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RIN FRAUD: EPA'S EFFORTS TO ENSURE MARKET INTEGRITY IN THE RENEWABLE FUELS PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

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C O N T E N T S

	Page
Hon. Cliff Stearns, a Representative in Congress from the State of Florida, opening statement	1
Prepared statement	4
Hon. Diana DeGette, a Representative in Congress from the State of Colorado, opening statement	6
Hon. Michael C. Burgess, a Representative in Congress from the State of Texas, opening statement	7
Hon. Lee Terry, a Representative in Congress from the State of Nebraska, opening statement	8
Hon. Henry A. Waxman, a Representative in Congress from the State of California, opening statement	9
Prepared statement	11
Hon. Brian P. Bilbray, a Representative in Congress from the State of California, opening statement	13
Hon. Fred Upton, a Representative in Congress from the State of Michigan, prepared statement	138

WITNESSES

Jennifer Case, Chief Executive Officer, New Leaf Biofuel	15
Prepared statement	17
Additional responses for the record	88
Answers to submitted questions	139
George Andrew Sprague, Owner, Union County Biodiesel Corporation, LLC	21
Prepared statement	23
Answers to submitted questions	142
Thomas Paquin, President, VicNRG, LLC	30
Prepared statement	32
Additional responses for the record	105
Answers to submitted questions	144
J.P. Fjeld-Hansen, Managing Director, Musket Corporation	54
Prepared statement	56
Answers to submitted questions	148
Joe Jobe, Chief Executive Officer, National Biodiesel Board	62
Prepared statement	64
Additional responses for the record	110
Answers to submitted questions	150
Charles Drevna, President, American Fuel and Petrochemical Manufacturers	73
Prepared statement	75
Answers to submitted questions	152
Byron Bunker, Acting Director, Compliance Division, Office of Transportation and Air Quality, Office of Air Radiation, Environmental Protection Agency	115
Prepared statement	118
Answers to submitted questions	155
Phillip Brooks, Director, Air Enforcement Division, Office of Enforcement and Compliance Assurance, Environmental Protection Agency[1]	

SUBMITTED MATERIAL

Subcommittee exhibit binder	159

[1] Mr. Brooks did not present a statement for the record.

RIN FRAUD: EPA'S EFFORTS TO ENSURE MARKET INTEGRITY IN THE RENEWABLE FUELS PROGRAM

WEDNESDAY, JULY 11, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON ENERGY AND COMMERCE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:05 a.m., in room 2123, Rayburn House Office Building, Hon. Cliff Stearns (chairman of the subcommittee) presiding.

Members present: Representatives Stearns, Terry, Myrick, Sullivan, Burgess, Blackburn, Bilbray, Gingrey, Gardner, Griffith, Barton, Whitfield, Degette, Castor, Markey, Green and Waxman (ex officio).

Staff present: Nick Abraham, Legislative Clerk; Charlotte Baker, Press Secretary; Andy Duberstein, Deputy Press Secretary; Todd Harrison, Chief Counsel, Oversight and Investigations; Cory Hicks, Policy Coordinator, Energy and Power; Heidi King, Chief Economist; Ben Lieberman, Counsel, Energy and Power; Monica Popp, Professional Staff Member, Health; Krista Rosenthall, Counsel to Chairman Emeritus; Alan Slobodin, Deputy Chief Counsel, Oversight; Sam Spector, Counsel, Oversight; Peter Spencer, Professional Staff Member, Oversight; Alvin Banks, Democratic Investigator; Alison Cassady, Democratic Senior Professional Staff Member; Brian Cohen, Democratic Investigations Staff Director and Senior Policy Advisor; and Alexandra Teitz, Democratic Senior Counsel, Environment and Energy.

OPENING STATEMENT OF HON. CLIFF STEARNS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. STEARNS. Good morning, everybody, and welcome to the Subcommittee on Oversight and Investigations of the Energy and Commerce full committee.

My colleagues, today we will examine the Environmental Protection Agency's handling of fraud in its program to implement the Renewable Fuel Standard. Specifically, we will look at the impacts on the biodiesel marketplace from the fraudulent production and trade in renewable fuel credits, or Renewable Identification Numbers, RINs, and the impact from EPA's efforts to address this serious problem.

