

## EPA Proposes Reducing Renewable Fuel Mandate, Citing Market Issues and Technical Constraints

***Several aspects of the Agency's proposal raise issues for industry to address in comments and explore in the rulemaking process.***

### Background and Summary

On November 29, 2013, the US Environmental Protection Agency (EPA) published notice of its proposed 2014 Renewable Fuel Standard (RFS) in the Federal Register. Unlike previous years, EPA is proposing to lower the quantity of total renewable fuel from that required by statute to address concerns about the "blend wall." Comments on the proposal are expected to address the reasonableness of EPA's projections of availability of renewable fuels and whether EPA has permissibly interpreted its authority to reduce required volumes from those mandated by statute.

The US Clean Air Act (CAA) Section 211(o) requires EPA annually to set standards for renewable fuels to be blended into the US transportation fuel supply. There are four categories of renewable fuels: (1) cellulosic biofuel; (2) biomass-based diesel; (3) advanced biofuel; and (4) total renewable fuel. The cellulosic biofuel and biomass-based diesel standards are nested within the advanced biofuel category, which itself is nested within the renewable fuel category. EPA sets volumes for each of the four fuel types and then, based on projected fuel consumption, calculates percentages of renewable fuels to be blended by the obligated parties (refiners and blenders). To determine the volume requirement for each fuel type, EPA used various assumptions to project a range of production in 2014 and then proposed an approach to select a single value within that range. EPA solicits comments on its approaches and assumptions for determining the ranges and selecting a single value from them, and indicates the values will be refined for the final rule. In this overview, we refer to the "preferred approach" volumes EPA proposes.

Due to market considerations and practical limitations like the "blend wall" (the amount of ethanol that can be blended into the fuel supply given infrastructure and engine compatibility considerations), EPA proposes to employ its authority under two so-called "waiver provisions" of the CAA to significantly reduce requirements from the statutory volumes for cellulosic biofuel, advanced biofuel, and total renewable fuel volumes. The 2014 (and 2015) biomass-based diesel volume would be maintained at the 2013 level. The statutory volumes, proposed volumes under the waivers, and proposed percentages of projected 2014 fuel consumption are detailed in Table 1 below.

**Table 1 – 2014 RFS Volumes (billions of gallons of ethanol equivalent) and Percentages**

Type of Fuel	CAA Volume Requirement	EPA Volume Proposal	EPA Projected Volume Ranges	EPA Percentage Proposal
<b>Cellulosic biofuel</b>	1.75	0.017	0.008–0.030	0.010%
<b>Biomass-based diesel</b>	≥1.0	1.28	1.28	1.16%
<b>Advanced biofuel</b>	3.75	2.20	2.00–2.51	1.33%
<b>Renewable fuel</b>	18.15	15.21	15.00–15.52	9.20%

## **EPA’s Proposed Standards**

### **Cellulosic Biofuel**

For cellulosic biofuel, EPA proposes a volume requirement of 17 million gallons (down from a statutory mandate of 1.75 billion) and a percentage standard of 0.010 percent (that is, an obligated party must blend or obtain credits for 0.01 percent of the total volume of gasoline and diesel that party imports or produces in 2014). EPA estimated this amount by: (1) determining a projected range of production of cellulosic biofuel for each company likely to produce cellulosic biofuel in 2014; (2) running a Monte Carlo simulation to aggregate the individual company ranges into the amount of cellulosic biofuel likely to be available; and (3) selecting a single volume within the projected range that represents EPA’s best estimate of the volume that will actually be produced in 2014. EPA’s Monte Carlo simulation requires numerous technical and market assumptions, which commenters likely will challenge as too aggressive and too conservative. Comments will also likely focus on the accuracy of the proposed range projection and the single volume requirement.

In addition, following the decision in *American Petroleum Institute v. EPA*, 706 F.3d 474 (D.C. Cir. 2013), which vacated the 2012 cellulosic biofuel standard, EPA is proposing to rescind the 2011 standard, which was based on the same method as the 2012 standard, and refund money paid by obligated parties for cellulosic biofuel credits. Some comments may question whether EPA’s 2014 estimate methodology is permissible under the *API v. EPA* decision (such a challenge has already been filed regarding the 2013 cellulosic volume requirement).

### **Biomass-based Diesel**

EPA proposes a volume requirement of 1.28 billion gallons for 2014 and 2015 (which is consistent with the 2013 level and above the statutorily required one billion gallons) and a percentage standard of 1.16 percent. EPA set the proposed standard at 1.28 billion without considering the statutorily required factors because the agency had analyzed the factors in setting the 2013 standard. Moreover, EPA did not propose to mandate more than 1.28 billion, even though the agency expects the biomass-based diesel industry to be able to produce more in 2014. According to the notice, EPA chose this route to allow the market to decide whether to produce and use volumes of biomass-based diesel above 1.28 billion gallons

to meet the advanced biofuel volume requirement, or to rely on other advanced biofuels. EPA specifically requests comment on the decisions to not reanalyze the required factors and to not set the requirement higher than 1.28 billion gallons.

### **Advanced Biofuels and Total Renewable Fuel**

For advanced biofuels, EPA proposes a volume requirement of 2.20 billion gallons (reduced from a statutory mandate of 3.75 billion gallons) and a percentage standard of 1.33 percent. For total renewable fuel, EPA proposes a volume requirement of 15.21 billion gallons (down from a statutory requirement of 18.15 billion gallons) and a percentage standard of 9.20 percent. Concerns about the blend wall and a projected shortfall of non-ethanol renewable fuels drove EPA's proposal to lower the volume requirements.

