EPA renewable fuel shift may increase cost of compliance

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Renewable Identification Numbers (RINs) are the "compliance currency" for refiners and importers of gasoline and diesel fuel.\(^1\) RIN compliance efforts are costly in themselves,\(^2\) but noncompliance is too. A non-compliant company is subject to civil penalties which could feasibly run up to $47,357 a day.\(^3\) Non-compliance may also require that company to return any economic benefits that resulted from its non-compliance.\(^4\)

Given these stakes, those required to retire RINs should understand not only what RINs are but also how they relate to compliance. This understanding can also be useful to others, such as those interested in trading RINs, because the way compliance is determined can affect RIN prices.

Accordingly, this article is an introductory discussion on (a) what are RINs, (b) how are they priced, and (c) how EPA's 2020 rules may affect compliance costs.

1. What are RINs?

Generally, a RIN is a number that attaches to a batch of renewable fuels.\(^5\) RINs function as receipts that can either be retired by their generator or traded to a third party.\(^6\) This third party can itself either retire the RIN or trade it to another. But not just anyone can generate a RIN, not just anyone can trade a RIN, and not just anyone can be credited with retiring a RIN.
RINs must be generated before they can be retired or traded. RINs can be generated in two ways: (1) a renewable fuel producer produces a batch of qualifying renewable fuel and assigns a RIN to this batch, or (2) an importer assigns a RIN to an imported batch. Once generated, the RIN becomes logged in EPA’s Moderated Transaction System (EMTS). Only RINs logged in this system may be retired or traded. RINs may also be separated from their underlying fuel and traded separately.

The separation process is regulated. A RIN can be separated by possessing the batch, blending it, or exporting it. Only the following can hold a separated RIN: obligated parties; renewable fuel exporters; renewable fuel producers; and registered RIN market participants. So, while not just any person can trade RINs, it is possible to become registered and to start.

Why RINs are regulated this way can be explained by placing them in a broader context.

RINs are used by EPA to measure an obligated party’s compliance with the Renewable Fuel Standard (RFS) program. Launched under the Energy Policy Act of 2005, the RFS requires a statutorily specified number of renewable fuels to be introduced into the United States every year. This volume is known as the national Renewable Volume Obligation (RVO). To satisfy the national RVO, EPA imposes individual RVOs on obligated parties. Individual RVOs are approximately equal to the percentage of gasoline and diesel fuel that the obligated party is expected to introduce into the United States during the coming year, as compared to other obligated parties. This concept is explained succulently in *Americans for Clean Energy v. EPA*.

EPA first determines the annual volume requirement...[which] represents the total volume of renewable fuel that must be sold or introduced into the Nation’s transportation fuel supply in a given year...After EPA determines the [renewable volume requirement]...it translates the volume requirement into percentage standards. The percentage standards inform each obligated party of how much renewable fuel it must introduce into U.S. commerce based on the volume of fossil-based gasoline or diesel it imports or produces. The percentage standards represent the percentage of transportation fuel introduced into commerce that must consist of renewable fuel. Once EPA issues a rule informing obligated parties (refiners and importers) of their renewable fuel obligations, it is up to the obligated parties to comply with the statute.

Each RIN counts towards the obligated party’s RVO, which in turn is made up of RVOs for each designated fuel. Designated fuels are cellulosic biofuel (D3/D7), biomass-based diesel (D4), advanced biofuel (D5), and renewable fuel (D6). Each obligated party’s RVO is satisfied when the party retires the appropriate number of RINs according to each category.

But the categories are nested: D3 and D4 fuels also qualify towards D5 counts, and D5 contributes towards D6 counts. The rule is organized this way because D3 and D4 have lower greenhouse gas lifecycles than corn starch ethanol, which is the primary source of D6 fuels. This reveals the RFS policy goal of increasing renewable fuels while decreasing greenhouse gas emissions.

Thus, RINs are both the compliance currency for climate control and also a systematic method to create demand for renewable fuels.

