RENEWABLE FUELS ASSOCIATION

July 26, 2013

The Honorable Fred Upton
Chairman
Committee on Energy and Commerce
U.S. House of Representatives

The Honorable Henry Waxman
Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives

Dear Chairman Upton and Ranking Member Waxman:

The Renewable Fuels Association (RFA) is the national trade association representing the U.S. ethanol industry. The RFA appreciates the opportunity to respond to the questions posed in the fifth white paper, "Implementation Issues," as part of the Committee's review of the Renewable Fuel Standard (RFS).

As we have noted previously, we believe strongly that the RFS provides both EPA and obligated parties with more than enough flexibility to address the sundry implementation issues that have arisen, including specifically the various issues addressed in this white paper. Consequently, we remain opposed to legislative changes to this important program.

1. **Does EPA's annual RVO-setting process work well or are there concerns? If there are problems, are they correctable by EPA? Are any statutory changes needed?**

The annual RVO-setting process is effective and allows EPA to adjust the required volumes of cellulosic and advanced biofuel annually based on the best available data of production capacity. No statutory changes are needed. As it developed the RFS provisions of the Energy Independence and Security Act of 2007 (EISA), Congress knew the timing of cellulosic and advanced biofuels commercialization was somewhat uncertain. Accordingly, Congress gave EPA significant authority and flexibility to set the standards annually based on the short-term outlook for the availability of these biofuels. Further, because the annual RVO is actually a *percentage*, the obligated party's actual RIN obligation is somewhat sensitive to changes in gasoline and diesel demand that may occur over the course of the compliance year.

It is notable that EPA's annual rulemaking to establish RVOs is an open and collaborative process. EPA first proposes the RVO levels based on its own analysis of the marketplace; the Agency asks for stakeholder input and comments on the proposed volumes. Then, after considering all comments from stakeholders, EPA makes any necessary modifications and finalizes the annual RVOs. In this way, affected industries and the public have the ability to provide significant input to EPA on the annual requirements.

The statute states that EPA must determine whether to adjust a particular year's cellulosic and advanced biofuels requirements by November 30 of the preceding year. This implies that EPA must publish its final rule specifying RVOs for the following year no later than November 30. Publishing the RVO requirements by this deadline allows adequate notice and preparation time for both obligated parties and renewable fuel producers. Unfortunately, EPA's publication of the final RVOs for 2012 did not occur until January 9, 2012, and the final 2013 RVOs still have not been published. The delay in publishing the 2012 and 2013 final RVOs has created some uncertainty in the marketplace and has made it more difficult for obligated parties and renewable fuel producers alike to plan ahead. However, this challenge is correctable by EPA. The Agency can and should ensure that it meets the November 30 deadline for final RVO publication every year.

2. **Are the cellulosic biofuel provisions in the RFS working well or do they need to be changed? Has EPA modified its cellulosic biofuel standard-setting process for 2013 and future years appropriately, following the DC Circuit's decision to vacate EPA's 2012 standard? If not, what further changes are needed? Should EPA be required to reduce the advanced biofuel and total renewable fuel volumes when it lowers the cellulosic biofuel volume? What would be the consequences of such a change?**

While cellulosic biofuel production capacity has not materialized as rapidly as desired, the cellulosic biofuel provisions of the RFS have worked effectively and allowed EPA to adjust the required volumes as needed. Congress granted EPA broad authority to adjust the cellulosic biofuel requirements annually and the Agency has done so each and every year since the RFS2 became effective. Through the annual RVO-setting process, EPA has waived 98% of the cellulosic biofuel requirements from 2010-2013. However, EPA has effectively waived **99.8%** of the cellulosic biofuels requirements from 2010-2013 because it has required only 4.26 million waiver credits to be purchased, representing just 0.2% of the 1.85 billion gallons of cellulosic biofuels required by the statute from 2010-2013.[1]

While we do not believe EPA acted inappropriately in setting the 2010-2012 cellulosic biofuel requirements, we note that the Agency's approach to proposing the 2013 cellulosic biofuel standard comports with the D.C. Circuit Court decision. EPA's proposed cellulosic biofuel requirement for 2013 was not "aspirational," nor was it intended to serve as "stretch goal" for cellulosic biofuel production. Rather, the proposed 2013 volume was based on the best available data and information available to EPA at the time regarding most likely actual production volumes.

