

August 26, 2022

Benjamin Hengst, Deputy Director, Office of Transportation and Air Quality

United States Environmental Protection Agency

1200 Pennsylvania Ave NW

Washington, DC 20460

– and –

Dallas Burkholder,

USEPA National Vehicle and Fuel Emissions Laboratory/OAR

2565 Plymouth Road

Ann Arbor, MI 48105

Re: Market stabilizing mechanism - Possible approaches for setting cellulosic volumes

Dear Mr. Hengst and Mr. Burkholder:

Thank you for your inquiry regarding possible approaches to achieving market stability under the Set Rule. We present below three options for a programmatic response to rebalance cellulosic volumes in the presence of cellulosic RIN surpluses and shortfalls, together with a suggested process whereby the cellulosic Set Volume (as defined below) would be adjusted. Given the complexity of legal, regulatory, and policy considerations EPA must balance, we sought to provide a variety of potential approaches for EPA to consider. These proposed options would be used in narrow circumstances under which:

- Adjustment to the Set Volume for cellulosic biofuels is warranted due to the presence of a surplus or shortfall, and
- Adjustments are limited to rebalancing the cellulosic volumes.

Excess volatility is among the most damaging aspects of the market for fuel producers and jeopardizes stable growth. Option 3 below best addresses this risk by establishing a policy that applies for the duration of the Set Rule and signals program stability from administration to administration. However, Option 1 or Option 2 may be preferable to EPA for various reasons although neither will be as effective in addressing the key risk to market stability. If EPA chooses an option that requires supplemental rulemakings, we believe including a policy to govern those rulemakings in the Set Rule will be essential for market participants seeking stability – and may help limit the variability of RFS implementation from one Administration to another.

Background and Premise: The “Set”

The options presented below are based on fundamental premise that the RFS requires EPA to “Set” the applicable volume (the “**Set Volume**”) of cellulosic biofuel for 2023 and subsequent years based on a reasonable projection of what the industry could achieve:

- given a properly functioning RFS program (e.g., adequate market-forcing price signals; no SREs);
- including any carryover cellulosic RINs from the previous year;
- consistent with the factors in § 211(o)(2)(B)(iii), including EPA’s “review of the implementation of the program”; and
- on the “assumption” that EPA will not need to issue a cellulosic waiver.

It should be noted that the “assumption” a cellulosic waiver will not be required is not a guarantee, nor does it require EPA to make conservative projections to ensure, a cellulosic waiver will never be required; rather, the “assumption” is satisfied so long as EPA had a reasonable, record-based rationale for its projection.

Three Options for a Programmatic Response to D3 RIN Surplus and Shortfall

Each of the three options provided below would fall within EPA’s clear authority under CAA Sec. 211(o)(2)(B)(ii) to establish cellulosic Set Volumes. We will provide EPA with a more complete discussion of that legal justification in a subsequent document.

Options 1 and 2 – Annual Adjustment (if needed) by rulemaking

If EPA anticipates a D3 RIN surplus or shortfall, where total volumes available are materially out of line with the cellulosic Set Volume, EPA could issue either a direct final rulemaking (Option 1) or undertake a full rulemaking (Option 2) to adjust the cellulosic Set Volume for the upcoming year.

Approach: EPA would, on an annual basis, review whether the expected volume of D3 RINs available will exceed or fall short of the cellulosic Set Volume and, only as needed, either issue a direct final rule (Option 1) or conduct a full rulemaking (Option 2), each limited in scope to increasing the cellulosic Set Volume for the upcoming year by an amount sufficient to absorb any material D3 RIN surpluses.

D3 RIN shortfalls would continue to be addressed using the existing cellulosic waiver credit mechanism, provided that “available volume” includes all volume available, including carry-over RINs, when calculating the waiver.

In the absence of any such surplus or shortfall for the relevant year, EPA takes no action.

Benefits:

- A direct final rulemaking requires minimal administrative resources.
- A full rulemaking with a sharply limited scope might avoid most of the complex matters that delay timely RFS rulemakings in other cases.

Drawbacks:

- Any annual rulemaking leaves market participants exposed to variability in RFS policy perspectives from one Administration to another.
- A direct final rulemaking creates litigation risk even if a small number of stakeholders object.
- A full rulemaking under the RFS (even if limited in scope) re-introduces the resource demand and litigation risk the agency hopes to escape by establishing a multi-year Set Rule.