2. RIN pricing

RIN prices are heavily influenced by two factors: the blend wall and policy uncertainty.

a. Blend wall

A blend wall refers to the point at which the marketplace and existing infrastructure cannot practically accommodate more fuel with renewable content. In the United States, the blend wall occurs at 10 percent.

When the national RVO is set higher than the blend wall, RIN prices become volatile. This volatility may be explained by EPA’s statement that: “if the RIN market is functioning efficiently the RIN price should be approximately equal to the difference between a renewable fuel’s supply price and its demand price.” When the RVO is set higher than the blend wall, more ethanol is demanded. This increases its price and should also increase RIN prices for ethanol too. But this seems to suggest that RINs are an added cost of the underlying fuel.
Instead, RINs function more as a transfer payment than an added cost. Income from separated and sold RINs allows the blender to offer the customer a discount on higher blended fuel while decreasing the cost of producing this fuel. Inversely, the RIN purchaser is able to pass the price of the RIN onto the customer. Thus, as EPA notes, “[a]ll obligated parties, including merchant refiners, are generally able to recover the cost of the RINs they need for compliance with the RFS obligations through the cost of the gasoline and diesel fuel they produce.” This tends to suggest the price of a RIN may ultimately be negligible, which indeed EPA notes that it is under certain conditions.

But this analysis assumes that no party is exempt from its RIN requirement. Once some parties are exempt, the blended volume of fuel may still be above the blend wall, but it need not be. Ultimately when exemptions are granted, the number of RINs available for purchase means supply out paces demand, creating one more way to cause volatility in RIN pricing.

Still, the bottom line is that while conditions exist that make the price of the actual RIN negligible, which discounts the ability for the blend wall to affect RIN pricing, obligated parties must still retire enough RINs to satisfy their individual RVO, unless they are exempt. If they do not, as mentioned above, fines for non-compliance create an incentive to comply with the RFS.

b. Policy uncertainty

Policy uncertainty affects RIN pricing because EPA sets demand: EPA determines how many RINs must be retired each year. Even small changes to volume obligations affect RIN prices. And because RINs may be retired the year they are generated, or even the following, changes to future RVOs affect the present demand for RINs.

The RVO changes do not have to be permanent to affect RIN pricing. One study found that significant changes in the RIN market occurred after each of these three events: (1) EPA proposed reducing the following year’s obligation, (2) a news article leaked a draft of proposed cuts to the proposed rule, and (3) EPA released the final RVO. Therefore, uncertainty also affects RIN pricing because policy uncertainty destabilizes demand.

3. How recent developments may affect cost of compliance

EPA’s final rule for 2020 RVOs and its 2021 volume requirement for bio-based diesel largely adopts EPA’s July 2019 Proposal and Supplement for volume requirements and other policy positions. These other policy positions involve (1) how EPA calculates the national RVO; (2) controversy over small refinery exemptions (SREs); and (3) EPA’s stance on the Americans for Clean Energy v. EPA decision. The volume requirements and policy positions affect compliance costs by their relationship to the blend wall or by causing policy uncertainty.

The 2020 final volume for cellulosic biofuel is 560 million gallons, up from 418 million in 2019. The 2020 final volume for advanced biofuel is 5.09 billion gallons, up from 4.92 billion in 2019. The 2020 final volume for total renewable fuels is 20.09 billion gallons, up from 19.92 billion in 2019. Lastly, the 2021 final volume for bio-mass based diesel is 2.43 million gallons, which is the same as the final volume for 2020. With the final renewable fuel percentage set at 11.56 percent, these volumes exceed the blend wall, which will likely increase compliance costs. But compliance costs also increases because of policy uncertainty with how RVOs are calculated.

Beginning in 2020, the EPA will use a different approach to calculate the national RVO. Instead of calculating national obligations and retroactively diminishing these obligations when SREs are granted, the 2020 rule projects the “volume of gasoline and diesel that will be exempt in 2020 due to small refinery exemptions based on a three-year average of the relief recommended by the Department of Energy (DOE)” into the formula from the beginning. This will “effectively increase the percentage standards that apply to non-exempt obligated parties.” This change may increase compliance costs because (1) non-exempt parties must now blend more renewables or buy more RINs, and (2) policy uncertainty may exist around the DOE’s recommendation.

