Testimony of

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I. SUMMARY OF TESTIMONY

- The National Association of Truckstop Operators ("NATSO") is the premier national trade association representing off-highway fuel retailers, from multi-billion dollar travel center and convenience store chains to small, single-store operators. Although virtually all of NATSO's members sell gasoline – and many blend ethanol – NATSO's testimony will focus primarily on the *diesel* market and the opportunities for policymakers to incentivize diesel retailers to incorporate increasing amounts of *advanced* biofuels into the nation's diesel fuel supply.

- The Renewable Fuel Standard ("RFS" or the "Program") successfully created market incentives that have led many of NATSO's most successful members to incorporate biodiesel into their diesel fuel supply. They do this as a means of lowering prices for consumers and competing for market share. At the same time, the RFS has been undermined in a number of ways – some embedded in the Program's underlying structure and others due to decisions made by the executive branch as it implements the Program. The 21st Century Transportation Fuels Act (the "Bill" or "Legislation") would resolve many of these issues, though in other areas it could be improved to provide further market certainty and protection against counterproductive executive branch implementation decisions.

    - NATSO's approach to analyzing and responding to the Bill is simple: We support the provisions that will facilitate market opportunities for our members to lower fuel prices by buying advanced biofuels; our suggestions for improvement are designed to move the Legislation in a direction that further *enhances* those opportunities and/or eliminates unnecessary obstacles that can impede them. NATSO has not taken a formal position on the legislation as a whole.

- The Legislation appropriately maintains the RFS's framework whereby fuel marketers act as surrogates for consumers in assessing advanced biofuels' value proposition.

- The Legislation improves upon the RFS's current balance between growth-oriented certainty while maintaining flexibility to respond to unforeseen circumstances. Although the RFS was a strong assertion of legislative power, it is clear today that Congress gave too much discretion to executive branch officials' ideological and/or policy preferences. The mere existence of this discretion generates enough uncertainty that chills investment in renewable fuel infrastructure and undermines returns on investments that have been made.

    - The Legislation's rules-based RVO process would make the Program more predictable and less susceptible to executive branch interference. However, because the Legislation does not address the Program's Small Refinery Exemption Regime, it still leaves the RFS susceptible to being undermined by the executive branch.

    - In providing a longer "off-ramp" for advanced biofuel than "conventional" corn-based ethanol, the Legislation appropriately recognizes that advanced biofuels still cost more than the fuels they are designed to displace. At the

same time, by cutting off the advanced biofuels mandate and ending the RFS after 2032, the Bill sends the wrong market signal and could undermine the commercialization of advanced biofuels.

- The Bill includes a number of misfueling mitigation provisions designed to facilitate a smooth a transition to a high octane fuel performance standard. Although NATSO does not have a formal position on the wisdom of such a transition, these misfueling mitigation provisions can be improved in a number of ways to better accommodate the Legislation's objective.

II. INTRODUCTION

Chairman Shimkus, Ranking Member Tonko, and members of the Subcommittee, thank you for the opportunity to testify on the draft legislation titled the "21st Century Transportation Fuels Act." The legislation is an important step forward as Congress examines the future of transportation fuels in the United States and the regulatory framework governing them.

My name is David Fialkov; I am the Vice President of Government Affairs and the Legislative and Regulatory Counsel at the National Association of Truckstop Operators ("NATSO" or the "Association"). NATSO is the premier national trade association representing off-highway fuel retailers, travel centers and truckstops. NATSO represents both large, multi-billion dollar travel center and convenience store chains, as well as small, single-store operators. Given the breadth of its membership, NATSO represents a substantial majority of retail sales of diesel fuel in the United States.

Although virtually all of NATSO's members sell gasoline – and many blend ethanol – my testimony today will focus primarily on the diesel market and the opportunities for policymakers to incentivize diesel retailers to incorporate increasing amounts of *advanced* biofuels into the nation's diesel fuel supply. Federal policies such as the Renewable Fuel Standard ("RFS" or the "Program"), when crafted and implemented properly, can reduce vehicles' greenhouse gas ("GHG") footprints while lowering fuel prices for over-the-road truck drivers. This, in turn, lowers the prices for all goods that are moved by truck, benefitting the entire U.S. economy and enhancing our energy independence.

The RFS created market incentives that have led many of NATSO's most successful members to incorporate biodiesel into their diesel fuel supply. They do this as a means of lowering prices for consumers and competing for market share. In this

respect, the RFS has been an extraordinary success: biomass-based diesel production is more than three times what was originally anticipated, and can continue to be the largest source of high GHG-reduction fuels in the coming years.

