Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Big Changes Ahead For Renewable Fuel Standard

By **Joel Beauvais and Steven Croley** (April 23, 2018, 11:54 AM EDT)

Joel Beauvais

Steven Croley

The Renewable Fuel Standard, or RFS, has been the focus of sustained policy discussion and resulting uncertainty during the first year of the Trump administration. Over the past year, the administration has floated, and then set aside, several proposals for substantial policy change. The administration has also granted RFS exemptions to a substantial number of small refineries, dampening demand for the tradable credits known as renewable identification numbers, or RINs — which represent production of renewable fuels and are used to demonstrate compliance with RFS requirements — and RIN prices have decreased from approximately $1 in November 2017 to about $0.34 today. The administration meanwhile is conducting high-level policy discussions and considering a number of potential other changes, including allowing sales of E15 (gasoline that is 10 to 15 percent ethanol by volume) during summer months, currently prohibited in most areas of the country.

In this article, we analyze such developments, with a focus on the legal framework and implications for the RFS program writ large. Our forecast for the remainder of 2018 is continued uncertainty.

Recapping the First Year of the Trump Administration

During 2017, the Trump administration explored several potential changes to the RFS program, including moving the "point of obligation" for compliance with the program from refiners and importers to blenders or distributors; eliminating the requirement that renewable fuel exporters retire RFS credits (which would have the effect of increasing credit supply and reducing RIN prices); and broadening the U.S. Environmental Protection Agency's reading of its authorities to waive renewable fuel volume requirements.

These proposals ultimately were tabled, however, primarily in response to strong opposition from biofuels and agricultural interests, as well as from farm-state senators. The EPA's rule setting 2018 volumes for renewable fuels (and 2019 volumes for biomass-based diesel), finalized last November, thus largely continued the status quo. Yet the push for policy reform continues. Accordingly, during the past several months the president, White House and agency officials, and key senators have participated in high-level policy discussions. And the EPA reportedly is considering a number of potential regulatory changes, several of which are discussed below.

Small Refinery Waivers

As these discussions have progressed, the EPA reportedly has granted RFS exemptions to a substantial number of small refineries, with noticeable cumulative impacts on the overall program. Under the RFS statute, "small refineries" — defined as those with a crude oil throughput of 75,000 barrels per day or less — were originally exempted from the program's requirements through 2010. The statute required the U.S. Department of Energy to assess whether the program would thereafter impose a disproportionate economic hardship on such refineries. In 2009, the DOE concluded that small refineries could satisfy compliance obligations through the purchase of RINs and would not be disproportionately disadvantaged, such that the exemption should not be extended beyond 2010. Later that year, however, Congress directed the DOE to revisit the issue with greater focus on regional and individual refinery impacts. The DOE completed a new study in 2011, concluding that 13 of the 59 small refineries otherwise subject to the RFS would suffer disproportionate economic hardship if required to comply with the program. The EPA then extended the exemption for these refineries as a group for an additional two years, through 2012.

All that is instructive history. The waivers currently in the news involve the EPA's authority to issue case-by-case exemptions to individual small refineries in response to requests from owner/operators. For under the RFS statute, small refinery owner/operators still can petition the EPA "at any time" for an "extension" of the exemption from the RFS program based on disproportionate economic hardship. In evaluating such requests, the EPA must consult with the DOE and must consider the findings of the 2011 DOE study together with "other economic factors." The agency is required to take action on a petition within 90 days of receiving it. The EPA promulgated regulations governing waiver petitions in 2010 and updated them in 2014.

