Statement Of

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On Behalf of the

Society of Independent Gasoline Marketers of America (SIGMA)

and the

National Association of Convenience Stores (NACS)

Before the

House Energy and Commerce Committee, Subcommittee on Energy and Power

June 22, 2016

Hearing on

"The Renewable Fuel Standard – Implementation Issues"

I. SUMMARY OF TESTIMONY

1. The Society of Independent Gasoline Marketers of America and the National Association of Convenience Stores commend the Environmental Protection Agency ("EPA" or the "Agency") in setting its 2014-2016 renewable volume obligations under the Renewable Fuels Standard ("RFS") program. We believe the Agency has struck an appropriate balance among many competing interests.
2. EPA has recognized the potential harm that could occur from breaching the so-called "blend wall." It appropriately used its statutory waiver authority to establish renewable volume obligations below statutory levels and at a level achievable by the marketplace.
3. While the proposed renewable volume obligations for 2017 appear achievable, further growth in the renewable fuels industry is constrained by insufficient consumer demand and retailer liability concerns.

II. INTRODUCTION

Chairman Whitfield, Ranking Member Rush, and members of the Subcommittee, thank you for the opportunity to testify today on the Renewable Fuel Standard ("RFS"). My name is R. Timothy Columbus, and I am a partner at Steptoe & Johnson LLP in Washington, D.C.

I am testifying today on behalf of both the Society of Independent Gasoline Marketers of America ("SIGMA") and the National Association of Convenience Stores ("NACS"), for both of which I serve as general counsel.[1] Members of SIGMA and NACS account for approximately 80% of retail motor fuel sales in the United States.

SIGMA and NACS believe the EPA has done a commendable job at getting the RFS back on track with its 2014-2016 renewable volume standards and proposed 2017 volume standards. My testimony also addresses continuing obstacles to greater renewable fuel usage, including insufficient consumer demand and retailer concerns regarding infrastructure and liability.

III. BACKGROUND ON THE FUEL RETAILING AND CONVENIENCE INDUSTRY

In 2015, the fuel wholesaling and convenience industry employed more than 2.5 million workers and generated $574.8 billion in total sales, representing approximately 3.2 percent of the U.S. GDP. Of those sales, approximately $349 billion came from fuel sales alone. Because of the number of fuel and other transactions in which our industry engages, we handle approximately

[1] SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel. NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,800 supplier companies as members, the majority of whom are based in the United States.

one of every 30 dollars spent in the United States. Our retailers serve about 160 million people per day – around half of the U.S. population – and our industry processes over 73 billion payment transactions per year.

These figures may be daunting, but the convenience store and fuel retail industry is truly an industry of small businesses. Approximately 63 percent of convenience store owners operate a single store, and approximately 75 percent of the industry is composed of companies that operate ten stores or less.

The fuel wholesaling and convenience store market is one of the most competitive in the United States. SIGMA's and NACS' members operate on tiny margins (around 2 percent or less) and are unable to absorb incremental cost increases without passing them on to consumers.

IV. RETAILER OBJECTIVE AND INTERACTION WITH THE RFS PROGRAM

SIGMA and NACS had very serious misgivings about the enactment of the RFS in 2005. In general, these organizations support open markets that provide the maximum amount of supply available; a mandate on any specific element of supply has the potential to distort the market and drive up prices to consumers. Artificially high prices hurt our businesses.

Today, after a decade of experience, SIGMA and NACS generally support the RFS when EPA is able, through its regulatory powers, to strike the right balance for the fuels marketplace. SIGMA and NACS members want to sell legal products, in a lawful way, to customers who want to buy them. As new fuels enter the market, they want to be able to sell those fuels lawfully and with minimal volatility and risk. It is best for the American consumer and America's industrial position in the world marketplace to have reasonably low and stable energy prices.

It is important to keep in mind, however, that SIGMA's and NACS' support for the RFS is based upon an expectation that the program will be administered in a manner that reflects the realities of the market as it exists today, rather than how Congress projected the market would look in 2005 and 2007. When Congress last revised the RFS in 2007, those revisions were premised upon an expectation of (1) a rise in demand for gasoline and (2) widespread availability of cellulosic ethanol by 2013. Neither of those expectations has been met.

