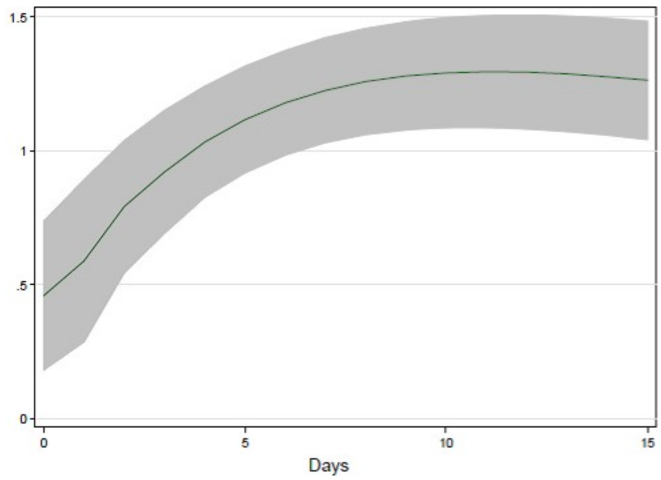
Bob Neufeld

From: Bob Neufeld
Sent: Thursday, February 1, 2018 3:40 PM
To: 'knittel@'
Subject: RIN Pass Through

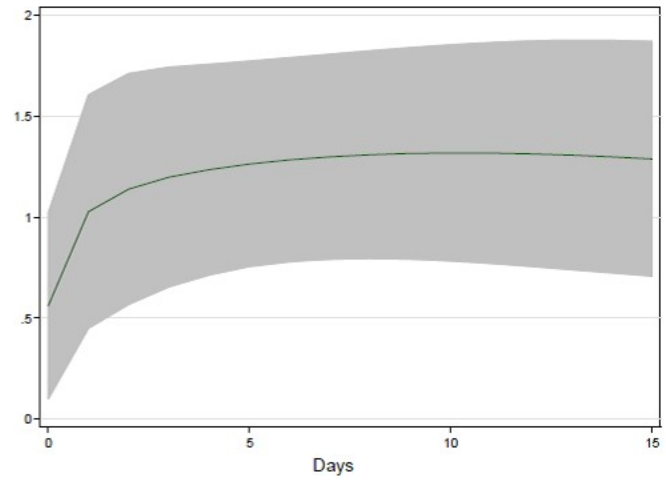
Dr. Knittel,

You and I briefly exchanged emails several years ago on this subject. Be forewarned, I do not agree refiner RIN costs are fully passed through to the spot BOB markets. This is why I am contacting you for clarification on your paper "The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuel Standard". Specifically, I was intrigued by Figure 8, inserted here. In the interests of full disclosure, I also want you to know I have petitioned the DC Circuit Court of Appeals, representing myself, for review of EPA's point of obligation decision. That petition, however, is based solely on statutory construction, i.e., whether unobligated parties can sell RINs from blending volumes not exceeding the volumes (or a fair share thereof) specified in §211(o), paragraph (2) of the Clean Air Act. I am not making any economic arguments in that challenge. I commit to not using any of your response in that litigation.

