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Legal Sidebar

Tenth Circuit Ruling May Limit Availability of Small Refinery Exemptions from the Renewable Fuel Standard: Implications for Congress

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A recent appeals court decision may limit the availability of small refinery exemptions (SRE) from the Clean Air Act's renewable fuel standard (RFS) going forward. These exemptions have garnered attention from stakeholders and Congress as the number of exemptions sought and granted has increased significantly the last few years. In *Renewable Fuels Association v. Environmental Protection Agency (EPA)*, a three-judge panel of the U.S. Court of Appeals for the Tenth Circuit (Tenth Circuit) vacated the EPA's decisions to exempt three small refineries from complying with the RFS. Under that program, EPA requires refineries and importers of non-renewable fuels to account for a certain amount of renewable fuel being blended into transportation fuel (i.e., an annual renewable volume obligation). Congress included exemption provisions in the RFS for small refineries that do not process more than 75,000 barrels a day of crude oil on average in a calendar year. The RFS allows small refineries to petition EPA "at any time" "for an extension of the exemption" "for the reason of disproportionate economic hardship." In *Renewable Fuels Association*, several renewable fuels producers challenged EPA's decisions to grant petitions to exempt three small refineries. The court vacated all three exemptions for reasons that may have implications for other small refineries under the Tenth Circuit's jurisdiction (i.e., Colorado, Kansas, Oklahoma, New Mexico, Utah, or Wyoming). This Sidebar addresses *Renewable Fuels Association* by providing background on the RFS and the recent ruling before exploring how the court's decision may reduce the number of small refinery exemptions granted and its implications for Congress.

Small Refinery Exemptions under the Renewable Fuel Standard

Under the Clean Air Act, the RFS generally requires EPA to ensure that increasing (i.e., market-forcing) specified volumes of categories of renewable fuels are blended into transportation fuel in the United States each year. In turn, EPA requires refineries and importers of non-renewable fuels (obligated parties) to meet annual renewable volume obligations (RVOs) by either blending renewable fuels into transportation fuel themselves or obtaining credits (renewable identification numbers or RINs) from other

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entities that blended renewable fuels. Each obligated party's individual RVO is based on its gasoline and diesel production or imports and an annual percentage standard that EPA promulgates every year. The annual percentage standards for each renewable fuel category are based on projected gasoline and diesel consumption in the U.S. and the statutory volume requirements.

When the RFS was enacted in 2005, Congress included an exemption provision for small refineries. Under the RFS, a refinery is considered a small refinery if it does not process more than 75,000 barrels a day of crude oil on average in a calendar year. The RFS automatically exempted all small refineries from RFS compliance until 2011 (i.e., through the 2010 compliance year). Congress required EPA to extend this exemption for two additional years (i.e., through 2012) if a study the Secretary of Energy conducted determined that compliance with the RFS would subject small refineries to a "disproportionate economic hardship." In addition—and of relevance to the Tenth Circuit decision—the RFS allows small refineries to petition EPA "at any time" "for an extension of the exemption" "for the reason of disproportionate economic hardship." The statute requires EPA to consult with the Department of Energy (DOE) regarding any such petitions and to act on the petitions within 90 days of receiving them. If granted, the exemption is only valid for the compliance year(s) petitioned for—small refineries must petition for each compliance year and demonstrate disproportionate economic hardship due to RFS compliance for that year.

EPA considers the information in small refinery exemption petitions (including the petitioners' names) and its decisions to grant or deny them as confidential business information (CBI). As a result, information about which refineries petitioned for the exemption, the outcome of those petitions, or the analysis supporting EPA's decision is only available to the extent the refinery itself discloses it. However, EPA now publishes aggregate data on petitions received, grants issued, and volumes exempted on its RFS Small Refinery Exemptions dashboard. According to the dashboard, EPA extended the small refinery exemption for 24 small refineries for 2011 and 2012 pursuant to DOE's study. For the 2013 to 2018 compliance years, EPA received as few as 13 petitions in 2014 and as many as 42 petitions in 2018 for small refinery exemptions. EPA granted the fewest petitions in 2015, exempting seven small refineries, and the most to-date in 2017, exempting 35 small refineries. The increasing number of small refinery exemption petitions filed and granted over the last few years, beginning with the 2016 compliance year, has gained attention from a number of different stakeholders.

Tenth Circuit Opinion in *Renewable Fuels Association v. EPA*

In *Renewable Fuels Association v. EPA*, renewable fuels producers challenged EPA's decision to grant petitions to exempt three small refineries from the RFS for specific compliance years: HollyFrontier Cheyenne Refining LLC (Cheyenne) for 2016, HollyFrontier Woods Cross Refining LLC (Woods Cross) for 2016, and Wynnewood Refining Company, LLC (Wynnewood) for 2017. Despite the confidentiality of the exemption petition process, the petitioners determined that the refineries had received the exemptions based on media reports and public company filings. They challenged a number of aspects of EPA's decisions, and the Tenth Circuit agreed with the challengers with respect to two central legal issues.

"Extension of Exemption": A Small Refinery Is Only Eligible for an Exemption If It Has Continually Received an Exemption

The Tenth Circuit first agreed with the petitioners that small refineries are only eligible to receive a small refinery exemption if they have previously received an exemption for every compliance year up to the compliance year for which they seek an exemption. The statute allows small refineries to petition EPA for "an *extension* of the exemption." To interpret this phrase, the court considered the plain meaning of the term "extension" as defined by various dictionaries. These definitions, it determined, generally involved something being increased or added to, such as a period of time. The court reasoned, based on these

definitions and "common sense," "that the subject of an extension must be in existence before it can be extended." In other words, a small refinery could only *extend* an exemption it already had received. In reaching this conclusion, the court distinguished extending an exemption from renewing or restarting it.

