

The EPA's New Biofuels Plan And A Residue Of Uncertainty

By Joel Beauvais and Steven Croley (July 2, 2018, 2:07 PM EDT)

On June 26, the U.S. Environmental Protection Agency issued its long-awaited proposal concerning the next round of annual volume requirements under the Renewable Fuel Standard, or RFS — including requirements for 2019 for cellulosic biofuel, advanced biofuel, and total renewable fuel and requirements for 2020 for biomass-based diesel, or BBD. The proposed rule calls for a 490 million gallon increase in the advanced biofuel and total renewable fuel requirements for 2019, and a 330 million gallon increase in BBD for 2020.

While the proposal generally indicates stability and growth for the RFS program, several unresolved issues leave a residue of uncertainty. In particular, the proposal does not address certain controversial proposals discussed in recent months — including eliminating summertime limits on use of E15, reassigning to large refiners mandates that have been waived for small refineries, or changing rules for biofuels exports. Meanwhile, in the proposal, the EPA also requests input on potential restrictions on trading of renewable identification numbers, or RINs, the credits used to demonstrate compliance with the RFS. This is an issue of critical importance for fuel producers, banks and other participants in renewable fuel markets and is likely to attract significant attention. This article discusses the central issues raised by the proposal and their implications for the RFS program more broadly.

2019-2020 Proposal Overview

The RFS statute sets volume targets for incorporation of four different categories of biofuels into transportation fuels (cellulosic, advanced, BBD and total renewable fuel). Each year, the EPA must issue a rule implementing these targets for the following calendar year (or two years in advance in the case of BBD). And every year since the current program's inception, the EPA has adjusted one or more of the volume targets through the use of its statutory waiver authorities. Whether a particular biofuel qualifies for a given renewable fuel category is determined by the feedstock, fuel type and/or "life cycle" greenhouse gas emissions attributed to production and use of the fuel. The annual mandates for the four fuel categories are "nested": Cellulosic biofuel and BBD are subcategories of advanced biofuels, and all three of these fuel types (together with conventional corn ethanol) fall within the overall category of total renewable fuel.



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The 2019-2020 proposed rule for the RFS' four biofuel categories is summarized as follows:

	2018	2019 Statutory Volumes	2019 Proposed Volumes	2020 Proposed Volumes
Cellulosic biofuel (million gallons)	288	8,500	381	N/A
BBD (billion gallons)	2.1	≥1.0	2.1	2.43
Advanced biofuel (billion gallons)	4.29	13.00	4.88	N/A
Total renewable fuel (billion gallons)	19.29	28.00	19.88	N/A

(All values ethanol-equivalent on an energy content basis, except BBD, which is biodiesel equivalent. The 2019 BBD volume was finalized in a prior rulemaking.)

The EPA sets cellulosic volumes based on its projection of how much qualifying fuel will be produced for the coming year. For 2019, the EPA is calling for 381 million gallons of cellulosic — a 93 million gallon increase from 2018, but still far below the 8.5 billion gallon statutory target. The 2019 proposal is based primarily on projected growth in compressed natural gas/liquid natural gas, or CNG/LNG, from biogas, which has grown in recent years by over 30 percent annually and accounts for 94 percent of the proposed mandate.

The RFS statute includes a “cellulosic waiver” authority, which allows the EPA to reduce statutory volumes for total renewable fuel and advanced biofuels by the same or lesser amount as it reduces cellulosic in any given year. For 2019, the EPA is proposing to use this authority to reduce total renewable fuel and advanced biofuel requirements by the same amount that it is proposing to reduce the cellulosic requirement — an 8.1 billion gallon cut. (The U.S. Court of Appeals for the D.C. Circuit has consistently upheld the EPA’s exercise of its cellulosic waiver authority in past rules.) The result is a proposed 590 million gallon increase in both the advanced biofuel and total renewable fuels mandates relative to 2018. This yields an “implied” conventional biofuel (largely corn ethanol) volume of 15 billion gallons — calculated by subtracting the advanced biofuel requirement from the total renewable fuel requirement.

Finally, the EPA is proposing to set the 2020 BBD standard at 2.43 billion gallons, an increase of 330 million gallons relative to 2019. The EPA suggests that there may be some challenge in achieving the large increase in the proposed 2019 advanced biofuel mandate — most of which is expected to be satisfied with BBD production and imports. The proposal highlights the fact that Congress has not yet extended the biodiesel tax credit to 2018 (let alone to 2019), as well as the U.S. Department of Commerce’s decision to impose tariffs on biodiesel imports from Argentina and Indonesia and the potential that those tariffs may increase.