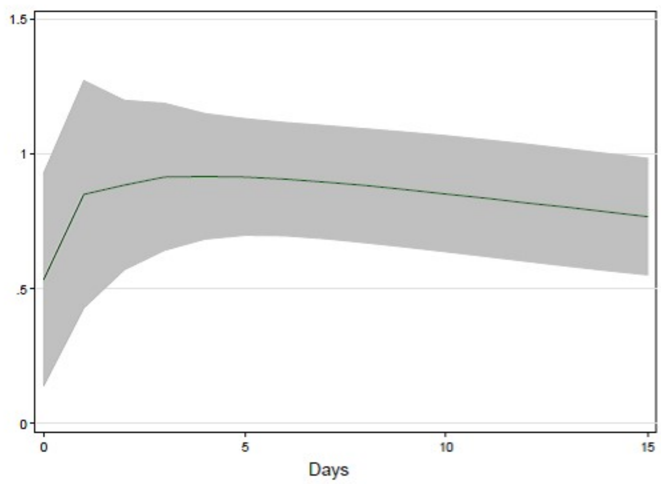
Gulf diesel–Gulf jet fuel



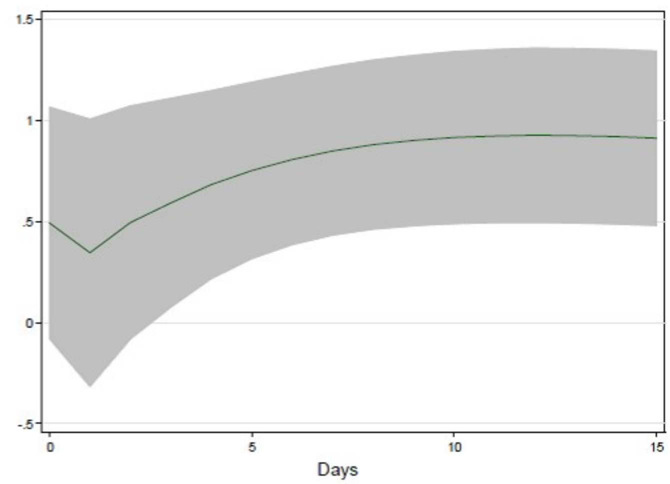
NYH diesel–Rotterdam diesel



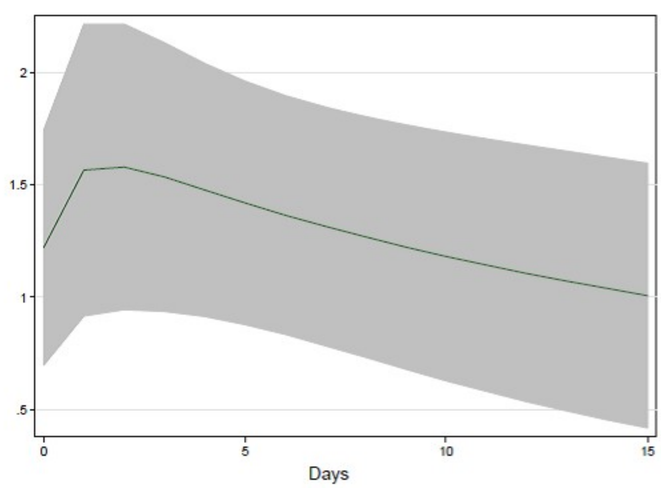
Gulf diesel–Rotterdam diesel



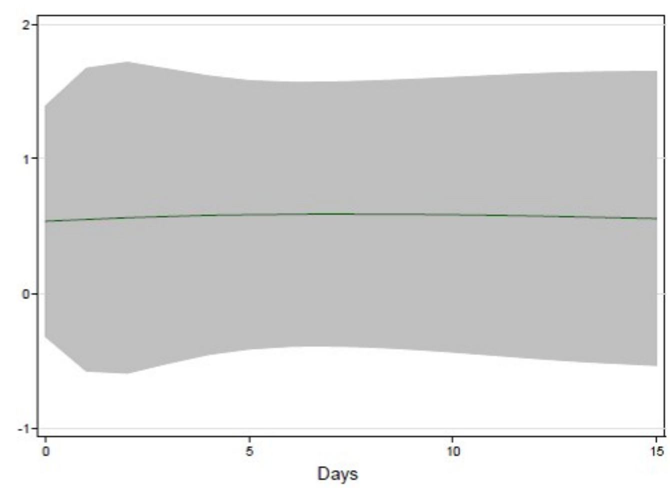
NYH RBOB–EBOB



NYH RBOB–Brent



LA RBOB–Brent



What intrigues me is the different shape of the LA RBOB-Brent response curve, which appears to show no response at all but some pass through. I believe your findings are correct for NYH but not for the rest of the country including LA. My explanation is that the East Coast imports a great deal of its gasoline and BOB supply – 11.6% of consumption in 2016. Importers, therefore, have almost total pricing power in NYH; if the BOB price does not cover the RIN expense, the product simply stays on the ship metaphorically speaking and a shortage results. The West Coast, however, was a net exporter of 12,703,000 barrels of gasoline and blend stocks in 2016 and prices there should not be sensitive to the RIN-based needs of importers.

To expand, vertically integrated companies long on RINs obtain their compliance RINs for free. I know EPA says they have RIN expenses, but such a conclusion defies logic. Sure, retiring a RIN for compliance might be an opportunity cost for the missed RIN sale, but selling a RIN needed for compliance requires an offsetting cash cost of replacing it sooner or later. Conversely, not selling the RIN and retiring it for compliance avoids the later cash expense of buying compliance. Having free compliance RINs, VIRs are immune to RIN prices. Their refineries buy RINs, but their marketers are selling that many RINs and more at the same price. It nets out on the financial statements. More than that, being net buyers of BOB, VIRs have every incentive to hold RIN pass through to zero. If RIN pass through increases, the refinery may save RIN costs on the 100 bbls it produces, but the marketing arm will pay even more in RIN pass through on the 150 bbls it purchases. In its ideal world, the VIR would hold pass through to 0 and drive RIN prices up, which, I believe, is why they oppose moving the point of obligation.

On the other hand, merchant refiners have every incentive to achieve 100% pass through of the RINs they buy. In almost all of the US except the East Coast, however, VIRs and merchants together over supply the market necessitating exports. On the other hand, neither segment can supply the entire market on its own – a necessary but insufficient situation. In this case, unlike NYH, no one has total pricing power. The tension between the two industry segments should result in RIN pass through somewhere between 0 and 100%. This is consistent with the LA RBOB chart above showing the pass through coefficient at about 50% whereas the coefficient for NYH is closer to 1.

Can you please clarify this for me? How are the paper's LA results consistent with the NYH data? Why is my explanation for complete pass through in NYH and incomplete pass through in LA and elsewhere incorrect?

Thanks for taking the time to read this and, if I'm lucky, responding.
Best,
Bob

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