



November 2, 2016

VIA ELECTRONIC MAIL & OVERNIGHT COURIER

The Honorable Gina McCarthy  
Administrator  
U.S. Environmental Protection Agency  
1200 Pennsylvania Avenue NW, Room 3000  
Washington, DC 20460

**Re: Opposition to petition(s) for rulemaking to change the definition of an obligated party under the Renewable Fuels Standard, 40 C.F.R. § 80.1406**

Dear Administrator McCarthy,

**I. INTRODUCTION**

Cumberland Farms, Inc. (“Cumberland Farms”) respectfully submits these comments in opposition to the above-referenced petition(s) for rulemaking, namely that which was submitted by Valero Energy Corp. and its subsidiaries (“Valero”) on June 13, 2016.<sup>1</sup>

Through its petition, Valero requests that the Environmental Protection Agency (“EPA”) invoke its rulemaking authority to change the point of obligation under the Renewable Fuels Standard (“RFS”) program. Under current rules, “obligated party” is defined as the entity that imports or refines gasoline or diesel fuel. Under the petitioned rule change, that term would instead be defined as the entity holding title just before the rack sale at a bulk terminal—referred to as a “rack seller” in the petition, and as the “position holder” in tax parlance.<sup>2</sup> Such a change would effectively remove Valero and other merchant refiners from the market for Renewable Identification Numbers (“RINs”).

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<sup>1</sup> See Richard Walsh, Valero Energy Corp., *Petition for Rulemaking: Renewable Fuel Standard Definition of Obligated Party—40 C.F.R. § 80.1406* (June 13, 2016) (hereinafter the “Petition”). To the extent other parties may seek the same regulatory changes, our opposition extends to those petitions as well.

<sup>2</sup> Valero correctly identifies Cumberland Farms on its master list of rack sellers that it submitted to EPA. See Petition at Attachment D.

Valero alleges that it is “uniquely situated” to advise EPA on the merits of that proposal, by virtue of its various points of interaction with the RFS.<sup>3</sup> But Cumberland Farms, too, has played several different roles in the fuel marketplace throughout its history—as have many other market participants besides Valero.

Based on our experiences, and confirmed by the information available to us, we firmly believe that the fuels market—and EPA’s related policy goals—are better served under the current definition than under the petitioned change. Conversely, the definition sought by Valero would create new inefficiencies and perverse economic incentives that will frustrate the very purpose of the RFS. This problematic and self-serving proposal should be rejected, and EPA should maintain the existing point of obligation.

## **II. BACKGROUND**

### **A. Company Overview: Cumberland Farms is a large family-owned convenience store chain, and has diverse experience with the RFS and the overall fuel marketplace.**

Our company was founded as a dairy farm more than 75 years ago, by an immigrant couple with little more than a cow and the dream of a better life for their children. By 1960 we had opened our first retail stores, and less than two decades later we started adding our first gas pumps outside. As that winning combination continued to grow in popularity, we acquired Gulf Oil from Chevron Corp. through a series of transactions beginning in 1986.<sup>4</sup> Today, we are among the largest convenience store chains in the country, with approximately 560 retail locations—and counting—across the New England states, New York, and Florida. Virtually all of those stores sell motor fuel.

Over the course of those many decades, Cumberland Farms has participated in the fuel marketplace as some combination of (1) an importer and a blendstock component blender—i.e., an obligated party and a buyer of RINs; (2) a spot buyer and biofuel blender—i.e., a position holder and seller of RINs; (3) a rack buyer; (4) a bulk terminal operator; (5) a distributor; and (6) a retailer.

Yet throughout that growth and evolution, we have remained family-owned and family-operated.<sup>5</sup> We have also developed an exceptional team of dedicated employees, with a broad diversity of skillsets and a combined 34,000 years of work experience in the industry. Our

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<sup>3</sup> Petition at 2.

<sup>4</sup> What began as an intellectual property transaction progressed into present-day Gulf Oil Limited Partnership—a major U.S. importer, blender, terminal operator, wholesaler, and franchisor. That company remained a subsidiary of Cumberland Farms until its recent sale to new ownership in December 2015.