This hearing is part of the subcommittee's ongoing investigation into RIN fraud and should spotlight potential solutions to the most

urgent problems confronting the biodiesel market. This hearing should also serve to identify additional challenges from fraud within the Renewable Fuels Program in general.

EPA is responsible for developing and implementing regulations to ensure that the United States national transportation fuel supply during a given year contains certain mandated volumes of renewable fuel. The RIN credit trading program is designed to add flexibility to the system and facilitate compliance by petroleum refiners and importers, known as, quote, "obligated parties," end quote, with renewable fuel standards that were created under the Energy Policy Act of 2005 and expanded under the Energy Independence and Security Act of 2007 to cover gasoline and diesel transportation fuels.

Now, in recent years a sizeable market for biomass-based diesel has developed. This market is second only to corn ethanol in size, producing more than 1 billion gallons of biodiesel fuel last year.

As we will hear in testimony this morning, unlike ethanol fuels, the price for RINs is critical to making ends meet for small biodiesel producers, the marketers who collect and distribute the fuel, and small blenders of the fuel, especially travel centers and truck stops. RIN prices have ranged from $1 to $1.50 per gallon of biodiesel, compared to about 2 pennies per gallon for ethanol.

Unfortunately, my colleagues, when the price for RINs is relatively high, so is the incentive to game the system. Since November 2011, EPA has identified some 140 million invalid or fraudulently created biodiesel RINs generated by three producers. Additionally, EPA investigations could amount to tens of millions of more invalid RINs identified.

Just last month, a Federal jury in Maryland found Rodney Hailey of Clean Green Fuel guilty of selling $9 million worth of fraudulent RINs to brokers, oil companies, and producers, and then using the money to go on a spending spree that included the purchase of luxury cars and high-end jewelry. Mr. Hailey had generated 32 million credits for fuel that never existed.

Meanwhile, EPA does not certify or validate the fuel produced and registered in its systems that track RINs. The Agency maintains that obligated parties are responsible for conducting their own due diligence when conducting RINs transactions. This approach makes sense, to a point; however, to date EPA has not indicated what is acceptable for due diligence investigations by the companies.

On top of this uncertainty, EPA effectively penalized companies that were, quote, "victims of fraud" by requiring them to replace invalid RINs for compliance purposes. As we will hear from witnesses on our first panel this morning, this current approach to fraud has thrown the biodiesel marketplace into turmoil, creating significant uncertainty for small players, locking some innocent companies out of the markets altogether.

Clearly there is a problem with the current situation. Today we will discuss how to fix the problem and how to do so with appropriate urgency. As we do so, we must recognize the range of fraud that may occur in the Renewable Fuels Program. Testimony today will indicate other types of fraud and abuse, such as with exports,

which we should be sure EPA seeks to address effectively and quickly.

We will hear from two panels of witnesses this morning. On the first panel we will hear from stakeholders with important perspectives across the life cycle of a RIN, two small biofuel producers, a marketer of biofuel, and a blender of the fuel for a major truck stop chain, all of whom have firsthand experience with the impact of fraud. We will also hear from respective representatives of the obligated parties and the biofuel production industry overall about industry efforts to respond to fraud risk.

On the second panel we'll hear testimony from two EPA officials who have been involved in devising compliance requirements and ensuring those requirements are met.

So I am pleased to learn that EPA appears to recognize the legitimate concerns of stakeholders and may be amenable to implementing some of their suggestions. That's a positive sign, but much, much remains to be worked out, and uncertainty continues to reign in this market, putting many small operators at risk.

[The prepared statement of Mr. Stearns follows:]

Opening Statement of the Honorable Cliff Stearns
Subcommittee on Oversight and Investigations
Hearing on "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program"
July 11, 2012
(As Prepared for Delivery)

Today we will examine the Environmental Protection Agency's handling of fraud in its program to implement the Renewable Fuel Standard. Specifically, we will look at the impacts on the biodiesel marketplace from the fraudulent production and trade in renewable fuel credits, or Renewable Identification Numbers (RINs), and the impacts from EPA's efforts to address this problem.

