Summary Testimony of Chet Thompson, President and CEO, American Fuel & Petrochemical Manufacturers

U.S. House Energy and Commerce Subcommittee on the Environment and Climate Change, ***Protecting the RFS: The Trump Administration's Abuse of Secret Waivers***

October 29, 2019

Summary

- AFPM's members operate approximately 110 refineries, accounting for more than 95 percent of U.S. refining capacity, that produce the gasoline, diesel, jet fuel, and petrochemical building blocks for the thousands of products that make innovation and progress possible. Our members are the obligated parties under the RFS.

- Importantly, AFPM's members also produce nearly 20 percent of U.S. ethanol and a substantial volume of the renewable diesel produced the in U.S. We are uniquely positioned to evaluate the true market impacts of these policies.

- Congress established small refinery exemptions as a critical safety net in recognition that small refineries are national security assets, solid foundations of their local economies and a critical source of supply that increases competition in the fuels market.

- Contrary to the premise of today's hearing and much of the narrative around this issue, however, small refinery waivers have not had any demonstrable impact on domestic biofuels demand, which is at or near record highs.

- In fact, until recently, the Administration's RFS policy reduced compliance costs while enabling record biofuel use. EPA recently departed from this balance with a proposed reallocation that amounts to nothing more than an unjustified increase in the regulatory burden for non-exempt parties. This increase will, in all likelihood, be met with a combination of drawing down the Renewable Identification Number ("RIN") bank and more imported biodiesel.

- AFPM opposes the legislation under consideration today, H.R. 3006, as it is both practically unworkable and would eliminate critical protections for refineries' confidential business information. The Committee should instead consider substantial, long-term reforms to the RFS that can benefit all stakeholders, such as a transition from the RFS to fuel-neutral 95-RON octane standard discussed in hearings last year, as well as bipartisan bills such as H.R. 2540, authored by Representatives Flores and Welch.

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Protecting the RFS: The Trump Administration's Abuse of Secret Waivers

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The American Fuel & Petrochemical Manufacturers ("AFPM") appreciates the opportunity to provide testimony on the Environmental Protection Agency's ("EPA") implementation of the Renewable Fuel Standard ("RFS"). AFPM's members operate approximately 110 refineries, accounting for more than 95 percent of U.S. refining capacity, that produce the gasoline, diesel, jet fuel, and petrochemical building blocks for the thousands of products that make innovation and progress possible. Importantly, AFPM's members also produce nearly 20 percent of U.S. ethanol and a substantial volume of the renewable diesel produced the in U.S. We are uniquely positioned to evaluate the true market impacts of these policies.

Congress established small refinery exemptions as a critical safety net in recognition that small refineries are national security assets, solid foundations of their local economies and a critical source of supply that increases competition in the fuels market. Nationwide, the refining sector supports more than 2 million well-paying jobs. There are 36 small refineries in 17 states, accounting for approximately 8 percent of total refining capacity in the U.S. They contribute to the economic health of their local communities through economic development, taxes, and philanthropy. They are investors in infrastructure, safety, and education. Refineries are worth standing up for, and the simple fact is that the Administration's granting of waivers to small refineries has been a lifeline to those refineries disproportionately impacted by the RFS program.

Contrary to the premise of today's hearing and much of the narrative around this issue, however, small refinery waivers have not had any demonstrable impact on domestic biofuels demand, which is at or near record highs. In fact, until recently, the Administration's RFS policy reduced compliance costs while enabling record biofuel use. EPA recently departed from this balance with a proposed reallocation that amounts to nothing more than an unjustified increase in the regulatory burden for non-exempt parties. This increase is expected to be met with a combination of drawing down the Renewable Identification Number ("RIN") bank and more imported biodiesel.

AFPM opposes the legislation under consideration today, H.R. 3006, as it is both practically unworkable and would eliminate critical protections for refineries' confidential business information. The Committee should instead consider substantial, long-term reforms to the RFS that can benefit all stakeholders, such as a transition from the RFS to fuel-neutral 95-RON octane standard discussed in hearings last year, as well as bipartisan bills such as H.R. 2540, authored by Representatives Flores and Welch.

I. Although AFPM does not take a position on individual exemptions, EPA has the legal obligation to grant small refinery exemptions to all facilities that demonstrate disproportionate economic hardship.

