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Deal-Making on the RFS: Follow the North Star

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With a flurry of negotiations and political conflict, the Renewable Fuel Standard (RFS) squeezed its way into the national news cycles of recent weeks (Kopperud, February 23, 2018; Renshaw, February 27, 2018; *farmdoc daily*, February 28, 2018).The key issue for negotiations is likely to involve questions about what actions can be taken by EPA administratively and what actions would require an act of the U.S. Congress.

According to news reports, the negotiations are considering multiple options: (1) count U.S. ethanol exports toward the annual requirements; (2) institute a price cap on RIN prices; (3) limit RIN trades to blenders and refiners, removing market speculation; and (4) waive the limits on blending E15 (15% ethanol content in gasoline). In addition to these four options, two others that might be in consideration involve waiving requirements for specific refineries, such as small refineries. Given the attention around the bankruptcy of the refiner Philadelphia Energy Solutions, Inc. (PES), there may also be an attempt to waive the requirements for it.

Since Congress created the RFS in 2005 and expanded it substantially in 2007, the statute and its mandates on the transportation fuels industry have been extensively litigated. For the negotiations, the numerous court decisions help provide plenty of legal guidance on the statute. Those court decisions, however, leave very little room for negotiators to make changes outside of revising the statute through an act of Congress.

Clear Guidance from the Courts: Follow the North Star of the RFS

Any analysis about negotiating modifications to the RFS must begin and end with the very clear direction provided by courts thus far. The RFS was designed by Congress to be a market forcing policy that would create demand for renewable fuels through the mandates for increasing consumption; the north star of the RFS, it must guide all EPA implementation decisions (*farmdoc daily*, August 18, 2017; October 5, 2017). Accordingly, any of the options being negotiated that would operate to reduce demand, decrease consumption of renewable fuels, or that otherwise conflicts with the market-forcing intent of Congress, would be in violation of the statute and would likely not hold up in court.

(1) Count ethanol exports toward annual requirements

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It would not appear that the RFS statute permits this revision because the statute is very clearly intended only for mandates on domestic transportation fuels. Specifically, the general requirements are for implementation that will "ensure that gasoline sold or introduced into commerce in the United States, on an annual average basis, contains the applicable volume of renewable fuel" in the statutory schedule (42 U.S.C. §7545(o)(2)). The statute, in fact, contains numerous uses of the phrase "sold or introduced into commerce in the United States" but provides no authority for addressing exports of renewable fuel. It is difficult to conclude that the statute permits any use of exports to meet the mandated requirements, especially if doing so would reduce the demand for renewable fuel domestically or conflict with the market-forcing intent of the statute.

(2) Institute a RIN price cap

As discussed previously, implementing a cap on RIN prices would operate as a waiver of the volume mandate, reducing the levels in the statute (*farmdoc daily*, December 21, 2017). EPA's waiver authority to reduce the RFS mandates is limited (except for cellulosic ethanol) and does not provide for an effective waiver through capping RIN prices. In terms of general waiver authority, EPA can waive the total RFS mandated volumes if implementation of the mandate will cause severe economic harm (*farmdoc daily*, October 12, 2017). Or, EPA can waive the RFS volumes if there is inadequate domestic supply of renewable fuel to meet the mandate but that phrase only includes factors that impact the availability of renewable fuel to refiners, blenders and importers; it does not include downstream factors or consumers (*farmdoc daily*, August 18, 2017; October 5, 2017; January 14, 2016). For the general waiver authority, the guidance from the courts is considerable and clear: there is no legitimate cause for direct waiver of any portion of the RFS outside of the explicit authorities. Because a cap on RINs prices operates as a waiver by other means, it also must adhere to this guidance.

Additionally, if a RIN price cap operates against biomass-based diesel as an effective waiver it is likely not permissible. The biomass-based diesel volumes can be waived if there is a significant disruption of feedstock or other market problem that causes biomass-based diesel prices to spike significantly (*farmdoc daily*, October 19, 2017). Following the guidance from the courts on the general waiver provisions, a cap on RIN prices that impacts only biomass-based diesel is also not likely to survive a court challenge because it operates fundamentally as a waiver on RFS volumes by other means; a waiver not explicitly granted in the RFS statutes is impermissible.

(3) Limit RIN trades to blenders and refiners

Under the statute, this limit might be acceptable. The RIN credit program applies to "any person that refines, blends, or imports gasoline" and explicitly permits the person generating a RIN to "use the credits, or transfer all or a portion of the credits to another person, for the purpose of complying" with the statutory mandates (42 U.S.C. §7545(o)(5)). As such, there does not appear to be any explicit limitation on the ability to restrict RIN trades to those parties listed in the statute. Any question about such a limit would then fall to the analysis above regarding its impact on the market-forcing intention of the statute. If such a revision did not harm that intent, it could well pass muster with the courts.

