



**WRITTEN STATEMENT OF
AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS
AS SUBMITTED TO THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**Committee on Energy and Commerce
United States House of Representatives**

on

“RIN Fraud: EPA’s Efforts to Ensure Market Integrity in the Renewable Fuels Program”

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Testimony Summary of Charles Drevna, president of the American Fuel & Petrochemical Manufacturers (AFPM)

House Committee on Energy and Commerce – Subcommittee on Oversight and Investigations, Hearing on “RIN Fraud: EPA’s Efforts to Ensure Market Integrity in the Renewable Fuels Program”

AFPM’s refinery members are the “obligated parties” responsible for meeting the requirements of the Renewable Fuels Standard (RFS), a law requiring obligated parties to blend increasing volumes of biofuels into the transportation fuel supply. There are several nested mandates within the RFS, including a requirement for 1 billion gallons of biomass-based biodiesel. In order to demonstrate compliance with the RFS, obligated parties submit a requisite number of renewable identification numbers (RINs) to EPA by the end of February following the compliance year. RINs essentially act as credits that can be bought and sold among biofuel producers, brokers and obligated parties.

In order to facilitate RIN trading, the EPA established the EPA Moderated Transaction System (EMTS), through which all RINs must be generated. Only EPA registered biofuel producers that have submitted third party engineering reports are eligible to generate RINs on the EMTS, although other parties are then able to trade RINs, and in particular biodiesel RINs.

Unfortunately, some bad actors are taking advantage of weakness in the system and have generated and sold more than 140 million fraudulent RINs that we know of. For context, 140 million RINs constitute between 5-12% of the biodiesel RIN market to date. EPA’s handling of the fraud was concerning in several ways:

- After first getting a tip that Clean Green Fuels (the first fraudulent producer) was not producing biodiesel and after visiting the producer’s site to confirm, it took EPA more than a year to inform obligated parties. In the meantime, obligated parties unknowingly purchased millions of fraudulent RINs.
- After announcing that Clean Green Fuels RINs were invalid, EPA informed obligated parties that they had 14 days to replace invalid RINs and subsequently issued Notices of Violations to 24 obligated parties for violating the Clean Air Act, effectively punishing the victims of the fraud.
- The same situation was repeated when a second producer, Absolute Fuels, was found to be producing fraudulent RINs.
- Despite multiple requests from obligated parties, EPA has declined to identify any due diligence steps that would, at minimum, provide an obligated party legal protection if they unknowingly purchase an invalid RIN. Again, this “buyer beware” policy amounts to punishing the victims of fraud.

In total, the cost of replacing all RINs (essentially forcing refiners to double comply with the RFS) is nearly \$200 million, with additional cost to settle the NOV’s. For the past several months, AFPM has been engaged in discussions with stakeholders – including association members, biofuel producers, and EPA– to attempt to resolve this situation. While those discussions have been very productive and AFPM appreciates EPA’s engagement, obligated parties need resolution on legal certainty before the end of this year. Absent that legal certainty, the integrity of the RFS is in jeopardy, small biofuel producers will be squeezed, and obligated parties will continue to be subject to a punitive and costly regulatory regime that provides no protection, regardless of how much due diligence an obligated party undertakes.

I. Introduction

Chairman Stearns, Ranking Member DeGette and Members of the Committee, thank you for providing the opportunity to testify at today's hearing on fraud in the renewable identification number (RIN) trading system. I'm Charlie Drevna and I serve as president of AFPM, the American Fuel & Petrochemical Manufacturers.

AFPM is a 110-year old trade association that was known as the National Petrochemical & Refiners Association until early this year. Our association represents high-tech American manufacturers that use oil and natural gas liquids as raw materials to make virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of vital products in daily life.

AFPM's members make modern life possible and keep America moving and growing as we meet the needs of our nation and local communities, strengthen economic and national security, and support 2 million American jobs. The entire oil and natural gas sector – including the producers of oil and natural gas – supports more than 9 million American jobs and pays more than \$31 billion a year in taxes to the U.S. government, plus additional funds to state and local governments.

AFPM's refinery members are the "obligated parties" responsible for meeting the requirements of the Renewable Fuels Standard (RFS). These companies have been the *victims* of fraud perpetuated by EPA-registered biodiesel producers and have had to pay approximately \$200 million as a result of EPA's punitive "buyer beware" enforcement policy. We are aware of no other government program that penalizes the victims of fraud¹ and we greatly appreciate the Committee's leadership in addressing the problem. We continue to believe that EPA must take

¹ EPA's regulations embrace a "Buyer Beware" approach and specify that "[i]nvalid RINs cannot be used to achieve compliance with the Renewable Volume Obligations of an obligated party or exporter, regardless of the party's good faith belief that the RINs were valid at the time they were acquired." 40 C.F.R. § 80.1431(b)(2).

responsibility for ensuring the integrity of the program that Congress has authorized it to administer and must make clear that obligated parties will not be punished for being the victim of fraud. We have been meeting with EPA and other affected parties to address these issues, but to date EPA has not clarified its idea of what constitutes adequate due diligence under the RFS.