In developing the 2007 RFS2 legislation, Congress automatically exempted small refineries, regardless of parent company, from the requirements of the program through the 2010 compliance year, with the ability for EPA to extend the exemption for an additional two years. This was a purposeful exemption that recognized small refineries are critical suppliers in many regions of the country and Congress did not want to lose those facilities or create disincentives for companies to own those assets. EPA extended that exemption for all small refineries in 2011 and 2012. Beginning in 2013, eligible small refineries were permitted to apply for an exemption "at any time" provided they demonstrate disproportionate economic harm. Refineries are evaluated on an individual basis irrespective of parent company size or profitability. The Department of Energy (DOE) and EPA look at the specific facility, local, and regional competitive factors. These factors include items such as access to capital, percentage of diesel production, cash flow, and refinery margins, all of which are confidential business information. If the requisite showing of harm is made, EPA has a non-discretionary duty to grant waivers to the covered facility.

As the mandated volumes have increased (approximately 20 percent since 2013), so has the burden on refineries. This 20-percent increase in the mandate has led to more refineries needing relief and petitioning for exemptions. The increase over the past few years coincides with EPA's efforts to push renewable fuel mandates past the blendwall. This has been an unsurprising development. In fact, in its 2011 study, DOE predicted that as volumetric mandates increased and approached the ethanol blendwall, RIN prices and the resulting burden on small refineries would also increase.

The evolving DOE and EPA administration of the small refinery exemption program and resulting litigation is also a critical factor in the number of granted petitions. For example, in May 2014, DOE released a memorandum updating its metrics for the "viability" component of its scoring, effectively making it more difficult for refineries to demonstrate the requisite harm. In the aftermath of DOE's change to scoring metrics, several federal appellate court cases have limited EPA's authority to deny small refinery exemptions. For example, the Tenth Circuit told EPA that disproportionate economic impact did not require a showing that the refinery would close without the exemption (Sinclair 10th Cir 2017). And the Fourth Circuit held that EPA must look at specific circumstances faced by each applicant including the gasoline/diesel production mix, which affects a refinery's ability to blend renewable fuels (Ergon 4th Cir. 2018).

The combination of increasing mandates and a return to more balanced review of the scoring based on federal judicial determinations have been crucial reasons for the recent increase in small refinery exemptions.

II. All available data show that there has been no decline in domestic biofuels consumption as a result of small refinery waivers.

The recent discussion about the Administration's actions on small refinery waivers is predicated on the faulty premise that biofuel demand has suffered as a result of the waivers. The charts in Appendix A unequivocally show that there has been no decline in domestic biofuel consumption, and that production is near record highs despite trade issues and the lapse in the biodiesel tax credit.

To summarize, the latest Energy Information Administration ("EIA") data show that year-to-date ethanol consumption is at an all-time high both volumetrically (8.39 billion gallons) and as a blend rate (10.17 percent). The reason for this is simple. Refiners, including exempt refiners, produce gasoline BOBs, which must be blended with 10 percent ethanol to reach the required octane specification in finished gasoline. Virtually all gasoline sold in the U.S. is blended with ethanol whether or not it is produced by an exempt refinery and regardless of when such exemption is granted. Ethanol production this year is running at the second highest rate on record, with a small decline (1.9 percent) explained by a large decline (15 percent) in exports. Administrator Wheeler confirmed this analysis in his testimony before the House Science Committee on September 19, 2019, stating that "[w]e do not see any demand destruction from the small refinery program on ethanol production."

Likewise, U.S. biodiesel consumption is near the record high set in 2017 and higher than 2016, despite the lapse of the biodiesel tax credit at the end of 2017. Biodiesel production is at a record level this year, with 1.022 billion gallons produced through July. Biodiesel's biggest challenge is its cost, which routinely averages $0.75-$1.00 more per gallon than the petroleum diesel it displaces.

III. Legislation requiring that hardship applications be submitted before the compliance year is impractical and removing critical confidential business information protections undermines U.S. energy security.