Based on this understanding, the court held that "a small refinery which did not seek or receive an exemption in prior years is ineligible for an extension, because at that point there is nothing to prolong, enlarge, or add to." The court determined that this interpretation would "funnel[] small refineries towards compliance over time" to achieve the "aggressive and 'market forcing'" renewable fuels targets set by the statute. Finding that none of the three small refineries at issue had received an exemption every year prior to the compliance years at issue in the petitions, the court held that the petitions were improperly granted.

Flaws in EPA's Analysis

The Tenth Circuit also vacated EPA's decisions based on two flaws it identified in how EPA analyzed the petitions. First, the court determined that the statute only allows EPA to consider "disproportionate economic hardship" caused by RFS compliance—not by other economic factors. Though the provision allowing for small refinery petitions does not explicitly require that the "disproportionate economic hardship" be due to RFS compliance, because it references other related provisions in the statute that *do* connect "disproportionate economic hardship" with RFS compliance, the court concluded that the petitions for exemptions may only be granted for hardship due to RFS compliance. Having determined that the RFS only allows EPA to consider RFS compliance in its analysis, the court held that EPA had improperly considered other factors, such as an industry-wide downward trend of lower net refining margins, in its analysis of the petitions at issue.

Second, the court held that when EPA assesses the hardship from RFS compliance, the agency must account for its pre-existing position that RIN costs are "passed through" to consumers when it analyzes whether RIN costs generate a "disproportionate economic hardship." EPA has generally taken the position that unintegrated refiners who demonstrate compliance by purchasing RINs rather than blending renewable fuel recoup those costs in the price of their petroleum blendstocks. The court observed that EPA did not address this RIN cost recoupment theory when analyzing whether RIN costs imposed a disproportionate economic hardship on the refineries. The court concluded that EPA had "failed to consider an important aspect of the problem" by declining to explain either its changed position or why the RIN cost recoupment theory did not apply to the circumstances of these specific small refineries petitions.

Implications of the Decision and Considerations for Congress

The various holdings in the case could have important implications for the RFS program that may reduce the number of SRE exemptions in the Tenth Circuit. First, the holding that small refineries can only receive exemptions if they have received an exemption every compliance year to that point likely will affect other small refineries in the Tenth Circuit that petition for an exemption. At most, seven small refineries in the nation have received an exemption every compliance year to date because EPA granted seven exemptions in 2015. The actual number of small refineries still eligible under the Tenth Circuit's reasoning may be less than seven if any of those small refineries did not receive an exemption for every other compliance year thereafter. Due to EPA's decision to treat even the names of petitioners as CBI, it is unclear which—if any—of these seven are located within the Tenth Circuit. However, given that 35 small refineries received exemptions in 2017 and approximately a third of all small refineries are located within the Tenth Circuit, it is likely that some small refineries within the Tenth Circuit (1) may no longer be eligible for the exemption under the court's interpretation and (2) may have received exemptions for prior compliance years that could be challenged.

Second, the holding that EPA may only consider hardship caused by RFS compliance will require EPA to limit its analysis of other small refinery exemption petitions in the Tenth Circuit accordingly, which could result in fewer petitions being granted. However, it is unclear how many of the small refinery petitions that EPA previously granted rely on such external factors given that the agency's confidentiality policies. In addition, entities other than the small refinery receiving the exemption (e.g., renewable fuel producers) may not have sufficient information to challenge such decisions to the extent they do rely on factors the Tenth Circuit held to be improper. It is accordingly unclear what impact—if any—the court's interpretation of the exemption provision will have in practice.

Third, the holding regarding EPA's pass-through theory of RIN costs could be addressed several ways. EPA could change course on its theory if it adequately supports its changed position. Or EPA could adequately explain in its petition decision why the theory does not apply to the small refinery at issue. But if EPA maintains its position that RIN costs are passed on to the consumer through fuel prices and cannot distinguish the small refinery at issue, petitions that rely on RIN costs to support claims of disproportionate economic hardship may be less likely to be granted.

The decision could still be appealed. After initially stating that EPA intended to apply the Tenth Circuit decision nationwide, recent reports suggest that the agency intends to appeal the decision and ask the full Tenth Circuit to consider the case en banc. If the Tenth Circuit denies the government's request for rehearing or affirms the panel's decision, EPA could file a petition for a writ of certiorari with the Supreme Court.

Assuming the Tenth Circuit's decision stands, the court's interpretation raises a number of considerations for Congress. After all, small refinery exemptions (including EPA's position on confidentiality) have been of interest to the 116th Congress. Congress could consider whether the Tenth Circuit's interpretation reflects the intent of Congress as to which small refineries may be exempt from RFS compliance. In particular, Congress could consider whether the exemption was intended to be temporary to allow small refineries more time to comply, as the court's opinion posits, or available for any compliance year as market conditions and economic factors change over time. Congress may also evaluate whether other economic hardships unrelated to RFS compliance should be considered when deciding whether to exempt a small refinery. To the extent the court's opinion does not reflect congressional intent, Congress could consider amending the small refinery exemption provision to provide more explicit directions.

Beyond amending the RFS to directly address the issues that the Tenth Circuit considered, Congress may also more broadly examine the costs the RFS imposes on obligated parties, which cause small refineries to petition for exemptions. To the extent Congress determines that any such costs are higher than anticipated or fail to have the intended market-forcing effect, it could consider amending other provisions of the RFS to modify either the burdens imposed or the parties who bear them.

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