This hearing is part of the subcommittee's ongoing investigation into RIN fraud and should spotlight potential solutions to the most urgent problems confronting the biodiesel market. This hearing should also serve to identify additional challenges from fraud within the renewable fuels program in general.

EPA is responsible for developing and implementing regulations to ensure that the U.S. national transportation fuel supply, during a given year, contain certain mandated volumes of renewable fuel. The RIN credit trading program is designed to add flexibility to the system and facilitate compliance by petroleum refiners and importers – known as "obligated parties" – with renewable fuel standards that were created under the Energy Policy Act of 2005 and expanded under the Energy Independence and Security Act of 2007 to cover gasoline and diesel transportation fuels.

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Unfortunately, when the price for RINs is relatively high, so is incentive to game the system. Since November 2011, EPA has identified some 140 million invalid or fraudulently created biodiesel RINs generated by three producers. Additional EPA investigations could amount to tens of millions of more invalid RINs identified.

Just last month, a federal jury in Maryland found Rodney Hailey, of Clean Green Fuel, guilty of selling $9 million worth of fraudulent RINs to brokers, oil companies and producers and then using the money to go on a spending spree that included the purchase of luxury cars and high-end jewelry. Hailey had generated 32 million credits for fuel that never existed.

Meanwhile, EPA does not certify or validate the fuel produced and registered in its system that tracks RINs. The agency maintains that obligated parties are responsible for conducting their own due diligence when conducting RINs transactions. This approach makes sense, to a point. However to date, EPA has not indicated what is acceptable for due diligence investigations by the companies.

On top of this uncertainty, EPA effectively penalizes companies that were "victims" of fraud by requiring them to replace invalid RINs for compliance purposes. As we will hear from

witnesses on our first panel this morning, this current approach to fraud has thrown the biodiesel marketplace into turmoil, creating significant uncertainty for smaller players–locking some innocent companies out of the market altogether.

Clearly there is a problem with the current situation. Today we will discuss how to fix the problem, and how to do so with appropriate urgency. As we do so, we must recognize the range of fraud that may occur in the renewable fuels program. Testimony today will indicate other types of fraud and abuse, such as with exports, which we should be sure EPA seeks to address effectively.

We will hear from two panels of witnesses this morning. On the first panel, we will hear from stakeholders with important perspective across the lifecycle of a RIN -- two small biofuel producers, a marketer of biofuel, and a blender of the fuel for a major truck stop chain -- all of whom have first-hand experience with the impacts of fraud. We will also hear from representatives of the obligated parties and the biofuel production industry overall about industry efforts to respond to fraud risks.

On the second panel, we will hear testimony from two EPA officials who have been involved in devising compliance requirements and ensuring those requirements are met. I am pleased to learn that EPA appears to recognize the legitimate concerns of stakeholders and may be amenable to implementing some of their suggestions. That's a positive sign, but much remains to be worked out, and uncertainty continues to reign in this market, putting many small operators at risk.

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Mr. STEARNS. With that, I recognize the distinguished ranking member from Colorado Ms. DeGette.

OPENING STATEMENT OF HON. DIANA DEGETTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO

Ms. DEGETTE. Thank you, Mr. Chairman, for holding this hearing today.

The EPA's Renewable Fuel Standards Program was created and amended under President Bush, first by the Energy Policy Act in 2005 and then by the Energy Independence and Security Act of 2007. I support this program, and I want it to be a productive hearing today that results in real improvements to that program, but all too often, as we have found in the last year and a half, these hearings have turned into excuses to make political points and beat up on regulatory agencies, in this case a little bit blaming the victim, the EPA, for fraud by some of the other outside private businesses. I hope it doesn't happen today as we go along, because this hearing in particular should not be used just to bash the EPA.

Again and again, when we consider environmental protection, we hear about the need for market-based programs. Industry wants government out of the way so the magic of the market can clear up our air and water.

Well, Mr. Chairman, here is a program right here today that uses a market-based approach. Congress established specific goals for adding renewable fuels to the fuel supply. The EPA worked closely with the petroleum sector to develop a flexible credit-trading program that allows refiners and other obligated parties to comply with the renewable fuel standard. Under the program, as the chairman said, they can buy credits on the open market, which sets prices on the basic laws of supply and demand.

