



**RENEWABLE IDENTIFICATION NUMBERS (RINS)  
TRADING UNDER THE RENEWABLE FUELS  
PROGRAM: CONTINUED UNINTENDED  
CONSEQUENCES FOR SMALL FUEL RETAILERS  
UPDATED REPORT**

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## **I. INTRODUCTION**

Since my last report on the unintended consequences of the Renewable Fuel Standard (“RFS”) program for small fuel retailers, the Environmental Protection Agency (“EPA”) has proposed to deny requests to initiate a rulemaking to change the point of obligation under the RFS program.<sup>1</sup> As someone who studies and follows this issue closely, I believe the EPA’s Proposed Denial relied on and uncritically adopted views and statements proffered by large retailer coalitions—such as the National Association of Convenience Stores (“NACS”) and the Society of Independent Gasoline Marketers of America (“SIGMA”)—instead of independently assessing relevant information. Then

markets and local economies. Sections II, III(A), III(B)(1), and V below reiterate the findings of my August 2016 report, while providing updated information where appropriate. Sections III(B)(2), IV and VI offer new information based on case studies and additional data not contained in the August 2016 report.

## **II. BACKGROUND**

More than a decade ago, in an effort to decrease imports, reduce greenhouse gas emissions, and enhance America’s energy security, Congress passed the Energy Policy Act of 2005. Among other provisions, this legislation created a RFS mandating the blending of renewable fuels—such as ethanol—into gasoline and diesel. Each year, EPA sets a blending target known as the renewable volume obligation (“RVO”). For example, in 2010, EPA directed that 12.9 billion gallons of ethanol and other biofuels be blended into gasoline and diesel. By 2016, the amount had jumped to 18.1 billion gallons and the proposed RVO requirement for 2017 is 18.8 billion gallons. Since the law was passed, ethanol’s share of the U.S. gasoline mix has increased from less than three percent to nearly 10 percent.

In addition, Congress directed the EPA to generate a system of tracking numbers that could be used to ensure that mandated blending requirements were being met by the “obligated parties.





brand owner, e.g. Shell, Exxon, etc. Unbranded retail stations typically don't have any specific blend specifications. However, as discussed above, the RFS obligated party is the refiner or the importer of petroleum, even though the blending occurs at the terminal/rack. Indeed, some large retailers do their own blending.

***B. Gaming the system***

Here is, where the market distortions come into play. Since the RVOs apply to refiners and importers, and not to

marketers and large retailers to gain revenues and a competitive advantage over small retailers. Reports indicate that large retailers are using the RIN profit stream for retail expansion and acquiring a larger share of a limited market. The acquisition of convenience store chains by cash-rich limited partnerships suggests the chains' market share will continue to grow. The effect of these convenience store chain acquisitions has been detrimental for small retailers. In fact, these retailers are losing both sales volume and stores to large retailers. In other words, small retailers aren't just less profitable than before; rather, they are going out of business due to their growing inability to compete with large retailers and a related loss of sales. As a result, the demise of small "mom-and-pop" fueling stations has accelerated, with more than 12,000 closing since 2007.

Furthermore,





Specifically, Benavides found that for Pilot/Flying J, the per-store average margin nationwide was \$0.66 per gallon, and for Loves the nationwide store average margin was \$0.65 per gallon. Based on these figures drawn from his mathematically and academically robust estimated margin indicator model, he finds that these fuel margins equate to twice the profit than conventional wisdom might assume.

The scenario described in Benavides's analysis demonstrates the dramatic price competition that has allowed aggressive market consolidation in the fuel retail market. Truck stops are a segment of the fuel retail market that is experiencing the same level of unfair competition that all fuel retailers are experiencing under the RFS. Large truck stop chains, like Pilot/Flying J and Love's, are increasing market share while independents are dwindling year after year.

