

As EPA Sets 2017 Renewable Fuel Volumes, Future Is Unclear

On November 23, 2016, the Environmental Protection Agency (EPA) released its final 2017 volumes under the Renewable Fuel Standard (RFS), an ever-controversial program established by Congress to spur the development and use of biofuels in the U.S. transportation sector.

Specifically, the EPA published final volumes for cellulosic biofuel, biomass-based diesel (biodiesel), advanced biofuel and total renewable fuel well below statutorily-prescribed volumes but at the highest levels to date, demonstrating the agency's intent to continue driving development, distribution and use of these fuels.

Notably, the EPA increased from its Spring 2016 proposal the final volume for total renewable fuel — for the first time up to the statutory ceiling for conventional (corn-based) ethanol — as well as the volume for advanced biofuel, while slightly reducing the volume for cellulosic biofuel and holding steady its proposed volume for biodiesel.

In finalizing these volumes, the EPA utilized largely the same methodology it employed in late 2015 (the 2015 rule) when it retroactively set levels for 2014 and 2015 and established volumes for 2016 for these categories of fuels, but it tweaked the authority on which it relied for waiving the statutorily-prescribed volume for total renewable fuel.

As with its spring 2016 proposal and earlier rules, the agency has again sought a middle ground that it believes will encourage further production of cellulosic, biodiesel and other advanced biofuels by increasing volume requirements while recognizing the existing constraints to distribution and use of the fuels.

And as with its prior rules, the EPA will likely face legal challenge once it publishes the final rule in the Federal Register. More significantly, it is also possible the entire RFS program may face restructuring by the EPA itself or by the new Republican-led Congress.

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RFS In a Nutshell

The RFS program, codified in Clean Air Act section 211(o), was intended to increase the use of renewable fuels in the U.S. transportation sector in order to reduce greenhouse gas (GHG) emissions and increase energy security. Congress established statutory volumes for these fuels by category, which increase yearly in order to stimulate further growth in advanced biofuels, which have a lower GHG lifecycle than conventional fuels.

The program also incentivizes the production and use of non-advanced or conventional renewable fuels, but these volumes are to remain constant in 2015 and beyond, again to focus on stimulating advanced biofuels production. Under the RFS, each November, the EPA is to set the following year's volumes of RFS fuels, except for biodiesel, which is to be set 14 months in advance.

Each of the categories of biofuels is "nested," meaning cellulosic and biodiesel volumes can also meet advanced biofuel volume requirements, and all three can meet total renewable fuel volume requirements.

Although Congress mandated minimum volumes for each of the fuels through 2022, it provided two statutory waivers in case the specified volumes could not be met in a given year. The first, known as the "cellulosic waiver," section 211(o)(7)(D)(i), allows the EPA to reduce the volume of total renewable fuel and advanced biofuel to address any shortfall in volumes the agency calculates as available for cellulosic biofuel compared to statutory levels.

The second, referred to as the "general waiver," section 211(o)(7)(A), authorizes the EPA to reduce volumes by finding there is an inadequate supply of renewable fuel (or to avoid severe economic or environmental harm) to meet statutorily-prescribed renewable fuel levels.

Once volumes are finalized, the agency translates them into compliance obligations that refiners and importers must meet each year through production or purchase and blending of renewable fuels, or, alternatively, through the purchase of renewable identification numbers (RINs), which are generated by other renewable fuel producers. Hence, the RFS obligation and resulting costs fall directly on refiners and importers which must utilize annually increasing amounts of biofuels to produce transportation fuels in the U.S.

The intended benefits accrue to biofuel producers and importers in terms of an increased market, and ultimately to the public through an increase in fuel diversity and energy security and a reduction in GHG emissions.

Opposing Views

The refining industry has long been critical of the RFS program for its imposition of costs

on the industry to benefit renewable fuel producers and its belief that the EPA has set volumes that are unjustifiably costly and largely unattainable.

A chief argument is that ethanol cannot be blended into the nation's transportation fuel supply in an amount greater than 10 percent of that supply for a number of legal (e.g., warranty) and practical reasons (e.g., lack of demand and distribution infrastructure), a phenomenon called the "E10 blend wall" (named after the predominantly marketed gasoline/ethanol blend).

The biofuels industry, on the other hand, sees the steadily increasing volumes of mandated biofuels as absolutely critical to driving the market toward greater production and use, particularly of advanced biofuels, which are generally more expensive than conventional fuels. They argue that reductions in volume undercut the development of the biofuels market, in violation of congressional intent.