II. Renewable Fuels Standard

The Energy Policy Act of 2005 established the first RFS, which requires refiners to blend increasing volumes of biofuels into the transportation fuel supply. The biofuel mandates were expanded greatly in the Energy Independence and Security Act of 2007. This law created multiple mandates for specific types of biofuel and established a requirement for obligated parties to blend, in aggregate, up to 36 billion gallons of biofuels into the fuel supply by 2022. One of the specific biofuels mandated under the law is biomass-based diesel. This year, obligated parties are required to blend a billion gallons of biomass-based diesel into the fuel supply, most of which is met by soybean-based biodiesel. Due to the high price and poor performance qualities of biodiesel, this mandate greatly disadvantages consumers.²

In order to demonstrate compliance with the RFS for the previous calendar year, obligated parties are required to obtain and submit to EPA the requisite number of renewable identification numbers (RINs) by February 28th of the following year. RINs are unique 38 digit serial numbers that biofuel producers create and assign to specific gallons of biofuels as they are produced. In the case of biodiesel, each gallon of biodiesel produced generates 1.5 RINs. In many cases, and particularly with biodiesel, a RIN may change hands many times through RIN aggregators and brokers before an obligated party purchases the RIN for compliance.

² Biodiesel derived from soybean oil costs significantly more to produce than diesel fuel (e.g., approximately \$1.65 more per gallon) and has poor cold weather performance and a lower energy content compared to petroleum-derived ultra-low sulfur diesel fuel.

In order to facilitate RIN trading, the EPA created the EPA Moderated Transaction System (EMTS). EPA registers biofuel producers and importers to allow them to enter RINs into the EMTS. The agency also registers third parties, which allows them to own RINs and trade those RINs through the EMTS. The biodiesel producer registration process includes, among other requirements, reviews of third-party engineering reports to ensure only valid producers are able to generate RINs and list them on the EMTS. Unfortunately, EPA's review of these biodiesel producer engineering reports amounts to little more than a rubber stamp approval and has enabled biodiesel producers to game the system. Absent a "tip," EPA does not enforce its requirements and instead sits back and relies upon a "*buyer beware*" enforcement scheme that actually penalizes the victims of fraud.

III. Fraudulent Activity and Impacts

The largest problem, to date, is the prevalence of fraudulent RINs generated by biodiesel "producers" that in fact made no biodiesel or made significantly less biodiesel than the number of RINs they created. We discuss these fraudulent RINs in more detail below and while we do not believe that EPA is a party to the fraud, we are concerned that EPA's unreasonable delay in advising obligated parties as to the existence of fraud raises questions of the Agency's complicity in these instances of non-compliance. EPA's inability to adequately address the situation and provide obligated parties with assurances that it will not continue to be punished for being victims of fraud in the future is also creating significant uncertainty and concern in the marketplace.

A. *Clean Green Fuels - Biodiesel Producer Fraud.* Sometimes truth is stranger than fiction. Once upon a time, there was a Maryland-based, EPA-registered, biodiesel producer called Clean Green Fuels. In July 2010, after receiving complaints that Clean Green was selling

invalid RINs, EPA inspectors visited Clean Green's facility and discovered that the company did not even have biodiesel production equipment on site. While the following may sound like fiction, EPA took no steps to notify obligated parties that Clean Green's 32 million RINs were invalid until October 2011 (15 months after EPA's initial site visit). While discounting its role as the enforcement agency of biofuel producers, EPA wasted no time in enforcing the RFS against refiners that purchased these RINs in good faith. In fact, after EPA finally announced that the Clean Green RINs were invalid, it informed obligated parties that they had 14 days to replace the invalid RINs. EPA could have prevented obligated parties from purchasing these RINs in the first place by simply indicating on EMTS that Clean Green was not a biofuel producer in good standing. Instead, EPA chose to remain silent, allow RIN fraud that it knew was occurring to continue, require obligated parties to replace these invalid RINs at a cost in excess of \$40 million, and then, as if to add insult to injury, EPA issued Notices of Violations and fines to the 24 obligated parties that purchased the Clean Green RINs even though they were the victims of fraud that EPA knew about and allowed to continue.

This case is but one glaring example of the problems with the RFS³ and highlights the biased enforcement philosophy EPA embraces with respect to renewable fuel producers and petroleum refiners. Unfortunately, biodiesel producer fraud is not limited to a single isolated example.

B. *Absolute Fuels – Biodiesel Producer Fraud.* Absolute Fuels is a Texas-based, EPA-registered biodiesel producer. In December 2010, a biofuel broker notified EPA that

³ When you consider the rampant fraud in biodiesel industry; dramatically higher prices for the mandated fuels; mandates to use cellulosic ethanol that does not exist; the introduction of high percentage blends of ethanol that damage engines in the existing fleet; and questionable environmental and ethical impacts, it is easy to conclude that the RFS is a broken policy in need of dramatic reform.