Now, as in any market, there are bad actors. That's what happened here. Three companies, Clean Green, LLC; Absolute Fuels, LLC; and Green Diesel, LLC, sold fraudulent renewable fuel credits via EPA's trading system. Many big-name oil companies bought these credits, and EPA did what it was supposed to do: It uncovered and investigated this fraud and, as the chairman said, in one case so far filed criminal charges.

Today we are going to hear from the trade association representing the petroleum refiners that bought these fraudulent credits. They want relief from the EPA for the fact that they were duped. Well, Mr. Chairman, I would submit this proposition: You can't have it both ways. You can't ask the government for a market-based compliance program and then blame the government or ask the government to not fully enforce the law because you were fooled by the free market.

I want to specifically talk about Mr. Drevna's testimony. He's the president of the American Fuel and Petroleum Manufacturers. And I read your submitted testimony. It paints the petroleum refiners as the real victims. It claims that they shouldn't be held responsible for the fraud they didn't commit. Of course, that makes sense without any context. Nobody should be blamed for fraud that they didn't commit. But while these refiners didn't commit the fraud, they weren't helpless victims either.

These are some of the most sophisticated petrochemical companies in the United States, and, to be honest, if they're going to participate in a market-based system from which they benefit, they have a duty to investigate the people who they're doing business with. That would happen in any private market.

Now, the EPA set clear rules for this market. The regulations clearly state that fraudulent renewable fuel credits can't be used for compliance, and they clearly state that the system is a buyer beware system. This buyer beware approach was not a secret, but yet the refiners failed to do basic research on the renewable fuel credits they were buying.

Two of the companies accused of the fraud, I am sorry to say, Mr. Green and Mr. Barton, they are based in Texas. Now, presumably many of the Texas-based refiners could have inspected the facility, knocked on the doors of the companies that falsely claimed to be producing large quantities of biodiesel, and concluded pretty quickly that things looked fishy. An article in The New York Times described one of the facilities as, quote, "a few plastic tubes" in, quote, "a tiny ramshackle building."

So it wouldn't have been hard for these big, sophisticated refiners to do their due diligence, but they didn't do their part, and now they are here today saying the EPA is punishing them unjustly, even though they were in clear violation of the Clean Air Act standards. Mr. Chairman, these companies should not be let off the hook for their failure to do their own due diligence.

I do think, though, that we have a lot to learn from this hearing. We do need to hear from the affected refiners about why they did not identify this fraud as apparently they could have easily done; we need to hear from other sellers of renewable fuel credits to learn how they are affected; and we need to hear from the EPA about how the Agency uncovered this fraud and how to prevent it in the future.

The EPA continues to work with affected stakeholders to ensure compliance and identify solutions to problems that have arisen in the wake of the fraud. I hope the witnesses today can give us a full picture of the challenges they faced in the wake of these fraud cases and constructive ideas for how the EPA can help the market recover as quickly as possible.

Thank you, Mr. Chairman.

Mr. STEARNS. I thank the gentlelady.

And I recognize Dr. Burgess for roughly about a minute. We're waiting for the full chairman Mr. Upton.

Mr. BURGESS. I can filibuster until he gets here.

Mr. STEARNS. You can filibuster. We have two others, Mrs. Blackburn and——

Mr. BURGESS. I will be brief.

OPENING STATEMENT OF HON. MICHAEL C. BURGESS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

You know, the renewable fuel standards law, we had a big hearing about it yesterday in the energy hearing. Whether we agree with the merits or not, and many of us do not agree with the merits, still if it's there, it should be administered fairly to all concerned.

In my district in north Texas, a number of small businesses are participants in the RIN program. One company, VicNRG, is testifying with us here today, and thank you for your participation, sir.

As a result of the Environmental Protection Agency's poor enforcement and their lack of due diligence in vetting fraudulent companies participating in the program, legitimate businesses are put in a position where they face staggering economic losses due to a system that—I mean, Lisa Jackson was here. She was here in this very committee, sitting at this very witness table, and she said, no, this is a buyer beware program.

Now, look, this is the same EPA that in the last Congress assured us that they could properly manage a carbon-based trading scheme called cap and trade. This program is infinitesimally smaller, and yet the EPA seems to have fallen flat on its face.