Throughout its history, however, the RFS has been undermined in a number of ways – some embedded in the Program's underlying structure (*e.g.*, a process for setting annual Renewable Volume Obligations ("RVOs") that can be subjective and difficult to predict), and others due to decisions made by the executive branch as it implements the Program. The 21st Century Transportation Fuels Act (the "Legislation" or the "Bill") would resolve many of these issues; in other areas it could be improved to provide further market certainty and protection against counterproductive executive branch implementation decisions.

My testimony today will address how the Legislation would further incentivize the market to displace diesel fuel with renewable substitutes, as well as how the Bill could be improved to more successfully achieve this objective. NATSO has not taken a formal position on the legislation as a whole.

III. BACKGROUND ON THE TRAVEL CENTER INDUSTRY

The travel center and truckstop business is a diverse and evolving industry. Every travel center location includes multiple profit centers, from motor fuel sales and auto-repair and supply shops, to hotels, sit-down restaurants, quick-service restaurants, food courts, and convenience stores. Although the industry was once tailored solely to truck drivers, it now caters to the entire traveling public, as well as the local population that lives in close proximity to a travel center location.

NATSO members' sole objective is to sell legal products, in a lawful way, to customers who want to buy them. As new fuels enter the market, retailers want to be

able to sell those fuels lawfully and with minimal volatility and risk. We are agnostic as to which fuel we sell to satisfy consumer demand, but we do have a strong bias in that we believe it is best for the American consumer—and America's industrial position in the world marketplace—to have reasonably low- and stable-priced energy.

A. PRICE FLOW AT RETAIL

The retail fuels market is the most transparent, competitive commodities market in the United States. As every American knows, customers can see fuel retailers' price signs from blocks away, or compare prices on apps on their cell phones. These signs represent more than just pricing information – they are value propositions to potential customers, not only with respect to fuel but also food and other convenience items that we sell in our stores and restaurants.

While the gasoline market is extraordinarily competitive – consumers will often change where they buy gas to save just a few cents per gallon – the retail diesel market is even more competitive and transparent as many travel centers' customers – truck drivers and trucking fleets – are more savvy and price-conscious than typical American motorists. (Fuel generally amounts to 30-40% of a motor carrier's overall costs.) Truck drivers are often aware of retail fuel prices when they are 100 miles away from potential refueling sites, and fleet managers use this information to direct drivers to specific retail locations in order to purchase the lowest-priced fuel available. This imposes strong downward pressure on retail diesel prices.

The competitive nature of the retail diesel market compels retailers to pass through cost savings to consumers in order to maintain and increase their market share. It is in retailers' interests to increase the amount of fuel that they sell to consumers. This is

not only because those sales directly drive profit opportunity, but also because such sales drive in-store traffic, which is a source of profit for the retailer.

Given the structure of the retail fuels market, therefore, all of NATSO's members are "price takers" at retail. This means we must take the price of fuel that the market sets and compete to gain market share as the transparency of the market exerts a constant downward pressure on retail fuel prices. It is important to remember, however, that there is a long chain of supply before fuel is sold to consumers at retail – and any costs that are incurred along the fuel production and supply chain will be passed down to retailers and ultimately absorbed by consumers.

To illustrate, under the RFS, when a retailer blends biodiesel into diesel fuel, the retailer is able to separate and sell compliance credits known as Renewable Identification Numbers ("RINs"); the RIN value is then passed along to consumers in the form of more competitively priced (less expensive) diesel fuel to entice the customer to stop for fuel and come into our travel centers.

In short, travel center operators have an incentive to blend biodiesel into their diesel fuel supply under the RFS because blending enables retailers to separate and sell RINs, which lowers the cost of the goods they sell every day.

B. RETAILERS DO NOT *CREATE* DEMAND, THEY *RESPOND TO* DEMAND

Retailers cannot force consumers to buy a particular product. Offering a product for sale does not guarantee that consumers will purchase it. Rather, retailers sell what consumers demand. 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.

Thus, to the extent the Subcommittee's objective is to incentivize increased penetration of advanced biofuels into America's diesel fuel supply, it must keep in mind this fundamental market reality: price-conscious motorists and truck drivers only buy advanced biofuels if those fuels are priced competitively with traditional diesel fuel. Diesel retailers, therefore, will only continue to *sell* advanced biofuels if doing so enables them to *lower* the price point at which they offer diesel fuel to motorists.