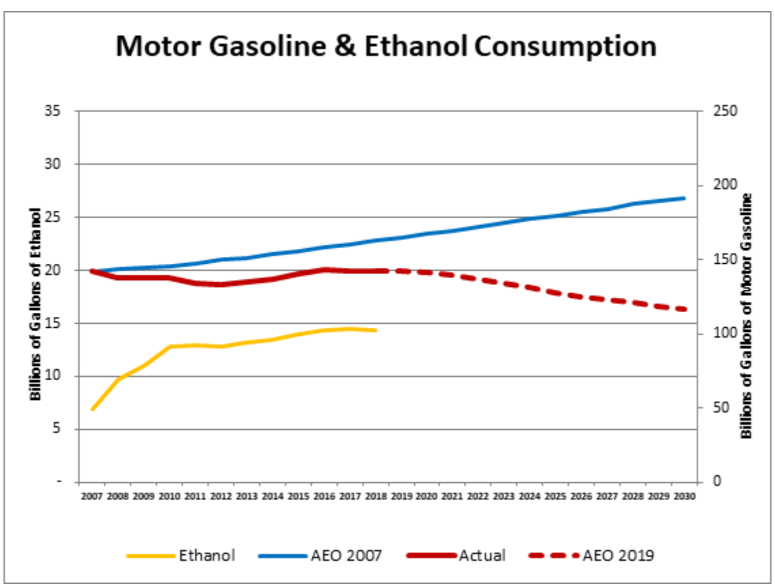
The RFS explicitly allows small refineries to petition for hardship waivers "at any time." This provision, included by Congress in the statute, correctly recognizes that it is impractical to place artificial deadlines on small refineries that may have need to petition for relief for any number of reasons at a later time. For instance, a petition in advance of a June deadline will not reflect an unexpected increase in the annual RFS percentage standards, unexpected increases in RIN prices, lower than expected margins, a greater demand for diesel compared to gasoline, or any other number of factors that DOE and EPA take into account.

Likewise, it is unreasonable to expect companies to lay bare their strongest case for economic hardship for competitors to review and utilize for commercial purposes. The refining industry is among the most competitive industries in the world, competing for advantages of fractions of a penny at a blending rack. It is in the public interest to maintain the confidentially of all information included in applications. As a result, AFPM strongly opposes H.R. 3006.

IV. EPA's proposed reallocation will increase compliance costs and incentivize imports without helping domestic biofuel producers.

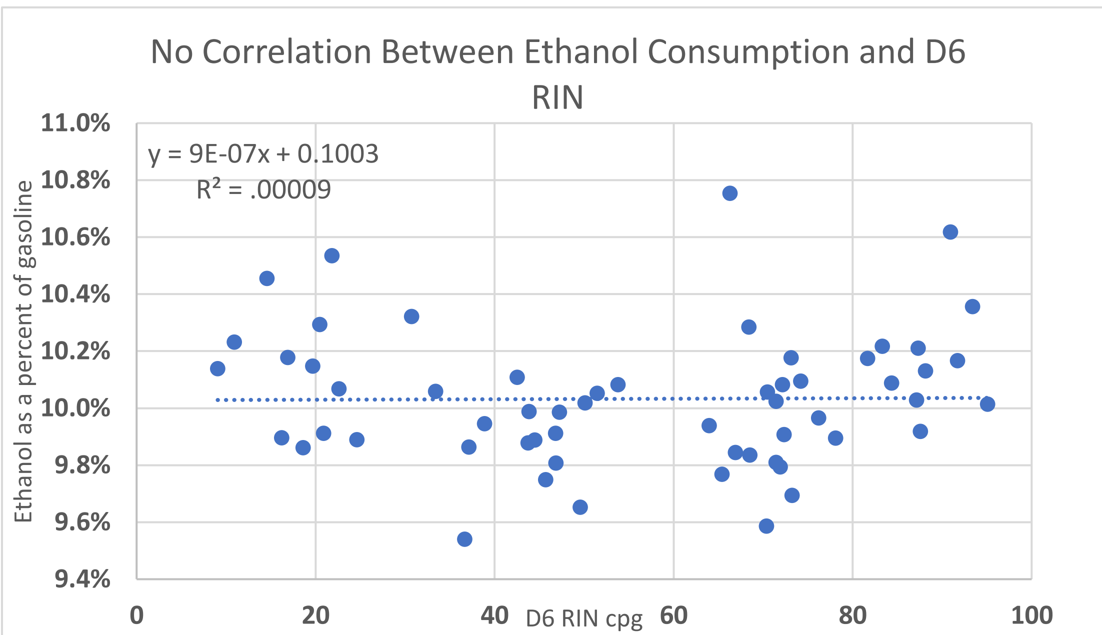
EPA issued a supplemental proposal for the 2020 renewable volume obligations, estimating that EPA will grant waivers for the equivalent of 580-770 million RINs and proposing to increase the requirements for non-exempt refiners. Unfortunately, this proposal ignores the fact that there is no "lost" volume to reallocate and amounts to increasing the mandates for non-exempt refiners. Under the proposed changes, obligated parties will be left with few realistic options to acquire the requisite RINs for the RFS compliance: draw from the RIN bank or import more biodiesel.

