

November 10, 2006

U.S. Environmental Protection Agency
EPA West (Air Docket)
1200 Pennsylvania Ave., NW
Room B108, Mail Code 6102T
Washington, DC 20460
Attention Docket ID No. OAR-2005-0161

Docket Number EPA-OAR-2005-0161

On behalf of the American Coalition for Ethanol (ACE), I commend the Environmental Protection Agency (EPA) for issuing the proposed rule to implement the Renewable Fuel Standard (RFS) program established by the Energy Policy Act of 2005. This historic program represents an important milestone in the growth of the domestic biofuels industry and will help reduce the nation's dependence on foreign oil, while promoting economic growth throughout rural America.

ACE is the grassroots voice of the ethanol industry and with nearly 1400 members nationwide, we are the largest organization in the U.S. uniting businesses and organizations in support of ethanol. ACE membership includes ethanol producers, commodity and farm organizations, investors, businesses supplying goods and services to the industry, and individuals supporting the increased production and use of ethanol. ACE was instrumental in the development and passage of the landmark RFS provision (§ 1501) of the Energy Policy Act of 2005, (referred to as the "Act" in these comments) creating specific, increasing annual minimum renewable fuel use levels.

ACE recognizes that writing this rule is a time-consuming and cumbersome process, and we commend EPA for doing an outstanding job of communicating with, and soliciting input from, stakeholders and striving to address the concerns of all interested parties, including ACE. The Agency has been forced to walk a fine line in crafting a rule to implement an entirely new RFS program because some provisions of Act are prescriptive while other provisions provide flexibility to EPA to interpret the law's intent. It can be difficult to operate in such an environment, especially when stakeholders as diverse as fuel ethanol producers and oil companies have differing priorities in the rulemaking process. Overall, ACE is pleased with many features of the proposed rule and expresses gratitude to EPA for their work in designing the program.

Nevertheless, ACE has identified specific shortcomings in the overall design of the proposed program that I wish to highlight for the record and urge EPA to seriously consider modifying key aspects of the rule to address these issues.

ACE looks forward to working with EPA to ensure the successful implementation of a final rule that satisfies the concerns of the organization and its members. On a broad level, ACE's overriding priority is to ensure that the rule complies with the letter and spirit of the law by guaranteeing that the annual obligations of the RFS are met with physical gallons – through actual use by obligated parties – every year of the program. Meeting this test will be the overall measurement of the success or failure of the RFS program. To address this overarching goal, ACE is commenting on the following specific issues in the proposed rule:

1. How to handle compliance with the RFS program in 2007.
2. The logic of EPA's construction of "equivalency values" for various renewable fuels.
3. EPA's interpretation of the lifespan of credits under the law and manufacture of a RIN-based system for compliance.
4. Tighter limits on deficit carryover.
5. The proposed rollover cap and when the cap should be applied.
6. EPA's voluntary labeling concept.
7. Ensuring the RFS rule preserves existing ethanol blending practices and does not consolidate blending only at the terminal level (i.e. the need to maintain splash blending practices).

1. Compliance in 2007

EPA is proposing to apply the RFS only for a portion of the calendar year in 2007. To determine how and when the RFS will apply in 2007, the Agency is proposing to use a "prospective" approach by simply applying the RFS to gasoline produced after the rule goes into effect – which even under optimistic conditions is likely to be 60 days after the issuance of the final rule in the *Federal Register*, or as late as May 2007, well into the second quarter of the year. ACE is concerned that this prospective approach will not ensure that the total volume of renewable fuel required to be used in 2007 by law is in fact used. EPA has acknowledged this concern in the proposed rule.

In our view, the Energy Policy Act of 2005 is clear in requiring EPA to promulgate rules to implement the RFS provisions that ensure to the maximum extent possible that the annual targets set forth in the RFS schedule are met. An approach that requires compliance for only a portion of 2007 will not satisfy the legal requirement that the 2007 RFS requirement – 4.7 billion gallons – be met. Under EPA's proposed approach, obligated parties could decide to use considerably less renewable fuel than is necessary to meet the annual requirement, with no apparent legal consequence.

Therefore, ACE recommends that EPA extend the "collective" compliance approach used for 2006 to 2007. As the Agency demonstrated for the 2006 compliance year, it has the ability to calculate the minimum percent renewable fuel obligation necessary to satisfy the RFS level set forth in the Act. It can do so for 2007, and, apply the RFS obligation a

collective basis for the 12-month calendar year beginning January 1, 2007. This would provide a clear legal requirement for obligated parties that is consistent with the RFS schedule set forth in the Act for 2007 and would help guarantee that the 2007 mandated level is in fact achieved in practice. In short, ACE believes 2007 should be a “full-year” program; renewable fuel use required under the statutory RFS schedule will only be guaranteed by a full-year collective compliance approach.