In 2007, demand for gasoline was expected to increase at an annual rate of approximately 1.3% through 2030. In reality, gasoline demand has diminished. The Energy Information Administration found that in 2015, 140.43 billion gallons of gasoline were consumed in the United States, approximately 1.5% less than the record high of 142.35 billion gallons consumed

in 2007 and far below the anticipated gasoline demand growth that was projected in 2007.[2] This is particularly significant because 2015 gasoline consumption was greater than the past few years, likely due to a lower price of gasoline compared to previous years. As retail gasoline prices increase, consumers may again drive fewer miles. Prices aside, higher corporate average fuel economy ("CAFE") standards combined with a struggling economy have lowered the country's gasoline usage. In addition, the country has not experienced the growth in flex fuel vehicles and sales of E85 (gasoline with a concentration of 51-83% ethanol) that experts anticipated.

At the same time, the cellulosic biofuel industry continues to transition from research and development and pilot scale operations to commercial scale facilities. This process has taken significantly longer than Congress expected when it revised the RFS in 2007.

Notwithstanding these unanticipated market realities, the statutory RFS volume targets continue to increase annually. If left in place, these targets could only be met if more ethanol is blended into every gallon of gasoline.

This was the situation the fuels market faced several years ago, which SIGMA and NACS highlighted in testimony before this Committee in 2012 and 2013.[3] Due to the aforementioned factors, the retail fuels market was and remains simply incapable of meeting the ever increasing renewable volume obligations ("RVOs") under the RFS statute. Back in 2012, EPA appeared uncertain about whether it would use its statutory authority to reduce the RVOs below the statutory levels. Consequently, the nation was dangerously close to hitting the so-called "blend wall."[4] Members on both sides of the aisle urged EPA to avoid breaching the blend wall to avoid a fuel supply catastrophe. As we stated in our 2013 testimony before this Committee, breaching the blend wall "will undoubtedly lead to a significant increase in the price of fuel, and will inflict substantial harm on the United States economy."[5]

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[2] Energy Information Administration, "Frequently Asked Questions," How Much Gasoline does the United States Consume?, *available at* http://www.eia.gov/tools/faqs/faq.cfm?id=23&t=10 (last accessed June 15, 2016).

[3] House Energy and Commerce Subcommittee on Energy and Power, "The American Energy Initiative: A Focus on Alternative Fuels and Vehicles, Both the Challenges and the Opportunities," 112th Cong. (July 10, 2012), https://energycommerce.house.gov/hearings-and-votes/hearings/american-energy-initiative-focus-alternative-fuels-and-vehicles-both; House Energy and Commerce Subcommittee on Energy and Power, "Overview of the Renewable Fuel Standard: Stakeholder Perspectives," 113th Cong. (July 23, 2013), https://energycommerce.house.gov/hearings-and-votes/hearings/overview-renewable-fuel-standard-stakeholder-perspectives [hereinafter *2013 Testimony*].

[4] The blend wall represents the point at which an insufficient supply of renewable fuel is delivered to consumers to generate the Renewable Identification Numbers ("RINs") necessary to comply with the Program. If the market reaches the blend wall, there will not be enough RINs to allow obligated parties to satisfy their volume obligations under the RFS. This will result in significantly elevated prices for RINs that are available, and as occurs in every industry, these costs would be passed down to retailers and absorbed by consumers.

[5] *2013 Testimony*, *supra* note 3, at 4.

Fortunately, in its rulemaking finalized last year,[6] EPA recognized the existence of the E10 blend wall and how it acts as a constraint in achieving greater renewable fuel usage.[7] In its rulemaking, EPA appropriately recognized that the statutory levels established in 2007 bear no rational relationship to market conditions. Thus, EPA used its statutory waiver authority to lower the RVOs below the statutory levels to a level achievable by the marketplace.

