Small Retailers
COALITION

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May 8, 2017

Via Certified Mail – Return Receipt Requested
Scott Pruitt
Administrator
U.S. Environmental Protection Agency
Mail Code 1101A
1200 Pennsylvania Avenue, N.W.
Washington, DC 20460

Re: **Notice of Intent to Sue**

Dear Administrator Pruitt:

First, on a personal note, Bill Douglass and I would like to wish you the best in your new role as Administrator. As a former EPA Regional Counsel, I can appreciate the excitement and some of the challenges associated with this transition time. We wish you and your team every success. Mr. Douglass is the Chairman of Douglass Distributing in Sherman, Texas and the Chairman of the Small Retailers Coalition ("SRC"), a group of 200-plus small retailers across the nation who own and operate branded and unbranded gasoline stations and convenience stores.[1] We met briefly at Earth Day Texas, where Bill gave you his card and let you know that we would be reaching out on a critical issue for small retailers. You were gracious and offered to listen to our concerns.

At the outset, although this letter lays out notice of legal claims that the SRC may pursue against EPA, we hope that this can also be the beginning of a dialogue with EPA with the goal that EPA will consider addressing our concerns without litigation.

Notice of Intent

This letter provides notice that the SRC intends to file suit pursuant to section 611 of the Regulatory Flexibility Act ("RFA"), 5 U.S.C. § 611(a)(1), against the United States Environmental Protection Agency ("EPA") and its Administrator based on EPA's noncompliance with sections 603 and 604 of the RFA. This action is necessary because EPA failed to follow the statutorily required process for evaluating the adverse economic impacts of the final Renewable Fuel Standard ("RFS") regulations for Renewable Fuel, Advanced Biofuel,

[1] Our retailers distribute gasoline under brands from major integrated refiners, independent refiners and under independent brands.

www.smallretailerscoalition.com
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and Cellulosic Biofuel for 2017 and the RFS Regulations for Biomass-Based Diesel for 2018 (the" 2017 Final Rule")[2] on small petroleum retailers when it promulgated this final rule.

Our claim is that, despite the fact the 2017 Final Rule is premised on "driving the market to overcome constraints in renewable fuel *distribution infrastructure*,"[3] EPA failed to prepare and make available for public comment the required regulatory flexibility analyses concerning the impact of the current RFS on small petroleum retailers – which comprise approximately 75 percent of the fuel distribution outlets in the nation.

Moreover, we intend to bring a claim that, by failing to consider the adverse economic impacts of the RFS on small retailers in any previous rulemaking under the RFS, EPA could not and did not make a good faith certification under the RFA that the 2017 Final Rule "will have no significant economic impact on a substantial number of small entities."[4] In particular, EPA failed to meet its obligation under the RFA by refusing to analyze the impact on small retailers of the current obligation for compliance in the RFS annual standards or "point of obligation"—which is currently placed on refiners and importers of gasoline and diesel fuel ("obligated parties"). Although notice for this claim is not legally required, the SRC is sending this notice letter as a courtesy to make EPA aware of the issue and to facilitate resolution.

This letter also provides the legally required notice, pursuant to 42 U.S.C. § 7604(b), that the SRC intends to file a citizen suit against EPA and its Administrator, based on EPA's failure to perform nondiscretionary duties mandated by the RFS under section 211(o) of the Clean Air Act ("CAA"). Specifically, EPA has failed to annually evaluate and adjust the regulations implementing the RFS program (in particular, the point of obligation) to ensure that they are "appropriate" as required by 42 U.S.C. §§ 7545(o)(2)(A), (o)(3)(B). EPA has also failed to complete the periodic review mandated by 42 U.S.C. § 7545(o)(11) to allow for the appropriate adjustment of the requirements of the RFS program as it relates to the point of obligation.

Background

On March 26, 2010, EPA issued final regulations establishing amendments to RFS program regulations.[5] These regulations included 40 C.F.R. § 80.1406, which established the point of obligation. As required by section 604 of the RFA, EPA prepared a final regulatory flexibility analysis in conjunction with issuing the March 26, 2010 rule. However, the ***only*** small entities that EPA considered in this analysis were small refineries.[6] EPA did not consider the impact the rule would have on small petroleum retailers, even though the rulemaking specifically

[2] 81 Fed. Reg. 89,746 (Dec. 12, 2016).