<sup>5</sup> This ownership structure has granted Cumberland Farms more freedom to focus on successful long-term business strategies—and, relatedly, on sound long-term public policies—rather than entertaining a myopic obsession with short-term profits and becoming a slave to quarterly reports. *Contrast, e.g., Valero Corp., Q2 2016 Earnings Release* (July 26, 2016) (hereinafter the “Valero Quarterly Report”) (reporting RIN purchases and other quarterly financial metrics to investors), *available at* <http://www.investorvalero.com/phoenix.zhtml?c=254367&p=quarterlyEarnings>.

company, our customers, and our communities have been well-served by this vast institutional knowledge. It also provides us with a well-informed perspective on public policy issues that impact our operations; here, it informs our position on the RFS point of obligation.

**B. Business Model: Cumberland Farms is successful because, in the hypercompetitive convenience store industry, we supply the efficiently-priced products that our customers demand.**

Cumberland Farms' retail fuel offering primarily consists of gasoline and, to a lesser extent, diesel fuel. Since at least the 1980s, we have procured those fuels for our retail locations in part by purchasing their bulk components—including oxygenates and petroleum blendstocks—and blending them at the rack, whereby we are the position holder. Today, we additionally purchase blended fuel under the terms of wholesale supply contracts tied to prevailing rack prices, whereby our suppliers are the position holder.

Which of these methods we utilize day-to-day is dictated by the market, and by the terms we negotiate in view of market conditions. Either way, the goal is to procure fuel as efficiently as possible, so that we can provide our retail customers with the best possible products at the best possible value. Consistently achieving that goal is critical to our survival in such a fiercely competitive industry. Indeed, with giant outdoor price signs—and, increasingly, the ability to comparison shop remotely via the internet and mobile applications—retail motor fuel is among the most price-sensitive consumer products on the market today.

To be successful in this environment, a change in product offerings must be driven by a change in market demand, not vice versa. Our customers will not buy a new fuel product simply because we offer it for sale; to the contrary, we can only sell a new fuel product if our customers actually want to buy them—as indicated, e.g., by their purchase of a particular motor vehicle and, in the case of flex vehicles, by their ultimate fuel choice at the pump. The variety and volume of fuel that we sell is, and must continue to be, a reflection of that reality.

### **III. THE POINT OF OBLIGATION**

**A. Market Dynamics: Under the current point of obligation, the pass-through of RIN values allows for the competitive pricing of renewable fuels.**

A core point of contention in the Valero petition is its assertion that, with the current point of obligation, “the value of the RIN is not passing through to consumers” but instead “is largely being retained” by the position holders who separate and sell the RIN.<sup>6</sup>

This flawed argument relies upon facts not in evidence, and it does not comport with how businesses like Cumberland Farms actually buy and sell fuel in the marketplace. Rather, in our experience, RIN values are indeed reflected in the downstream cost of fuel. To demonstrate this point—i.e., that RINs are credited to rack buyers at the time of wholesale purchase, and ultimately passed through to consumers at retail—we offer the following discussion using real