Not only do SREs affect the RVO calculation, but EPA will also consider whether to grant SREs in light of the DOE’s recommendation. Instead of granting or denying SREs through its historic all or nothing approach, EPA will begin granting partial exemptions. Not only is the policy to grant partial exemptions inconsistent with EPAs earlier policy, but the approach is inconsistent with EPAs previous interpretation of its authority.

Advocacy groups and industry leaders for renewable resource organizations may take issue with EPAs new partial exemption policy, which can produce policy uncertainty around whether this approach is enforceable. Indeed, these
groups declare themselves ready to "continue defending the RFS and fighting EPA's mismanagement of the program in the third branch of government."\textsuperscript{53}

These groups often challenge the policy changes and pursue EPA in court over issues such as SREs and the volume of fuels that become exempt from the national RVO. Indeed, several interest groups petitioned the United States Court of Appeals for the D.C. Circuit to review how EPA determined SREs in 2018.\textsuperscript{54} Potential decisions and challenges is not the only way that the courts introduce policy uncertainty into RFS compliance.

The 2020 rule states that EPA will defer acting on the D.C. Circuit’s decision in \textit{Americans for Clean Energy v. EPA}.\textsuperscript{55} In \textit{Clean Energy}, the D.C. Circuit Court held that EPA did not have the proper authority to waive RVOs on its “inadequate domestic supply” waiver authority when it considered demand side factors.\textsuperscript{56} The Court's ruling instructs EPA to reevaluate its decision to waive these volumes, which reportedly rises to 500 million gallons.\textsuperscript{57} EPA’s deference on whether to demand compliance for these gallons in 2020 signals that the 2016 RVO statutory levels might remain unsatisfied. But it also signals that EPA is willing to allow these volumes to remain uncollected. This position affects RIN pricing because (1) if the gallons are demanded, this increases the number of RINs demanded per party, but also (2) EPA creates policy uncertainty by refusing to collect volumes that a court decided it did not have authority to exempt. Obligated parties may wonder if EPA is ready to enforce the RVOs stated in its rules.

Ultimately, EPA’s strategic shift in how it measures RVOs, grants SREs, and its deference to the DC Circuit Court does not immediately show that EPA is committed to its “fundamental objective” which is to “increase the use of renewable fuels in the U.S. transportation system every year through at least 2022.”\textsuperscript{58}

4. Conclusion: cheap and costly

Compliance with the RFS is both cheap and costly. RIN prices may be volatile due to the blend wall and policy uncertainty, but RIN prices are negligible under certain conditions. The real cost of RINs is the price for failing to understand how they relate to the RFS and RVOs. EPA’s 2020 rule creates policy uncertainty around its new approach in how it calculates the RVO, how it will grant SREs, and whether it will allow statutorily required volumes to remain uncollected. Because policy surrounding RINs is itself changing, prudent obligated parties and those interested in trading in RINs are paying attention to EPA’s regulations as they relate to RINs. It is cheap to comply, and it may be expensive to overlook RIN requirements.

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\textsuperscript{1} 40 CFR § 80.1406(a)(1) (2020) ("An obligated party is any refiner that produces gasoline or diesel fuel within the 48 contiguous states or Hawaii, or any importer that imports gasoline or diesel fuel into the 48 contiguous states or Hawaii during a compliance period. A party that simply blends renewable fuel into gasoline or diesel fuel, as defined in §80.1407(c) or (e), is not an obligated party"); Renewable Fuel Standard, “\textit{RFS Uses a Market-Based Approach to Reduce Greenhouse Gas Emissions and Reliance on Imported Oil},” RIN Alliance (last viewed Jan. 24, 2020), https://www.rinalliance.com/resources/renewable-fuel-standard/.