[3] *Id.*

[4] *Id.* at 89,802.

[5] 75 Fed. Reg. 14,670 (Mar. 26, 2010).

[6] *See* EPA, RENEWABLE FUEL STANDARD PROGRAM (RFS2) REGULATORY IMPACT ANALYSIS, at 990 (Feb. 2010) (See Table 7.3-1).

states that fuel dealers are "potentially regulated entities" under the 2010 rule.[7] Moreover, EPA never did an analysis of how the RFS impacts small retailers in any subsequent final rules significantly amending the RFS in 2016 and in the 2017 Final Rule.

This is relevant because in the 2017 Final Rule, EPA largely relied on its RFA analysis from 2010 to come to the conclusion that no small entities (meaning small refiners) would suffer "significant adverse economic impact" from the RFS program through 2022.[8] This is despite the voluminous evidence in the record before EPA that the current point of obligation in the RFS is resulting in substantial economic hardship for small retailers.

The point of obligation not only is creating an uneven playing field for the fuel distribution market, it is also resulting in a dramatic reduction in the number of small retail fuel outlets for consumers. The 2017 Final Rule is replete with EPA theories about why the fuel distribution system in the United States cannot supply the required volumes of renewable fuels under the RFS, and yet, EPA refused to even analyze the impact of the program on small retailers (which, in the aggregate, comprise 75 percent of the retail fuel distribution sources in the country) as required by both the RFA and the RFS.

This was not a fact that just surfaced in the 2017 Final Rule. Since early 2014, small retailers and certain obligated parties have questioned whether 40 C.F.R. § 80.1406 should be amended and have filed formal petitions for reconsideration or revision of the definition of "obligated party."[9] These obligated parties contend that the system for demonstrating compliance with the annual RFS standards—through acquiring and remitting Renewable Identification Numbers ("RINs") to EPA—is not operating as intended and is driving up prices for obligated parties, retailers and consumers. In particular, they assert that the "the regulatory definition of 'obligated party' is a root cause of the RIN system's inefficiency, because it allows

[7] 75 Fed. Reg. 14,670, 14,670.

[8] 81 Fed. Reg. 89,746, 89,802-03.

[9] On January 27, 2014, Monroe Energy LCC ("Monroe") filed a "petition to revise" 40 C.F.R. § 80.1406 to change the point of obligation, and on January 28, 2016, Monroe filed a "petition for reconsideration" of the regulation. On February 11, 2016, Alon Refining Krotz Springs, Inc.; American Refining Group, Inc.; Calumet Specialty Products Partners, L.P.; Lion Oil Company; Ergon-West Virginia, Inc.; Hunt Refining Company; Placid Refining Company LLC; and U.S. Oil & Refining Company (the "Small Refinery Owners Ad Hoc Coalition") filed a petition for reconsideration of 40 C.F.R. § 80.1406. On February 12, 2016, Valero Energy Corporation and its subsidiaries (collectively, "Valero") filed a "petition to reconsider and revise" the rule. On June 13, 2016, Valero submitted a petition for rulemaking to change the definition of "obligated party." On August 4, 2016, the American Fuel and Petrochemical Manufacturers ("AFPM") filed a petition for rulemaking to change the definition of "obligated party." On September 2, 2016, Holly Frontier also filed a petition for rulemaking to change the definition of "obligated party."

unobligated blenders to profit from RINs rather than passing their value through to retail customers in the form of subsidized E85 prices."[10]

Likewise, small retailers are adversely impacted by the current point of obligation in the RFS program and have raised this issue to EPA. This is because of the requirement that places the obligation for compliance with renewable fuel mandates on fuel importers and refiners, rather than on blenders, allows large corporate mega-retailers that have the capability of blending gasoline or diesel with a renewable fuel at the rack to capture the RIN from the renewable fuel source.[11] Because these large retailers are not obligated parties under the RFS, they are then free to sell RINs and pocket the revenue.