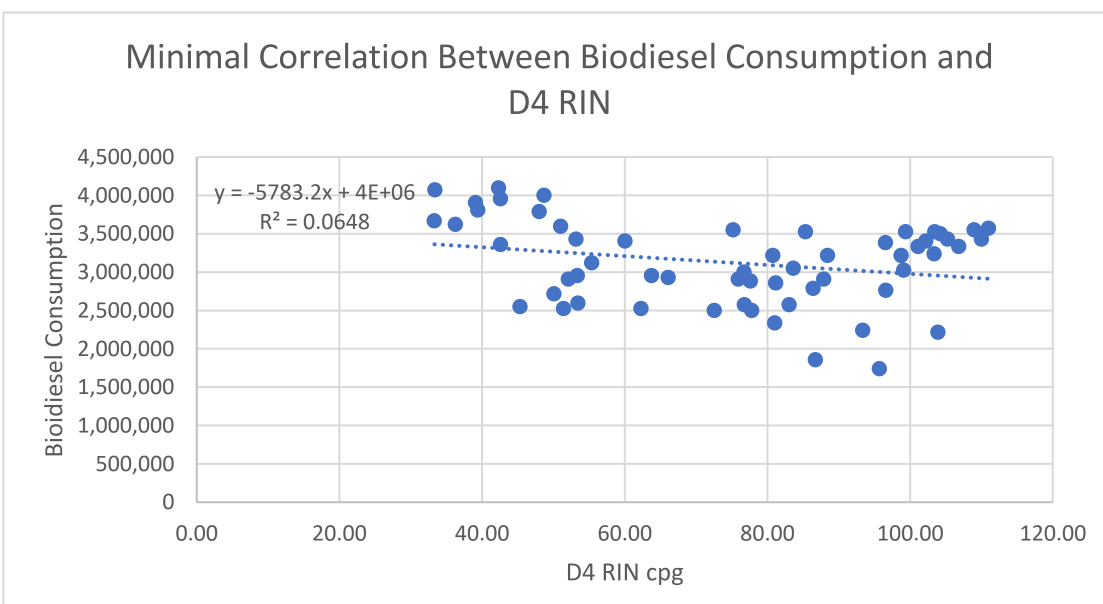
First, significant additional ethanol consumption is unlikely. As AFPM has testified to on multiple occasions, the U.S. energy landscape has changed significantly since the Energy Independence and Security Act of 2007. The most pertinent change for today's hearing is the gasoline demand forecast. In particular, in 2007 EIA projected that the U.S. would consume 165 billion gallons of gasoline in 2019 and 168 billion gallons in 2020. Now, the U.S. is projected to use 15 percent less than originally estimated – only 143 billion gallons. The difference in these projections is the key to understanding the E10 blend wall. Had EIA's projections materialized, at a nationwide E10 blend the U.S. would have consumed nearly 17 billion gallons of ethanol this year. Instead, with current demand, an E10 blend can only reach approximately 14.3 billion gallons of ethanol. Higher-level blends such as E15 face infrastructure and market challenges, most notably incompatible retail components and a legacy vehicle fleet that can not handle midlevel ethanol blends. Despite the Administration's decision to extend the one-pound Reid Vapor Pressure waiver to E15, thereby allowing it to be sold year-round in conventional gasoline areas, it is still not expected to be consumed in quantities sufficient to meet the 15 billion gallon conventional biofuel RFS mandate. In fact, to fill the gap between the 14.3 billion gallons of ethanol used in E10 and the 15 billion gallon conventional mandate, E15 sales would need to grow to 14 billion gallons next year, compared to a few hundred million gallons estimated this year. There is simply no way the infrastructure and vehicle fleet will turn over quickly enough to make this a reality in the near term.



As a result of the challenges with increasing ethanol consumption, companies utilize additional biomass-based diesel to meet the remaining 0.7 billion gallons of required conventional biofuel. Additionally, companies use biomass-based diesel to meet the nested biomass-based diesel mandate and the bulk of the advanced biofuel mandate. Therefore, taking into account the RIN multipliers, obligated parties need an estimated 3 billion gallons of biomass-based diesel to meet the 2019 mandates. However, the domestic biomass-based diesel industry has never produced more than 2.4 billion gallons in a given year, even with tax credits that are now expired. As a result, other compliance mechanisms must be used, including increasing imports of biofuels and drawing down the existing RIN bank to meet existing mandates that are already too aggressive. The result of the Administration's significant reallocation will only exacerbate this situation, increasing prices and incentivizing imports.