To calculate the specific volume requirements, EPA developed a new three-step framework, which EPA also proposes to use in years beyond 2014. In the first step, EPA determines the volume for total renewable fuel by adding: (a) the total amount of ethanol that can be consumed, given the blend wall and other relevant constraints — such as infrastructure for higher blend fuels (E15 and E85), and (b) the projected volumes of non-ethanol renewable fuels. In the second step, EPA calculates the total volume of all types of advanced biofuels that could be achieved. In the third step, EPA determines an appropriate volume of advanced biofuel at or below the available volume calculated in step two; this third step is necessary to ensure that ethanol volumes in the advanced biofuel category do not exacerbate blend wall concerns (ethanol made from certain sources other than corn starch qualifies as advanced biofuel). This framework again uses Monte Carlo simulations, requiring various assumptions that may be challenged. EPA specifically requests comment on all aspects of this framework.

### **EPA's Use of Waiver Authorities**

EPA relies on two separate statutory provisions as authority for reducing the advanced biofuel and total renewable fuel requirements. First, CAA Section 211(o)(7)(D)(i) requires EPA to reduce the required volume of cellulosic biofuel if the agency determines that the projected volume of cellulosic biofuel production will be less than the statutory volume requirement. If EPA reduces the requirement (and it has done so each year since the RFS cellulosic requirement took effect), EPA has discretion to then reduce the applicable volume requirements of advanced biofuel and total renewable fuel by the same or a lesser volume as the cellulosic biofuel reduction. Through the 2013 RFS, EPA had not exercised this option, but does propose to do so for the 2014 RFS.

Second, CAA Section 211(o)(7)(A) allows EPA to reduce the total renewable fuel volume requirement if the agency determines that “implementation of the requirement would severely harm the economy or environment” or if “there is an inadequate domestic supply” of renewable fuel. EPA had previously denied petitions for waivers brought under the first basis and does not attempt to rely upon that basis for the 2014 RFS; rather, EPA turns to the second basis. Although projected quantities of domestic renewable fuels meet or exceed the statutory 2014 volume, EPA is interpreting “inadequate domestic supply” to encompass the full range of constraints on the supply of renewable fuel to the ultimate consumers, including ability to distribute, blend, dispense, and consume renewable fuels. Thus, EPA asserts factors such as the unsuitability of blends above 10 percent ethanol for most existing vehicles and the lack of infrastructure to deliver higher percentage blends to compatible vehicles can create an inadequate domestic supply, thus permitting EPA to waive a part of the statutory requirement. EPA specifically invites comments on its proposed interpretation of the waiver provision based on “inadequate domestic supply.”

Prior to issuance of the draft 2014 RFS, the American Petroleum Institute and the American Fuel & Petrochemical Manufacturers (on behalf of their members) and several refining companies submitted

petitions under CAA Section 211(o)(7)(A), requesting a partial waiver of the 2014 applicable volumes under the RFS. Similar to EPA's reasoning, the petitioners argue that there is an inadequate domestic supply of renewable fuel due to blend wall constraints and limitations on the production of non-ethanol fuels like biodiesel. The petitioners also argue that implementation of the statutory requirement will lead to increased gasoline and diesel prices, which in turn will severely harm the economy. On the same day EPA issued the 2014 RFS proposal, EPA published a request for comments on the waiver petitions, and the agency anticipates publishing its decision in conjunction with the final 2014 RFS.

## **RIN Prices and Compliance**

Renewable Identification Numbers (RINs) are the compliance mechanism for the RFS. Obligated parties can acquire RINs either by blending renewable fuels or by purchasing RINs on the open market. Early in 2013, concerns that the blend wall would be reached this year or in 2014 caused RIN prices to rise rapidly more than 20-fold above historic prices. After a peak in March, prices fell somewhat into the summer, fell significantly after publication of the 2013 RFS in August, and have fallen further with publication of the proposed 2014 RFS. The contours of the final 2014 RFS will impact future RIN prices. In the 2013 RFS, EPA stated its intention to set the 2014 standard by the statutory deadline of November 30, 2013, such that the 2014 standards would be known well in advance of the 2013 compliance deadline. This timing would allow obligated parties to make informed decisions about their 2013 compliance strategies, such as whether to use banked RINs, or save certain RIN categories for 2014 compliance. Due at least in part to the government shutdown this fall, EPA did not meet the November 30 deadline and is not likely to issue a final 2014 RFS before the end of February, and quite possibly later than that. Thus, comments may also address whether and how EPA's timing will impact the price of RINs and the ability of obligated parties to comply with both the 2013 and 2014 RFS requirements.

## **How to Comment**

EPA is requesting comments on all aspects of its proposal, and there are many assumptions in the proposal which may merit comment. Comments on the proposed standards and on the waiver petitions must be received on or before January 28, 2014 (EPA states that comments on the 2014 RFS will also be considered to have been submitted on the waiver petitions). Comments must be submitted through one of the methods specified in the proposed rulemaking (either online, via email, via mail, or via hand delivery). The notice of proposed rulemaking for the 2014 RFS can be found at: <http://www.gpo.gov/fdsys/pkg/FR-2013-11-29/pdf/2013-28155.pdf>. The notice of the waiver petitions is at: <http://www.gpo.gov/fdsys/pkg/FR-2013-11-29/pdf/2013-28301.pdf>.

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## For Further Information

If you have questions about the 2014 RFS proposal, or would like assistance in preparing comments, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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