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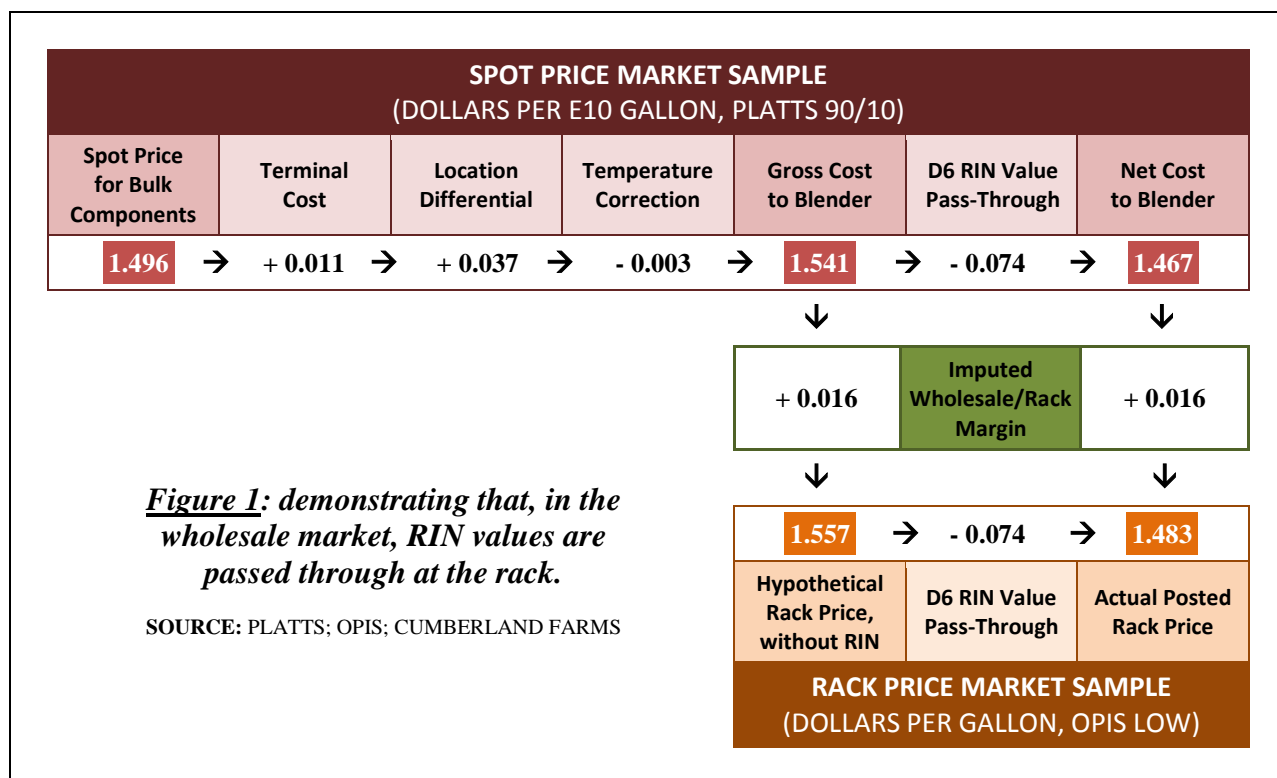
<sup>6</sup> Petition at 12.

market data and long-term observations from the geographic areas where Cumberland Farms operates.

**(i) Wholesale pricing and market structure**

First, consider how fuel is priced at wholesale. Cumberland Farms is a so-called “price seeker” as a wholesale buyer; market dynamics allow us to “seek” out the lowest prices available, and thus to buy product from the supplier that best competes for our business.

Figure 1 below uses data from one sample day in the Boston market earlier this year, to compare (1) the actual rack price of blended E10 fuel, with (2) the actual cost of the bulk components to the blender, net and gross of the RIN value per E10 gallon.<sup>7</sup> The “D6 RIN Value Pass-Through” component of Figure 1 is not merely theoretical, nor is it some unsubstantiated claim born of self-interest. Again, the underlying data comes from an actual market sample—and, furthermore, that specific sample comports with our general experience under the RFS.



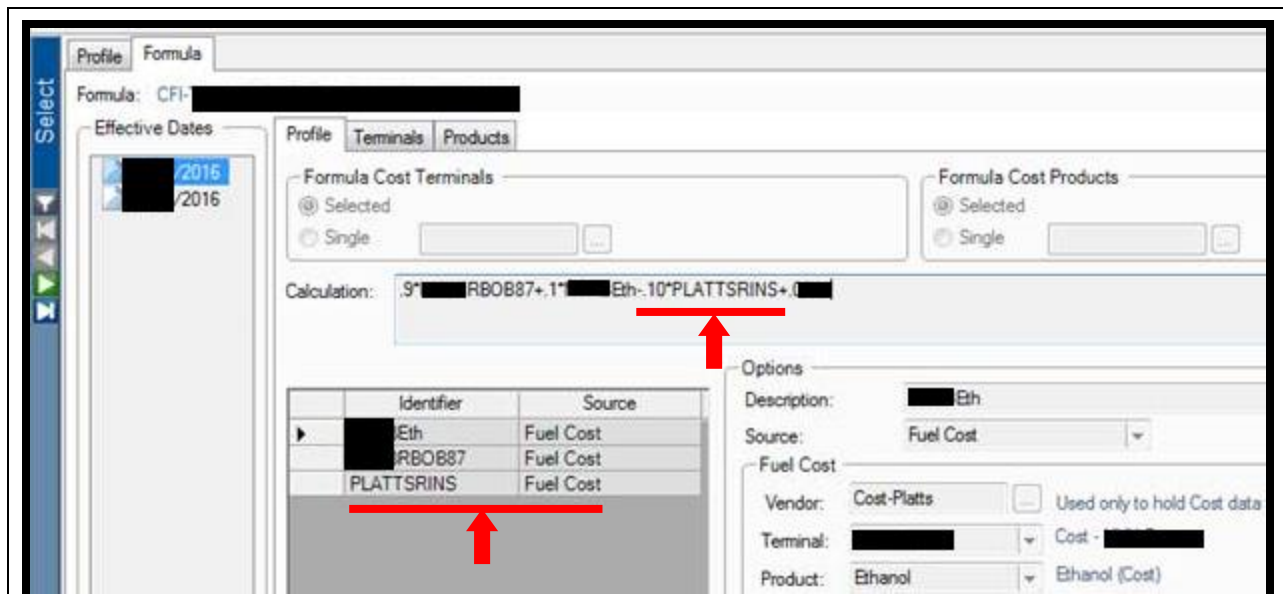
From this example, it is clear that RIN values are passed through at wholesale. If a blender instead tried to sell fuel at a profit *without* passing through the RIN value, their posted rack price in that circumstance would be exceptionally higher than the lowest competing price—here, \$1.557 versus \$1.483, for a difference of \$0.074 per gallon. No rational price seeker would