ACE has identified two transparent benefits to the collective approach for 2007. First, the collective approach is straightforward and simple to implement. This obligation could be published in the *Federal Register* or by some other means later this year and apply to obligated parties in an aggregate fashion, rather than on an individual basis. Second, the collective approach provides obligated parties and renewable fuel producers with sufficient time to prepare and gear-up for the new RFS program (given the new registration, record keeping, and reporting requirements that will be placed on ethanol producers and obligated parties, and the adjustments to human resource, accounting and computer systems that will need to be made in order to comply with these new requirements).

In fact, ACE would welcome the opportunity to co-host with EPA and other interested parties one or more workshops specifically designed for ethanol producers and others to become familiar with the registration, record keeping, and reporting requirements that will be inherent with the RFS program, and offer to work with the Agency and other stakeholders in making this type of event a reality. All of the stakeholders should have the appropriate time necessary to prepare for EPA’s proposed credit trading compliance system to apply in the out-years of the program under the collective compliance approach for 2007.

2. Equivalency Values

ACE strongly disagrees with EPA’s proposal to create equivalency values for a range of fuels.

Such an approach was never contemplated in the authorizing statute. In fact, efforts by advocacy groups to insert equivalency values of greater than one for their fuel were explicitly considered and rejected by Congress during the development and enactment of the Energy Policy Act of 2005. As EPA is aware, the Act clearly specifies that one gallon of cellulosic or biomass ethanol must receive 2.5 credits. Such a ratio was clearly conceived without reference to the British Thermal Unit (BTU) values of the fuels, which in these cases are equivalent. The motivation behind Congress specifically assigning cellulosic ethanol with a 2.5: 1 credit ratio in the law was to reward and encourage particularly energy-efficient production processes, but we are concerned that EPA appears to be using the statutory distinction between the treatment of starch-based ethanol and cellulosic-ethanol as the rationale for creating “virtual gallons” of other fuels based on BTU content. No provision of the Act provides EPA with authority to establish equivalency values based on BTU content, nor even hints that this is an appropriate basis for inventing such equivalency values. Moreover, by providing these fuels with equivalency values of greater than one, EPA is undermining the fundamental intent of the Act to ensure that annual demand for biofuels reach the levels set forth in the statutory RFS schedule.

The Act does not authorize EPA to establish equivalency values that favor some renewable fuels over ethanol with additional paper credits which arbitrarily make these fuels more significant than ethanol. In our opinion, EPA is inappropriately interpreting the law by creating equivalency values. The stated goal of the RFS program is to replace gallons of foreign oil and gallons of fossil fuels - not to replace gallons of BTUs. The assignment of equivalency values of greater than one to a new range of fuels will create a scheme whereby paper credits replace physical gallons. This is utterly inconsistent with congressional intent. Aside from those renewable fuels explicitly identified in the Act to receive 2.5 credits per gallon, one physical gallon of renewable fuel should receive one credit, no more, no less. We believe this is a simple, enforceable, and defensible way to value a credit. In short, ACE believes there is no legal basis for taking such an approach and it is incongruent with the purpose of the Act and the rule.

3. Credit / RIN Lifespan Concerns

The Act clearly intends for minimum volumes of renewable fuel to be used in the nation's gasoline pool on an annual basis under the RFS program. As such, the RFS is an annual program with annual obligations. The Act also specifically states that a credit may be used to show compliance "for the 12 months as of the date of generation." But EPA has loosely interpreted the Act's credit life language and developed a complex Renewable Identification Number (RIN) based system that stretches the life of a credit well beyond the 12 months envisioned by Congress by allowing RINs or credits to be used for compliance in the year they were produced (when the RIN is generated), or, the following year.

As a result, obligated parties can stockpile RINs or credits that can rollover indefinitely (ACE referred to this proliferation threat as the "snowball-effect" in discussions with EPA leading up to the proposed rule). ACE is concerned that allowing paper credits to be stockpiled for use in this fashion will result in less renewable fuel used than what is required by the statute. EPA acknowledges the risk of RIN proliferation and states in the proposed rule "the use of previous year RINs to meet current year compliance obligations does create an opportunity for effectively circumventing the valid life limit for RINs. This can occur in situations wherein the total number of RINs generated each year for a number years in a row exceeds the number of RINs required under the RFS program for those years."