2015 "Compromise" Rule Sets the Standard

Neither side was satisfied with the 2015 rule, which finalized volumes for the RFS fuels belatedly for 2014 and 2015, and for 2016 (and for biodiesel in 2017) well below statutory volumes. See Figure 1 below.

	2014 statutory	2014 final	2015 statutory	2015 final	2016 statutory	2016 final	2017 statutory	2017 projected	2017 final
Cellulosic biofuel (million gallons)	1.75 (billion)	33	3 (billion)	123	4.25 (billion)	230	5.5 (billion)	312	311
Biodiesel (billion gallons)	≥1	1.63	≥1	1.73	≥1	1.9	≥1	2.0 (final for 2017); 2.1 proposed for 2018	2.1 (final for 2018)
Advanced	3.75	2.67	5.5	2.88	7.25	3.61	9	4	4.28

biofuels (billion gallons)									
Total renewable fuels (billion gallons)	18.15	16.28	20.5	16.93	22.5	18.11	24	18.8	19.28

The EPA utilized actual gallons produced for the 2014 and (most of) 2015 figures. But for 2016, the agency determined that volumes for cellulosic biofuel were far below statutory limits and there were not sufficient volumes of advanced biofuel and total renewable fuel available or able to make up the shortfall.

As to conventional ethanol, the EPA agreed that the practical and legal constraints imposed by the “blend wall” prevented significantly higher volumes of total renewable fuel. Hence, the agency used a portion of the cellulosic waiver to reduce volumes of advanced biofuel from statutory levels, and combined the cellulosic and general waivers to reduce volumes of total renewable fuel from a statutory total.

The EPA asserted that constraints on distribution could be considered part of a finding of inadequate domestic supply under the general waiver. However, the agency set the volume for total renewable fuels at a level that would slightly exceed the “blend wall,” and stated its intention to go beyond that amount in future rules to help spur the market to overcome these constraints.

This was the first time the EPA used these waivers to reduce the advanced biofuel and total renewable fuel volumes. The agency’s acknowledged compromise was challenged by the refining industry generally as setting volumes too high and by the biofuel industry generally as setting volumes too low.

Judicial challenges to the rule and the EPA’s methodology are pending in the D.C. Circuit.

Final 2017 Volumes Continue Compromise but Push Past “Blend Wall”

In its proposed volumes, issued in May 2016, the EPA used largely the same methodology to set 2017 volumes (and 2018 volume for biodiesel) which continued the

small but steady increase in volume of biofuels over time, yet far below the statutory levels. See Figure 1 above.

Its calculations were largely driven by an anticipation of a significant shortfall in cellulosic biofuels (a proposed 312 million gallons versus a statutory 5.5 billion gallons) After reviewing additional production data and comments, the agency lowered the final cellulosic volume for 2017 to 311 million gallons.

With this shortfall, the EPA finds it impossible to achieve the numbers and timeline set forth by Congress for the other fuels. This final volume for cellulosic biofuels still represents a 35 percent increase over the 2016 figure.

As to advanced biofuels, the EPA determined, as it did in 2015, that there is insufficient supply through domestic production and imports to meet the 9 billion gallon statutorily-mandated volume. The agency then chose to use most, but not all, of the reductions allowed under the cellulosic waiver authority to reduce the 2017 volume to a “reasonably achievable supply” of 4.28 billion gallons.

The final 2017 volume is a slight increase over the proposed 4 billion figure, but a 19 percent increase over the final 2016 volume. The EPA based the increase from the proposed volume on “updated information” and a review of public comments that showed an increase in production of biodiesel and renewable diesel.

As to total renewable fuel, the EPA changed its position from the May 2016 proposal and 2015 rule, again based on updated information showing additional renewable fuel available in the market. The agency determined that conventional ethanol production would meet the implied statutory cap for that fuel (total renewable fuel minus advanced biofuel) of 15 billion gallons.

This meant fewer reductions were needed from the statutory cap for total renewable fuel, and the EPA could rely exclusively on the cellulosic waiver authority to reduce the reduce the statutory volume from 24 billion gallons to 19.28 billion gallons. The agency did not need to utilize the general waiver authority to reduce volumes further below the cellulosic shortfall, nor did it even use the maximum reduction permitted by the cellulosic waiver.