We believe the EPA has similarly allowed significant flexibility in its current rulemaking to stay below the E10 blend wall through the use of carryover Renewable Identification Numbers ("RINs") and allowable growth in the bio-mass based diesel market. This is particularly true in light of the "nesting" structure of RVOs, which provide flexibility in how obligated parties may satisfy their obligations. SIGMA and NACS members have an incentive to blend increasing amounts of biodiesel into the fuel supply because they can use the value of the RINs to lower their costs of goods sold and make biodiesel blends more cost competitive via the biodiesel blenders' credit.[8] Continuation of the biodiesel blenders' tax credit in its current form will continue to drive growth in the use of biodiesel, thus achieving the success of the program's objectives.

As the Committee is aware, on May 31, 2016, EPA also published a proposed rule outlining proposed 2017 RVOs under the RFS.[9] EPA again proposes to use its statutory waiver authority to lower the RVOs to more reasonable levels, using similar methodology to that employed in the 2014-2016 final rule. Importantly for all involved in the fuels marketplace, EPA published the proposed RVOs well in advance of its November 30th deadline. EPA's on-time performance will help generate stability in the market by allowing industry to prepare for the upcoming year. Based on our preliminary review of the proposal, SIGMA and NACS believe

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[6] It is worthwhile to note that during 2012 – 2015, EPA failed to establish RVOs on time, a situation that led to substantial marketplace uncertainty and elevated prices for RINs. SIGMA and NACS fervently hope that such a situation will never be repeated.

[7] EPA, Final Rule, Renewable Fuel Standard Program: Standards for 2014, 2015, and 2016 and Biomass Based Diesel Volume for 2017, 80 Fed. Reg. 77420 (Dec. 14, 2015), at 77449 (noting that "[c]onstraints including but not limited to the E10 blendwall, are real and can only be partially overcome by a responsive market in the near term." *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-12-14/pdf/2015-30893.pdf.

[8] Since 2005, there has been a biodiesel and renewable diesel blenders' tax credit of $1.00 for each gallon of biodiesel used in a qualified mixture. This tax credit, which expires at the end of 2016, has successfully stimulated production and driven consumer acceptance of biofuels by lowering the cost to consumers. The blenders' credit creates a strong incentive for downstream fuel marketers to blend renewable fuel into the fuel supply while lowering prices at the pump for consumers.

[9] 81 Fed. Reg. 34778 (May 31, 2016).

the 2017 RVOs will be achievable and the fuels market will again avoid breaching the E10 blend wall.[10] That is good news for American consumers.

V. CONSTRAINTS ON INCREASED RENEWABLE FUEL USAGE

SIGMA and NACS have devoted considerable resources to studying the renewable fuels marketplace on behalf of their customers, the American consumer.[11] That work has led to some firm conclusions about future renewable fuel usage, which we share here to inform the debate about the renewable market moving forward.

A. Insufficient Demand

More than anything else, the number one trait of any successful retailer is an ability to identify what his or her customers want to buy, and then sell that product at a cost that enables the retailer to earn a profit. Motorists do not purchase products because members of SIGMA and NACS sell them; members of SIGMA and NACS sell products because their customers purchase them. To date, very few retailers selling mid to high level ethanol-gasoline blends such as E15 or E85 have seen substantial sales of these products. Quite the opposite: most retailers that sell E15 or E85 have seen minimal sales of these products. Indeed, retailers have found that even consumers with E85-compatible flex-fuel vehicles tend to purchase E10.

Although E85 normally can be sold for less dollars-per-gallon than the more widely available E10, this price differential does not generate sufficient demand to justify a retailer's capital investment costs. Because E85 provides vehicles fewer miles per gallon ("MPG") than E10, retailers must sell it at a discount in order to be priced equal to gasoline on a dollar per British Thermal Unit ("BTU") basis. Even if E85 is sold on an equal dollar per BTU basis as E10, for E85 to infiltrate the market on a more widespread basis, there likely would have to be an *additional* discount to justify consumers having to stop and purchase the product more frequently relative to E10. The economics are simply not present in most places in the United States for this level of price discounting and market infiltration to occur.

