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EPA Proposes Revisions to the Renewable Fuel Program to Prevent Fraud and Protect Innocent Traders in Renewable Identification Numbers (“RINs”); Allows Limited Use of Program Immediately

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Introduction

In 2007, the Environmental Protection Agency (“EPA”) established a program for trading renewable fuel credits (called “Renewable Identification Numbers” or “RINs”) for companies that were unable to produce enough renewable fuel to meet standards imposed by the Clean Air Act.¹ Problems arose because the program imposed strict liability on anyone who traded in these credits if the credits proved to be invalid. As it turned out, there was widespread fraud involving companies claiming to have produced renewable fuels and the accompanying credits, when, in fact, they had created false RINs and no fuel.² Dozens of innocent traders were fined hundreds of thousands of dollars by the EPA, despite their lack of awareness, and the viability of the program was threatened. Last week, the EPA proposed a program intended to reduce the threat of fraud in this program, and to possibly limit the exposure of innocent traders. This alert describes this new proposal.

Summary of Proposal

On February 21, 2013, the EPA issued and published in the Federal Register a 60-page Notice of Proposed Rulemaking (“Proposal”) that would create a Renewable Fuel Standard RIN Quality Assurance Program (“QAP”). The Proposal is “intended to reduce the incidence of invalidly generated RINs entering the market, provide reasonable assurance of replacement of invalidly generated RINs, and increase liquidity in the RIN market.”³

The Proposal establishes a voluntary program that obligated parties (those required to produce certain amounts of renewable fuel) may use to verify that RINs have been validly generated and creates an affirmative defense to liability for invalid RINs that have been verified through these programs. Under the Proposal, as an alternative to the “buyer beware” liability under the existing regulations, obligated parties that purchase, transfer, or use RINs that have been verified according to an approved

¹ Final Rule, Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program, 72 Fed. Reg. 23,900 (May 1, 2007).

² See, e.g., Press Release, *Owner of “Clean Green Fuel” sentenced to over 12 years in prison in scheme to violate EPA regulations and sell \$9 million in fraudulent renewable fuel credits*, Office of the U.S. Attorney for the District of Maryland (Feb. 22, 2013) (sentencing man convicted of selling \$9 million in fake RINs to over twelve years in prison and to pay more than \$42 million in restitution); Sentencing, *United States v. Haley*, No. 11-0540 (D. Md. Feb. 22, 2013).

³ [RFS Renewable Identification Number \(RIN\) Quality Assurance Program](#), 78 Fed. Reg. 12,158 at 12,164 (Feb. 21, 2013).

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QAP can shield themselves from liability if those RINs are subsequently found to have been invalidly generated if they can also establish an affirmative defense that they lacked knowledge that the RINs were invalid. EPA has announced that participants in the market can immediately start using the program under this Proposal, and informally qualify for protection for RINs traded prior to issuance of the final rule. While this new program may be a welcome change to the current rule, the burden of proof for establishing an affirmative defense and the cost of the QAP, particularly Option A, may be so high that the value of the Proposal may be greater to the EPA than to innocent RIN traders and obligated parties.

Option A and Option B: Opportunities and Problems

The central focus of the Proposal is the creation of the QAP. EPA proposes two options (“A” and “B”) that obligated parties can use to verify RINs through a QAP. Both options would require independent third-parties to audit the production of renewable fuel and the generation of RINs and both would allow parties to qualify for an affirmative defense to liability for invalidly generated RINs. The two QAP options, however, differ in significant ways. Most notably, Option A places secondary responsibility for replacing invalid RINs on the third-party auditor, while Option B places this responsibility on the obligated party. Under both options, however, the primary responsibility to replace invalidly generated RINs lies with the RIN generator responsible for causing the invalidity. In the event the RIN generator does not take corrective action as outlined in the proposed regulations within 30 days, the next party responsible to take corrective action depends upon the Option selected (either the third-party auditor under Option A or the obligated party under Option B).

To the extent this Proposal recognizes the serious limitations in the current system by offering some level of protection to good faith RIN purchasers, it may well be an improvement for some obligated parties and RIN traders. However, the Proposal has several potential implications commenters are likely to address. For instance, the Proposal gives obligated parties two options to choose from when they purchase RINs that could limit their liability if the RINs are later found to be invalid. Option A shifts the cost of replacing invalid RINs to a third-party auditor, while Option B keeps the responsibility with the obligated party. Option A may be the preferred option for most obligated parties, because it shifts RIN replacement costs to a third-party. The cost of implementing Option A, however, may be so high because of the proposed audit requirements (ongoing and quarterly monitoring of feedstock, production, RIN generation and separation) and the additional liability being shifted to the auditor that it may be too expensive to use. Although liability would be capped at 2% for the first two years for auditors verifying RINs under Option A, it is not clear if the cap will continue in subsequent years and at what level. The proposed alternative, Option B, will similarly add costs to the RIN market because it also requires third-party audits (albeit of a more limited scope).

QAP and Affirmative Defense: A Major Sticking Point

Simply having an approved QAP does not shield an obligated party from liability. To achieve that protection, the obligated party must also successfully assert an affirmative defense. The obligated party must meet five conditions to assert an affirmative defense for an Option A-RIN and six conditions for an Option B-RIN. The difficulty of successfully meeting all of the requirements for asserting an affirmative defense to civil liability may be quite onerous. For instance, under both

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options, in order to assert an affirmative defense, the potentially liable person must prove by a preponderance of the evidence that *it did not know or have reason to know the RINs were invalidly generated prior to being verified by an auditor*. Traditionally, the prosecutor bears the burden of proving that a potential violator had knowledge of a particular act and lack of knowledge is simply a direct defense. However, civil liability under the Clean Air Act does not require any level of scienter (it is strict liability). Thus, under the Proposal, the government would appear to have no obligation to prove any level of knowledge; the potentially liable person has an obligation to proving a negative – i.e., that the party did not know or have reason to know of the RINs’ invalidity. This requirement could well render all of the other criteria irrelevant, since it may be an impossible burden to meet.

The EPA also seeks input on a number of other concepts to the RFS regulations, which on their face may have broad implications, but for which EPA did not propose specific language, such as: whether monthly, quarterly and/or annual reports of information submitted by renewable fuel producers or importers should be made publicly available; whether exporters should be required to demonstrate that they have acquired enough RINs to cover volumes exported on a quarterly, rather than annual, basis; and whether RIN separators should be required to include information in their quarterly reports regarding qualifying separation events.

The public comment period for this Proposal is open until **April 18, 2013** and a public hearing is scheduled to take place in Washington, D.C., on March 19, 2013. To ensure that obligated parties can actually benefit from this Proposal, it may be important to comment on several provisions of the Proposal and its potential implications. K&L Gates is available to assist and advise affected parties interested in commenting on the proposed rule.

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