EPA *should not* be required to reduce the advanced biofuel and total renewable fuel volumes when it waives the cellulosic biofuel volume. The statute clearly states that if EPA waives the cellulosic standard, it "…***may*** also reduce the applicable volume of renewable fuel and advanced biofuels requirement…by the same or a lesser volume" (emphasis added). Congress explicitly gave EPA the authority to allow other biofuels to offset the shortfall in cellulosic biofuels resulting from a waiver. For the most part, EPA has used this authority effectively. In the 2010-2012 compliance years, EPA allowed other advanced biofuels to fill the "gap" created by the Agency's waivers of the cellulosic biofuel standard and it has proposed to do so again in 2013. This ensured that the *total* annual renewable fuel volumes set forth by Congress were satisfied. Requiring EPA to reduce the advanced biofuel and renewable fuel requirements when the

[1] http://www.epa.gov/otaq/fuels/rfsdata/rfs2cellulosicwaivercredits.htm

cellulosic biofuel requirement is waived could add uncertainty to the marketplace, undermine investment in advanced biofuels, and eliminate a key measure of administrative flexibility. The current flexibility afforded to EPA with regard to annually adjusting cellulosic biofuel, advanced biofuel, and renewable fuel requirements should be maintained.

3. **How can EPA improve its enforcement of the RIN credit trading program? Does EPA have the resources that would be required to oversee RIN production and enforce against production of invalid RINs? What role should obligated parties have in verifying the integrity of RINs and what additional information do they need to exercise due diligence? Will EPA's proposed voluntary third-party quality assurance program address the concerns of all RIN market participants? If not, what else is needed?**

In general, EPA has done a good job of enforcing the RIN credit trading program. Since the beginning of the RFS2 program, only 0.3% of total RINs generated have been found to be fraudulent. Notably, not a single one of the 38.6 billion D6 RINs (typically generated from corn ethanol) have been found to be fraudulent. In the isolated cases where biodiesel RIN fraud did occur, EPA enforcement was swift and effective and the perpetrators of the fraud were successfully prosecuted. EPA has already demonstrated that it does in fact have the resources to effectively monitor the RIN program and take enforcement actions when necessary.

Dating back to adoption of the original RFS regulations, EPA has always made it clear that the RIN credit market would operate on a "buyer beware" basis and obligated parties should perform due diligence before entering into a RIN transaction. As the parties ultimately responsible for surrendering RINs to show compliance, obligated parties should play the primary role in verifying the integrity of RINs. Numerous services and tools are available to obligated parties in the marketplace today to facilitate due diligence on RIN generators and ensure the validity of RINs.

While we do not believe participation in EPA's proposed voluntary quality assurance program (QAP) will be necessary for the majority of renewable fuel producers and their counterparties, we believe the program will provide the additional level of RIN assurance that some market participants may feel is warranted. The requirements of the proposed QAP regulation, and the pre-approved QAP schemes already available in the marketplace, allow RIN buyers to access (in real time) extremely detailed information regarding RIN generation by renewable fuels producers.

4. **What is responsible for the rise in ethanol RIN prices in 2013? Can future increases in RFS compliance costs be avoided, and if so, how? If the government takes action to limit increases in RFS compliance costs, how might such action affect this market-based program?**

The rise is RIN prices in 2013 has been caused primarily by the refusal of most obligated parties to blend and market gasoline blends containing greater than 10% ethanol (E10). Potential future increases in compliance costs can absolutely be avoided—if an obligated party increases its use of renewable fuels, it simultaneously decreases its need to purchase detached RINs.