It is important to keep in mind that of the various mandates contained in the RFS, Congress did not include a mandate for consumers to purchase anything (and we are certainly not suggesting that it should have). While the U.S. Department of Agriculture is attempting to increase the number of retail outlets offering E15 and E85 through its Biofuel Infrastructure

[10] SIGMA and NACS do, however, have concerns with the U.S. Energy Information Administration's ("EIA") data upon which EPA relies. This data likely overestimates the amount of gasoline consumption in the United States by underestimating the amount of fuel component exports. As such, SIGMA and NACS encourages EIA to reevaluate its analysis methodology to better reflect marketplace realities to avoid setting improper RVOs in the future based on inaccurate data.

[11] *See generally*, http://www.fuelsinstitute.org/research.shtm.

Partnership, the number of outlets selling these blends will not by itself generate notably greater E15 and E85 consumption. Unless there is a substantial increase in consumer demand for higher fuel blends, retailers will naturally be reluctant to make the investments that are necessary in order to sell them.

B. Retailer Liability

When Congress enacted its fuel usage policies in 2005 and 2007, it fundamentally failed to address the critical components of achieving its goals, such as the fuels distribution network and its infrastructure. As a result, federal and state laws and regulations pose significant potential legal liabilities for selling fuel blends with concentrations of ethanol greater than E10.

As SIGMA and NACS have noted previously – and as EPA cited in its final rule for the 2014-2016 RVOs – retailer liability concerns are a key factor in fuel retailers' decision to not sell gasoline containing more than 10 percent ethanol.[12] Occupational Safety and Health Administration ("OSHA") regulations require retailers to use equipment that has been listed by a nationally recognized testing laboratory as compatible with the fuel the equipment is storing and dispensing.[13] The primary testing laboratory is Underwriters Laboratories ("UL"). However, prior to 2010, UL had not listed a single dispenser as compatible with any ethanol concentration greater than 10 percent. Further, under UL's policy, no device listing can be revised. Consequently, retailers who wish to sell any gasoline containing more than 10 percent ethanol (such as E15 or E85) must acquire a new dispenser that has been listed as compatible with the product if they have not purchased new dispensers in the last six years. Dispensers can cost upwards of $20,000 and many retailers are understandably disinclined to dispose of functional and modern dispensers in order to sell a new fuel <u>for which demand is at best uncertain</u>.[14]

[12] EPA, Final Rule, *supra* note 7, at 77464 (noting that EPA "[does] not believe, based on past experience, that the core concerns retailers have with liability over equipment compatibility and misfueling would change if the RFS volume requirements were increased significantly…[and does] not believe that the E15 expansion can occur on the scale and timeframe that ethanol proponents believe it can.").

[13] 29 C.F.R. 1926.152(a)(1) ("Only approved containers and portable tanks shall be used for storage and handling of flammable and combustible liquids.") "Approved" is defined at 29 C.F.R. 1910.106(35) ("Approved unless otherwise indicated, approved, or listed by a nationally recognized testing laboratory.") *See also* 29 C.F.R. 1910.7 (definition and requirements for a nationally recognized testing laboratory).

[14] The two primary device manufacturers (Gilbarco and Wayne-GE) have obtained UL listing for retrofit kits for some of their units to upgrade their compatibility to accommodate fuels containing up to 25% ethanol. These units are currently available for $2,000 - $4,000 per kit and may be available for more than 50% of the dispensers in the market. This reduces the costs for many retailers, but the expense still equates to nearly 10% of a store's annual pre-tax income – a significant risk given uncertain consumer demand.

It is feasible to convert dispensers to ensure compatibly with higher levels of ethanol-blended fuel, but it is much more complicated to determine the compatibility of underground storage equipment for the many reasons described below.

- **Recordkeeping** – Retail fueling facilities often change hands several times after a tank system is installed, leaving the current owners uncertain of the listing status of underground equipment. Retail outlets have experienced significant turnover in recent history. Many retail gasoline outlets were once owned by major integrated oil companies. That is no longer the case, and those companies now own and operate fewer than 1% of the facilities. In fact, today when Americans fill up their tanks at a Shell or Exxon station, it is highly likely that gas station is a mom-and-pop operation. Further, for decades, there have been no regulations that require retail outlets to keep records for their underground equipment. With the turnover in the industry and lack of records on underground storage equipment, determining compatibility with higher ethanol content fuels is nearly impossible without breaking concrete, when costs can quickly exceed $100,000 per location.

