather than continuing to only purchase RINs on the secondary market, a number of merchant refiners—including Northeast refiners—have made investments in ethanol blending capacity to significantly enhance their ability to acquire RINs internally.

- According to an April 2017 update from the Oil Price Information Service (OPIS), “Merchant refiner PBF Energy’s acquisition of a products terminal in Toledo, Ohio, was driven at least in part by the company’s **desire to increase its capacity to blend biofuels and reduce what it pays to buy Renewable Identification Number (RIN) credits** to comply with the Renewable Fuels Standard.”⁹
- In November 2016, OPIS noted that “Monroe Energy, the wholly owned subsidiary of Delta Air Lines, will soon begin selling gasoline and eventually diesel at rack terminals in the Northeast. As Monroe Energy adds rack availability, **it will clearly generate its own RINs.**”¹⁰

⁵ Oil Price Information Service Biofuels Update (Feb. 17, 2017). “RFS Compliance Costs Are Not Cause of Refiners’ Financial Woes: Tesoro.”

⁶ Babcock, Lade, and Pouliot (December 2016).

⁷ Knittel, Meiselman, and Stock (June 2015). “The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuel Standard.”

⁸ Informa Agribusiness Consulting (October 2017). [“Analysis of Whether the Prices of Renewable Fuel Standard RINs Have affected Retail Gasoline Prices.”](#) Prepared for the Renewable Fuels Association.

⁹ Oil Price Information Service Biofuels Update (April 18, 2017). “PBF Energy’s Purchase of Ohio Terminal Driven by RFS Costs: Sources.”

¹⁰ Oil Price Information Service Biofuels Update (November 22, 2016). “Delta Will Begin New Chapter With Trainer Refinery: Prepping for Rack Sales.”

- OPIS further noted that several Northeastern refineries are transitioning from the “merchant” model to a more integrated downstream model: “PES and PBF, for example, were **once primarily considered ‘merchant’ refiners**, but now sell gasoline and diesel at very competitive rack numbers, **which nominally enhance refining ‘cracks.’**”¹¹
- Western Refining is another refiner that is evolving from a “merchant refiner” to a model that allows internal capture of RINs through blending operations. According to the CEO of Western Refining, “We’re continuing to look at our businesses to try to figure out **how we can capture any RINs that we’re not capturing today** and really the goal is to put ourselves in a position where we’re **producing more RINs than our obligation is.**”¹²
- In August 2016, OPIS reported that merchant refiner Valero is “...trying to find ways to **blend more biofuels, thus reducing the number of RINs it will have to buy**, and is exploring such steps as acquiring additional terminals and by continuing to build exports to ease its RINs burden.”¹³

➤ **RINs are *not* the cause of any financial stress some Northeastern refineries may be experiencing.**

The letter from Gov. Wolf to Administrator Pruitt suggests RFS compliance could undermine “the continued viability of the oil refining sector in the Northeast.” However, any economic stress on the Northeast refining industry is largely due to factors unrelated to the RFS or RINs.

- Historically, East Coast refiners have generally had lower profit margins than their competitors in the Midwest and Gulf Coast regions because of their **reliance on imports of more expensive crude oil from West Africa and the North Sea**. These heavier crudes are **more costly to ship and refine** into gasoline, diesel, jet fuel and other refined products.
- **Philadelphia Energy Solutions (PES)** operates one of the nation’s oldest refineries, characterized by Reuters as “...a **‘zombie’ refiner at risk of being shuttered** in the wake of the financial crisis...”¹⁴
 - The Carlyle Group and Sunoco “**rescued the refinery...from bankruptcy**” in 2012 thanks to a “**taxpayer-funded rescue package**, which included the creation of a **tax friendly zone, \$25 million in grants and environmental liability waivers.**”¹⁵ PES invested in new infrastructure in 2013 to allow the refinery to import cheaper Bakken crude from North Dakota. The investment initially paid off, with PES turning strong profits in 2014-2015.
 - However, the collapse in oil prices and narrowing spreads between Bakken, WTI, and imported crude oil prices hit PES hard. The company is now dealing with a **substantial debt burden**, and Carlyle **scrapped plans to take PES public** in 2016. Carlyle reportedly tried to sell the refinery in 2016 after the failed IPO bid.

¹¹ *Id.*

¹² Oil Price Information Service Biofuels Update (November 2, 2016). “‘Oracle’ Says RINs Here to Stay.”

¹³ Oil Price Information Service Biofuels Update (August 1, 2016). “Refiners Can Cut RIN Costs Without Changing RFS: RFA’s Cooper.”