<sup>7</sup> The values presented represent—or are derived from—actual market data from the sample period. However, dates and locations have been redacted, and some numbers have been rounded; due to competitive concerns, we are limited in the cost and price information we can share publicly.

pay such an uncompetitive price for a generally fungible commodity like gasoline. Basic economics mandate that blenders must pass through RIN values in order to attract buyers in the market; otherwise, they could not compete on price.

So, when Cumberland Farms purchases blended fuel from a position holder, the RIN value has already been incorporated into the wholesale rack price—demonstrated in Figure 1 as the “Actual Posted Rack Price.” Similarly, the terms of our supply contracts specifically address how our supplier *must* pass through value from the RINs that they separate when blending our fuel.

And when Cumberland Farms is itself the position holder, our accounting system is literally programed to credit the fractional RIN value against the internal costs assigned to each blended gallon from which the RIN was separated.<sup>8</sup> Figure 2 below shows an actual screenshot from the software used by Cumberland Farms to calculate and account for our E10 fuel costs, using a cost formula consisting of several defined market variables.



***Figure 2: demonstrating that, for Cumberland Farms, a pass-through credit for RIN values is literally part of our fuel cost formulas.***

SOURCE: CUMBERLAND FARMS

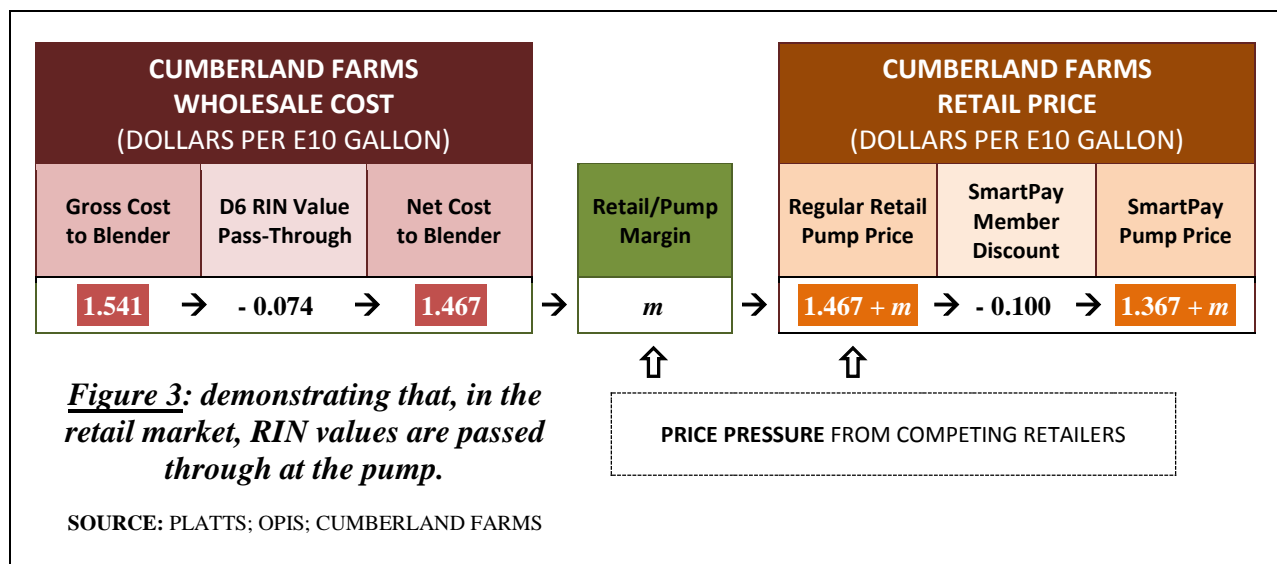
<sup>8</sup> Our precise bookkeeping methodology for crediting RIN values against fuel costs has evolved over the years, and may vary based upon the specific terms of our various wholesale contracts—but that has been immaterial to the end result. On this topic, EPA should be wary of claims that position holders are reaping “huge windfalls” by selling RINs. What may appear in a vacuum to be windfall RIN revenues are likely offset elsewhere on the balance sheet by correspondingly compressed profit margins. However we or any other similar company might approach the specifics of its internal cost accounting, market reality remains the same: intense competitive pressures at street level impose a virtual economic mandate to pass along RIN values directly to consumers in the form of lower prices.