Relatedly, some interest groups will claim that a high RIN price is needed to subsidize biofuel infrastructure. Again, a review of the data shows no correlation between D6 RIN prices (conventional RINs) and ethanol blending, and a very weak correlation between D4 RIN prices biomass-based diesel RINs) and biodiesel blending.





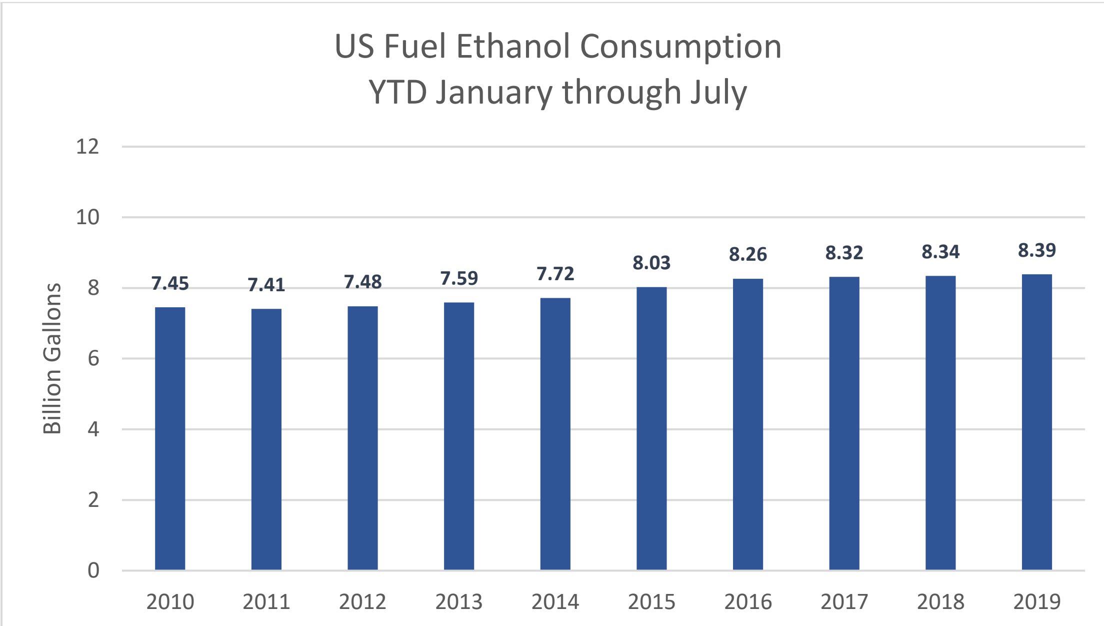
This lack of correlation underscores the problem with expecting a high RIN price to drive additional biofuel blending. Even with D6 RIN prices hitting $1.48 in the summer of 2013, blending did not appreciably increase. The RFS is increasingly unworkable, which is why AFPM has consistently advocated for a transition to a smarter fuels policy.