**B.**



*our competitive advantage* and then finally we focus on the Categories. [W]e think we were widening what we believe is a key competitive and sustainable advantage in the fuel space” (emphasis added).<sup>9</sup> The company’s Chief Executive Officer, Brian Hannasch, echoed Tessier’s comments with respect to Couche-Tard’s advantages over the competition:

I think in our situation with our scale, I think

*our footprint than most of our competitors.* So while it’s hard to quantify the exact impact, we think we’re advantaged vis-a-vis the industry when it comes to RINs, and that a higher RIN value is actually a positive for us vis-à-vis the industry, which is what I think is relevant (emphasis added).<sup>10</sup>

#### **D. Murphy’s**

In its Form 10-Q filed on November 3, 2016, with the Securities and Exchange Commission (“SEC”), Murphy’s directly acknowledges that it has benefited from “its

prices reduced our spot to wholesale rack margins, which stayed negative for much of the quarter (page 4).”<sup>12</sup>

While one might reasonably intuit that these RIN profit figures provide Murphy’s a competitive advantage vis-a-vis other market participants, that conclusion is confirmed through statements from a Murphy’s executive at the Raymond James 37<sup>th</sup> Annual Investors Conference. The most relevant excerpts follow:

“We have access to the RINs through the blending. We have the credit. We have the scale and scope to hold the working capital and manage through the volatility *that smaller* (page 5, emphasis added).”<sup>13</sup>

“So what’s the *differentiated capability* that sets us apart? It’s our fuel supply chain. And the way we do that is 50% of the gallons we sell are sourced through propp1-/F4 12 Tf1 0ity

Read together, the evidence from the latest report, and the statements of Casey's, Couche-Tarde, and Murphy's demonstrate the existence of strong, industry-wide gains among large retailers through obtaining renewable fuel – and RINs – at the blending point. These substantial RIN-oriented gains go well beyond what is necessary for these large retailers to turn a profit, and, if the point of obligation was shifted, these monies could be set aside for RFS compliance – rather than further padding large retailers' already robust pockets.

V. **WHY COMPETITION MATTERS IN THE RETAIL FUEL MARKET**

The trading of RINs purely for financial gain is a is a

important factor providing price ceilings for consumers and businesses. But that competitive market is now at risk.

Industry-wide statistics highlight the vulnerability of small fuel retailers. For large retailers, average net profit margins increased to nearly 3 percent in 2014 compared with 1.6 percent in 2012. At the same time, net profit margins among small private gas stations were relatively flat. Furthermore, an analysis conducted in 2013 by Study Groups/Finance & Resource Management Consultants found that “high volume retailers suck a lot of volume out of the market, making the economics more challenging for traditional convenience store operators and the dealers they serve.” The same study cited a case in Northern New Jersey where two independent retailers reduced their prices by more than 10 cents a gallon when they saw cars lining up 10- and 15-deep at a nearby Costco location. One of the operators reasoned he would be out of business if he didn’t lower his price to compete with Costco. At the same time, of course,

retailers through the current RIN market is coming at the expense of small operators, who lack the financial capacity to compete with larger retailers in a “race to the bottom.”

On a global scale, if profit margins for small, independent retailers continue to narrow in order to “meet the competition,” even more of these businesses can be expected to fail in coming years. Fewer small retailers, in turn, will result in higher fuel prices for consumers along with a reduction in the services these businesses provide, such as auto repair and maintenance.

## **VI. CONCLUSION: HOW TO BALANCE THE PLAYING FIELD BY CHANGING THE POINT OF OBLIGATION**

With higher RIN prices anticipated as mandated RVOs grow year after year, large retailers should increase the blending infrastructure for renewable fuels and promote higher blends by passing on the RIN value to consumers. But because large retailers are not obligated parties, they have no incentive to implement these initiatives. Put differently, higher RIN values won’t motivate large retailers to blend higher levels of renewable fuels because, in the current market, their RINs can be sold to generate substantial revenue.

On the other hand, if the RFS obligation were placed at the blending point, and large retailers become the obligated parties, to meet their newfound RFS obligations they would likely increase their marketing and distribution of higher renewable fuel blends. Importantly, such a change would eliminate some of the competitive disadvantage that small retailers currently face due to the RIN revenue generation capabilities of large retailers. Absent a shift in the point of obligation, small retailers will be increasingly

driven out of business, which will be harmful to market competition and local economies across the United States.