When it comes to RFS compliance, oil companies have a choice: purchase a gallon of ethanol (with a free RIN attached) ***or*** purchase a detached RIN from third parties or other oil companies who previously blended more ethanol than required. Unfortunately, most oil companies are choosing to purchase detached RINs and bank them rather than increasing their use of ethanol. This is occurring despite the existence of practical and economical options for increasing ethanol use. E15 and E85 blends are legally approved and offer a workable pathway for meeting increased RFS volumetric requirements. Only slight increases in E15 consumption would be needed in 2013 to satisfy this year's RFS obligations with physical gallons rather than banked RINs. If E15 accounted for **just 1%** of total gasoline sales in 2013, the RFS requirement for renewable fuel could be met strictly with physical gallons of ethanol.[2]

Ignoring all the data demonstrating the efficacy of E15 use in automobiles (including decades of E25 use in Brazil), oil companies and their surrogates have raised concern about a lack of automaker warranty coverage for E15. But the current automotive fleet is absolutely capable of consuming the marginally higher levels of ethanol that the RFS requires in 2013 and 2014 even if warranty coverage is not extended to the existing fleet. According to EIA, approximately 15 million flex-fuel vehicles are on the roadways today. Further, 30-35% of model year (MY) 2013 light duty vehicles include *explicit* coverage of blends up to E15 in their warranty statements and owners' manuals. By the end of 2013, there will be more than 20 million vehicles on the road that are unequivocally approved by the auto manufacturers themselves for E15 or E85 use—almost 10% of total vehicles. That number will grow in 2014, as additional automakers (e.g., Volkswagen) have announced plans to explicitly approve E15 use in new vehicles. Further, EPA's E15 waiver approval applied to MY2001 and newer vehicles. MY2001 and newer vehicles represent approximately 75% of the U.S. light duty automotive fleet and 85% of vehicle miles traveled. Less than half of these vehicles are still covered by a vehicle warranty in any case.

In recent weeks, a gallon of ethanol (with a free RIN attached) has sold for roughly 40-60 cents/gallon less than a gallon of gasoline. For 2012, ethanol's discount to gasoline averaged approximately 50 cents/gallon. Futures prices for ethanol and RBOB gasoline indicate an average discount of more than 50 cents/gallon persisting through December 2014. Thus, the argument that prices for ethanol (and attached RINs) are somehow contributing to higher gasoline prices is patently false. In fact, U.S. consumers are missing out on an opportunity for **lower gasoline prices** due to the oil industry's refusal to move to blends above E10. With ethanol priced 40-60 cents per gallon less than gasoline, a gallon of E10 would be 4-6 cents per gallon cheaper at the pump than a gallon of unblended gasoline. Meanwhile, a gallon of higher-octane E15 would be 6-9 cents per gallon cheaper.

We believe RIN price movements in 2013 have been exaggerated due to the facts that 1) speculators (who are neither renewable fuel producers not obligated parties under the RFS) are allowed to participate in the RIN market; and 2) the RIN prices reported by popular trade publications are unscientific and likely represent a very small segment of the market. Due to the opacity of the RIN market, it is unclear just how significant the influence of speculative buying has been on RIN prices. Accordingly, RFA believes EPA should improve transparency around 1) the obligated parties' use of RINs, and 2) participation in the RIN