They have successfully taken everything that was bad—the EPA has successfully taken everything that was bad about mortgage-backed securities and brought it to the energy sector. To place the burden of this poorly administered program on the backs of honest businesses is unconscionable. I hope our hearing today will shed light on the problems that the companies have faced with the trading program and that real reforms are achieved with what we're going to do today.

I'll yield to whoever is next.

Mr. STEARNS. Mr. Terry, the gentleman from Nebraska.

OPENING STATEMENT OF HON. LEE TERRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Mr. TERRY. Thank you, Mr. Chairman, for holding, I think, this important hearing.

I am a believer that if we are going to eliminate our addiction to OPEC oil, that we need to diversify our fuel portfolio, and that has to include biofuels. Now, of course, I could be accused, since I come from a Cornhusker State, of having a bias, of which I do, but the bias is that we need diversity, and we need biofuels to be part of that portfolio.

There are many that I serve with on both sides of the aisle that disagree with that statement, and, unfortunately, because of unquestionable RIN fraud, RINs have become one of the discussion points on eliminating biofuels altogether. So this is an important hearing so we can figure out how to fix the RIN fraud problem that we all know on both sides of the aisle exists. We are here today to find solutions to this fraud problem, and I want to thank our panel for being part of a solution here today.

I yield my time back to the chairman.

Mr. STEARNS. We have roughly 2 minutes. Does anyone else on the subcommittee seek recognition?

Mr. WAXMAN. Mr. Chairman, I ask unanimous consent that when the full committee chair comes in, that he be given 2–1/2 minutes.

Mr. STEARNS. Sure. All right. We'll reserve that balance, and, by unanimous consent, so ordered.

I recognize the ranking full chairman, the gentleman from California, Mr. Waxman.

OPENING STATEMENT OF HON. HENRY A. WAXMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. WAXMAN. Thank you, Mr. Chairman. I'll take a full 5.

Congress established the Renewable Fuels Program to reduce the country's dependence on petroleum-based fuels and cut greenhouse gas emissions from the transportation sector. These are laudable goals. Unfortunately, a few bad actors selling fraudulent biodiesel fuel credits have created a crisis of confidence in the biodiesel fuels market that risks undermining the whole program.

The reported cases of fraud have left petroleum refiners understandably skittish about purchasing biodiesel credits from small and unfamiliar biodiesel producers. As a result, through no fault of their own, many small legitimate biodiesel producers are struggling to sell their products and make a profit. Others along the fuel chain, such as the distributors of biodiesel and credit brokers, are feeling the pinch as well. We will receive testimony from a few of these affected parties today, and I look forward to hearing their suggestions for how to restore certainty and integrity to the market.

We'll also hear from the American fuel and petrochemical manufacturers. To hear them tell it, they were helpless victims of this fraud. This is revisionist history. The statutory renewable fuels provisions allow petroleum refiners to meet their renewable fuel obligations by purchasing renewable fuel credits.

In 2007, the Bush EPA set up the required Credit Trading Program. EPA had two basic options when designing this program. EPA could have required that each credit be verified by EPA prior to its sale. This approach is more burdensome, but would make the government, not industry, responsible if a credit turned out to be fraudulent. Or EPA could allow the industry itself to generate and verify the credits, which is how most markets operate.

EPA consulted extensively with industry stakeholders and chose the approach with the least amount of government involvement. The Petroleum Refiners Trade Association endorsed this approach. But that flexibility for industry carried with it an important and clear responsibility. The oil refiners and other obligated parties had to ensure that they were using valid credits to comply with the law. They didn't.

As we now know, several of the country's largest oil companies purchased millions of fraudulent renewable energy credits. This happened because they didn't do the basic due diligence they would do in purchasing any other product. With any due diligence they would have quickly discovered that the accused biofuel producers weren't producing any biofuel at all.

I find it ironic to hear my Republican colleagues criticize a program that is run by the industry and, more importantly, criticize EPA for not doing what the program did not intend them to do.

EPA plays a crucial role in establishing clear rules and obligations for the credit-trading system, and EPA carried out this responsibility. But recent events show that the system, as currently operated by industry and EPA, needs to be improved.