The risk of RIN proliferation is real: ethanol production will exceed RFS floor by one billion gallons already in 2006, and the 7.5 billion gallon per year goal for 2012 will be reached sometime in 2008 or 2009. Under the system that EPA designed for compliance, these gallons of renewable fuel used over and above the RFS floor will represent paper credits that can be used to circumvent will of Congress that the minimum demand levels be met each year of the program.

This could have adverse effects on the biofuels industry. Farmers and ethanol producers are currently making significant investments in expanded production capacity with the expectation that the statutorily guaranteed minimum market will indeed be achieved as a result of the RFS. However, if the compliance mechanism proposed by EPA allows

obligated parties to stockpile paper RINs or credits to satisfy the annual RFS obligation, it places these investments at serious risk.

To address the threat of RIN proliferation, EPA is proposing to set a cap on the number of RINs that could rollover from one year to another for use. While we appreciate EPA's effort to find a solution to address this rollover risk, ACE does not believe the proposed rollover cap is an adequate remedy.

Therefore, ACE recommends that EPA adopt a "retrospective" approach to credits which avoids the need for a rollover cap altogether. We strongly prefer that approach to EPA's loose interpretation of the Act, which will lead to an unduly long credit lifespan and development of a complex RIN-based system. ACE advises that the Agency comply with the Act's clear language calling for a 12-month credit lifespan by applying a retrospective system to ensure that minimum volumes of renewable fuel are used on an annual basis.

ACE recognizes that obligated parties need flexibility in order to comply with the RFS program, but we believe a system that allows them to bank, sell, and trade credits or RINs within a 12-month calendar year after which a credit or RIN is generated does indeed provide that flexibility and in fact is the only approach that is consistent with the spirit and letter of the law. We also acknowledge that in order to develop a compliance mechanism under a retrospective approach, credits or RINs may need a "born-on" or "generated-on" date under which they are born or generated at the point of blending with gasoline or at some other point, but we believe this would be more consistent with the letter and spirit of the law and know it is an approach that EPA has already contemplated – the framework for compliance could indeed be established.

4. Deficit Carryover

In addition to adhering to a 12-month lifespan for RINs, ACE also believes the rule should provide a tighter framework to address the deficit carryover provisions.

The Act included a provision allowing obligated parties to carry a deficit forward from one year into the next if it cannot generate enough or purchase sufficient RINs to meet its obligation in a given year. Deficits cannot be carried over two years in a row.

We recognized the need to provide flexibility and workability in the RFS program. Nevertheless, the Act specifically states that there must be an "inability" to generate or purchase sufficient credits for obligated parties to use this provision. We are concerned that the EPA has chosen not to include threshold standards that obligated parties must meet prior to taking advantage of the deficit carryover provisions. Instead, the Agency states that they believe "obligated parties will make a determined effort to satisfy [their obligation] on an annual basis, and that a deficit will demonstrate that they were unable to do so."

In order to ensure that the proper balance of interests is maintained, we believe the EPA should establish standards that obligated parties must meet before they are allowed to use this provision. As with the credit life of RINs, obligated parties potentially could use the

deficit carryover provision to undermine the amount of actual renewable fuel used in a given year.

5. Rollover Cap

While ACE strongly recommends that EPA implement a retrospective approach on credit life for compliance purposes, we recognize that the Agency prefers a cap on the number of previous year RINs that can be used to satisfy an obligated party's current year obligation as a course of compliance. EPA has proposed to set that rollover cap at 20 percent.

To be consistent with ACE's guiding priority that the RFS rule complies with the letter and spirit of the law by guaranteeing that the annual obligations of the RFS are met through actual use by obligated parties, we recommend that EPA at a minimum reduce the cap from 20 percent to 10 percent to more adequately address rollover concerns. The Act provides for the use of physical gallons of renewable fuel to satisfy annual obligations. In light of this requirement, a reduced cap of 10 percent is more defensible and would more consistently ensure the purpose of the law is achieved.

In the event a natural disaster such as a drought destroys a corn crop destined for fuel ethanol production, the Act contains waiver provisions that provide a safety valve for addressing a shortfall in the supply of ethanol.

Finally with respect to the rollover cap, ACE believes the cap should be applied in the first year a carryover or rollover of RINs is possible. Therefore, if a rollover or carryover of RINs is possible in 2008, EPA should apply the rollover cap in 2008, and not delay its application to 2009.