Smaller retailers, in contrast, are unable to blend fuel because they don't have access to the necessary infrastructure, and are forced to buy the finished product directly from blenders. As a result, large retailers with blending capabilities are making windfall profits from the sale of RINs, allowing them to then artificially lower the price of gasoline just enough to undercut small retailers and push them out of the market.[12]

Like small refiners, small retailers have made EPA repeatedly aware that an unintended market consequence of the current point of obligation is that it is creating a substantial economic hardship for 75 percent of retailers in this country's fuel distribution sector. It is creating haves and have-nots on a scale never before experienced in the retail fuel sector. The reality is that the point of obligation is creating such a market imbalance that the Small Retailers Coalition had to form in order to represent the interests of the small retailers.[13]

Unfortunately, the large trade associations like the National Association of Convenience Stores (NACS) and the Society of Independent Gasoline Marketers of America (SIGMA) do not represent the interests of the small retailers on this issue. This is because large retailers—who command superior resources—have captured these associations and are incentivized to safeguard the multi-billion dollar windfall these large retailers enjoy from selling their unobligated RINs. There is a clear divide in the retail fuel distribution industry; it is large mega corporations versus small independent businesses.

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[10] Obligated Party Petitioner's Opening Brief Regarding EPA's Refusal to Consider the Appropriate Placement of the Compliance Obligation in the Final Rule, at 31, *Americans for Clean Energy. v. EPA*, No. 16-1005 (D.C. Cir. Sept. 8, 2016), ECF No. 1634780.

[11] The terminal rack, or simply "terminal" or "rack," is the point at which fuel is prepared and distributed into the commercial market. It is where fuels are blended to meet the RFS and other requirements, and are then distributed into commerce.

[12] This does not mean they are passing on the windfall from the RIN to consumers or selling more E-85 than other blends. These mega-retailers are only passing on a fraction of the RIN value to undercut small competitors that cannot sell the unobligated RIN. The large retailers, in turn, pocket the difference as profit. Alex Holcomb, *Market Analysis of the Proposed Change to the RFS Point of Obligation*, at 9-11 (Feb. 22, 2017) (unpublished manuscript), http://www.alexjholcomb.com/wp-content/uploads/2017/05/Economic-Analysis.pdf.

[13] *About – SRC*, SMALL RETAILERS COALITION, http://smallretailerscoalition.com/about-the-chairman/ (last visited May 3, 2017).

This is precisely the scenario Congress sought to address in the RFA and why it specifically directed EPA to review the economic impact of its regulations on small business in the RFA. In the Small Business Administration's ("SBA") *A Guide for Government Agencies – How to Comply with the Regulatory Flexibility Act*, the SBA states that:

> The goal of Congress in creating the RFA was to change the regulatory culture in agencies and mandate that they consider regulatory alternatives that still achieve statutory purposes, while minimizing the impacts on small entities.[14]

Under the RFA, a covered agency is directed that it must "consider the impacts of its regulatory proposals on small entities, analyze effective alternatives that minimize small entity impacts, and make their analyses available for public comment."[15] The SBA Guidance goes on to say that:

> The RFA does not seek preferential treatment for small entities, require agencies to adopt regulations that impose the least burden on small entities, or mandate exemptions for small entities. Rather, it requires agencies to examine public policy issues using an analytical process that identifies, among other things, barriers to small business competitiveness and seeks a level playing field for small entities . . . ."[16]

Even so, despite knowing that the current point of obligation is having a devastating economic impact on small retailers, EPA never analyzed the impacts of this rule on small business in the retail fuel industry. Meanwhile, tens of thousands of small retailers have been pushed out of the market at a record rate as a consequence of the misplaced point of obligation and resulting dysfunctional RIN market. This does not comport with the RFA.

EPA erred when it failed to consider small retailers in its regulatory flexibility analyses

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. §§ 601–612, as amended by the Small Business Regulatory Enforcement Fairness Act ("SBREFA"), requires that federal agencies consider potential impacts of their rules on small entities. The RFA applies to any rule subject to notice-and-comment rulemaking under section 553(b) of the APA or any other law. *See* 5 U.S.C §§ 553(b), 603(a). Thus, regulations promulgated under the RFS program are subject to the requirements of the RFA.

"Whenever an agency . . . publish[es] general notice of proposed rulemaking for any proposed rule," the RFA requires agencies to "prepare and make available for public comment

[14] SMALL BUSINESS ADMINISTRATION, A GUIDE FOR GOVERNMENT AGENCIES: HOW TO COMPLY WITH THE REGULATORY FLEXIBILITY ACT, at 7 (May 2012), *available at* https://www.sba.gov/sites/default/files/advocacy/rfaguide_0512_0.pdf.

