RENEWABLE FUELS ASSOCIATION

March 26, 2018

Via Email

Assistant Attorney General
Environment and Natural Resources Division
U.S. Department of Justice
P.O. Box 7611
Washington, DC 20044-7611

RE: In re *PES Holdings, LLC., et al.*, D.J. Ref. No. 90-5-2-1-10993/1

Dear Assistant Attorney General:

On behalf of the Renewable Fuels Association ("RFA"), I am writing to express strong opposition to the government's proposed Consent Decree and Environmental Settlement Agreement ("Settlement Agreement") in the PES Holdings, LLC ("PES") bankruptcy proceeding currently pending in the U.S. Bankruptcy Court for the District of Delaware (Case No. 18-10122). First organized in 1981, RFA serves as the preeminent voice for the U.S. ethanol industry, and its members produce billions of gallons of renewable fuel each year. Allowing PES to abuse the United States bankruptcy laws to circumvent its regulatory obligations under the Renewable Fuels Standards ("RFS") provisions of the Clean Air Act would undermine the substantial investments the ethanol industry has made in reliance on levels established by Congress and EPA. It would also destabilize the RFS program and establish a dangerous precedent of rewarding significant violators of federal environmental laws.

U.S. bankruptcy courts approve environmental settlements only if they determine the settlement is reasonable, fair, and in conformity with applicable laws.[1] As explained more fully herein, the Justice Department should reject and revise its proposed Settlement Agreement with

[1] *United States v. Cannons Eng'g Corp.*, 899 F.2d 79, 84 (1st Cir. 1990); *United States v. Hercules, Inc.*, 961 F.2d 796, 798 (8th Cir. 1992).

PES because the terms are patently unfair, unreasonable, and inconsistent with the purposes of the RFS program. Specifically, the proposed Settlement Agreement:

1. Attempts to divert blame for PES's financial condition to the RFS program, rather than on PES's well-recognized failure to prudently invest and manage its resources;
2. Unjustifiably waives the vast majority of PES's renewable volume obligations ("RVOs") for the compliance period in question (January 2016 to April 2018);
3. Offers expansive releases of liability to parent companies who should actually be held legally responsible for compliance with RVOs;
4. Allows PES to take RINs that it should have used to satisfy its 2016-2017 RVO obligations and instead carry them over to satisfy its future 2018 RVO obligations, ignoring the compliance flexibilities already built into the RFS program and short-changing ethanol industry and the substantial investments it has made in the RFS program; and
5. Signals that the government is willing to look the other way when obligated parties misuse the bankruptcy process to shirk their regulatory compliance obligations at the expense of other obligated parties that follow the rules.

1. <u>The Proposed Settlement Agreement Is Based On The Flawed Premise That The RFS Program Is Causing Refinery Bankruptcies, Rather Than PES's Mismanagement Of Its Assets.</u>

PES has mischaracterized its Chapter 11 bankruptcy as the direct and inescapable result of RFS obligations. PES's position is meritless, and the government should not be misled into an unfavorable settlement by such false rhetoric. On the contrary, PES's situation is the consequence of its failure to ensure a diversified supply of crude, beyond that it previously obtained from the Bakken area of North Dakota,[2] and its failure to invest in the blending infrastructure to ensure compliance with Congressional RFS mandates. *See* University of Pennsylvania's Kleinman Center for Energy Policy (located less than 10 miles from PES) ("PES has a long history of being unprofitable" and "PES was in bad shape to begin with. * * * PES

[2] Philadelphia Energy Solutions Inc., Amendment No. 7 to Form S-1, Page 27 *A material decrease in crude oil production in the Bakken region could result in a material decrease in the volume of attractively priced Bakken crude oil processed by Refining* (Retrieved from SEC EDGAR website)

investors "…invested billions of dollars in more profitable infrastructure that rendered PES uncompetitive."). As well-known oil analyst Phil Verleger summed it up, PES is "…scapegoating the RFS for its financial woes…instead of properly attributing the demise of the refinery to the end of the long-time crude oil export ban, antiquated equipment and a lack of investment that kept the plant competitive with other northeastern refineries."