The economic effects of limiting RIN trading to blenders and refiners is uncertain. If one assumes that the current RIN market is inefficient and prone to manipulation and speculative excess, then limiting trading to only those directly obligated by the RFS may improve the efficiency of price discovery in this market. However, it is far from certain that this is an accurate description of the RINs market. In fact, there is evidence that the RIN market is a quite rational price discovery mechanism (*farmdoc daily*, August 23, 2017). If the current market is indeed an efficient mechanism, then limiting participation could easily make the market less liquid and prices even more volatile.

(4) Waive limits on E15

Under the RFS, there are no provisions that explicitly address this issue. The Reid Vapor Pressure (RVP) provisions are in a previous section of the statute (42 U.S.C. §7545(h)). In general, RVP measures volatility of gasoline and the lower the RVP the less volatile it is (Bracmort, 2017). The Clean Air Act (CAA) prohibits the sale of gasoline in the lower 48 states during the high ozone months of summer (June 1-Sept. 15) that is above 9 pounds per square inch (psi) because of volatility. The provision above, however, permits gasoline containing 10 percent ethanol to be sold at an RVP that is 1 psi above the limit (e.g., 10 psi) unless a governor of a state petitions and EPA finds that the higher limitation will increase air pollution in any area of the state.

Notably, EPA has previously granted partial waivers for E15 under the existing CAA provisions for automobiles manufactured after 2001 (EPA, E15 Fuel Partial Waivers). EPA has interpreted the CAA provisions to apply the 1 psi ethanol waiver only to E10 blends, leaving it discretion for RVP on other blends including E15 (EPA 2011). From the perspective of the RFS statute, the analysis is more straightforward. If changes to the RVP limitations works to increase demand for renewable fuels it would not be prohibited by the RFS provisions (*farmdoc daily*, February 28, 2018).

(5) Waivers for Small Refiners

Providing for small or specific refineries raise slightly different issues. In terms of small refineries (below 75,000 barrels of annual throughput), the RFS statute provided temporary exemptions from the mandate. It also provided EPA authority to extend the previous exemptions upon petition from the refinery that it would be subject to disproportionate economic hardship to the petitioning refinery. A recent court decision on this requires that EPA be reasonable and not create too high of a hurdle; it must not make the refinery's viability a necessary component for an exemption (*farmdoc daily*, December 6, 2017).

The challenge for this provision comes in the extent of its usage. Generally, EPA has to consider individual petitions from small refineries for an extension of the exemption from the mandate based on a finding of disproportionate economic hardship. An existing Department of Energy matrix and recommendations appear to carry significant weight in this decision. The statute and court decision indicate that the waiver decision requires an individualized evaluation of the economic hardship for each small refinery.

It remains uncertain how broad this authority for EPA can be interpreted. Specifically, an expansive interpretation might permit an effective backdoor waiver to the mandates if EPA were to exempt all small refineries in a year after having established volumes. Exempting all small refineries would effectively waive their portion of the mandate in that year. This is, however, likely to be limited to a single use because EPA would have to incorporate expectations for that blanket exemption extension in future years, shifting the small refinery mandates to larger refineries. It is hard to imagine a court permitting EPA to continue a blanket exemption policy without accounting for it; doing so would violate basic tenets of good faith, drifting into the realm of arbitrary and capricious rulemaking by the agency.

(6) Waivers for PES or Other Refiners

Finally, the PES bankruptcy raises the potential that negotiators or EPA might look to waive the requirements for that specific refinery. The RFS statute does not provide for individualized refinery waivers outside of the small refinery exemption provisions. Lacking explicit authority to waive requirements for individual large refineries, any analysis returns again to the north star of the statute. If EPA's decisions have the effect of reducing demand or usage, then they are likely to be found by a court to violate the market-forcing intent of the statute. This same reasoning would also seem to apply to any attempts to waive requirements for individual refineries such as PES. It is unknown at this time, however, what arguments would be used for such a waiver, nor is there clear guidance on the treatment of a bankrupt refinery. If this becomes a significant point in the negotiations, further analysis will be necessary.

Concluding Thoughts

Controversy continues to surround the RFS. Negotiators, however, have limited options in front of them to resolve the disputes administratively. Courts have not granted EPA expansive definitions of its authorities under the statute, requiring it instead to adhere to the primary market-forcing intent of Congress. This is the north star of the RFS and must guide EPA's interpretations of the statute and actions implementing it; it should also guide negotiators. At its core, this is rooted in a fundamental principle of lawmaking under the Constitution (*farmdoc daily*, January 16, 2014). It is therefore likely that any significant changes to the RFS would have to come from Congress via legislation that amends the statute.

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