Importantly, neither the RFS statute nor the EPA's regulations define "disproportionate economic hardship." The DOE's 2011 study, however, established a scoring matrix to assess hardship. This approach incorporates multiple metrics addressing two overall components — whether the refinery faces high costs of compliance relative to the industry average, and whether the program's impacts would significantly impair refinery operations. In October 2017, the Tenth Circuit in Sinclair Wyoming Refining Co. v. EPA[1], vacated the EPA's denial (contrary to the DOE's recommendations) of two small refinery waiver petitions. The court held that the EPA had exceeded its statutory authority by requiring the refineries to show that compliance with the RFS program would threaten their long-term viability. The court found that "hardship" means something less than threat of closure, and that "comparative economic hardship" required an evaluation of hardship relative to the economic state of other refineries. In Hermes Consolidated LLC v. EPA[2] and Lion Oil Company v. EPA[3], by contrast, the D.C. Circuit and the Eighth Circuit upheld the EPA's denials of small refinery exemptions, and thus the boundaries of the EPA's discretion in individual waiver cases remains somewhat unclear.

Because the EPA does not provide notice and comment or other public participation in deciding small refinery waiver petitions, nor does it publish the petitions or final decisions, there is little public information in this area. Recent reports indicate, however, that the EPA granted 25 such waivers for 2016 — equivalent to more than 500 million RINs — and that some 30 petitions for 2017 are now pending at the agency. The media also has reported that the EPA has granted waivers for small refineries owned by one of the largest refining companies in the country, and that petitions from several oil and gas "majors" are now before the agency. Biofuel producers have expressed strong opposition to such waivers, and a group of farm-state senators recently wrote the EPA to express their concern and request information on the waivers. In testimony before Congress, Secretary of Agriculture Sonny

Perdue characterized the waivers as “demand destruction” and stated that the U.S. Department of Agriculture also has requested information from the EPA.

Some back-of-the-envelope calculations give a rough sense of the potential scope of small refinery exemptions. According to the Energy Information Administration, or EIA, there were 141 operable refineries in the United States as of Jan. 1, 2017 — among which, at least 57 had an operable capacity of 75,000 barrels per day or less. The total operable capacity of these smaller refineries is more than 2 million barrels per day (more than 3 billion gallons per year), which is about 10 percent of the operable capacity of all U.S. refineries. In short, small refineries represent a significant percentage of total refinery capacity and thus of RIN demand.

Whether or not the recent waiver decisions will lead to litigation is not yet clear. The cases cited above involved challenges by small refinery owner/operators to EPA denials of waiver petitions; there are no reported cases involving third-party challenge to an EPA grant of an exemption.

“Severe Economic Harm” Waiver Requests and Related Issues

Meanwhile, from November 2017 through January 2018, the governors of Pennsylvania, New Mexico, Texas and Delaware submitted petitions requesting that the EPA waive RFS requirements for 2017 and 2018 somewhat more globally, on the grounds that the program will severely harm the economy of a state, region or the United States. The RFS statute requires that the EPA approve or deny these petitions within 90 days of receipt. In January and February 2018, however, the EPA sent letters to each of the governors suggesting that they resubmit their petitions with additional supporting information, after which the EPA would treat the petitions as “complete” and respond. It remains to be seen how the states will react. Separately, the EPA recently proposed to enter a consent decree and settlement agreement with a (nonsmall) merchant refinery now in Chapter 11 bankruptcy, excusing the refinery from compliance with RFS obligations equivalent to 329 million RINs for 2016 and 2017.

Year-Round E15 Waiver

At the same time, the administration is contemplating another action that would increase demand for renewable fuels. At an April 12 meeting with farm-state senators, President Donald Trump said that the administration would “probably” move to allow year-round sales of E15. This step has been under consideration since last summer and would require reversing the EPA’s prior interpretation of governing law.