Indeed, when EPA looked at the issue of refiner compliance costs in issuing RFS volume obligations for 2018, EPA confirmed what others have consistently found—that refiners like PES have the ability to recoup their investments in the RFS program:

> "[O]bligated parties…are generally able to recover the cost of acquiring the RINs necessary for compliance with the RFS standards through higher sales prices of the petroleum products they sell….This is true whether they acquire RINs by purchasing renewable fuels with attached RINs or purchase separated RINs. The costs of the RFS program are thus generally being passed on to consumers in the highly competitive marketplace."[3]

Although PES attempts to pin blame on the RFS program, it stands alone as the only entity using the bankruptcy court to seek regulatory amnesty from an obligation that affects every refiner equally.

A government-sponsored bailout to PES would also punish the only industry that has invested fully in the RFS program and met all Congressional mandates – the renewable fuels industry. Indeed, the RFS program has been the fundamental driver of investment, development, and growth of the U.S. biofuels industry since the law was first enacted in 2005 and enhanced in 2007. It has led to billions of dollars in investment in new technologies and facilities, employing hundreds of thousands of Americans, often in rural communities. PES should not be permitted to obtain a forced subsidy from this industry and the American farmers that support it—a subsidy that is an antithetical to increased consumer demand for cleaner, cheaper renewable fuels.

The Justice Department has no basis for shielding a company that refuses to take responsibility for the unfortunate mess it has created.

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[3] 82 Fed. Reg. at 58,526; *see also* Wells Fargo Equity Research: Independent Refiners: The Crack Ate My RINs—Policy and Profit Implications, November 16, 2017 ("Merchant Independent Refiners remain relatively disadvantaged versus their more integrated peers. These disadvantages will/have narrow(ed) as the financial incentive to 'build out' wholesale infrastructure persists."); Harvard University: The Pass-Through of RIN Prices to Wholesale and Retail Fuels under the Renewable Fuels Standard, June 2015 ("[A]n obligated party with a net RIN obligation, such as a merchant refiner, is able to recoup their RIN costs on average through the prices they receive in the wholesale market").

2. Waiving Three Quarters Of PES's RVO Undermines Congressional Intent Behind the RFS Program.

PES's Bankruptcy Plan of Reorganization is brazen in its attempt to evade compliance with a large portion of its applicable 2016 RVOs, all of its 2017 RVOs, and the portion of its 2018 RVOs that it incurred prior to the Effective Date of the Settlement Agreement—all of which would be in clear violation of 40 CFR § 80.1461(c)(1). According to PES's initial filing, the company owed 467 million RINs for the 2016 and 2017 compliance periods, in addition to millions of RINs that PES needed for the roughly three-month period between January 1, 2018, and the effective date of the Settlement Agreement. Of more than 500 million RINs owed for this entire period, PES only had 210 million RINs on hand at the end of 2017.

As far-fetched as PES's Plan may seem, the terms of the proposed Settlement Agreement are not much better. By allowing PES to retire only 138 million RINs for its pre-effective date obligation of more than 500 RINs, DOJ and EPA have effectively waived approximately three-quarters of PES's RVOs for this period. Incredibly, DOJ and EPA did not even require PES to use all of the 210 million RINs that it had on hand for compliance; the government team proposes to allow PES to carry over 65 million RINs toward future compliance obligations.

Exacerbating its noncompliance, PES reportedly had been also *selling* roughly 40 million RINs in the fall of 2017, even as the March 2018 RVO compliance deadline approached. This is a classic case of a regulated entity being allowed to have its cake and sell it, too—while PES seeks to escape from its financial responsibilities under the RFS program, it embraces that same program for the limited purpose of profiting from it.