This change is significant, since the EPA no longer needed to find that there was an inadequate domestic supply to meet statutory volumes, based on the alleged practical and legal constraints on demand due to the “blend wall,” a novel interpretation of its authority now being challenged in court.

The 19.28 billion figure represents the EPA’s view of the maximum reasonably attainable volume of total renewable fuel, a 6.5 percent increase from the 2016 final volume of 18.11 billion gallons.

In contrast to the other volumes, biodiesel volumes are expected to increase above statutory levels. The EPA finalized its proposal for a 100 million gallon increase from the 2017 final volume so that the level in 2018 will be 2.1 billion gallons compared to the 1

billion gallon statutory floor.

As in the prior rule, the agency has chosen not to set volumes for any of the fuels at a level that would draw down the substantial bank of existing RINs so as to allow the bank to provide compliance flexibility.

The EPA ultimately concludes that the final volumes will drive growth in renewable fuels and that Congress did not intend such growth to be stopped by “supply challenges,” including those associated with the “blend wall.” As with the 2015 rule, the EPA does not view the “blend wall” as a permanent constraint on the market, but rather a challenge that can be met by providing the market with incentives to further investment in renewable fuel use.

Indeed, the agency recently proposed measures to further ease barriers to the RFS program. On Nov. 16, 2016, it published a proposed rule that would increase the efficiency of biofuel production by allowing sequential processing at separate facilities, by revising its fuel regulations to expand the availability of higher ethanol fuels for use in flex fuel vehicles, and by considering fuel from other GHG-reducing technologies and sources to qualify under the program.

A Future Reset ... or More?

There has been significant pressure on Congress to reform the RFS, whether by lowering the statutory volumes permanently, relieving the refiners of compliance obligations and placing them elsewhere, or simply scrapping the whole program. To date, congressional proponents of the program have blocked such efforts, and the EPA has followed suit.

For example, on Nov. 10, 2016, the EPA issued for public comment a proposed denial of petitions seeking to move the compliance obligation from refiners/importers to blenders.

However, the recent elections could significantly change the calculus. First, the EPA itself may take action to alter the program. The RFS provides for a statutory reset under section 211(o)(7)(F), starting in 2016, when the agency has waived any applicable volume requirement below 20 percent for two consecutive years, or at least 50 percent for a single year.

This finding would require the EPA to promulgate a rule within a year from issuing the waiver to modify the statutory volumes through 2022. The agency has gone above the 20 percent trigger for advanced biofuels for 2015, 2016 and now 2017, and also exceeds the 50 percent trigger for that fuel in 2017.

The total renewable fuel final volume is just below the 20 percent threshold, but would have triggered it as originally proposed. Significantly, the EPA’s final rule makes no mention of the statutory reset or how it would address this provision, but it is likely to need to do so in the near future.

Indeed, were a Trump EPA hostile to the RFS program, the agency could use its statutory authority to significantly lower the advanced biofuel statutory levels, and might seek to use that opportunity to change the total renewable fuel volume and other key parts of its prior regulations.

At this time, it is unclear what position a Trump EPA might take. For one thing, the president-elect has only recently stated he would nominate Scott Pruitt, attorney general of Oklahoma, as his EPA administrator, and it is not clear what direction Pruitt would go on the RFS program if nominated and confirmed.

Moreover, Trump has taken differing positions on the RFS program over time, supporting it as a candidate in Iowa and then later opposing key parts of the program. One of Trump's trusted advisors, Carl Icahn, is the owner of several refineries and has strongly criticized the RFS program, and in particular the fluctuating cost of the RIN.

Moreover, the RFS program, in large part, aims to reduce GHG emissions from the transportation sector, making it vulnerable to a Trump administration that may seek to root out costly GHG-reducing regulations. Hence, the RFS program may face significant structural change under the new administration.

It is less likely (though possible) that the incoming administration will upset the final 2017 volumes as many companies will have planned around these increasing volumes.

Further, it is possible that Congress may take its own action to alter the program. Bills have been introduced, for example, to change the point of obligation or cap ethanol content at a level below 10 percent, and there are a number of strong congressional critics of the entire program.

While support for the program has not necessarily been a partisan issue — both Democratic and Republican legislators from farm states have strongly supported it — a new Congress, bolstered by a presidential critic, may take a serious shot at reforming or eliminating the RFS.

Therefore, it is unlikely the EPA will simply continue to follow its well-worn middle ground path when it proposes the 2018 volumes for these fuels in early 2017, and could very well choose a new road or have a new direction provided by Congress.