Understanding the E15 waiver issue requires a quick tour through some of the details s of the Clean Air Act’s fuels requirements. To help mitigate ground-level ozone pollution, CAA Section 211(h)(1) requires the EPA to limit evaporative emissions from gasoline during the “high-ozone season,” which the agency has defined as June 1 through September 15, when higher temperatures increase evaporation. Evaporative emissions are measured by Reid Vapor Pressure (RVP), expressed in pounds per square inch (psi). During the summer months, the CAA limits RVP of fuels to 9.0 psi for areas attaining the national ambient air quality standards for ozone, and a lower level (generally set by the EPA at 7.8 psi) for areas not attaining the standards. CAA Section 211(h)(4), however, provides a 1.0 psi waiver for “fuel blends containing gasoline and 10 percent denatured anhydrous ethanol” — meaning the RVP of such fuels can be 1.0 psi higher than otherwise required. Under EPA regulations, fuels with 9-10 percent ethanol by volume (E10) are eligible for this 1.0 psi waiver. Section 211(h)(4) also says that an entity generally will be “deemed to be in full compliance” with Section 211(h) if certain conditions are met, including that “the ethanol portion of the blend does not exceed its waiver condition under” CAA Section 211(f)(4).

That brings us to CAA Section 211(f). Although Section 211(f)(1) prohibits the use of fuels or additives that are not “substantially similar” to fuels used in certifying new motor vehicles and engines, Section 211(f)(4) authorizes the EPA to waive this prohibition if it determines that the fuel or additive “will not cause or contribute to a failure of any emission control device or system” to achieve applicable standards. By virtue of a provision that has since been amended, E10 has had a waiver since 1979. In 2010 and 2011, the EPA provided partial waivers that allow E15 to be used in model year 2001 and newer vehicles, provided certain requirements were met to avoid misfueling and to ensure fuel quality.

Importantly, in adopting its E15 misfueling regulation, the EPA specifically rejected a request to extend the 1.0 psi waiver to E15. The 2011 misfueling rule preamble includes a lengthy discussion of the EPA’s view that the relevant CAA provisions preclude extension of the 1.0 psi waiver to fuels other than E10. Now for the punchline: The lack of a 1.0 psi waiver for E15 bars summertime sales of E15 in most of the country. Eliminating that bar could very well boost demand for ethanol, though it could also reduce RIN prices inasmuch as there would be more opportunity to to blend renewable fuel in order to satisfy RFS obligations.

To reverse the EPA’s prior interpretation of the statute to allow year-round sales of E15 would presumably require a new notice-and-comment rulemaking, and that change would almost certainly be challenged in court. Trade associations representing fossil fuel interests have already stated their strong opposition to the proposal.

What’s Next?

The EPA reportedly is considering still other policy changes. These include, for example, whether to prohibit entities such as financial services companies that are not “obligated parties” under the RFS from trading RINs — a move some stakeholders assert would reduce RIN prices and volatility by limiting “speculation.” Here again, any such change would require a notice-and-comment rulemaking, would raise complex implementation issues, and could be consequential for RIN market participants.

In addition, the EPA has also announced that it is preparing to undertake a rulemaking to “reset” renewable fuel volumes for future years. The RFS statute requires the agency to do this, because the EPA has waived renewable fuel volumes by more than 20 percent in two successive years, triggering by statute a reset. The administration’s forthcoming Spring Unified Regulatory Agenda may indicate the potential time frame for this rulemaking, which could have a significant impact indeed on the implementation of the RFS program.

How any of the above will be resolved remains to be seen. It is clear that the RFS program will see continued policy focus, potential regulatory change and resulting litigation and, in the meantime, continued uncertainty in the RIN markets in 2018 and beyond.

Joel C. Beauvais and Steven Croley are partners at Latham & Watkins LLP in Washington, D.C. Beauvais is a member of the firm's environment, land and resources (ELR) department, and Croley is a member of both the ELR and litigation and trial departments. Beauvais previously served as deputy assistant administrator for water at the EPA. Croley previously served as general counsel for the U.S. Department of Energy and as deputy White House counsel for President Barack Obama.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Sinclair Wyoming Refining Co. v. EPA, 2017 WL 8785563 (10th Cir. 2017).

[2] Hermes Consolidated LLC v. EPA, 787 F.3d 568 (D.C. Cir. 2015).

[3] Lion Oil Company v. EPA, 792 F.3d 978 (8th Cir. 2015).