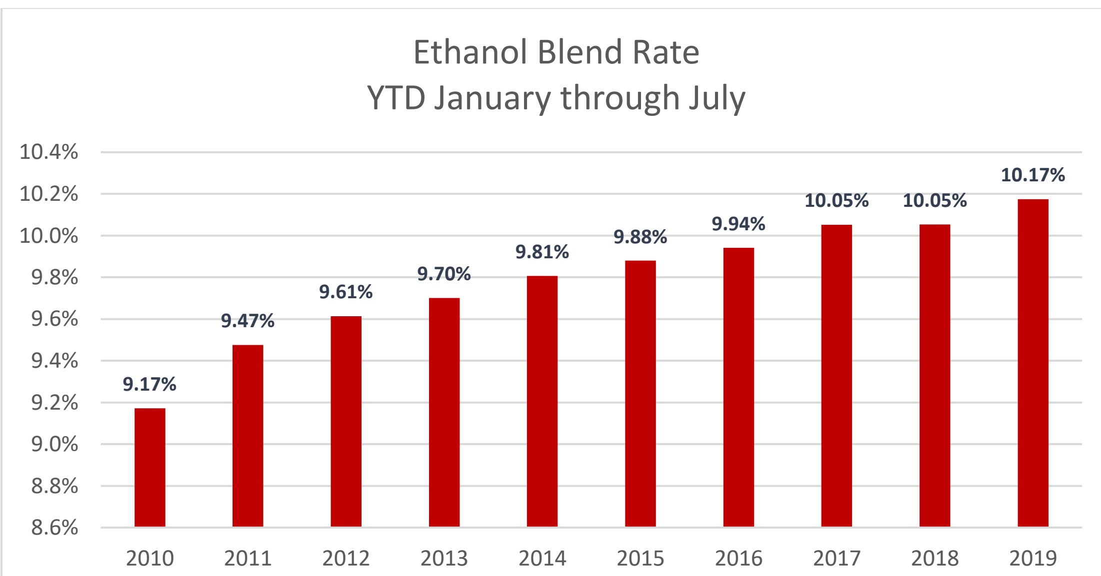
To be clear, the Trump Administration has also taken substantial policy actions to benefit biofuel producers. The most apparent is the decision to grant a one-pound Reid Vapor Pressure waiver to E15, allowing it to be sold year-round. AFPM opposes this action, but it is yet more evidence that the Administration's RFS policy is not "devastating the renewable fuel industry" through its biofuels policies. The Administration has also expanded the mandated volumes despite declining gasoline consumption, including year-over-year increases beyond statutory minimums in the biomass-based diesel category.

V. Recommendations and Conclusion

AFPM appreciates the opportunity to provide its perspective on this critical issue. Unfortunately, the debate in recent months has been untethered from basic facts about the economics of the fuels market. AFPM recommends that the Committee take a critical look at the data referenced in this testimony and take a skeptical view towards claims that EPA's management of the RFS and ancillary programs have harmed the biofuels industry. Indeed, until the recent proposal to reallocate small refinery waivers, the Administration's approach has supported both lower compliance costs and record domestic biofuel consumption.

Rather than focusing legislative efforts on fixing a non-existent problem with small refinery waivers, AFPM recommends the Committee give serious consideration to near-term relief such as H.R. 2450, and long-term solutions that can benefit all stakeholders, such as a transition away from the RFS to a 95-RON octane standard. AFPM stands ready to work with the Committee and all stakeholders on reasonable legislation to address the many challenges with this program.


US Fuel Ethanol Consumption
YTD January through July
Billion Gallons
12
10
8
6
4
2
0
7.45
7.41
7.48
7.59
7.72
8.03
8.26
8.32
8.34
8.39
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019