EPA has been meeting extensively with stakeholders to identify solutions for problems in the renewable fuels credit market. But it

is not just up to EPA. Buyers and sellers must be active and vigilant participants in the marketplace, and if things go wrong, the industry can't demand that the government bail them out by waiving the law.

Market-based approaches to meeting environmental requirements are often preferable because they are less costly and less burdensome than traditional regulation, but market-based approaches are only acceptable if they produce at least equivalent environmental results. Waiving the requirement for industry to replace fraudulent credits basically says that if something goes wrong, the public, not industry, must pay the price. That kind of response gives market-based approaches a bad name and is not acceptable.

I hope that today's hearing helps all the affected parties continue their work toward real solutions that protect the functioning and integrity of the Renewable Fuels Program. We can't criticize EPA for a market-based approach, which I usually hear people on the Republican side of the aisle support, and now they want to criticize EPA for not running it the way they would have liked EPA to run it. But EPA followed the advice of so many, and the Bush EPA turned it over to the industry itself to monitor the program.

I yield back my time.

[The prepared statement of Mr. Waxman follows:]

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNI
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

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Opening Statement of Rep. Henry A. Waxman
Ranking Member, Committee on Energy and Commerce
Hearing on "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program"
Subcommittee on Oversight and Investigations
July 11, 2012

Mr. Chairman, Congress established the renewable fuels program to reduce the country's dependence on petroleum-based fuels and cut greenhouse gas emissions from the transportation sector. These are laudable goals. Unfortunately, a few bad actors selling fraudulent biodiesel fuel credits have created a crisis of confidence in the biodiesel fuels market that risks undermining the whole program.

The reported cases of fraud have left petroleum refiners understandably skittish about purchasing biodiesel credits from small and unfamiliar biodiesel producers. As a result, through no fault of their own, many small, legitimate biodiesel producers are struggling to sell their products and make a profit. Others along the fuel chain—such as the distributors of biodiesel and credit brokers—are feeling the pinch as well.

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They didn't. As we now know, several of the country's largest oil companies purchased millions of fraudulent renewable energy credits. This happened because they didn't do the basic due diligence they would do in purchasing any other product. With any due diligence, they would have quickly discovered that the accused biofuel producers weren't producing any biofuel at all.

EPA plays a crucial role in establishing clear rules and obligations for the credit trading system, and EPA has carried out this responsibility. But recent events show that the system as currently operated by industry and EPA needs to be improved. EPA has been meeting extensively with stakeholders to identify solutions for problems in the renewable fuels credit market.

But it's not just up to EPA. Buyers and sellers must be active and vigilant participants in the marketplace. And if things go wrong, the industry can't demand that government bail them out by waiving the law.

Market-based approaches to meeting environmental requirements are often preferable because they are less costly and less burdensome than traditional regulation. But market-based approaches are only acceptable if they produce at least equivalent environmental results. Waiving the requirement for industry to replace fraudulent credits basically says that if something goes wrong, the public, not industry, must pay the price. That kind of response gives market-based approaches a bad name and is not acceptable.

I hope that today's hearing helps all the affected parties continue their work toward real solutions that protect the functioning and integrity of the renewable fuels program.

Mr. STEARNS. The gentleman yields back.

Anyone else seek recognition? We have roughly a little over 2 minutes.

The gentleman from California, Mr. Bilbray.

OPENING STATEMENT OF HON. BRIAN P. BILBRAY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. BILBRAY. Mr. Chairman, I think it's only fair to point out that there is so much that the industry can work with that we give them the infrastructure for the practical application of the theory of how this is approached.

I think both sides of the aisle should remember that after 9/11 there was a bipartisan effort that saw a need for the Federal Government and State governments to cooperate at changing the way we operated so that this country could be safe. The product of that was REAL ID legislation. We upgraded the identification to reduce fraud, reduce the risk to this country, and both sides worked on that.

Something comparable that we may want to talk about here, and Ms. Case and I were talking about the fact that just as much as REAL ID helped with national security, maybe the fact of upgrading the way to be able to identify true renewables as opposed to those fraudulent ones is to improve the documentation so that fraud can be detected better in the process.