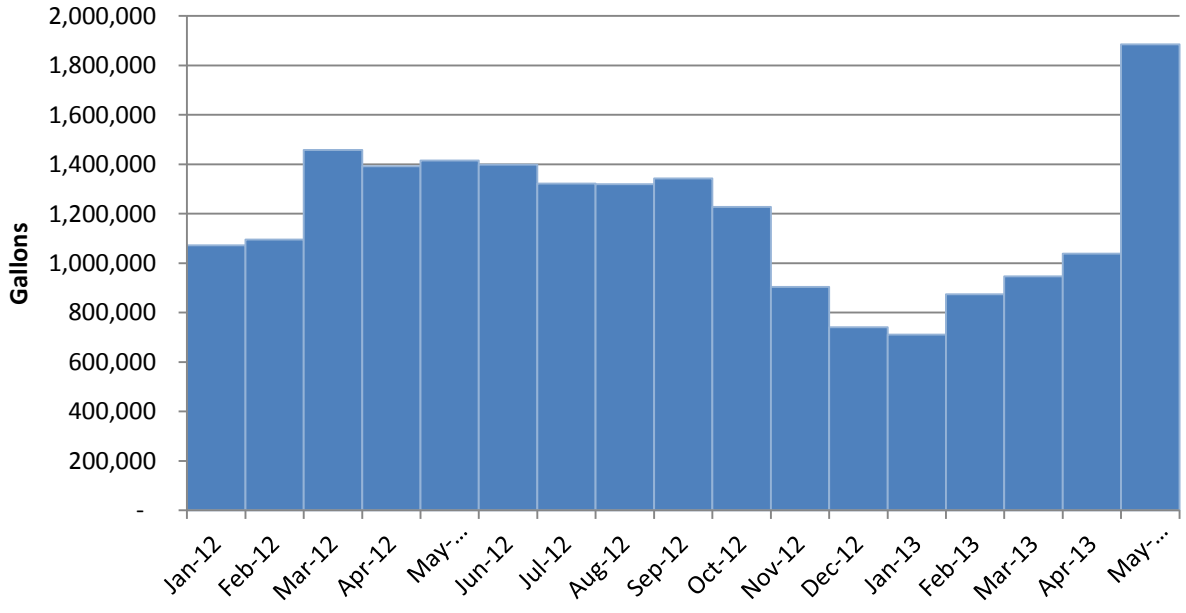
[2] Assumes gasoline demand of 133.8 billion gallons, 13.38 billion gallons of ethanol use at E10, and 200 million gallons of ethanol use at E85. Thus, 220 million gallons of ethanol would need to be consumed as E15 to meet the 13.8 billion gallon RFS requirement for "renewable fuel." This means 1.47 billion gallons of E15 would need to be consumed, which equates to 1.09% of projected gasoline demand. Does not account for impact of sugarcane ethanol imports that may be used to meet advanced biofuel standard.

market by non-obligated third parties who are not renewable fuel producers. We believe EPA should provide to the public information on annual company-level renewable volume obligations (RVOs), monthly data on company-level RIN separations and RIN retirements, and monthly disclosure of RIN transactions by non-obligated third parties who are not renewable fuel producers. This information could be shared via EPA's existing EMTS data web site.

5. **Are increases in RIN prices likely to affect the production or marketing of renewable fuels? If so, how might this affect implementation of the RFS and RIN prices moving forward?**

There is evidence that higher RIN prices have already encouraged greater production of renewable fuel and have driven increased usage of higher-level ethanol blends. Further, higher RIN prices are actually leading to *lower* fuel prices for consumers of E85 and other higher-level blends. Progressive fuel blenders, marketers and retailers are buying ethanol (with free RINs attached), blending it to make E85, separating the RINs from the gallons, and selling the RINs to refiners who have stubbornly chosen to buy RINs rather than physical gallons of ethanol. Thus, the sale of the RIN is allowing progressive retailers and marketers to reduce the price of the E85 for the consumer. In many cases in recent months, E85 has been priced $0.80-$1.00 per gallon or more below gasoline. In response to these discounts, consumer demand for E85 is increasing. While there is no reliable data available on national E85 sales, some state government agencies collect reliable data on E85 sales. Recent data from the Minnesota Department of Commerce, for example, shows that E85 sales nearly doubled from April to May (Figure 1). Certainly, higher RIN prices played a large role in this increase, as the value of RIN enabled progressive marketers and retailers to pass along increased savings to consumers.

Figure 1. Estimated Monthly E85 Sales in Minnesota



Source: Minnesota Department of Commerce

The market-driving benefit of the RFS credit program was recently affirmed by BP Biofuels CEO Phil New, who stated:

"[t]he conventional RIN markets are responding to the blend wall – exactly as could have been anticipated. The RIN markets are now starting to incentivize all members of the value chain to seek ways to resolve the blend wall. What had become a static, entrenched relationship is now starting to look much more fluid, as the incentives provided by the RIN markets provide a real prompt to innovation – not just on the supply side, but for the better demand side players as well."[3]

Similar comments have come from oil industry economist Phil Verleger, who wrote:

- "In short, no RIN problem exists. Instead, the trouble has been created by the stubborn resistance of some refining companies…to the RFS program.
- "…refiners have resorted to "export blackmail" rather than try other solutions. One of these would be sales of E85 (85:15 ethanol/gasoline), which would alleviate the problem.
- "…the obvious solution to the RIN price problem involves no EPA intervention and no regulatory action at this point. It simply calls for boosting E85 sales.
- "Refiners and marketers could meet their RFS requirements by boosting E85 sales."[4]

6. Should the provisions applicable to obligated parties be modified to provide relief for entities unable to generate sufficient RINs? Would such an approach apply different compliance requirements for refiners that blend ethanol and refiners that do not blend ethanol? What would be the justification for and potential consequences of such a change, including the potential for market distortions?

No, the provisions defining who is obligated under the RFS should not be changed. As a point of clarification, obligated parties generally do not "generate RINs," as stated in the Committee's question. Rather, a RIN is generated by renewable fuel producers to commemorate the production of a gallon of qualifying renewable fuel. The RIN is obtained by the obligated party, either through the purchase of a physical gallon of renewable fuel (with attached RIN) or through the purchase of a detached RIN from a third party of other obligated party who has over-complied.

At the request of the oil industry, the credit trading system was designed by Congress to allow compliance flexibility for those refiners who choose not to blend physical gallons of renewable fuel. The RIN system was intended to ensure that a national market would exist to address expected economic variations among regions in the country related to renewable fuels production and sales. The Senate Environment and Public Works Committee reported that the credit trading program was meant to "allow the ethanol to be used where it makes the most economic and environmental sense while providing a mechanism to transfer those credits back to the point of gasoline production or importation so that refiners, blenders, and importers can demonstrate compliance with the renewable fuels obligation."

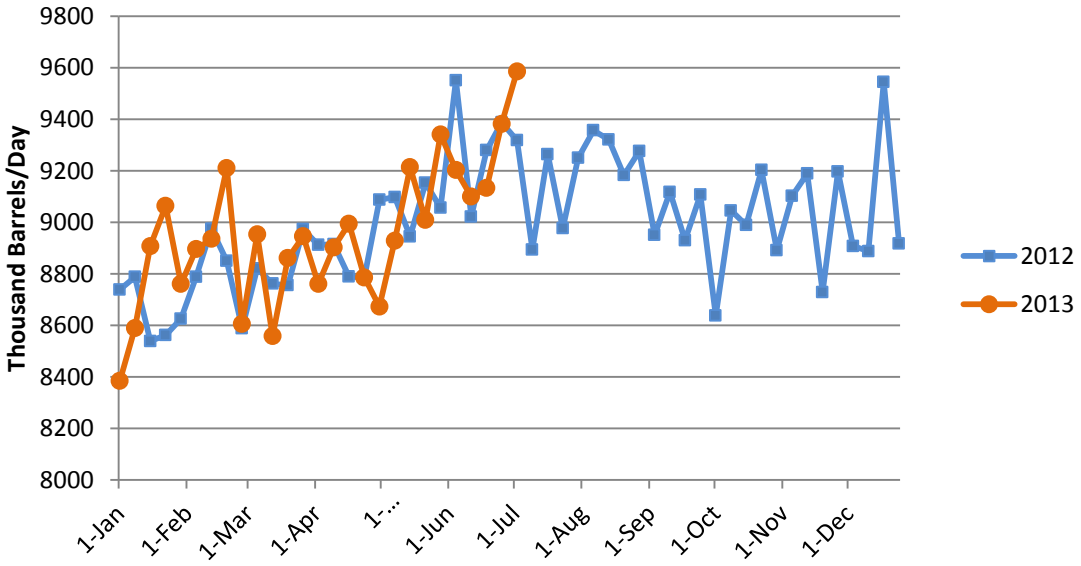
[3] 8th Annual World Biofuels Markets, Beurs World Trade Center, Rotterdam, Netherlands, March 13, 2013, Biofuels Digest.
[4] Philip K. Verleger, Jr., President, PKVerleger LLC. "The Price of RINs: How High! How Stupid!" March 2013.

