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Expert Opinion

EPA Finalizes 2013 Renewable Fuels Standard

by Greg Kort

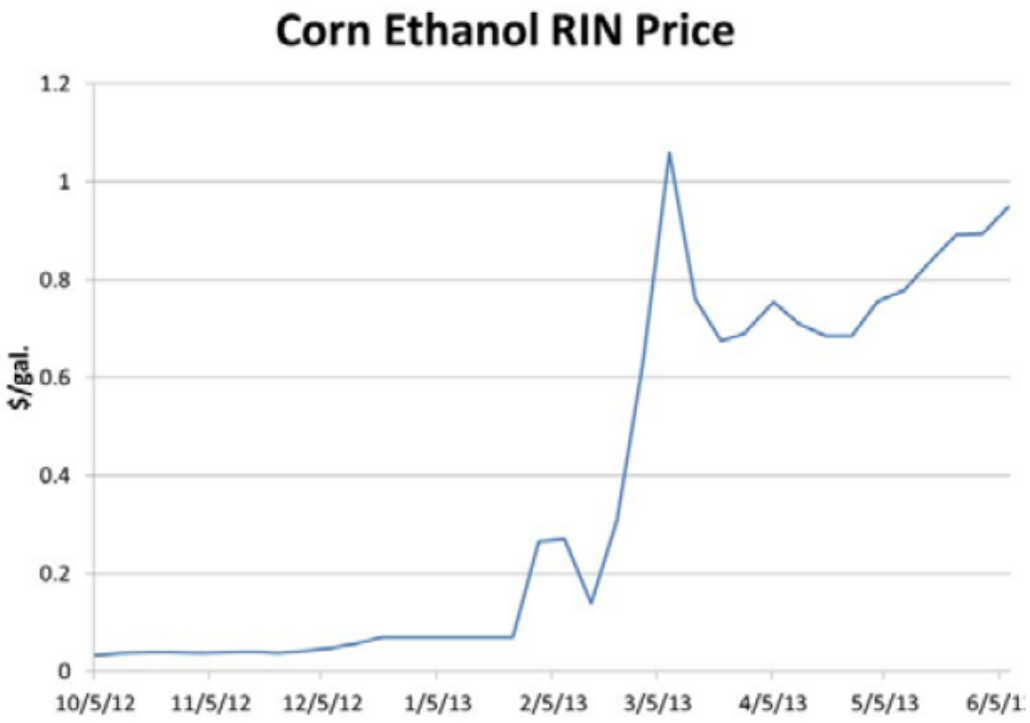
The Renewable Fuel Standard ("RFS") program, intended to cut down on greenhouse-gas emissions and develop biofuel technologies began in 2006 pursuant to the requirements of the Clean Air Act (CAA) Section 211(o). The standard was added to the CAA through the Energy Policy Act of 2005 and subsequently modified through the Energy Independence and Security Act of 2007. The RFS mandates that US refiners must blend a specific amount of renewable fuels into their gasoline each year, and it set a goal for the industry to blend 36 billion gallons of renewable fuels a year by 2022. The Environmental Protection Agency determines what proportion of those renewable fuels comes from conventional corn-based ethanol and what proportion comes from other biofuels, such as biodiesel.

To comply with the RFS mandate in 2013, refiners are required to use 13.8 billion gallons of corn based ethanol. Under federal law gasoline must contain at least 10 percent renewable fuels. While the EPA has approved blends of 15 percent, refiners have not adopted the higher concentration on a nationwide scale, citing engine damage concerns from auto manufacturers. Due to lower annual gasoline demand in the US, the RFS mandated renewable fuels volume exceeds the possible blended volume of 15 percent, creating a "blend wall" for gasoline.

The blend wall is making it more costly for some refiners to comply with the RFS – specifically when it comes to acquiring Renewable Fuel Identification Numbers (RINs). To show compliance with the mandate, RINs are attached to each gallon of renewable fuel. Once the renewable fuel is blended into gasoline, refiners can retain the certificate to show compliance or trade it to another party. In addition, RINs can be carried forward from one year to the next if there are excess RINs.

Refiners face significant costs to comply with RFS

Refiners who sell unblended gasoline are faced with significant costs to comply with the RFS mandate because they must purchase RINs in the open market. Demand for RINs has increased because of falling gasoline demand in the US and higher renewable fuel consumption targets as mandated by the RFS RIN prices have rose from $0.03 per gallon in 2012 to more than a $1.00 per gallon in 2013 (See figure below.)



Source: The Ethanol Blend Wall and the Renewable Fuel Standard, Oil & Gas Journal, Penn Energy, August 12, 2013

Recently, some refining companies have announced their anticipated annual compliance costs to meet the RFS obligations based on current RIN prices. These estimates are presented below:

- Valero Energy Corporation – estimated RFS compliance cost between $600 to $800 million per year.
- Marathon Petroleum – estimated RFS compliance cost of $200 million per year.
- CVR Refining – estimated RFS compliance cost of $200 million per year.
- Holly Frontier Corporation – estimated RFS compliance cost between $125 to $150 million per year.

EPA Recent Developments

As a result of the blend wall concerns, the EPA reportedly proposed to cut the ethanol mandate to 13 billion gallons next year, a significant decrease. A proposal from the EPA would cut the total renewable fuels mandate to 15.21 billion gallons in 2014 instead of the 18.15 billion gallons established by the 2007 law. The EPA proposal reportedly calls for the use of 13 billion gallons of conventional corn-based ethanol and 2.2 billion gallons of advanced biofuels such as biodiesel, down from 13.8 billion gallons and 2.75 billion gallons respectively.

Summary

RIN prices for refiners are expected to remain elevated as the industry struggles with the gasoline blend wall. Even with the possible cut in ethanol volumes in 2014, the blend wall will still be factor. Demand for gasoline in the US is continuing to decline, as national energy policies focused on reducing fuel consumption abound. These policies include changes to US corporate average fuel economy (CAFE) standard, which will no doubt have an impact on gasoline demand. US Refiners will increasingly rely on the secondary market for RINs to meet their RFS regulatory obligations. From a valuation standpoint, costs to comply with the RFS mandate represent a refiner's cost to stay in business and are a form of economic obsolescence that must be accounted for in all three approaches to value.

For more information regarding this article please contact Greg Kort at greg.kort@property-tax.com

[1] EPA considers U.S. ethanol mandate cut amid complaints, Bloomberg, October 11, 2013, <http://www.bloomberg.com/news/2013-10-10/epa-considers-u-s-ethanol-mandate-cut-amid-complaints.html>.