  Last year, EPA published a final rule updating its Underground Storage Tank ("UST") regulations.[15] Under the new regulations, UST owners and operators storing any regulated substance blended with greater than 10 percent ethanol or greater than 20 percent biodiesel must now demonstrate compatibility by either: (a) certification or listing of their system equipment or components by a nationally recognized testing laboratory (such as Underwriters Laboratories) for use with the fuel stored; (b) written explicit approval of the equipment or component by the manufacturer; or (c) another method that the implementing agency determines to be no less protective of human health and the environment than the other two options.[16]

  Failure to demonstrate compatibility with these regulations is a violation of the Resource Conservation and Recovery Act, which could subject retailers to penalties of up to $37,500 for each day of noncompliance. As a practical matter, without the ability to verify and proactively demonstrate that their equipment is UL-listed to store E15 or other ethanol blends, the retailer is assuming liability risk if it stores such fuels.

- **Misfueling** – Assuming a retailer's equipment is listed as compatible with E15, there is still liability exposure if customers misfuel. EPA's rule authorizing the sale of E15 restricts its use to vehicles manufactured after 2001 and prohibits its use in earlier models or small engines.[17] EPA issued a misfueling mitigation rule requiring the placement of

[15] Environmental Protection Agency, Final Rule, Revising Underground Storage Tank Regulations – Revisions to Existing Requirements and New Requirements for Secondary Containment and Operator Training, 80 Fed. Reg. 41566 (July 15, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-07-15/pdf/2015-15914.pdf.

[16] 40 C.F.R. §280.32.

[17] *See* 40 C.F.R. 80.1504; *see also* EPA, Final Rule, Regulation to Mitigate the Misfueling of Vehicles and Engines with Gasoline Containing Greater Than Ten Volume Percent Ethanol and Modifications to the Reformulated and Conventional Gasoline Programs, 76 Fed. Reg. 44406 (July 25, 2011).

dispenser decals near the E15 selector and requiring additional measures, but there are no *physical* applications available to prevent consumer misfueling.[18] Further, it is expected that a sizeable percentage of consumers may not know when their vehicles were manufactured.

This puts retailers in a precarious situation. If they offer E15 and a consumer uses that fuel in a non-approved engine, retailers can be held responsible for violating the Clean Air Act and be subject to fines of up to $37,500 per violation. Even if the retailer is fully compliant with EPA's misfueling mitigation requirements, it may be subject to civil litigation under the Act's private right of action provision.[19]

- **Automobile Warranties** – As mentioned above, many engine manufacturer owner's manuals and warrantees do not authorize the use of E15. Retailers may be subject to liability for engine damage or for selling a fuel that voids the consumer's warranty. This exposure could threaten a facility's economic viability.

The simple threat of enforcement actions or litigation deters many retailers from offering higher ethanol blends.

Legislation introduced in the past would have addressed many of the retailer liability concerns SIGMA's and NACS' members have with selling fuels containing more than 10 percent ethanol.[20] Enactment of this legislation would have provided legal certainty with respect to retailer liability, thus breaking down barriers to more widespread distribution and use of newer fuels such as E15.Unfortunately, the legislation failed to advance and has not been introduced this Congress.

Taken together, retailers have many significant obstacles to blending more renewable fuel into the fuel supply. Fuel retailers and marketers make decisions every day regarding the services and products they will offer to their customers. These decisions are not without risk. However, deciding to convert or switch a store's fuel infrastructure to accommodate new fuel for which demand is uncertain at best is very different from deciding whether or not to stock other consumer products, like fresh fruits and vegetables. Such decisions take time and retailers need

[18] *See also* Federal Trade Commission, Final Rule, Automotive Fuel Ratings, Certification and Posting RIN 3084-AB390, 81 Fed. Reg. 2054 (Jan. 14, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-01-14/pdf/2015-32972.pdf.