Even if the terms of the government's proposed compromise were not so inexcusably lenient, the Settlement Agreement suffers from a fatal legal flaw—it treats PES's RIN obligations as just another *monetary claim* that can be discharged for pennies on the dollar rather than as a *regulatory obligation* that must be complied with.[4] RIN obligations are not only regulatory obligations, they are the means by which obligated parties such as PES demonstrate that physical gallons of renewable fuel are blended into transportation fuel at required levels. In this way, PES's RIN obligations are similar to any other regulatory obligation that costs money,

[4] *See* 28 U.S.C. § 959(b) (debtors must comply with the law).

such as the operation of pollution control equipment.[5] Consider a coal-fired power plant facing financial hardship due to market conditions. Imagine if the plant sold off its scrubbers and failed to invest in other pollution control technology and, as a result, operated in violation of the Clean Air Act. Would DOJ or EPA countenance allowing excess emissions from the plant because its owners claimed they could not afford pollution controls? Would DOJ or EPA give a credit toward *future* emission limit compliance because the plant was emerging from bankruptcy? Of course not. But that is essentially what the government is agreeing to here, and it is completely inconsistent with the law and the government's past positions.

In creating the Renewable Fuels Standard, Congress intended "[t]o move the United States toward greater energy independence and security, [and] to increase the production of clean renewable fuels."[6] Through this program, Congress envisioned increasing concentrations of renewable fuel in transportation fuel.[7] The RIN market was intended to provide a flexible means of demonstrating compliance for obligated parties who could not necessarily physically blend the required levels of renewable fuel. PES is trying to abuse this flexibility, however, by characterizing its RIN obligations as monetary obligations, and therefore dischargeable, rather than what EPA set them up to be—regulatory obligations. Congress's goals in mandating renewable fuels use would be undermined by allowing an obligated party such as PES to misuse the bankruptcy process to game the RFS program and evade non-dischargeable obligations.

If the government were to finalize this settlement in the RFS context, it would also establish an extremely harmful precedent for other market-based environmental programs, encouraging others to use the bankruptcy process similarly to nullify those obligations. The Justice Department needs to revise the terms of the PES settlement to preserve the programmatic integrity of its fuel and emissions trading programs, to maintain a level playing field, and to adhere to the Congressional mandates behind the RFS program.

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[5] *See* Answering Brief of the United States, *U.S. v. Apex Oil Company* (7th Cir. 2008) ("[A]ny action that it might take to comply with an injunction 'costs money.' Any injunction that limits the company's operations or distracts it from its core business may also cost the company money-making opportunities. Those inevitable costs of corporate compliance do not make such injunctions dischargeable."); see also *Amicus Curiae Brief of the United States, Safety-Klee (Pinewood) Inc. v. South Carolina* (4th Circuit 2000)..

[6] Energy Independence and Security Act, P.L. 110-140 (2007).

[7] *Id*. § 202, 42 U.S.C. 7545(o)(2).

3. The Settlement Agreement Does Not Hold Corporate Parents Responsible, As The Clean Air Act Requires.

The proposed PES Settlement Agreement is also flawed because it fails to consider the formidable assets of PES's parent entities, which are responsible for RIN compliance under the statute.[8] This oversight is exacerbated by the government's decision to not punish these parent companies for evading their responsibility, but to *reward* them with a broad release from liability. Such a government-condoned noncompliance is completely at odds with all EPA laws and policies.[9]

As with EPA's other fuels programs, if a subsidiary cannot comply with its RFS obligations, EPA can attach liability to corporate parents so that the goals of the program are nevertheless met. Yet the government here agrees to settle all liabilities and obligations of PES's parent companies, with broad release language that is flatly inconsistent with EPA's previously-stated position on parental liability:

> "We believe that the ability to hold a parent corporation liable for violations caused by a subsidiary company is necessary in order to ensure that the goals of the RFS program are met in the event that relief cannot be obtained by the subsidiary company. This approach is consistent with the gasoline sulfur program, the Highway and Nonroad Diesel sulfur programs, and other fuels programs."[10]

