

**STATEMENT OF THE
AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS
ON THE PROPOSED
RENEWABLE IDENTIFICATION NUMBER
QUALITY ASSURANCE PROGRAM**

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Introduction

Good morning. My name is Tim Hogan and I am the Director of Motor Fuels for the American Fuel & Petrochemical Manufacturers in Washington, DC. Our members produce virtually all of the nation's transportation fuels and are obligated parties under the Renewable Fuels Standard (RFS). While there are numerous problems associated with mandating renewable fuels under the RFS, the purpose of today's hearing is narrowly focused upon measures to reduce the likelihood of fraudulently generated Renewable Identification Numbers (RINs). AFPM understands the need for a feasible, workable RFS rule and the rampant fraud in the biodiesel industry stands as one of several obstacles to accomplishing this goal.

AFPM supports the efforts of the Administration to improve the integrity of the Renewable Fuel Standard (RFS) program. We are disappointed that EPA chose to punish refiners who were the victims of fraud committed by biodiesel producers. The discovery of more than 140 million fraudulent biodiesel RINs led AFPM to reach out to EPA, renewable fuel producers, and petroleum marketers in an effort to address this problem. Aside from the unfairness of penalizing individual refiners that purchased RINs from EPA-registered biodiesel producers through the EPA EMTS exchange, the biodiesel fraud has created a RIN liquidity problem for many small biofuel producers.

Our group quickly realized that providing an alternative to the strict liability buyer beware program that was built upon the concept of creating an affirmative defense around some level of proscribed due diligence would help restore RIN liquidity.

Now, more than a year later, the publication of the Proposed Rule on QAPs represents a big step towards implementing a solution. We applaud EPA for recognizing the need to create an affirmative defense to buyer beware liability; however, we are concerned that the proposal goes too far in its burdensome due diligence requirements, which we will discuss in more detail.

AFPM supports many aspects of the Agency's proposal, including:

- The voluntary nature – Participants have the option to use the validation program as needed. As a consequence, there will be “validated” and “not validated” RINs in the marketplace.
- The promulgation of performance standards that can be implemented by independent, EPA-approved validators.
- The availability of an affirmative defense that is tied to “validated” RINs, provided that the obligated party did not cause the RINs to become invalid.

While we remain generally supportive of the regulatory solution, we have specific concerns with how it is to be implemented. First and foremost, we believe that EPA has lost sight of the goal of the Proposed Rule. Rather than put in place a due diligence program that is cost effective and reduces the risk that biofuel producers will generate fraudulent RINs, the agency has pivoted to create a 3rd party enforcement branch that is responsible for ensuring total compliance with each regulatory requirement under the RFS. This mission creep has the potential to result in an expensive program that is underutilized and fails to solve the RIN liquidity problem.

Today, I would like to discuss four issues in greater detail: data collection elements for QAPs, the need to communicate validated RINs to Obligated Parties, an interim enforcement solution for RINs generated prior to the effective date of the rule, and notification of invalid RINs.

A. Elements of a QAP

In reading the Proposed Rule, it became apparent that EPA is attempting to create a third-party audit of each regulatory requirement governing the generation and transfer of RINs. This would result in due diligence requirements that go far beyond what is necessary to reduce the risk of fraudulently generated RINs and could increase the costs of the QAP, resulting in low participation and a failed effort to restore RIN liquidity.

The due diligence activities identified in the proposed QAP include far too many data elements that would provide little or no additional risk reduction. For example, a quarterly requirement to review an annual report provides no incremental risk reduction and simply adds costs. The requirement to count the number of employees also provides very little, if any, incremental risk reduction. Rather than review each data element in the two proposed QAP programs, we think it makes sense to discuss what is needed to reduce (not completely eliminate) the risk of fraudulently generated RINs.

First, a credible audit program would be built around a biofuel producer site visit to verify the existence and operability of the equipment on-site and gain an understanding of equipment capacity and the level of energy consumption that corresponds to various production levels. An unscheduled follow-up site visit should be required annually. A requirement to notify the QAP provider of any facility modifications also should be included.

Second, there needs to be an audit component that examines feedstock receipts. These receipts are necessary to verify the amount of biodiesel produced and to ensure that the RIN code

matches the type of biofuel that is produced. We note that there is no need to audit each feedstock receipt, but rather a statistically significant sample of feedstock receipts should be audited.