NATSO's approach to analyzing and responding to the Legislation is simple: We support the provisions that will facilitate market conditions and opportunities for our members to lower fuel prices by buying advanced biofuels such as biodiesel; at the same time, our suggestions for improvement are designed to move the Legislation in a direction that further *enhances* those opportunities and/or eliminates unnecessary obstacles that can impede them.

IV. COMMENTS ON THE 21ST CENTURY TRANSPORTATION FUELS ACT

A. THE BILL APPROPRIATELY MAINTAINS THE RFS'S STRUCTURE AND FRAMEWORK

The RFS is well designed to achieve its objectives of displacing petroleum-based fuels with renewable substitutes. The legislation has been successful because Congress, in designing the RFS, recognized that the only way to get truck drivers to buy more advanced biofuels was to make such fuels less expensive at retail than diesel. However, while the RFS creates for fuel retailers an *incentive* to blend as much advanced biofuel as we can, this incentive only exists as long as our customers view the end product as an attractive value proposition. Of the various mandates contained in the RFS, Congress did **not** include a mandate for consumers to purchase anything.

The Legislation would appropriately maintain this framework, whereby fuel marketers act as surrogates for consumers in assessing advanced biofuels' value proposition.

B. THE BILL IMPROVES UPON THE RFS'S CURRENT BALANCE BETWEEN GROWTH-ORIENTED CERTAINTY WHILE MAINTAINING FLEXIBILITY TO RESPOND TO UNFORESEEN CIRCUMSTANCES

The RFS is an extraordinary example of the policymaking relationship between the legislative and executive branches. When Congress enacted the RFS more than a decade ago, it was a strong assertion of legislative power, fundamentally altering motor fuels markets throughout the country by defining various categories of renewable fuel in accordance with GHG-reducing capabilities and specifying precise renewable fuel consumption targets over many years.

At the same time, however, Congress left to the Environmental Protection Agency ("EPA or the "Agency") a large amount of implementation responsibility and discretion. Much of this was due to the justifiable concern that rigid volume obligations could lead to negative economic consequences under certain circumstances (hence, for example, EPA's authority to waive volume obligations to avoid severe economic harm or in instances of inadequate domestic supply of renewable fuel).

While some flexibility is necessary, it is clear today that Congress gave too much discretion to executive branch officials' ideological and/or policy preferences. Throughout this decade, such discretion has generated delays in RVO announcements, less-than-optimal growth in annual RVOs, and unjustifiable bailouts of companies that chose not respond to the RFS's incentives. The mere *existence* of this flexibility generates enough uncertainty that chills investment in renewable fuel infrastructure and undermines returns on investments that are made.

In reforming the RFS, Congress should use the wisdom gained from experience over the last ten years to refine this balance of power between the branches of government—control of the RFS should move away from the executive branch and back toward Congress. In essence, Congress should remove much (though not all) of the EPA's discretion to adjust annual RVOs and instead provide a rules-based RVO process with baked in flexibilities to accommodate unforeseeable changes in circumstances.

In some ways, the Legislation succeeds in doing this, and in other ways it could be improved.

1) The Legislation's rules-based RVO process would make the Program more predictable and less susceptible to executive branch interference.

The Legislation would base annual RVOs on actual gallons produced[1] in previous compliance years, with mid-year and end of year adjustments to account for increases or decreases in production. This system would eliminate much of the uncertainty and speculation surrounding the RVOs, thereby reducing volatility in RIN markets. This provision would also incentivize biofuel producers to produce as much advanced biofuel as the market could absorb (in order to maximize the next year's RVO). Furthermore, increasing annual mandates would encourage fuel marketers and blenders to invest in the infrastructure necessary to incorporate such biofuels into their fuel supply (since buying and blending such fuels will allow them to lower their overall cost of goods sold).

[1] "Gallons produced" is somewhat of a misnomer, since the Legislation is in fact referring to gallons produced and *consumed in the United States*. By basing the production number on EPA's Moderated Transaction System ("EMTS"), the Bill is capturing gallons of advanced biofuel produced overseas and imported into the United States and consumed here, and is not capturing gallons produced in the United States and exported and consumed overseas. This is the correct approach. The RFS should be encouraging U.S. consumption of GHG-reducing fuels, and should be designed to lower fuel prices in the U.S. rather than outside our borders.