Ironically, as indicated in PES's bankruptcy filing, one of PES's ultimate corporate parents is one of the world's largest and well-heeled investment firms—the Carlyle Group L.P.—with whom PES shares several critical managers. Indeed, under the proposed Settlement Agreement the government's get-out-of-jail card would be shared by PES's parent companies and joint venture partners, including Carlyle PES, LLC, Philadelphia Energy Solutions LLC, and Sunoco, Inc., none of which are held accountable for PES's RIN obligations:

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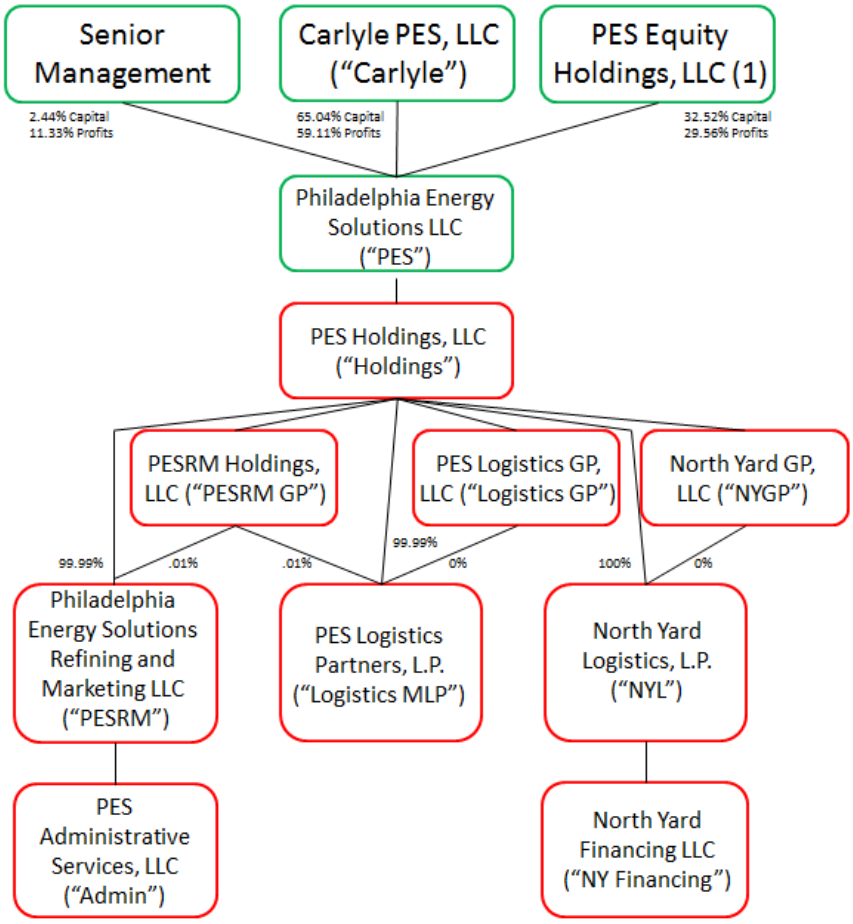
[8] *See* 40 C.F.R. § 80.1461(c).

[9] *See, e.g.*, EPA's final benzene rule ("[A]ll parent companies, and all subsidiaries of all parent companies, must be taken into consideration when evaluating compliance" with the rules governing parent corporation liability.); 72 Fed. Reg. 8, 428, 8, 490 (Feb. 26, 2007).

[10] U.S. Environmental Protection Agency, *Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program, Summary and Analysis of Comments* 11-19 (April 2007) (emphasis added).



Although PES's bankruptcy filing blames compliance with the RFS program as a cause of its financial woes, PES's investor-owners conspicuously withdrew more than $590 million in dividend-style payments from the company in recent years.[11] The government's failure to look to PES's parent entities to satisfy PES's RIN obligations is surprising, but its decision to reward the elusive parents with a broad release from liability is stunning.

4. <u>The Settlement Agreement Unfairly Allows PES To Carry-Forward RINs For Post-Effective Date Compliance</u>.