Third, an audit of monthly utility bills should enable a comparison of the energy consumed with the amount of biofuel produced during that month and could be evaluated against the facility's energy requirements for various production levels as determined during the initial site visit.

Fourth, bills of lading for transporting the finished fuel from the production site should be reviewed and compared to the feedstock receipts. While all bills of lading should be provided to the third party auditor only a statistically significant number of bills of lading should be verified.

In implementing the QAP, there is a need to distinguish between data collection and verification. Spot checks have been the basis of attest engagements since 1995. Random statistical sampling has been a primary feature of the RFG Survey Association. EPA should make clear that audit requirements should be based on an analysis of a statistically significant representative sample for relevant data elements.

B. Communicating Validated RINs to Obligated Parties

To ensure that the benefits of RIN validation translate into actual RIN liquidity it is critical to revise EMTS to reflect the validation status of RINs. EMTS revisions should be implemented expeditiously and no later than the effective date of the final rule.

There is, however, a need for an interim communication system. To the extent that EPA envisions some type of validation program existing between now and the effective date of the final rule, some type of electronic bulletin board is necessary to communicate RIN validation status to obligated parties. We suggest that EPA work with approved auditors to implement a web-based, interim communication tool that provides obligated parties with the information needed to facilitate their purchase of validated RINs prior to appropriate changes in EMTS.

C. Interim Enforcement

While we continue to question the fairness and constitutionality of EPA's decision to hold obligated parties responsible for invalid RINs that were fraudulently sold by biodiesel producers and are aware of no other government program that penalizes the victims of fraud in this manner, we appreciate the efforts taken by OECA to mitigate the harm caused by this policy decision. Specifically, we support EPA's *Second Interim Enforcement Response Policy*. We note, however, that the policy for 2012 RINs is limited to biomass-based diesel and would request that the same treatment be applied to other RINs that may be invalid. With respect to 2013 RINs, while the policy extends to all types of "verified" RINs, obligated parties have no way to determine which RINs are verified under a QAP meeting the requirement of the Proposed Rule. We therefore suggest that the Interim Enforcement Response Policy be revised to provide the same treatment to all RINs generated in 2013 prior to the effective date of a final rule and modifications are made to EMTS to facilitate the use of validated RINs.

D. Notification of Invalid RINs

The Proposed Rule would require an obligated party to report the discovery of an invalid RIN to the Agency “within the next business day.” This is impractical and should be extended to 5-7 business days in order to allow time for a thorough investigation to confirm the invalidity and to notify company management.

Conclusion

While AFPM has serious concerns with the structure and workability of the RFS as a program generally, the RIN system and EMTS must work for our refining members to know that they will be able to comply with the RFS without being punished for being the victims of fraud. We reiterate our appreciation of the agency’s staff for recognizing the need to address rampant fraud in the biodiesel industry and their willingness to propose a regulatory solution. Regardless of one’s position on the RFS, there is widespread agreement that the current system needs to be fixed to avoid the perpetuation of fraud and increased costs to consumers. An efficient and cost-effective solution that avoids unnecessary complexity is needed. High cost and complexity could jeopardize the goal of ensuring RIN liquidity.

We generally support the concept of providing an affirmative defense to liability where an appropriate amount of due diligence has been performed. We have serious concerns as to EPA’s perspective on what constitutes adequate due diligence and believe that both QAPs go well beyond what is necessary to reduce the risk of fraudulently produced RINs.

We also ask EPA to give serious thought to a means to efficiently communicate the whether a particular RIN has been validated prior to revisions of the EMTS, and ask that work on EMTS proceed so that the system is ready on or before the effective date of a final rule.

We ask EPA to extend the terms of the Interim Enforcement Policy to all RINs generated prior to the effective date of a final rule.

Finally, we note that each of the three publicized biodiesel RIN fraud cases occurred because only a single party was involved in the transaction. The person producing the fuel was allowed to separate and sell RINs that were not attached to wet gallons. Only biodiesel producers have this loophole in the regulations and closing this loophole is the single most important way to address the rampant fraud in the biodiesel industry. We note that a representative from API will address this issue in greater detail this morning.

Thank you for the opportunity to testify. I would be pleased to answer any questions.