Absolute Fuels was generating RINs without producing biodiesel. A month after receiving this tip, EPA launched an investigation. In February 2012, 14 months after receiving a tip and more than a year after it had begun its investigation, EPA announced to obligated parties that Absolute Fuels had generated fraudulent RINs. Unfortunately, EPA's delay in announcing this fact allowed obligated parties to continue purchasing RINs from Absolute Fuels throughout 2011. In fact, EPA stood by while obligated parties purchased more than 48 million RINs that the agency will require obligated parties to replace at a cost in excess of \$60 million.

C. *Green Diesel – Biodiesel Producer Fraud.* On April 30, 2012, EPA issued a Notice of Violation to Green Diesel for generating more than 60 million invalid RINs between July 2010 and July 2011. The full impact of this fraud is still unknown as is the exact cost to obligated parties of having to replace the RINs that were traded on EMTS during the pendency of EPA's investigation – although it likely will exceed \$75 million. Also unknown is EPA's intent to initiate enforcement actions against obligated parties that possess Green Diesel RINs.

D. *Other Fraud in the System.* Putting aside the 140 million fraudulent RINs discussed above, the approximately \$200 million in RIN replacement costs, and the two dozen settlement agreements with accompanying fines that EPA forced upon the victims of this fraud, obligated parties remain concerned with other investigations into fraudulent RINs and other examples of RIN transactions that could threaten the integrity of the program.

Unfortunately, fraud appears to continue among some biodiesel producers. On May 24th the FBI raided a Park Ridge, New Jersey building as part of its investigation into fraud in the biodiesel industry. The outcome of that investigation remains unknown.

Other issues that could implicate the validity of RINs occur downstream from the producer. For example, renewable fuel that is subsequently exported does not count toward the

RFS mandates. As such, the person that exports this fuel bears an obligation to cancel an equivalent number of RINs. Although in these cases the separated RINs remain valid, we believe that the regulations would benefit from additional clarity in this area to ensure that obligated parties with no ability to verify the validity of previously separated RINs are not ultimately held liable under EPA's buyer beware theory. The failure to address this potential liability will have negative impacts on biodiesel RIN liquidity.

IV. Current Status

On February 23, 2012, EPA replied to a letter from Chairmen Upton and Whitfield and emphasized that the principle of RIN ownership is "buyer beware." EPA also acknowledged that it does not certify or validate RINs, nor have specific written procedures or criteria for informing the RIN marketplace of allegations that RINs are invalid.

Although obligated parties have purchased RINs in good faith, EPA continues to enforce its "buyer beware" position and punish the *victims* of fraud in addition to the perpetrators. As recently as March 2012, EPA indicated that more aggressive enforcement against obligated parties would occur:

We stress here again that it is incumbent upon all parties to undertake due diligence to ascertain the validity of RINs to be used to meet an RVO under the Renewable Fuels Standard (RFS) Program. We expect that parties will prevent future violations, and intend to take a more aggressive approach to violations arising from the use of 2012 and later RINs.⁴

⁴ U.S. Environmental Protection Agency, Office of Enforcement and Compliance Assurance, *Interim Enforcement Response Policy to Resolve Violations Arising from the Use of Invalid 2010 and 2011 Biomass-Based Diesel Renewable Identification Numbers*, p. 1 (March 14, 2012).

AFPM is unaware of any other government agency that punishes the victims of fraud. To date, EPA has not identified an acceptable level of due diligence that would provide safe harbor for the innocent victims of biodiesel RIN fraud.

Since February, AFPM has worked collaboratively and in good faith with its members, stakeholders in the biofuels industry, with Congress, and with EPA to identify the causes of, and solutions to, the problem. While those conversations have been productive and AFPM appreciates EPA's engagement, AFPM's members need a solution this year that provides legal certainty and a defense for companies that unknowingly purchase invalid RINs. To date and to our great frustration, EPA has not identified what constitutes adequate due diligence and has not formally committed to providing obligated parties with a legal defense to fraudulent RINs that are acquired without knowledge of the fraud.

V. Conclusion

While AFPM has serious concerns with the structure and workability of the RFS as a program generally, the RIN system and EMTS is one component that must work for our members to know that they will be able to comply with the RFS without being punished for being the victims of fraud. At present, the uncertainty in the market for biodiesel RINs is particularly harmful to small biodiesel producers that are unfamiliar to obligated parties looking for certainty in their RIN purchases. Regardless of one's position on the RFS, there should be widespread agreement the current system needs to be fixed to avoid the perpetuation of fraud and increased costs to consumers. Our hope is that today's hearing will help identify areas of concern and provide some clarity on the steps needed to repair this broken system. AFPM appreciates the Committee's leadership and looks forward to working with the Committee to address this critical issue.