Brooke Coleman

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Sent:	Wednesday, October 01, 2014 3:18 PM
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Subject:	Follow Up: RIN Market Question
Attachments:	E85 - A Tale of Two Markets - FINAL smaller PDF2.pdf; MN_E85_RIN impact_updated.pdf

Chad and Jim,

It was good to see you last week. By way of follow up, you asked for information about RIN markets; or more specifically, how hypothetically higher RIN prices result in lower ethanol prices without increasing E10 prices (the conclusion reached by peer-reviewed modeling performed by Bruce Babcock: http://www.card.iastate.edu/publications/dbs/pdffiles/14wp549.pdf). It is late in the game, but I think it makes sense to reiterate our position in writing.

To start, the case for RINs not pushing up E10 prices is well-evidenced at this point, including the chart we sent under prior heading: http://www.ethanolrfa.org/page/-/images/Charts/RINs%20and%20Retail%20Gas%20Prices%20-%20No%20Connection.jpg. The Administration admitted to us in a public meeting – that I participated in – that RIN prices are not a substantive gas price risk on the E10 side (the week of May 19th).

The challenge your team seems to be alluding to is how dependable the desired result of the RFS is (as outlined by Babcock and recognized by Jim Laity) from a market expansion perspective (i.e. will the RFS produce the desired result of pulling more renewable fuel into the marketplace without creating the problems the oil companies cite). A couple of thoughts:

1. The generalization that E85 is not being priced to allow the RFS to work is false. Ron cited 20 cpg as the average savings (I believe, no source cited). There is no perfect data set for E85 pricing, but the easily accessible stuff does not support the thesis. For example, http://www.e85prices.com/ shows the average E10 price today to be $3.36 and the average E85 price to be $2.54. The data here is robust but incomplete, like it is in many places including EIA, but it's easy to see that the gap is substantial in many parts of the country (the site shows the % E85 discount relative to E10 by state, as well).

2. The honest (general) answer to the E85 pricing question – evidenced below – requires acknowledging that Big Oil controlled stations seem to be pricing their E85 to fail (when they use it at all, and pocketing the savings in the process) while independents seem to be pricing E85 closer to what the market should derive. Any model result that does not account for this discrepancy – understanding that 50% of the retail gasoline marketplace is independent – is wrong. Put another way, looking at the world through the lens of the "[EIA] average national E85 price" allows Big Oil's E85 price distortions [which distort average pricing data] to muddy the fact that the RFS empowers roughly half of U.S. gas stations to provide a gasoline alternative at a significant discount, even if the branded stations refuse to initially. At this point in the RVO process, the federal government is either leveraging independents against the big oil branded stations to do higher/cheaper ethanol blends or vice versa (there does not appear to be a third team on the field here, and the current proposal empowers the big branded stations who refuse to use or price E85 the right way).

    a. The attached E85 price assessment ("Tale of Two Markets") – which has been submitted to your team multiple times now – shows that "since RIN prices began to rise in 2013, the nationwide average discount for E85 (vs. E10) at independent stations has been 14% or greater for all but one month. During the same period, the nationwide average discount for E85 at major-branded stations reached 14% only once." The report breaks down pricing data for more than a half dozen states, and notes that about 50% of stations are independents.

b. Jim asked about data supporting the expectation that as RIN prices increase, ethanol/E85 price decreases. The best data set is Minnesota, because they keep better records than most states on this issue, which observed this very dynamic (see attached; "MN_E85_RIN impact" at slide 2). We have been faced with the argument that "well, that's Minnesota, a very ethanol friendly state." Yes, the RFS market dynamic intended is going to work most quickly and visibly in states with the most readiness for higher renewable fuel blends (especially if higher RIN prices are only allowed to work for a couple months before being undercut by the proposed RVO). But gasoline marketers elsewhere are not stupid; when independents see cheaper fuel and higher margins in MN and other ready states, they will move to do the same as new markets work themselves out.

c. I will send under separate heading a draft case study, embargoed, of gas stations in a major U.S. city. The study adds some color to the problem side of the equation. The analysis shows that major branded stations – in a particular city – are picking up ethanol/E85 on wholesale markets for a significant discount to gasoline, and then turning around and pricing it at about the same price as E10. My personal view is: (a) this behavior needs to be investigated rather than rewarded; (b) this behavior comes partly as a result of the 2014 RVO proposal, which alleviates any market urgency for branded stations to actually sell the stuff in 2014; and, (c) this type of thing will iron itself out if we stick to the program, because there would be an incentive to keep up with independents on price and actually sell the stuff to get ahead of compliance.

d. The broader arguments made by the oil industry are not credible (e.g. the threat that they are all going to outwardly collude to short fuel markets, as delineated by the NERA report). Professor Babcock, when consulting with EPA, destroyed that study. The only credible argument we have seen is that the refineries that ignored the program are being forced into buying RINs at considerable cost (as opposed to buying and selling ethanol at considerable profit). We have already sent articles to Ron and others showing that many of these same complainants have invested in ethanol blending capacity to get on the profit side of, say, a 60 cpg D6 RIN (as many other oil companies have done). "Loop holing" the program to protect these guys is going to not only strand billions in advanced biofuel investment, but also will not help them systemically (they should be able to improve their bottom line with the RFS, and most of these guys are now fine because they switched their crude feedstock) and will raise questions for obligated parties/counsel about how best to "comply" with other CAA rules like 111d (i.e. don't).

e. A recent report from RFA delineates which companies offer higher ethanol blends and which companies do not: http://www.ethanolrfa.org/page/-/Protecting%20the%20Monopoly.pdf?nocdn=1. The report does not include pricing data, but does name names and describe how these companies control distribution (something that the Administration is proposing to include as pretext for obligated parties to avoid their obligations under the RFS) through franchise agreements.

In addition to important aspects of this already discussed – that, (a) the RFS is working among independents; and, (b) those who seem to be distorting pricing are of predictable color, which is the very behavior set targeted by the RFS in the first place – there is a final important market variable to reemphasize: the RVO proposal itself. There is a self-fulfilling prophecy component to this, in which concerns about oil dominated market intransigence (the "blend wall") creates a methodological shift in the proposed RVO that in and of itself sends a clear signal to those naturally disinclined to sell fuels like E85 (i.e. the majors) to not sell it (or price it in ridiculous ways to make it seem like consumers don't want it). This market signal curbs the infrastructural development the Administration claims it is waiting for. For example: "It was just starting to get to the point where oil companies were saying, 'Fine, we'll start putting in alternative fuels,'" Walk, vice president of Protec Fuel in Boca Raton, Florida, said of deals he had in the works to build or retrofit pumps at some 450 stations. Now, those conversations have gone by the wayside. It's not canceled, but it's on hold.".

Please let us know if further data gaps exist. -brooke

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