[15] *Id.* at 1.

[16] *Id.*

an initial regulatory flexibility analysis" that "describe[s] the impact of the proposed rule on small entities." 5 U.S.C. § 603(a).

An agency must also prepare a final regulatory flexibility analysis whenever it "promulgates a final rule under section 553 of [the APA]." *Id.* § 604(a). In addition, an agency must comply with the small-entity analysis requirements of the RFA if it effects a substantive change in a regulation. *See Int'l Internship Programs v. Napolitano*, 853 F. Supp. 2d 86 (D.D.C. 2012), *aff'd*, 718 F.3d 986 (D.C. Cir. 2013). An agency can bypass the small-entity analysis requirements in the RFA if the head of the agency certifies that the "rule will not, if promulgated, have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(b). Failure to comply with one or more of the statutory requirements authorizes courts to take "corrective action consistent with" the RFA, "including, but not limited to (A) remanding the rule to the agency, and (B) deferring the enforcement of the rule against small entities" 5 U.S.C. § 611(a)(4).

Further, EPA published guidance to its rule writers in regards to RFA requirements clearly dictating that:

> [Y]ou should analyze who is subject to the requirements of the rule even if the rule is either not immediately enforceable or does not impose immediately applicable requirements on those subject to the rule. You should perform this analysis as long as you know (1) who will be regulated; and (2) what requirements will be imposed.[17]

Despite the fact the RFS explicitly states that it applies to "[e]ntities . . . involved with the . . . distribution and sale of transportation fuels, including gasoline and diesel fuel, or renewable fuels such as ethanol and biodiesel,"[18] EPA never did any analysis whatsoever on the effects of the RFS and the point of obligation on small retailers, in any version of the rule from 2010 through 2017. It's not that EPA's analysis is insufficient; it is non-existent. This failure to even consider the significant economic impacts on small retailers is a procedural deficiency, which—as a defect in the flexibility analyses—is a sufficient basis for a court to strike down the rule.[19]

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[17] EPA, FINAL GUIDANCE FOR EPA RULEWRITERS: RFA AS AMENDED BY THE SBREFA, at 13 (Nov. 30, 2006), https://www.epa.gov/sites/production/files/2015-06/documents/guidance-regflexact.pdf.

[18] 75 Fed. Reg. at 14,670; 81 Fed. Reg. 89,746, 89,746 (Dec. 12, 2016); *see also* 42 U.S.C. § 7545(o)(2)(A)(iii) ("[R]egulations promulgated under [the RFS] . . . shall contain compliance provisions applicable to refineries, blenders, *distributors*, and importers, as appropriate." (emphasis added)).

[19] *See, e.g.*, *Aeronautical Repair Station Ass'n, Inc. v. F.A.A.*, 494 F.3d 161 (D.C. Cir. 2007); *Nat'l Ass'n of Home Builders v. U.S. Army Corps of Engineers*, 417 F.3d 1272 (D.C. Cir. 2005) (resolved by partial consent judgment); *Thompson v. Clark*, 741 F.2d 401 (D.C. Cir. 1984); *Nw. Min. Ass'n v. Babbitt*, 5 F. Supp. 2d 9 (D.D.C. 1998); *S. Offshore Fishing Ass'n v. Daley*, 995 F. Supp. 1411 (M.D. Fla. 1998).

Failure of EPA to even consider the impacts of the point of obligation on retailers in the 2017 Final Rule is particularly egregious because EPA states:

> The final standards are expected to continue driving the market to overcome ***constraints in renewable fuel distribution infrastructure***, which in turn is expected to lead to substantial growth over time in the production and use of renewable fuels.[20]

How can a rule that does not even consider the impacts on gasoline retailers adequately address constraints in distribution? How can a rule that doesn't take into account that the point of obligation is closing tens of thousands of retail outlets every year, "lead to substantial growth over time in the … use of renewable fuels?"