6. Voluntary Labeling

ACE supports efforts to encourage the most energy-efficient production of ethanol. However, we are concerned that the voluntary labeling approach proposed by EPA will be virtually unworkable. Feedstock production, transportation, and conversion to ethanol occur along a broad spectrum of energy efficiencies. Measuring the energy efficiency with which each of these processes is carried out, and then determining where along this spectrum to accredit ethanol produced from these processes with a green label, will be extremely challenging and probably cannot be achieved with consistency and accuracy. Instead, ACE strongly supports the establishment of new incentives by Congress for ethanol producers to retrofit existing plants with the most energy-efficient production technologies and to encourage the use of innovative and energy-efficient technologies in new plants, while providing financial incentives to farmers to employ energy-efficient crop production practices.

7. Preserving Existing Ethanol Blending Practices

As a grassroots coalition uniting companies and organizations that support ethanol, ACE membership includes ethanol producers and marketers but also petroleum marketers, jobbers, wholesalers, and even some retailers. Some of these members have expressed to ACE and EPA the importance of ensuring the RFS rule preserves the existing blending practices for ethanol by preventing the consolidation of blending only at the terminal level.

Currently, blenders of refined fuels may include refiners of petroleum products, refiners and manufacturers of renewable fuels, and just as important, jobbers and wholesalers who facilitate the distribution of blended renewable fuels to the marketplace.

EPA outlined several guiding principles the Agency intends to follow with respect to carrying out the RFS, including ensuring that the expansion of the use of renewable fuels follows distribution and blending practices already in place, and that the RFS program should preserve existing business practices for the production, distribution, and use of both conventional and renewable fuels. ACE members are acutely focused on ensuring the RFS rule does not consolidate all ethanol blending at the terminal level. Doing so would eliminate the practice of “splash blending,” (adding ethanol to gasoline at a site outside the pipeline or refinery terminal) and because terminals have large minimum volume requirements, such a policy would consolidate control of ethanol gallons to only the largest marketers and oil companies. The availability of off-terminal blending by independent marketers is critical to keeping ethanol’s price competitive, and in many cases, this off-terminal blending is the only way provide ethanol to small rural markets. Consider, for example, the history of ethanol blending practices in South Dakota as provided by an ACE member, Harms Oil Company.

According to Harms Oil, ethanol-blended fuel (E10) became economically available to the blender and ultimately the consumer in 1989 through an off-terminal bulk blending facility adjacent to the Aberdeen, South Dakota, Kanab pipeline terminal (now owned by Valero). In 1991, additional off-site blending facilities were constructed nearby some of the other terminal markets within South Dakota. By 2005, more than 60 percent of all gasoline sold in South Dakota was blended with ethanol and 80 percent of the pipeline terminals in the state offered ethanol-blended fuel at the terminal. Despite a relatively mature ethanol market in South Dakota and strong consumer acceptance, there remain pipeline terminals in the state that do not offer ethanol. In some instances, the nearest pipeline terminal that offers ethanol to jobbers or retailers is at least 75 miles away, so in these cases splash blending facilities located nearby ethanol jobbers and retailers provide a critical service to satisfy market demand.

In South Dakota, there are 25 sellers of gasoline and only five to 10 suppliers of ethanol. As a result, some blenders have made investments in off-site bulk blending facilities. The market has clearly demonstrated a need for blending at places other than the pipeline terminal, even when there is renewable product available at the terminal. We are convinced the importance of splash blending is not simply confined to South Dakota, indeed, we firmly believe off-terminal splash blending is a critical business practice that needs to be maintained nationwide.

In summary, we urge EPA to craft the RFS rule consistent with the Agency’s desire to maintain current marketplace and business practices, and in doing so recognize the key role splash blend facilities play in making ethanol-blended fuel available in the marketplace. It is important to preserve splash blending in order to provide renewable fuel products to markets where the pipeline terminal does not offer renewable fuels, to continue to provide additional blending options where there are a limited number of sellers at the pipeline terminals, and to foster competition for the benefit of consumers.

Close

Finally, despite the flaws that we perceive in the current proposed rule offered by EPA, ACE very much appreciates the willingness of Agency staff to reach out to ACE during the proposal development process and to strive to address our concerns. We look forward to working with EPA to remedy our concerns about the proposed rule and to guarantee its successful implementation in the final rule the Agency will issue early in 2007.

With a few key modifications, we believe that the final rule will establish a program that is faithful to the spirit and letter of the Energy Policy Act of 2005 and will ensure a strong and growing role for renewable fuel use in the U.S. for years to come.

If you have any questions about these comments, please do not hesitate to contact me at 605-334-3381.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Jennings". The signature is fluid and cursive, with a large initial "B" and a long, sweeping underline.

Brian Jennings, Executive Vice President
American Coalition for Ethanol

cc: Office of Management and Budget