The American and Texas flag fly in front of the Chevron Corp. Pasadena Refinery on March 8, 2020. Photographer: Sharon Steinmann/Bloomberg via Getty Images

A Hidden Regulatory Tax on Large Refiners and Fuel Consumers Goes Away

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Exempting small oil refineries from the Renewable Fuel Standard effectively creates a tax on both larger refiners and people fueling up at the pump. The Environmental Protection Agency recently denied over 100 exemptions, explaining why most also should be rejected going forward, writes environmental attorney Michael H. Levin.

On June 3, the Environmental Protection Agency virtually eliminated—at least administratively—one of the indirect taxes that often arise under regulatory regimes: small refiner exemptions, or SREs, under the Clean Air Act's Renewable Fuels Standard.

Such exemptions for disproportionate economic hardship, or DEH, relieve petitioning small refiners from obligations to (a) blend increasing amounts of renewable fuels into their gasoline or diesel production or (b) acquire covering per-gallon credit called Renewable Identification Numbers, or RINs, from biofuel producers like corn- and cellulose-ethanol plants or anaerobic digester facilities at dairy or hog farms. They act as a tax on larger refiners required to make up for exempted fuel volumes by blending more renewables or purchasing more RINs.

Because renewables generally are much cheaper than conventional gas or diesel, SREs also tax fuel consumers, who pay substantially more at the pump than they would for blended car or truck fuel—a problematic result given ballooning pump prices.

More broadly, SREs pit the oil industry and oil states seeking less blending and more exemptions against biofuels producers and Midwest corn-ethanol states seeking more blending and fewer exemptions. Nevertheless, for the Renewable Fuel Standard's first decade, SREs were relatively noncontroversial. This was partly because Congress exempted all, then most, small refiners from Renewable Fuel Standard compliance through Obligation Year 2012—giving them space to decide whether to blend renewable fuels or exit the transport sector by switching to production of, say, heating oil or aviation fuel. It also was because, through 2015, the EPA granted only a handful of SREs annually.

Then the EPA under President Donald Trump expanded SREs nearly five-fold, endorsing broad interpretations that: DEH may include general economic conditions; petitioning small refiners are presumptively entitled to 100% rather than prior partial exemptions; and small refiners may receive standalone waivers even if they never received a previous exemption.

The EPA issued almost 90 SREs from 2016 through 2018. Exempted volumes of gasoline and diesel fuel soared from 2 billion gallons in 2013 to 30 billion gallons in 2017-18, with avoided RINs purchases rising from 190 million to 3.2 billion RINs, creating sectoral flash points, which arguably put SREs among the most-litigated Clean Air Act items since 2016.

In 2020, the US Court of Appeals for the 10th Circuit unanimously invalidated the Trump-era interpretations, ruling among other things that a refinery must have continuously maintained its exempt status to qualify for a new extension SRE and that only harm from complying with the Renewable Fuel Standard—not from general economic conditions or a firm's business decisions—qualifies as DEH. In June 2021, the US Supreme Court decided that the EPA may grant non-continuous SREs but left untouched the 10th Circuit's other rulings.

In its June 2022 denials, the EPA under President Joe Biden expanded on a December 2021 proposal and its April 2022 denials of more than 30 SRE petitions remanded by the D.C. Circuit at the agency's request. It wiped the slate clean by denying all 69 remaining petitions. In 70 densely reasoned pages, the agency ruled that:

- While a small refiner need not have continuously maintained its exemption status, to receive an "extension of the exemption" in Renewable Fuel Standard language, it must at least have received—not just have been eligible for—the Standard's initial blanket exemption; otherwise, there would be no exemption to extend.
- DEH must be solely caused by a small refiner's costs of Renewable Fuel Standard compliance, whether from blending biofuel or acquiring RINs. Harm attributable to

pandemics, inflation, recession—or a refinery's discretionary dividend payments—is not cognizable for SRE purposes.

- Harm rarely can be shown by small refiners because they typically pass through to customers all their costs of acquiring RINs. The EPA updated—backstopping with economic analyses—its past market studies to confirm these cost pass-throughs.
- In addition, harm must be disproportionate relative to other refineries' costs of Renewable Fuel Standard compliance. But compliance is inherently proportionate, since the Renewable Fuel Standard allocates biofuel obligations based on each refinery's production—smaller refiners are obliged to acquire fewer RINs. Beyond this, the EPA stated, no disproportionality can exist where the price of RINs is essentially the same for all participants in a nationally traded RINs market on any trade day.
- Even where large refiners blend renewables they produce into their petroleum products rather than buy RINs, they must, and do, discount their prices by the value of RINs they generate internally or be priced out of the competitive fuels market. The EPA calls this the "RINs discount," cites numerous analyses to support it, and concludes the result is no different than if these refiners bought RINs and passed through their cost. So despite surface appearances, small refiners who can't blend internally are not disadvantaged by refiners who do—the DEH outcome is the same.
- Nor, the EPA concluded, does disproportionate harm arise from some large refineries' ability to shift monthly production between conventional fuels and renewables in efforts to minimize Renewable Fuel Standard compliance costs. Every refinery, the EPA noted, is free to purchase required RINs month-by-month to smooth out RINs price fluctuations. To treat as DEH such alternative business decisions which are not caused by compliance would undercut Renewable Fuel Standard predictability and turn DEH into insurance for refiners on the losing end of such market gambles.

Accordingly, the EPA denied every pending SRE petition on structural as well as factual grounds, stating that absent a compelling DEH demonstration in the face of near-universal industry cost pass-throughs, a small refinery "should have no reasonable expectation that its SRE petition will be granted in the future."

The agency softened this result by granting a one-time compliance amnesty to some 35 small refiners whose Year 2018 SREs were issued by the Trump EPA but later reversed when 2018 RINs were no longer available. It reduced 2019-2020 pandemic-year Renewable Fuel Standard obligations to free up more RINs for compliance during those years. And it proposed new, extended compliance periods going forward—including ability to use future RINs to satisfy 2020-2021 obligations—for small and other refiners facing possible RINs shortfalls.

Conclusion

Regulatory taxes tend to reach equilibrium because they sufficiently subsidize beneficiaries without overstressing taxed entities' absorption capacity. That's why they persist. Given the tensions underlying this balance, the EPA's denials may be a coda to the SRE litigation saga or a prelude to more of the same.

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