

## Focus on Fuels

**In This Issue**

TM&C Services

Controversial Renewable Fuel  
Statndad Program

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### What to do with the Controversial Renewable Fuel Standard Program



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To no one's surprise, the renewable fuel program continues to be controversial. The controversy has matured from expected negative impacts to actual negative impacts, possibly including the shutdown of a major East Coast refinery. The program is not the first governmental attempt to mandate market intervention in the hope of solving some problem. Some examples would be rationing during World War 2, petroleum price controls in the 70s, a myriad of programs in state environmental regulations, and the mother of all programs, international efforts to control the climate. The renewable fuel standard program was designed to reduce the U.S. dependence on energy supplies from unstable regions of the world. Each of these government interventions was conceived to address some perceived need like food or energy shortages or environmental problems. Some of the programs have accomplished significant success either in the short term or, in the case of state and federal environmental legislation, for the long term; however, few of the programs have been implemented without some pain and in some cases, so much pain, they were cancelled. So, with the current controversy in the RFS program, it can be instructive to look at a historic program - petroleum price controls in the 70s.

#### TM&C Services in Fuel Regulations

TM&C provides a full range of services in its fuels regulatory practice. Some of these services are listed below.

- Preparing, reviewing and submitting fuels reports, including CDX submissions.
- Facility audits for compliance with fuels programs.
- Interaction with EPA to pose fuels-related questions.
- Industry specialist assistance for required

#### Controversial Renewable Fuel Standard Program

##### Petroleum Allocation and Price Controls

In August 1971, the Nixon administration, concerned about inflation, unemployment and most importantly, the coming election in 1972, established a 90-day freeze on wages and prices. A board to administer the price control policies was established after the initial 90-day freeze. The program was ended in 1974. An exception to that were the natural gas and petroleum prices which continued to be controlled due to international events. In October 1973, the Organization of Arab Petroleum Exporting Countries joined together to implement an embargo on oil shipments to the United States and certain other countries in retaliation for U.S. support of Israel. This embargo ended in 1974, but the oil markets were again disrupted in 1979 with the Iranian Crisis. Armed with

- gasoline attestations.
- Industry specialist assistance for in-line blending audits.
  - Assistance in setting up a fuels compliance group/program.
  - Personnel reviews of compliance-related groups.
  - Compliance status reviews and recommendations.
  - Negotiations/consultation during EPA enforcement actions.
  - 3rd-Party Engineering reviews.
  - Due diligence reviews of facilities and companies in RFS RINs Program.

the authorizations of the Emergency Petroleum Allocation Act of 1973, the petroleum markets were constrained by government fiat rather than economic drivers for the next seven years. The consumers suffered greatly from the government intervention, and the petroleum industry became bloated with government induced inefficiencies. Once the decisions became political rather than economic, it became impossible for the markets to react efficiently.

### **Outcome of the Government Intervention**

What was done with these unprecedented nonwartime powers? In short, a lot. The Arab oil embargo created transportation fuel shortages resulting in the infamous gas lines in the 70s. Service stations regularly ran out of gasoline allocations and would close to reduce operating costs. The gas lines became the symbol representing a failed U.S. energy policy. The various programs to address the initial OPEC embargo resulted in the start-up of inefficient refineries, under production of domestic crude, higher than necessary petroleum product prices, significant trade imbalances as foreign crude prices skyrocketed with prices increasing more than 1,500%, and a morass of government programs and modifications to those programs to address any politically charged effect of the programs. For instance, price controls on domestic crude oil led to various mandated mechanisms to either share the lower priced crude oil or to allocate the low price advantage through some financial calculation. Crude produced from low producing "stripper" wells was shut in because the cost to run these small volume wells was more than the realization from the low valued "old" oil. After a stripper was shut down for a specific amount of time, it could be restarted at uncontrolled prices. The renewable fuel program is beginning to show similar flaws.

### **Renewable Fuel Program Implications**

The renewable fuel program was enacted under the Energy Security and Independence Act of 2007. It was partially in response to impressions left from the 1970s oil embargos. The U.S. did not want to be at the mercy of the oil-producing countries. It was also in response to the belief that U.S. oil production had peaked and would continue to decline at a rapid pace. It also did not hurt that the program was politically popular in agricultural states that are important to the political ambitions of seekers of national office, which explains why a Republican President would approve a program opposed by the generally Republican friendly oil-producing states; however, the two basic reasons for the program, energy security and independence from the political influence of oil-producing countries have been eliminated with the amazing increase in U.S. oil production from fracturing shale regions to produce light crude oil. The U.S. is now poised to become not only the largest consumer of petroleum products but also the largest crude oil producer. So what do you do with a program that has outlived its purpose? That is another politically charged question.

### **What to do with the RFS Program**

Ronald Reagan became President of the United States in January 1981. Within one week of his inauguration, he abolished the remaining price and

allocation controls on domestic oil and gasoline production and distribution. It was a bold move because the petroleum industry had responded logically to the regulations and had become more like a utility than a robust competitive industry. Over 100 refineries closed over the next 10 to 15 years. The price of oil on average dropped, and the price of the most expensive oil dropped precipitously. The impact of the regulations was felt for the next decade.

The renewable fuel program has similarities in that some of the activities in the renewable fuel industry and the petroleum industry would only continue if there is a government mandate. The program has begun to transmogrify from, "throw some ethanol into that gasoline," to a national debate on whether the program has been a factor in the bankruptcy of a large East Coast refinery.

Just like special interests that contorted the petroleum price controls and allocations in the 70s, the impacts of the RFS program are being attacked by specific parties seeking exemptions. Small refiners are asking, and in some cases getting, waivers for "disproportionate economic hardship." The Philadelphia Energy Solutions (PES) refinery sought and received some relief from the RFS program. Under the agreement, PES will retire 138 million RINs before April 1 when it plans to emerge from bankruptcy and another 64.6 million of the credits after that date. Carl Icahn unsuccessfully lobbied for a change in the point of obligation from refineries to the terminal level. Ethanol producers are lobbying to expand the 1 psi waiver to gasoline with 15% ethanol. As long as the program is politically driven, the political exceptions will expand, and the program will become more Byzantine.

The most effective solution to the current problems in the EISA would be to abolish the program. With no program, there would be less pressure by special interest groups to lobby for specific exemptions or waivers. The problem with abolishing the program is it is sure to have some impact on the current participants that benefit from the program. It is a real question whether the U.S. has the political fortitude to end a program that serves some but is a detriment to others.

Barring complete abolition of the program, the simplest and least controversial (least controversial, not noncontroversial) change might be a two-pronged approach. First, reduce the obligation from the current 19 billion gallons to something more manageable; say 15 to 17 billion gallons. Second, extend the 1 psi waiver to E15. This would bring the program back to its early implementation days when ethanol RINs were 5-10 cents per gallon and ethanol addition above the mandate was economically driven. E15 could become the dominant fuel (a win for the ethanol lobby) and the refiners would no longer be faced with extraordinary RIN prices. The key to this modification of the program is that the market would become the driver in additional ethanol use.

Setting the RVO level deserves a few more comments. The main problem with the RFS program since 2013 is that the RVO has either been set at, or anticipated to be set at, slightly over the E10 blendwall. It is very important in any solution that the RVO not be set above the E10; or, if E15 becomes a common gasoline grade, the E15 blendwall. If the 1 psi

waiver is extended to E15 and the RVO is set slightly higher than the E15 blendwall, RIN prices will continue to be high and the program will continue to be a thorn in the side of whoever must enforce it.

Whatever develops, Turner, Mason & Company can keep you up to date. Give us a call if you would like to discuss any of these issues.

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