Small Refinery Waivers

Over the past year, there has been extensive controversy regarding the EPA's recent use of its authority to exempt "small" refineries from RFS mandates, based on a showing that they will suffer disproportionate economic harm if required to comply. In the proposed rule, the agency provides new information on the implications of its small-refinery waivers for 2016 and 2017. Specifically, the EPA identifies 1460 million RINs that were not required to be retired for 2017 and 790 million RINs for 2016. These are in addition to roughly 330 million RINs that the EPA will not require a Philadelphia-area merchant refinery to retire for 2017, as a result of a bankruptcy settlement. All told, these actions reduced RFS requirements by more than 2.5 billion RINs cumulatively for 2016 and 2017. Farm state senators have sent multiple letters to EPA Administrator Scott Pruitt stating their opposition to use of the small-refinery waivers, and biofuels trade associations have challenged the waivers in two lawsuits.

In response to this pressure, it was widely reported that the EPA was considering reallocating the obligations that were waived for small refineries — by requiring large refineries and importers to instead shoulder the burden. This proposed reallocation met with fierce opposition from large refiner owners, who argued that the EPA lacks legal authority to make such a reallocation. Notably, the proposed rule does not include any reallocation. In fact, the EPA expressly states that it has not yet granted any exemptions for 2019 but "is maintaining its approach that any exemptions for 2018 that are granted after the final rule is released will not be reflected" in the final 2019 standards. This proposal is sure to be the subject of comment and vigorous stakeholder debate.

RIN Market Trading Limits and Transparency Measures

The EPA proposed rule also states that the agency is considering potential changes to the RFS regulations to minimize or eliminate potential manipulation of the RIN market. Specifically, the EPA is considering "prohibiting parties other than obligated parties from purchasing separated RINs; requiring public disclosure if a party holds a certain percentage of the RIN market; and/or requiring obligated parties to retire RINs for compliance purposes on a more frequent basis (e.g., requiring monthly compliance)." The agency requests comment on the potential impacts of such changes, emphasizing that it is not proposing regulatory changes at this time. If the agency decides to move forward with any of these ideas, it would do so in a separate rulemaking. These issues are of significant concern to stakeholders that buy, sell or hold RINs — including fuel refiners and importers, banks, and other entities that trade in RINs.

What Is Not Addressed in the Proposal?

Importantly, the EPA's proposed rule is conspicuously silent on several other issues that could substantially affect biofuels markets.

First, the proposal does not address whether the EPA will seek to lift restrictions on summertime use of E15 (fuel that is greater than 10 percent and up to 15 percent ethanol by volume). Under the EPA's current regulations to control gasoline volatility, E15 cannot be sold during the summertime ozone season in most of the U.S. That is based on the EPA's long-standing view that the Clean Air Act allows waivers from summertime restrictions only for E10 and not E15. President Donald Trump has stated, however, that the EPA will "probably" change that interpretation — a move that would increase ethanol demand, but would likely be challenged in court by fossil fuel producers. It remains to be seen whether the EPA will move forward on this, and the 2019-2020 proposal is silent on this issue.

Second, the proposal says nothing about changing how exported biofuels are treated under the RFS regulations. Under current regulations, biofuels exporters are required to retire any RINs associated with such fuels — based on the principle that RFS requirements are intended to drive domestic consumption of biofuels. If RINs were not retired for exported fuels, this would have the practical effect of reducing the stringency of RFS requirements. Last year, the EPA floated the possibility that it might revise its regulations on this point, but later backtracked in the face of strong opposition from biofuels stakeholders and farm state senators. Media outlets have reported that the EPA was again considering this policy change, but the 2019-2020 proposal does not address it.

Third, the proposal does not mention the pending “reset” rulemaking for 2020 or later years. Under the RFS statute, the EPA is required to undertake a rulemaking to reset statutory volumes for a renewable fuel category if the agency waives the statutory volume for that category by at least 20 percent two years in a row. The law requires the EPA to reset the volumes based on consideration of six broad factors, including impacts on the environment, energy security, infrastructure, consumers and the economy. This requirement was triggered for all fuel categories by the 2017-2018 annual rule. In that rule, the EPA stated that staff had been directed to begin preparations for a reset rulemaking. Yet the 2019-2020 rule does not address the reset at all. And the Spring 2018 Regulatory Agenda — through which the White House Office of Management and Budget publicizes the administration’s plans for upcoming rulemakings — does not include an entry for a reset rulemaking. If and when the EPA takes up this rulemaking, it could have substantial consequences for the RFS program for years to come.

Finally, the EPA notes in the proposal that it has yet to decide how it will address the decision in *Americans for Clean Energy v. EPA*, the 2017 decision of the D.C. Circuit that struck down the agency’s exercise of its “general waiver” authority to reduce 2016 volumes of total renewable fuel and advanced biofuels. That issue, too, will presumably be addressed in a future rulemaking.

Conclusion

While the EPA’s proposed RFS rule itself signals stability and growth for biofuels mandates, the unresolved issues discussed above make for continued uncertainty concerning the larger administration of the RFS program. The EPA’s handling of small-refinery waivers in particular appears to be exerting significant downward pressure on RIN prices, and continues to generate controversy. If the past year is any indication, the RFS program will see a number of important twists and turns over the coming months.

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