The Figure 2 example clearly shows that our E10 fuel cost formula explicitly includes a credit for the market RIN value—represented by the “-.10\*PLATTSRINS” portion of the calculation for the sampled contract.<sup>9</sup> It is hard to conceive of a more straightforward demonstration of RIN value pass-through in practice.

**(ii) Retail pricing and market structure**

Second, consider how fuel is priced at retail. Unlike our position in the wholesale market, Cumberland Farms is a so-called “price taker” as a retail seller; we generally must “take” whatever retail fuel price is imposed by local market forces, offering our product at a competitive price if we are to attract any customers.<sup>10</sup>

Figure 3 below expands upon the same data presented in Figure 1, illustrating (1) the net cost of blended E10 fuel to Cumberland Farms as a position holder, (2) the pricing of that fuel by Cumberland Farms when sold at retail, (3) and the resulting impact on our margin at the pump. As before, the data is from an actual wholesale market sample and comports with our general experience.



<sup>9</sup> The full formula has been redacted to remove competitively-sensitive information, but is composed of the following variables: “.90\*[RBOB cost] + .10\*[ethanol cost] - .10\*[RIN value] + [terminal costs],” thus calculating the net cost of E10 gasoline consistent with Figure 1. The credit is 10% of the RIN value because, in this example, the finished fuel product contains 10% ethanol.

<sup>10</sup> This is a market reality which pervades our industry. See generally, e.g., John Wilen, *The cost of gas: How two stations set their prices*, The Associated Press (May 23, 2008) (“If a station raises its prices before its competitors, it may lose gasoline sales. But the longer station managers wait—with wholesale prices rising—the more money they lose.... In the end, Kehler decides to wait a full 24 hours before raising his prices by the 4 cents a gallon his own wholesale prices have already risen.”), available at [http://usatoday30.usatoday.com/news/nation/2008-05-23-1070321808\\_x.htm](http://usatoday30.usatoday.com/news/nation/2008-05-23-1070321808_x.htm). Avoiding this reality would require a massive illegal price-fixing scheme of patently ridiculous proportions. Such a nationwide conspiracy plainly does not exist; rather, the fuels market continues to offer value to consumers by fostering free and intense competition between retailers.

From the Figure 3 example, it is clear that RIN values are passed through to consumers by retailer position holders, as a credit in the form of lower retail prices.<sup>11</sup> If Cumberland Farms sold RINs for a profit *without* concurrently passing through that value, our price at the pump would be notably more expensive—here,  $\$1.54+m$  versus  $\$1.467+m$  or less, for a difference of at least  $\$0.074$  per gallon.<sup>12</sup> Especially with the growing array of cost-comparison tools at their disposal, consumers would not pay such an inflated price; as with the wholesale scenario, economics dictate that retailers must pass through RIN values in order to price their fuel in a way that is competitively sustainable.

Furthermore, if retailers were retaining RINs as profit instead of passing the value through to consumers, one might anticipate a linear relationship between retail margins and the market value of RINs—i.e., an increase in RIN values may correlate with an increase in profit at the pump.<sup>13</sup> The proprietary information analyzed by Cumberland Farms shows no such correlation, however.