Option 3 – Automatic adjustment by formula in the Set Rule

EPA could substantially simplify the approach by including a formula in the Set Rule to automatically increase or decrease the cellulosic Set Volume based upon EPA’s determination of the expected D3 RIN surplus or shortfall (which would be made annually at a pre-determined date).

Approach: EPA would include a formula in the Set Rule that enables predictable adjustments to manage D3 RIN availability materially out of line with the established cellulosic Set Volume. This formula could be based on the projected total volume of D3 RINs available at a specific date relative to the original Set Volumes.

Benefits: This approach would only require EPA to issue public notification that mandated cellulosic volumes were updated using the formula included in the Set Rule, which is consistent with EPA’s desire to reduce reliance on annual rulemaking to implement the RFS.

Drawbacks: This novel approach to managing the inherent challenges in predicting D3 availability over time has not been tested in the courts and could, if rejected, require an additional rulemaking to cure issues identified by the court.

Suggested Set Volume Adjustment Process

Any of the above options could use data gathered from the annual cellulosic waiver assessment required by the RFS as the basis for an adjustment of the cellulosic Set Volume up or down to address either shortfalls or surpluses of D3 RINs.

Approach: In the preamble to the initial Set rulemaking (and each volume setting rule, as appropriate), EPA outlines the following mechanism to manage RVO rulemaking and address situations in which the projected volume of cellulosic biofuel production either exceeds or falls short of the cellulosic Set Volume:

- (1) EPA will continue to conduct limited annual rulemakings for each year (“**Year N**”), by November of the preceding year (“**Year N-1**”), under which it will set applicable percentages under § 211(o)(3)(B) and, if needed:
 - (a) determine, under § 211(o)(7)(D), whether the projected volume of cellulosic biofuel production will be less than the cellulosic Set Volume and, if so, issue a cellulosic biofuel waiver to reduce the mandated cellulosic volume for Year N to the projected “available volume” including carry-over RINs (and make cellulosic waiver credits available); and
 - (b) If EPA projects that the cellulosic biofuel volume available in Year N (including D3 RINs produced in Year N-1 but unused for Year N-1 compliance) will exceed the cellulosic Set Volume, either absolutely or by more than a fixed *de minimis* percentage of the D3 RIN Bank, EPA will, **using its choice of the options presented above**, increase Year N’s cellulosic Set Volume to a level that reduces D3 RIN surpluses to a fixed *de minimis* percentage, taking existing surpluses and Year N anticipated production volumes into account.
- (2) If a volume shortfall becomes evident at some later point in Year N, EPA will¹ issue a waiver under both § 211(o)(7)(A) (the “General Waiver” authority) and § 211(o)(7)(D) (the “Cellulosic Biofuel Waiver” authority) to reduce the cellulosic biofuel volume mandated for Year N to the volume available (and make cellulosic waiver credits available).

¹ This could be done in rulemaking contemporaneously with rulemaking for the following year (“**Year N+1**”) that is completed by November of Year N.

Benefits: Utilizing the determination required under law as the basis for assessing and, if needed, acting on either surpluses or shortfalls is a natural (and modest) modification to EPA’s RFS implementation approach to date. This approach: (i) extends existing market stabilizing tools EPA has had in its portfolio to ensure the workability of a *de minimus* RIN bank, and (ii) is logically consistent with the requirement to provide “appropriate certainty for regulated entities and fuel producers...and for other purposes as the Administrator determines will help achieve the goals of this subsection.” The cellulosic Set Volume could be adjusted upwards using the approach of any of Options 1, 2 or 3.

Drawbacks: Unless implemented using Option 3 above, this approach (i) relies on an annual rulemaking process, contrary to EPA’s desire to reduce the number of rulemakings needed to implement the RFS, and (ii) leaves market participants exposed to variability in RFS policy perspectives from one Administration to another.

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We would be pleased to engage with you in more detail on these options and our suggestion for mechanics, including the legal basis for each. In the interest of speed, we are submitting this letter to you as the smaller group below, but we continue to engage with our colleagues in the cellulosic fuels industry and collaborate with them on this effort.

Sincerely,