2) The Legislation does not address the Program's Small Refinery Exemption regime, leaving the RFS susceptible to being undermined by the executive branch.

The Bill's rules-based RVO system will only achieve the objectives of enhanced certainty and less volatility *if* it addresses the Program's current flawed small refinery exemption regime. The fact that the Legislation is silent on this topic is a real flaw.

In recent years, the EPA has granted small refinery "hardship" exemptions to an unprecedentedly large number of small refineries. This has dramatically lowered RIN prices and in turn lowered demand for advanced biofuels. It has also diminished the value of investments that NATSO members have made, in response to government incentives, to bring such fuels to market.

EPA has granted these waivers without providing basic information to market stakeholders. Market participants are not told when waivers are given, the volume quantity that is waived, or the refineries that have received the waivers. The waivers have undercut Congress's intent when it enacted the RFS. They have resulted in more volatility in RIN markets and lower demand for advanced biofuels. Any legislation to reform the RFS is must remedy this situation.

When these waivers are issued retroactively (*i.e.*, for compliance years for which RVOs have already been finalized), as they have been in recent months, they function as *de facto* cuts in the RVO. Refineries that have *not* received waivers continue to have their static obligation, while refineries that *do* receive waivers have their obligations cut by an amount commensurate with the waivers they have received.

This depresses the price of RINs—refineries that have their obligations waived can sell all of their RINs in an open market, and the increased supply of credits

diminishes their value.[2] This, in turn, inhibits marketers' ability to lower their costs by blending biodiesel and separating RINs, thereby diminishing overall demand for biodiesel and other advanced biofuels.

EPA's distribution of "hardship" waivers is intellectually incoherent because the price of RINs are baked into refiners' so-called "crack spreads" (*i.e.*, the difference between refiners' cost of *raw* products and the price at which they sell *refined* products). All refiners (large and small) are able to pay for the costs associated with buying RINs by simply charging more money for the fuel that they sell commensurate with RIN costs. Indeed, EPA itself has acknowledged this market fact: "[R]efiners can indeed expend significant funds to purchase RINs needed to demonstrate compliance with the RFS program, but **the cost is offset** by a corresponding increase in the market price of the fuel they sell that is attributable to the RFS obligations. The market price they receive for the gasoline and diesel fuel they sell reflects the cost of RINs." EPA further added that: "Obligated parties [are] charging more for domestic gasoline and diesel to ensure they recoup the costs associated with RIN prices. So while [an obligated party] is directly paying for RINs they buy on the market, they are passing that cost along in the form of higher wholesale gasoline and diesel prices."[3]

Perhaps most troubling, these waivers have been issued in secret. EPA has not solicited any public comment as to whether its reformulation of the waiver criteria is appropriate, nor does it inform stakeholders when waivers are given. As a practical matter, waiver recipients receive an inequitable advantage over other market participants

[2] On multiple occasions, EPA has reportedly gone so far as to artificially generate and distribute current year RINs as restitution to refiners that have previously had waiver requests denied under a standard stricter than the one it currently has in place. This exacerbates the price-reducing effect the waivers have had on RINs.

[3] EPA (November 2017). *Denial of Petitions for Rulemaking to Change the RFS Point of Obligation.* (EPA Report No. EPA-420-R-17-008), *available at* https://nepis.epa.gov/Exe/ZyPDF.cgi?Dockey=P100TBGV.pdf (emphasis added).

by being permitted to sell RINs based on asymmetrical information with respect to the RINs' value.

To illustrate: If the market today values biodiesel RINs at $.50/RIN, and a refinery receives a waiver at 10:00am, that means that all RINs the refinery was holding in order to demonstrate compliance to EPA will eventually enter the market (since the refinery doesn't need them anymore), thereby diluting RIN values and lowering the cost of RINs (similar to how the value of money decreases when central banks print more of it). Once the refinery receives the waiver and begins selling its RINs to other market participants, the refinery can do so at the higher $.50/RIN price because their counterparties do not know that a waiver has been granted and that the price of RINs should be lower. It is not until after the RINs are sold that stakeholders can analyze market activity and determine that waivers were given and downwardly adjust RIN values accordingly.

Throughout all of this, fuel marketers that have invested in biodiesel tanks and blending equipment are seeing the value of such investments diminish because biodiesel demand is diminishing as RIN prices go down. Those considering make such investments see what is happening and are strongly discouraged from making the investments.