Figure 4 below graphs historical data from the U.S. market, to compare (1) the actual value of a D6 RIN per E10 gallon with (2) our actual retail profit margins for E10 gasoline, where  $m$  is a constant number representing our overall average cents-per-gallon profit margin over nearly a decade.<sup>14</sup> As that graph illustrates, our retail margins vary regularly within a relatively predictable range, independent of the market value for RINs. We have found no statistically-significant correlation between the two datasets.<sup>15</sup> This finding stands squarely opposed to Valero’s assertion that retailers are keeping RINs as profit; because RIN credits are

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<sup>11</sup> Alternatively, when Cumberland Farms or another retailer buys blended gasoline from a position holder, the value of the RIN has already been incorporated into the rack or contract price, as discussed in the previous section on wholesale pricing and market structure.

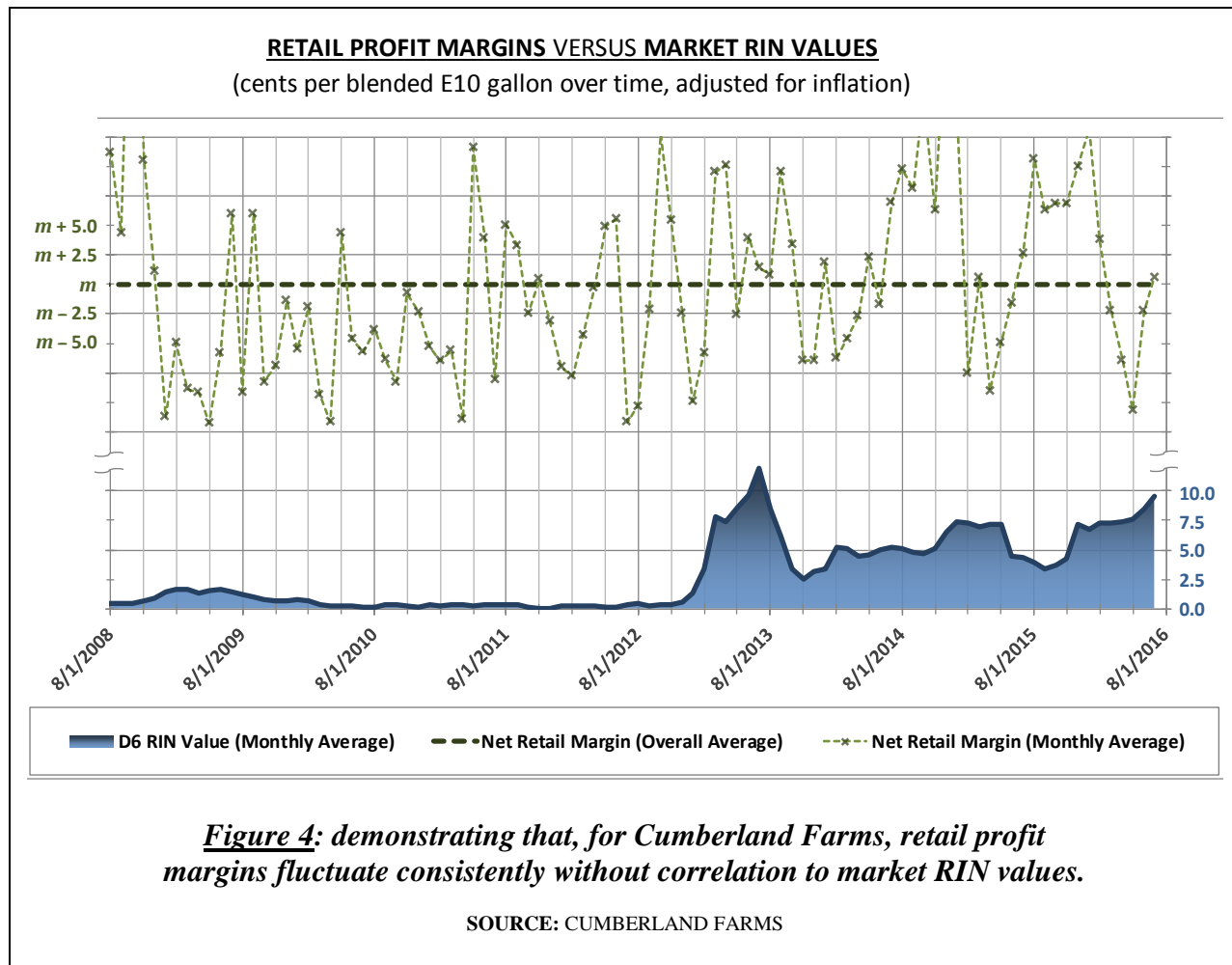
<sup>12</sup> We should also note the impact of SmartPay, our free membership program which allows our customers to save an additional ten cents per gallon—represented as the “SmartPay Member Discount” in Figure 3, yielding an ultimate retail price of  $\$1.367+m$ . An unfamiliar observer might fairly wonder how Cumberland Farms can afford to give such a generous discount, particularly given our representation that we already offer the most competitive prices possible at regular retail. Simply put, it works because it reduces overhead. SmartPay allows members to directly debit their checking accounts rather than paying with a credit or debit card, allowing Cumberland Farms to pay significantly lower processing fees—and, in turn, to pass that savings through to our customers. Whether through RIN credits under the RFS, or through reduced overhead through SmartPay, we have every market incentive to compete aggressively by passing through as much additional value to our customers as possible.