[11] Jarrett Renshaw, "U.S. biofuels sector blasts EPA settlement with bankrupt Philadelphia refinery," Reuters (Mar. 12, 2018).

Under the Settlement Agreement, PES may take 64.6 million RINs that it held at the end of 2017 and apply them toward PES's 2018 compliance, rather than pay down its RIN deficit for 2016 and 2017. There is no plausible justifiable justification for this. The United States should not "credit" PES for obligations incurred after the effective date of the Settlement Agreement when PES emerges from Chapter 11.

This 64.6 million RIN "credit" carry-forward is particularly unreasonable given that PES will now be excused for failing to comply with three-quarters of its obligations prior to the effective date of its bankruptcy. The fact that PES was *selling* RINs only a few months ago makes if offensive that PES won't have to put up all the RINs that remain toward its past regulatory obligations. When PES emerges from Chapter 11, it should be on equal footing with other obligated parties, none of which have a credit toward their RVOs carried forward from previous years. DOJ and EPA must at least remove this 64.6 million RIN credit toward future compliance obligations (which are not due until March of 2019) and instead require that PES retire all of its 210 million RINs for compliance with its RVO's that preceded the effective date of its bankruptcy petition.

The proposed Settlement Agreement ignores the RIN-compliance mechanisms already built into the RFS program, too. Obligated parties such as PES can: buy gallons of renewable fuel with RINs attached or simply buy the RINs on the market; trade RINs with other obligated parties; carry over unused RINs between compliance years; and carry a compliance deficit into the next year. *See* 40 C.F.R. § 80.1427. And if EPA determines that the financial burden of a given year's RVO set by Congress in the RFS is simply too much, Congress gave EPA the authority in 211 (o)(7)(A)(i) of the Clean Air Act to alleviate that burden across the board by waiving a portion of the RVO for that year. But Congress did not authorize any waiver of RVO obligations specific to a given obligated party, as the Settlement Agreement now proposes. If the Justice Department were to proceed with the Settlement Agreement, it would be ignoring the compliance flexibilities already provided to obligated parties and would be acting in contravention of the Congressional intent to consider only sector-wide economic impact.

5. <u>The Proposed Settlement Signals the Government Is Willing To Allow Obligated Parties To Misuse The Bankruptcy Process To Shirk Their Regulatory Compliance Obligations</u>.

Finally, RFA also opposes the proposed Settlement Agreement because of the unreasonable and unfair precedent it would set. Despite the Settlement Agreement's language

that the terms are fact-specific and have no precedential value outside of this case, the Settlement Agreement sends a signal that the government will no longer ensure compliance with the law to the fullest extent possible. A half-hearted settlement such as this does not "comport[] with the goals of Congress"[12] in passing the RFS to increase the blending of renewable fuels into transportation fuel.

The Justice Department should be just as vigilant of an obligated party trying to evade its RVO obligations as it is of a power plant attempting to evade its emission trading obligations by shutting down a scrubber to save money. If market-based approaches to compliance are going to continue to thrive as an integral part of U.S. environmental law, the government cannot condone the behavior of those who figure out ways to exploit the system, particularly when those ways undercut the efficiency and program effectiveness that Congress intended. Nor should the government be complicit in an abuse of the bankruptcy process to allow a regulated party to gain financially from its noncompliance at the expense of the broader public interest.

For the reasons discussed above, RFA respectfully requests that the United States rescind and revise its proposed Settlement Agreement with PES. RFA specifically requests that the proposed Settlement Agreement be modified (a) to account for the contribution of PES's parent companies, as required under the RFS program, (b) to provide parental releases from liability only for those entities contributing to PES's RIN obligations, and (c) to require PES to utilize all of its current RINs—including the 64.6 million RINs that the Settlement Agreement would allow PES to carry forward—to be used toward its 2016 and 2017 pre-effective date obligations.

RFA appreciates your consideration of its comments.

Sincerely,

Bob Dinneen

President and CEO, Renewable Fuels Association

[12] 960 F. Supp. at 299.