\textsuperscript{3} See 42 U.S.C § 7545(d)(1); Civil Monetary Penalty Inflation Adjustment Rule, 84 Fed. Reg. 2056, 2059 (Feb. 6, 2019) (to be codified at 40 CFR Part 19); 40 CFR §§ 80.1460-61 (2020).

\textsuperscript{4} 40 CFR § 80.1463 (2020).

\textsuperscript{5} 40 CFR §§ 80.1125, 1425 (2020).

\textsuperscript{6} See 40 CFR §§ 80.1127, 1129 (2020).

\textsuperscript{7} See 40 CFR § 80.1426 (2020).

\textsuperscript{8} 40 CFR §§ 80.1125–26 (2020).

\textsuperscript{9} Id.

\textsuperscript{10} 40 CFR § 80.1452 (2020)

\textsuperscript{11} See 40 CFR §§ 80.1127, 1131 (2020).

\textsuperscript{12} 40 CFR § 80.1129 (2020).

\textsuperscript{13} See 40 CFR § 80.1429(b)(1) (2020).
19 42 USC § 7545(c)(2) (West 2020).
20 42 USC 7545(c)(2)(A) (West 2020); 40 CFR §80.1406(a)(1) (2020) (noting that blenders are not obligated parties).
29 See Kelsi Bracmort, supra note 18, at 14.
30 See Stock, supra note 2, at 10 (“Moreover, the overwhelming majority of retail outlets are set up to sell E10 but not higher ethanol blends. These practical challenges to selling fuel with an ethanol content exceeding 10 percent became known as the E10 blend wall.”); See Stock, supra note 28; Dallas Burkholder, A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and Their Effects, EPA, 11 (2015) (“Because the amount of ethanol that could be blended as E10 was effectively capped, obligated parties looked to alternative sources of RINs, such as increased blending of ethanol as E85, the blending of additional non-ethanol biofuels, or the use of carry over RINs.”)
32 Burkholder, supra note 30, at 7.
33 Id. at 2.
34 Stock, supra note 2, at 10.
36 See Burkholder, supra note 30, at 8 (“…through the end of 2012 ethanol was generally priced below gasoline on a volumetric basis, and D6 RIN prices were only a few cents, likely attributable to RIN transaction costs.”)
37 Bracmort, supra note 18, at 14.
38 Stock, supra note 2, at 12.
40 Id.

44 Id.
45 Id.
46 Id.
47 Id.


52 Now, EPA justifies its ability to grant partial exemption on two grounds: (a) seeming approval of its changed approach to granting past exemptions, and (b) its ability to “issue a final decision consistent with [the Department of Energy’s] recommendation.” 84 Fed. Reg. 57677, 57681 (Oct. 28, 2019). Indeed, EPA presses that “nowhere does Congress indicate that EPA must take an all-or-nothing approach.” Id. While this may be, in a July 2019 memorandum, EPA Administrator Idsal rejected the DOE’s recommendation of a 50 percent exemption by arguing, “the best interpretation of Section 211(o)(9)(B) is that EPA shall either grant or deny petitions for small refinery hardship in full, and not grant partial relief.” Renewable Fuels Assn. v. EPA, No. 19-9562, Petition, Appendix A, 2 (filed 9/19/2019), https://growthenergy.org/wp-content/uploads/2019/10/Petition-for-Review-of-2018-SRE-Decision-10.22.2019-002-4629-5874-1162-v.1.pdf.


54 Renewable Fuels Assn. v. EPA, No. 19-9562 (filed 9/19/2019).

55 Ams. for Clean Energy v. EPA.

56 Id.

57 ACE CEO Reaction to EPAs Proposed 2020 RVOs, Am. Coalition for Ethanol (July 5, 2019) (citing American Coalition for Ethanol CEO Brian Jennings as saying, in reference to the proposed RVO for the 2020 RFS, “It’s also a missed opportunity to restore the 500 million gallon shortfall the D.C. Circuit Court ordered the EPA to handle following the Americans for Clean Energy et al v. EPA lawsuit.”), https://ethanol.org/news/news/2019/07/05/ace-ceo-reaction-to-epa%E2%80%99s-proposed-2020-rvos/.


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