EPA's compliance with the RFA is subject to judicial review in connection with EPA's failure to consider the economic impact of the point of obligation on small retailers in EPA's rulemaking under the RFS.[21] Under section 611 of the RFA, "a small entity that is adversely affected or aggrieved by final agency action is entitled to judicial review of agency compliance with the [RFA] requirements." 5 U.S.C. § 611(a)(1). Since the promulgation of regulatory amendments to the RFS in 2010 to issuing the 2017 Final Rule, EPA has repeatedly failed to satisfy its statutory obligation to consider the impact of its regulatory proposals on small petroleum retailers and to analyze regulatory alternatives that can achieve the RFS's goal while minimizing the burden on small petroleum retailers. *See id.* §§ 603(a)–(c), 604(a)–(c). As such, unless EPA takes action to move the point of obligation to the rack as a regulatory alternative, the SRC will file action for judicial review.

EPA failed to perform nondiscretionary duties under the CAA

The RFS program was intended to drive the market towards greater volumes of renewable fuels available in the marketplace, not to drive small- and medium-sized retailers out of business. Through the RFS program, Congress mandated the introduction of increasing volumes of renewable fuel into the national pool of transportation fuel. CAA § 211(o)(2)(A)(i). EPA unequivocally embraces this goal: "the fundamental objective of the RFS provisions under the CAA is clear: To increase the use of renewable fuel in the U.S. transportation system every year through at least 2022 in order to reduce greenhouse gases (GHGs) and increase energy security."[22] EPA must implement the mandates of the CAA—including the continuing duties the statute imposes—consistent with this objective.

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[20] 81 Fed. Reg. 89,746 (Dec. 12, 2016).

[21] EPA itself has stated that it recognizes that "in any rulemaking to modify the RFS point of obligation, EPA would need to consider the impacts on small entities, as it did in prior rulemakings." Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation, at 43 (Nov. 10, 2016), https://www.epa.gov/sites/production/files/2016-11/documents/420d16004.pdf.

[22] 80 Fed. Reg. 77,419, 77,421 (Dec. 14, 2015).

EPA, however, has failed to consider and address through rulemaking its determination of the appropriate party obligated to satisfy the RFS volumes, and its impact on the distribution of renewable fuels. In its current form, the point of obligation itself functions as a constraint on distribution and produces an unjustifiable and disproportionate adverse economic impact to small retailers.

Specifically, EPA has failed under the Act to perform these non-discretionary duties, which relate to defining the obligated party for Renewable Fuel Standards ("RFS"):

1. To "conduct periodic reviews of . . . the feasibility of achieving compliance with the requirements" and "the impacts of the requirements . . . on each individual and entity" regulated under the RFS. 42 U.S.C. § 7545(o)(11).

2. To evaluate and adjust annually the regulations implementing the RFS program to ensure that it regulates the "appropriate" parties. 42 U.S.C. §§ 7545(o)(2)(A)(iii), (o)(3)(B)(ii).

Under the CAA and EPA rules, the Agency must complete these duties within sufficient time to publish a final rule every November. 42 U.S.C. § 7545(o)(3)(B)(i); 40 C.F.R. § 80.1405(b).

EPA action is necessary to remedy the dysfunctional renewable fuels market and to ensure the survival of small, independent petroleum retailers. By failing to consider the effect of an improperly placed point of obligation on fuel distribution, EPA all but ensures the death of small petroleum retailers in addition to perpetuating the renewable fuel supply constraints it seeks to remedy.

SRC members are harmed

SRC members are directly and indirectly harmed by EPA's failure to fulfill its statutory duties. The market inefficiencies associated with the misplaced point of obligation have created a multi-billion dollar financial windfall for large retailers that control the vast majority of blending terminals across the country. Moreover, the market inefficiencies created by the dysfunctional RIN market effectively undermine the CAA's goal of increasing the distribution of renewable fuels across the country. To remedy these deficiencies, a change in the point of obligation is necessary. This change is within EPA's authority to correct.

Person Providing Notice

As required by 40 C.F.R. § 54.3, the person providing this notice is:

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SRC would prefer not to resort to litigation to resolve the allegations set forth in this letter. The dire economic situation created by the current misalignment of the point of obligation, however, has left SRC no choice but to pursue all available legal remedies. We are available to discuss SRC's views on the appropriate placement of the point of obligation any time that is convenient for you. Please do not hesitate to contact me should you have any questions.

Sincerely,

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American Oversight v. EPA (18-cv-00364) ED_001686C_00001080-00009

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