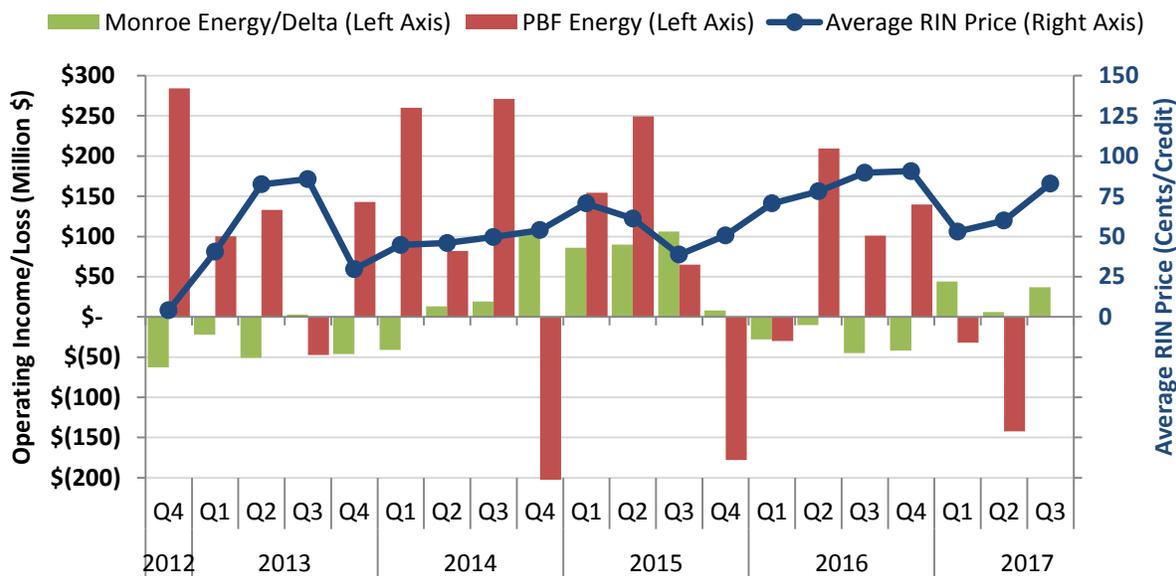
¹⁴ J. DiNapoli, Reuters (August 1, 2017). “[Exclusive: Philadelphia oil refinery taps debt restructuring adviser-sources.](#)”

¹⁵ *Id.*

- Even labor leaders representing employees at the PES refinery acknowledge that **RINs are not the source of the company's financial troubles**. Ryan O'Callaghan, of the United Steelworkers Local 10-1 (which represents nearly 700 workers at the refinery), said he questions the company's allegations regarding the impact of RINs on profitability and added, "We have information that the **RINs might not be impacting them as stated.**"¹⁶
- In an attempt to better control its jet fuel costs, **Delta Airlines** purchased a 90-year-old oil Trainer, PA, refinery from ConocoPhillips for \$180 million in early 2012. The purchase was subsidized by the state of Pennsylvania, which provided a **\$30 million grant** to the airline.
 - Delta's plan was to retool the **Monroe Energy** facility so that it could process a wider variety of crude oil sources and maximize jet fuel output. As a result of high crude oil prices and high maintenance costs, the refinery reported steep financial losses in five of its first six quarterly filings with the Securities and Exchange Commission (SEC). It is also likely that Delta's inexperience in managing an oil refinery contributed to the poor financial performance initially. But, similar to PES, the Monroe Energy refinery's performance underwent a considerable turnaround in 2014-2015. Monroe Energy recorded remarkably strong profits, as facility upgrades allowed processing of lower-priced Bakken crude.
 - But similar to PES, Monroe Energy has been affected by reduced availability of Bakken crude oil by rail and the narrowing spread between Bakken, WTI and imported oil. Still, **Monroe has been profitable in the most recent three quarters**, according to SEC filings.
- As shown in the chart below, there is absolutely no discernable relationship between RIN prices and quarterly operating income for Monroe Energy and PBF Energy (PES is not a public company and thus does not publicly report its quarterly earnings).
 - Monroe Energy experienced its worst quarter financially in late 2012 when RIN credits averaged just 4 cents. Conversely, the refiner has its strongest financial performance in quarters when RIN prices were in the 40-70 cent range in 2014 and 2015.
 - Similarly, PBF Energy saw strong performance in several quarters when RIN prices were elevated and losses in quarters when RIN prices were relatively lower.
 - This provides further evidence that RIN costs are recouped by merchant refiners through higher "crack spreads."

¹⁶ K. E. Carey, "USW workers mull strike against Philadelphia Energy Solutions refinery." July 1, 2017. Delaware County Daily Times. www.delcotimes.com/article/DC/20170701/NEWS/170709984

Monroe (Delta) and PBF Quarterly Operating Income/Loss vs. RIN Credit Prices



➤ **There is no evidence that the RFS and RINs are causing “severe harm” to the economy of Pennsylvania or the Northeast.**

As Gov. Wolf’s letter points out, EPA may waive RFS obligations if it is demonstrated that implementation of the requirements would somehow cause **“severe harm” to the economy or environment of a state, a region, or the United States**. Congress established—and EPA has correctly reinforced—a **narrow and rigid standard** for proving RFS volumes will cause “severe harm.”

In denying a waiver request from the Governor of the State of Texas in 2008, EPA interpreted the statute’s general waiver provisions to require petitioners to prove three things:

1. that the source of “severe harm” is the **“...RFS program itself...”**, not other precipitating or related factors¹⁷;
2. that the “harm” rises to a level that is **“severe” in nature**¹⁸; and
3. that “severe harm” is being experienced by the **“economy”** of a state, a region, or the United States, **not a narrow sub-sector or specific industry**.¹⁹

Using the same criteria that guided the denial of the 2008 waiver request, EPA subsequently denied general waiver requests claiming “severe harm” in 2012 and 2014.²⁰

Neither Gov. Wolf nor the Northeast refiners have provided any evidence that the RFS requirements, as administered by EPA, are causing (or will cause) “severe harm” to the “economy” of Pennsylvania or the Northeast region. None of the three required conditions for proving “severe harm” has been satisfied.

¹⁷ 73 Fed. Reg. 47169 (emphasis added)

¹⁸ *Id.* (emphasis added)

¹⁹ *Id.* (emphasis added).

²⁰ See, 77 Fed. Reg. 70752 (Nov. 27, 2012); and 80 Fed. Reg. 77428