<sup>13</sup> Arguably, just the *presence* of such correlation, by itself, would still be insufficient to support the Petition. But the *absence* of such correlation, as demonstrated, does serve to further rebut Valero’s contention that RINs are a source of excess profit for position holders at the expense of consumers and the RFS.

<sup>14</sup> Again, competitive concerns require that we redact certain highly-sensitive information, like our raw cents-per-gallon profit margins over time. However, by substituting the constant  $m$  on a  $\pm 2.5$  cpg scale, and using the same scale for RIN values, we can achieve an adequate comparison for present purposes.

<sup>15</sup> The square of the Pearson product moment correlation coefficient (the “r-squared” value) for the two datasets is 0.046 according to the Microsoft Excel RSQ function, where an r-squared value of 1.000 indicates a perfect linear relationship and an r-squared value of 0.000 indicates no linear relationship.

instead passed through to our customers in the form of lower prices, their value is not retained as additional profit and thus is not reflected in our margins.<sup>16</sup>



**B. Policy Outcomes: Under the current point of obligation, the RFS is successfully driving the displacement of petroleum products through a fairly-structured RIN market.**

Another core point of contention is Valero’s assertion that, with the current point of obligation, “[t]he RFS structure incentivizes market behavior that does not improve renewable fuel market penetration in multiple ways.”<sup>17</sup>

<sup>16</sup> Consider, as yet another example, the price of oil itself. If retailer like us were, in fact, able to capture the benefit of cost reductions, why wouldn’t we be charging \$4/gallon now, just as we were several years ago when oil prices were \$100/barrel? The answer, of course, is that as our petroleum costs have gone down, an efficient and hyper-competitive retail market causes consumer prices to go down with it.

<sup>17</sup> Petition at 22.



This self-serving assertion is a gross oversimplification of the motor fuels marketplace. Promotion of renewable fuels—and of fundamental fairness—is better served by the current point of obligation than by the proposed change. And, to the extent that renewables may not be penetrating the market precisely as EPA might hope or expect, policymakers should examine factors beyond the RINs market for the causes and potential solutions.

*(i) Demand for Renewables*

It is certainly appropriate for EPA to monitor the RIN market for analytical purposes, and to ensure its efficient and effective operation. And to that end, based on recent observations from an EPA source—cited by Valero’s own petition—“the RIN market seems to be functioning generally as expected; providing an incentive for the continued growth of renewable fuels in the transportation fuel market without causing overall increases to the retail price of transportation fuel.”<sup>18</sup>

The motives of downstream marketers like Cumberland Farms do not undermine or conflict with that intended outcome, because we are generally fuel-agnostic—i.e., our business is to safely and legally supply the fuels that our customers demand, without particular regard to what that fuel is made from. Beyond the presence of sufficient demand and efficient pricing, we do not require much in the way of additional incentives to displace hydrocarbons with renewables.