[19] *See* 42 U.S.C. § 7604.

[20] H.R. 4345, The Domestic Fuels Protection Act of 2012, 112th Cong. (2012)(introduced by Rep. John Shimkus (R-IL)). H.R. 4345 provided a way for existing retail equipment that is technically compatible with new fuels to be legally recognized as such, thereby eliminating some of the costs associated with unnecessary equipment replacement. It also protected market participants from liability in the event self-service consumers circumvent federally required misfueling measures; and, it protected market participants from retroactive liability should today's laws governing fuel sales change in the future. *See also* H.R. 1214, The Domestic Fuels Protection Act of 2013, 113th Cong. (2013))(introduced by Rep. John Shimkus (R-IL)).

to know there will be a return on investment large enough to justify the initial investment, and that the fuel in question can be sold legally. All of these issues prevent the introduction of more renewable and alternative fuels in the contemporary marketplace.

VI. MODIFICATIONS TO THE RFS

As SIGMA and NACS have testified in the past, provided the program continues to be administered appropriately, the associations do not support the repeal of the RFS at this time. Over the last decade since Congress enacted the RFS, the road to implementation has not been easy. Fuel retailers and marketers did not ask for this program, and despite being caught in the middle of competing interests, they have learned to live with it. We believe the EPA has the statutory authority – and has used that authority lawfully – to properly align RVOs to ensure the RFS achieves its objectives while protecting American consumers and businesses. Although SIGMA and NACS believe that EPA's waiver authority is clearly established and supported by law, if questions remain with respect to EPA's waiver authority due to ongoing litigation, we would support this Committee's clarifying EPA's waiver authority to ensure EPA is able to make adjustments to the Program moving forward.

Also, I would be remiss if I did not address recent proposals that would make blenders (or the entity that owns the product immediately before it is dispensed from a terminal, the "position holder") so-called "obligated parties," rather than refiners and importers. Those advocating for this position state that such a change would bring more renewable fuels into the marketplace and address the currently perceived inequity of burdens between buyers and sellers of RINs. Those advocating for this position are wrong. Changing the point of obligation under the RFS would not achieve those objectives.

If blenders or position holders were classified as obligated parties, they would be subject to regulatory and market obligations with which they may not be able to comply. For instance, their ability to comply with point of obligation requirements would be dictated by their upstream counterparts, who would then have significant leverage and incentive to raise prices. This results in an anti-competitive environment that would lead to upward pressure on the retail price of motor fuel. Refiners and importers should remain obligated parties because those entities control the petroleum product's composition and how product is introduced into commerce. Position holders, conversely, do not have such control because they are fundamentally *buyers* of refined products. Changing the point of obligation would inject substantial disruptions into the renewable fuels market and impose significant burdens on participants. Congress should reject calls to change the point of obligation under the RFS.

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While the 2017 RVOs appear achievable, retailer liability concerns and insufficient consumer demand will continue to prevent further expansion of renewable fuel usage. Retailers cannot force consumers to buy a particular product. Retailers already have an incentive to blend as much renewable fuel as they can, but the infrastructure liability concern imposes an enormous barrier to selling higher concentrations of ethanol. Setting the RVOs above the level that can reasonably be absorbed and consumed in the market would be counterproductive to a successful RFS program. It would result in significant market disruptions and higher prices for consumers.

VII. CONCLUSION

SIGMA and NACS believe EPA is doing a responsible job of balancing competing political and regional interests in its implementation of a complex regulatory regime under the RFS program. The 2014-2016 final rule and the 2017 proposed rule appear to balance the desire to promote an increasing amount of renewables into the nation's fuel supply while recognizing the constraints imposed by the E10 blend wall. Moving forward, SIGMA and NACS remind policymakers that fuel retailers and marketers are the closest proxy for the consumer. We stand ready to assist the Committee in its oversight of the RFS program and in the future consideration of any policy changes.

Again, thank you for the opportunity to testify before you today. I am happy to answer any questions you may have.