<u>The Legislation must fix this broken small refinery exemption provision</u>. The most appropriate course of action is to simply eliminate the exemption for small refineries. This would remove the uncertainty and volatility that the exemption creates and recognize that all refiners have had at least 10 years to adjust their business operations to comport with the incentives that Congress established, and those that have not adjusted are <u>still</u> not subject to any disproportionate hardship relative to their competitors.

If this is not achievable, Congress can either exempt all refiners that meet certain criteria, *or* require all waiver requests be received by EPA a minimum period of days (*e.g.*, 60 days) *prior to* the Agency finalizing RVOs for a given compliance year. That way, when RVOs are finalized, the market can be confident that those numbers will not be adjusted downward after the fact. It would arguably be most consistent with the RFS's purpose if EPA were required to upwardly adjust the RVOs applicable to refiners that have not received waivers; this would allow the market to satisfy the entire RVO while at the same time alleviating any purported hardship on small refiners.

3) In providing a longer "off-ramp" for advanced biofuel than "conventional" corn-based ethanol, the Legislation appropriately recognizes that advanced biofuels still cost more than the fuels they are designed to displace.

The only reason any fuel marketer blends biodiesel into their diesel fuel supply is to make the finished product less expensive. Absent government incentives, biodiesel as a commodity is substantially more expensive than diesel fuel. Thus, advanced biofuels such as biodiesel would not be blended into diesel fuel in the absence of the RFS and other government incentives.

Ethanol, by contrast, is an economical source of octane and therefore would be blended with gasoline even if the RFS were repealed.

It makes sense, therefore, that the Committee would extend the mandates for advanced biofuels for a longer period of time than for "conventional" corn-based ethanol biofuel. Because advanced biofuels cost more money than the fuels they are trying to displace, such biofuels must continue to be subject to robust federal incentives for a period of years if there is any hope for them to be competitive. Absent such incentives, advanced biofuels will not displace petroleum-based fuels. This is not necessarily the case for conventional biofuel.

4) By cutting off the advanced biofuels mandate and ending the RFS after 2032, the Bill sends the wrong market signal and could undermine the commercialization of advanced biofuels.

Congress's objective should be to enable advanced biofuels to get to a place where they can be commercialized – *i.e.*, compete without government incentivizes – and grow on their own. It is not clear that the ten-year "extension" of the advanced categories of the RFS is sufficient to achieve this objective. It would be particularly unfortunate if advanced biofuels are able to make critical efficiency and economic improvements over the course of the next decade, only to have the "rug pulled out from under them" before they are able to make it across the finish line. NATSO urges Congress to take seriously the suggestions made by those in the advanced biofuel production community that indicate a reasonable period of years beyond 2032 is necessary in order to make those fuels fully competitive with petroleum-based diesel fuel.

IV. MISFUELING MATTERS

NATSO's primary focus in this testimony concerns the Legislation's impact on advanced biofuels markets and economics. The Bill does, however, include a number of misfueling mitigation provisions designed to facilitate a smooth a transition to a high octane fuel performance standard. Although NATSO does not have a formal position on the wisdom of such a transition, NATSO does have views as to how these misfueling mitigation provisions can be improved to better accommodate the Legislation's objective.

First, the Bill should clarify that any technological solution to prevent misfueling must be "technically and economically feasible" *for retailers* (as well as other stakeholders such as automobile manufacturers).

Second, the Legislation is too prescriptive regarding nozzle sizes for fuel pumps dispensing higher octane fuels. Such overly specific requirements can impose unnecessary costs on supply chain participants – namely automobile manufacturers – and these costs would be passed down to consumers. Although NATSO agrees that it is imperative to develop a mechanism to ensure that consumers cannot put lower octane fuels into newer vehicles that are designed to run on higher octane fuel, this mechanism should be industry-driven, and be as economically and technically feasible as possible. NATSO's understanding is that mandating a 0.77 inch diameter standard for nozzles is not the most economically and technically feasible method for achieving this objective.

Finally, the Bill should clarify that any retailer who complies with all of the applicable misfueling prevention requirements (purchasing necessary infrastructure equipment, posting appropriate signage, etc.) will not be held liable under either federal or state enforcement actions, *or* private lawsuits. Without such protection, retailers will inevitably be reluctant to invest in new fuels and this will disrupt the Legislation's objective of facilitating a smooth transition to higher octane fuels.

V. CONCLUSION

Thank you for the opportunity to present testimony before you today. I look forward to continuing to work with Congress on the issues discussed above, and I am happy to answer any questions that you may have.