Ethanol Blend Rate
YTD January through July
10.4%
10.2%
10.0%
9.8%
9.6%
9.4%
9.2%
9.0%
8.8%
8.6%
9.17%
9.47%
9.61%
9.70%
9.81%
9.88%
9.94%
10.05%
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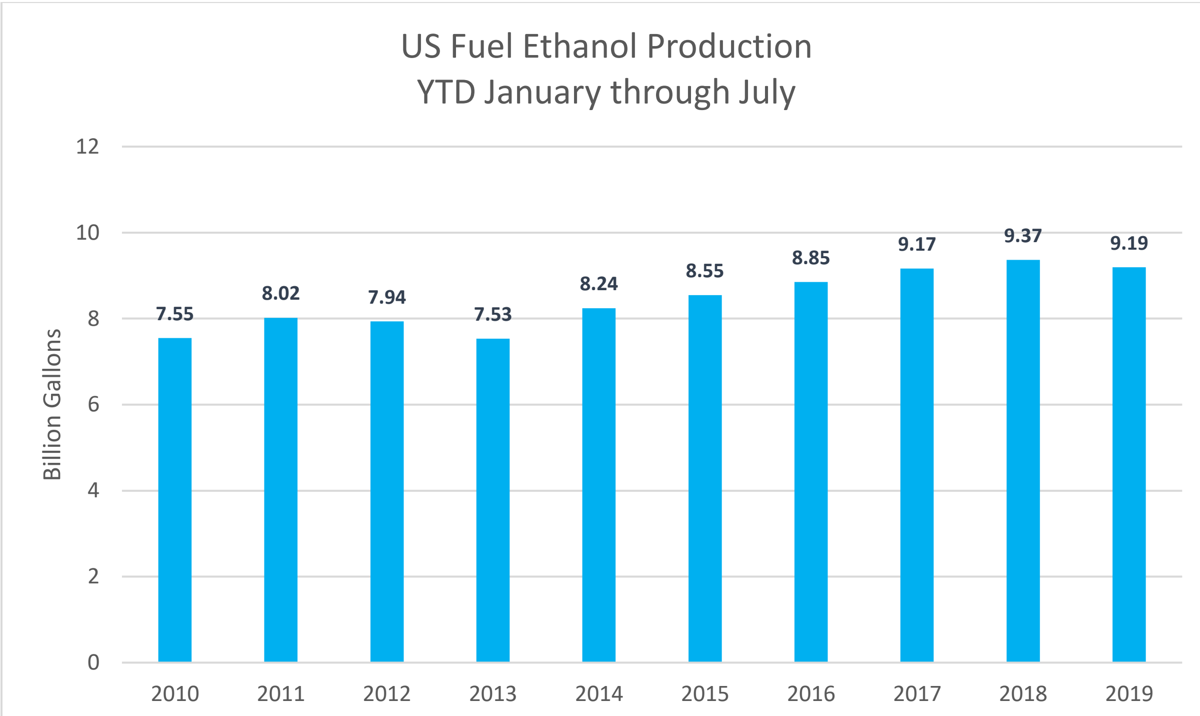
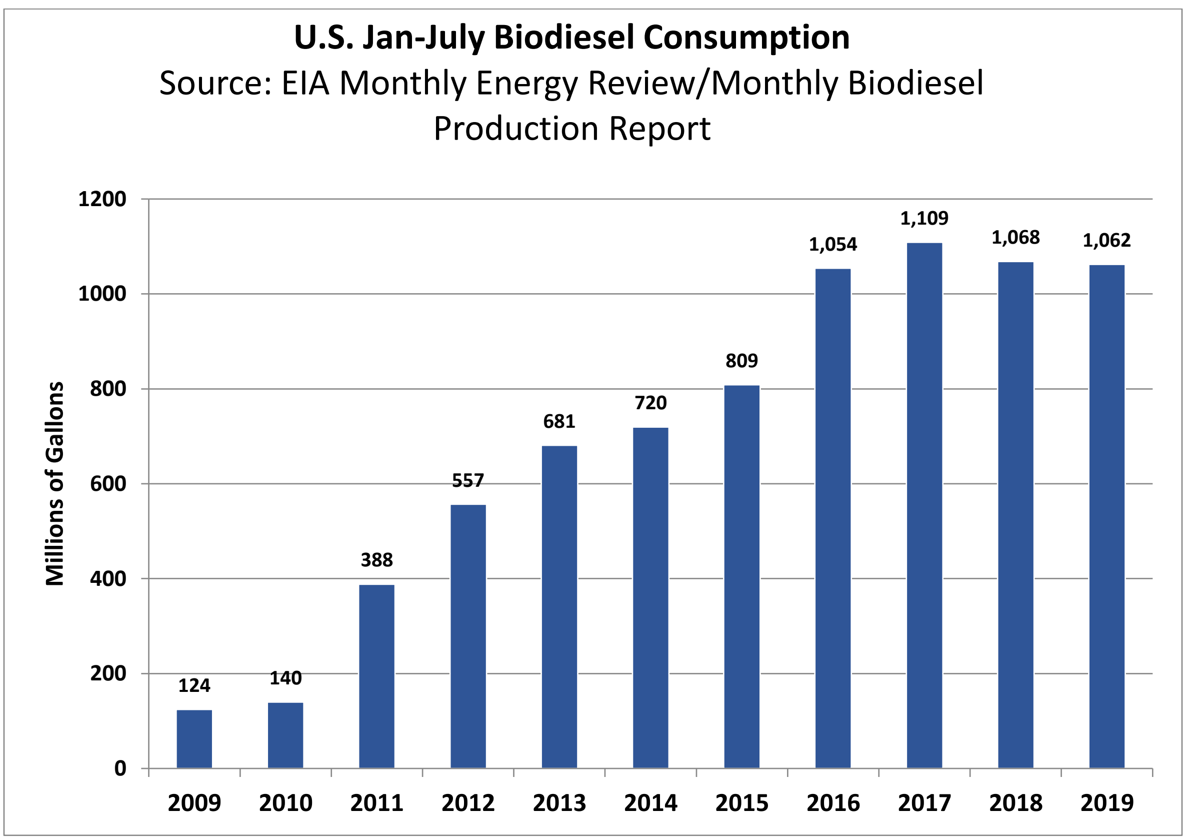
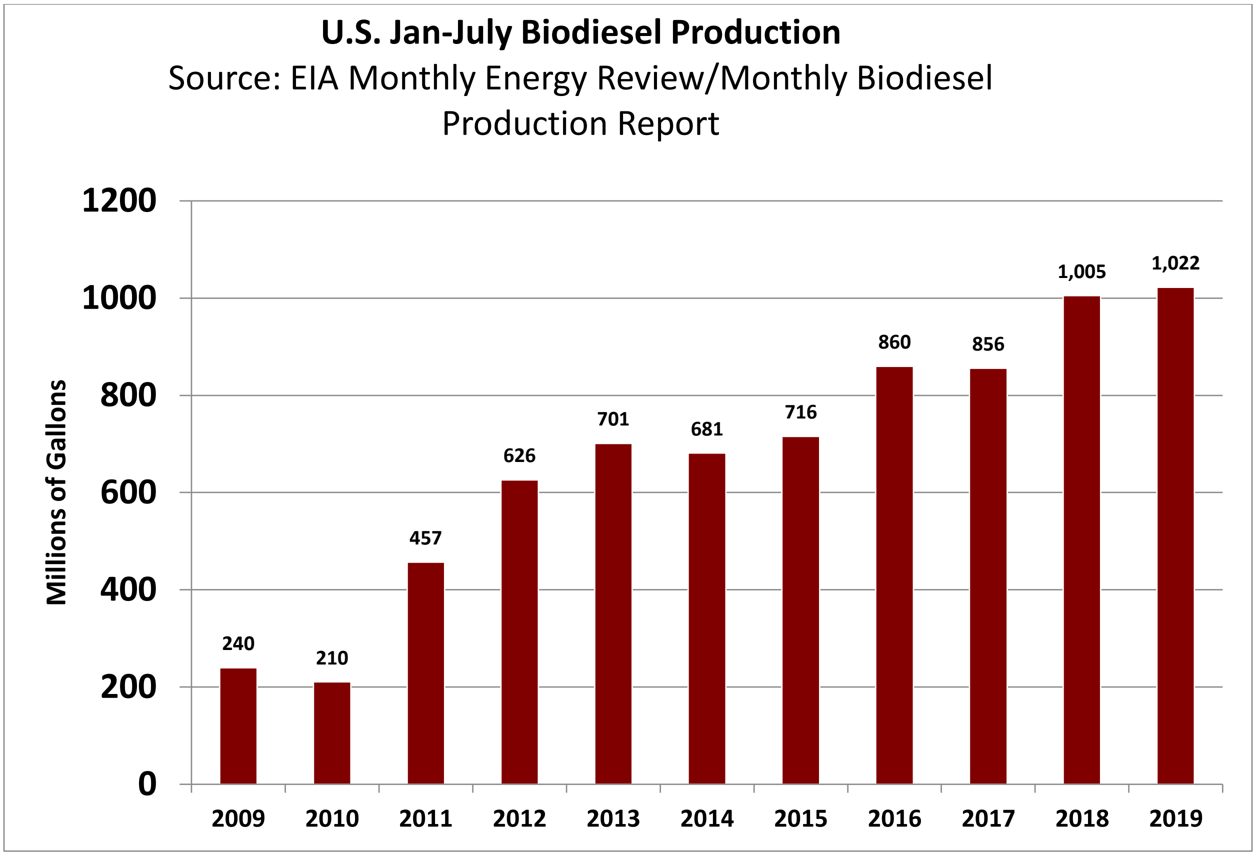
2016
2017
2018
2019


US Fuel Ethanol Production
YTD January through July
Billion Gallons
0
2
4
6
8
10
12
7.55
8.02
7.94
7.53
8.24
8.55
8.85
9.17
9.37
9.19
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019


U.S. Jan-July Biodiesel Consumption
Source: EIA Monthly Energy Review/Monthly Biodiesel Production Report
Millions of Gallons
0
200
400
600
800
1000
1200
124
140
388
557
681
720
809
1,054
1,109
1,068
1,062
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019


U.S. Jan-July Biodiesel Production
Source: EIA Monthly Energy Review/Monthly Biodiesel Production Report
Millions of Gallons
1200
1000
800
600
400
200
0
240
210
457
626
701
681
716
860
856
1,005
1,022
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019