The RIN program has worked effectively and has allowed obligated parties to efficiently demonstrate compliance. The program should not be revised to apply different compliance requirements to different refiners, as suggested by the Committee's question. Such a program would cause extreme confusion, uncertainty, and fungibility problems in the marketplace, and would create an unlevel playing field in the refining sector.

7. **Is the RFS incentivizing refiners to make less gasoline available to the American market, either through increased exports or reduced refinery production? If so, can anything be done to address this?**

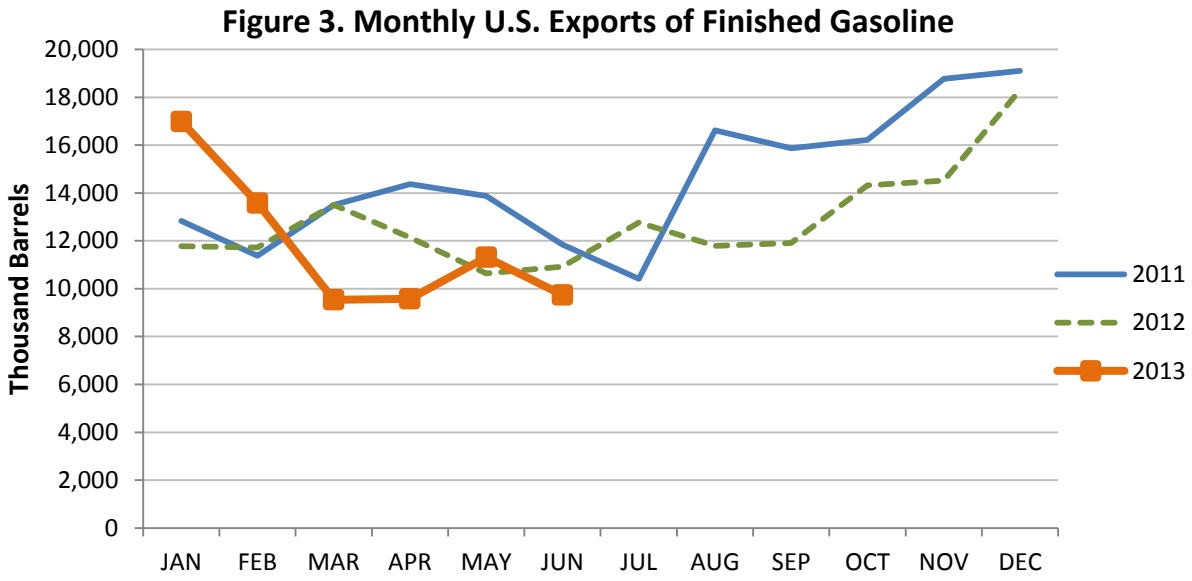
No. While refiners have threatened that they will purposely short the U.S. gasoline market in order to avoid RIN obligations, there is no evidence whatsoever that this has occurred. In fact, year-to-date gasoline production and U.S. deliveries have been *higher* than in 2012 when ethanol RIN prices averaged less than $0.03 (Figure 2).

Figure 2. Weekly U.S. Refiner/Blender Net Production of Finished Motor Gasoline



Source: EIA

Refiners have similarly threatened that they will increase gasoline exports to avoid RIN obligations. This hasn't happened either. Gasoline exports in 2013 have been similar to 2012 levels and *lower* than 2011 levels (Figure 3), indicating that refiners are not, in fact, ramping up exports to short the U.S. market and avoid RIN obligations.



Source: EIA

While there is no indication that refiners have shorted the U.S. gasoline market, they continue to suggest that the RFS will cause them to do so. It is appalling that refiners would purposely and pre-meditatively reduce the available supply of U.S. gasoline (and increase consumer prices) simply to avoid blending more renewable fuels and lessening their compliance obligation with the RFS. If this behavior does in fact occur, American consumers should be made aware that pump prices are increasing simply because U.S. oil refiners are choosing to deny them access to greater volumes of renewable fuels.

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Thank you again for the opportunity to comment. If there is any additional information you would like RFA to provide, please do not hesitate to ask.

Sincerely,

Bob Dinneen
President & CEO