As supposed evidence to the contrary, Valero invokes the struggling market for E85. But in doing so, it makes the erroneous assumption that demand for E85—or any other fuel—is unlimited, provided that prices are brought low enough by RINs.<sup>19</sup> Cumberland Farms has attempted to sell E85; that experiment has largely failed, because demand is simply insufficient to support a thriving and efficient market for a boutique fuel like E85. This is attributable to factors beyond the RFS: there are not enough flex vehicles on the market, and not enough consumers who want to put E85 into their flex vehicles—because, e.g., they know that they will get fewer miles per gallon compared to E10. Similarly, our reluctance to embrace E15 has little to do with RIN pass-through. Rather, significant concerns with liability and infrastructure compatibility would make adoption of E15 far more costly than the market can presently justify.<sup>20</sup>

Valero and other merchant refiners are situated differently. They cannot plausibly be described as fuel-agnostic, because they have a vested interest in maintaining demand for one particular fuel source: petroleum. If they are no longer “obligated” to do so, they will not have any incentive to displace petroleum, their primary revenue-generating product, with competing

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<sup>18</sup> Dallas Burkholder, EPA Office of Transportation & Air Quality, *A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effects* at 31 (May 14, 2015) (hereinafter the “Burkholder Assessment”), available at <https://www.regulations.gov/document?D=EPA-HQ-OAR-2015-0111-0062>

<sup>19</sup> See Petition at 19 (“Retail prices of E85 remained high because Rack Sellers kept the RIN value rather than pass it to the retailer and consumer...”).

<sup>20</sup> These may well be valid issues to address from a policymaking perspective, but changing the point of obligation is not the answer.

renewable alternatives.<sup>21</sup> As such, their motives are naturally at odds with the goals of the RFS; it is appropriate and necessary for the point of obligation to rest with them. Otherwise, the cost of ethanol-compatible blendstocks would predictably increase and the market would further balkanize with a patchwork of boutique fuels, driving up retail prices and driving down demand for renewables.

### *(ii) Equity and Market Confidence*

A properly-functioning market must instill confidence by assuring that it cannot be unduly influenced for the purpose of benefiting certain individual market participants. Undoubtedly, Valero and certain other individual obligated parties have made acquisition and divestment decisions in recent years—after the RFS was established—which impacted their relationship with the fuels market and their relative need to buy or sell RINs. But it would be inequitable for EPA to fundamentally revise the point of obligation, a lynchpin of the RINs market and the RFS overall, simply to accommodate these individual business decisions—particularly at the expense of other market participants who have been playing by the same set of rules.

According to the same EPA source cited in the Valero petition, “the structure of the RFS program” itself—including the current point of obligation—“does not cause a systematic competitive advantage for one type of refiner or the other.”<sup>22</sup> However, “differing business decisions, RIN acquisition strategies, and many other factors” will of course impact individual obligated parties in different ways.<sup>23</sup> That is the nature of a market-based economic system and, as in any market, the participants must bear the risk of their choices—without the expectation of a government bailout, which Valero is essentially requesting through its petition.

## **V. CONCLUSION**

For the reasons discussed herein, Cumberland Farms opposes changing the point of obligation under the RFS, and we ask that EPA deny Valero’s petition accordingly. The current system does not create “huge windfalls” for retailer position holders, as Valero claims.<sup>24</sup> Instead, competitive pressure from the street ensures that consumers benefit from RIN values in the form of lower prices, driving demand for renewables and thus furthering the purpose of the RFS.

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<sup>21</sup> In its petition, Valero makes much of its foray into the production of ethanol and other renewable fuels. *See* Petition at 2. But context is important. Valero averages less than 4 million gallons of ethanol production daily, while refining more than 117 million gallons of petroleum over the same period of time. *See* Valero Quarterly Report (reporting adjusted operating income of \$49 million from ethanol production, compared to \$954 million from petroleum refining). Valero has been, and very much remains, a petroleum company before all else.

<sup>22</sup> Burkholder Assessment at 31.

<sup>23</sup> *Id.*

<sup>24</sup> Petition at 14.

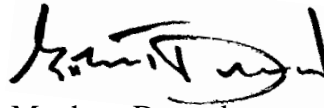
Thank you for your consideration of our position. We remain available to assist you and your staff, should EPA require additional details or wish to discuss this matter further. You may contact us by email at mdurand@cumberlandfarms.com or by phone at 1-508-270-7267.

Sincerely,

CUMBERLAND FARMS, INC.



David Masuret  
Senior Vice President of Petroleum Supply  
and Operations



Matthew Durand  
Manager of Government Affairs and  
Public Policy, Office of the General Counsel

cc: Janet McCabe  
Assistant Administrator for Air and Radiation  
U.S. Environmental Protection Agency

Christopher Grundler  
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Ari Haseotes  
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Mark Howard  
Executive Vice President and Chief Legal Officer  
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