In fact, I would ask my colleagues to consider the fact that maybe what we need here is an E–Verify for environmentally friendly fuels and the use of technology and computerization as a way of allowing those who want to play by the rules set by this Congress and stay within those boundaries to be able to verify that they are actually within the boundaries.

Just as much as REAL ID brought security to the country, and just as much as everyone knows that if we want to enforce, you know, our employment laws, E–Verify is going to be the vehicle, maybe with this crisis we should look at changing our procedures and giving the private sector a secure way of knowing what is truly an environmental fuel and what isn't. And I'd ask both sides of the aisle to cooperate on this, like we have done in the past, so that the private sector can play within the rules that we have set.

I yield back.

Mr. STEARNS. Anyone else wishes to speak on this side? If not, Mr. Green is recognized for 5 minutes. Do you have an opening statement?

Mr. GREEN. No, Mr. Chairman, I don't have an opening statement.

Mr. STEARNS. OK. All right. We'll go to our witnesses now. I say to Mr. Bilbray, I am glad that the subcommittee chair, Mr. Whitfield from Kentucky, is here to hear your eloquent presentation. That would be legislation in his purview. We, and you particularly, would like to lead the charge for this E–Verify in the RIN program. I think it's an excellent idea, and I think many of us would support that idea. So——

Ms. DEGETTE. Mr. Chairman, would that be a new government-run program?

Mr. STEARNS. This is in the early stages.

I ask the gentlelady unanimous consent to let Mr. Whitfield, who's from Kentucky, introduce Mr. Sprague.

With no objection, Mr. Whitfield, you are welcome to introduce your distinguished witness.

Mr. WHITFIELD. Mr. Chairman, thanks very much. And I am delighted to be here this morning, and I appreciate the opportunity to introduce a constituent of mine, Mr. Andy Sprague, who is a farmer, who is an engineer, who is a biodiesel entrepreneur.

It has been interesting listening to the discussion this morning, because I'm so delighted that you all asked Mr. Sprague to testify, because he is not a major oil company, he is not a gigantic refiner, but he is producing a significant amount of biodiesel, and the lack of confidence in EPA's RIN program is particularly troublesome for those smaller people involved in this business.

So he'll be a spectacular witness. He's quite knowledgeable in every aspect of this subject matter, and I'm delighted that he's here with us today to provide his expertise.

Thank you very much.

Mr. STEARNS. And I thank the gentleman.

So, Mr. Sprague, you're a spectacular witness, not to put any pressure on you.

We also have Ms. Case, who is cofounder and CEO of New Leaf Biofuel located in San Diego, California.

We have Mr. Thomas Paquin, the president of VicNRG, LLC, which markets and trades commodities in the diesel industry as well as RINs.

Mr. J.P. Fjeld-Hansen is the managing director of the Musket Corporation, affiliate company of Love's Travel Stop and Country Stores, Incorporated. They purchase biodiesel fuel from a variety of producers and transport it to the Love's Travel Centers.

Mr. Joe Jobe is the chief executive officer of the National Biodiesel Board. The National Biodiesel Board is a national trade association representing the biodiesel industry.

We have Mr. Charles Drevna, president of American Fuel and Petrochemical Manufacturers. Its members are the obligated parties responsible for meeting the requirements of the Renewable Fuel Standard.

So thank you all for your time. I know coming here to Washington takes you away from your work, so you're very much appreciated.

We'll start out with you, Ms. Case, for your opening statement, but I have to swear you in first. So if you'll please stand.

Before you stand, as you know, the testimony you're about to give is subject to Title XVIII, Section 1001, of the United States Code. When holding an investigative hearing, this committee has a practice of taking testimony under oath. Do you have any objection to testifying under oath?

It appears none.

The chair would advise you that under the rules of the House and the rules of the committee, you are entitled to be advised by counsel. Do any of you wish to be advised by counsel?

In that case, please rise and raise your right hand.

[Witnesses sworn.]

Mr. STEARNS. With that, Ms. Case, we'll welcome you with your opening statement.

STATEMENTS OF JENNIFER CASE, CHIEF EXECUTIVE OFFICER, NEW LEAF BIOFUEL; GEORGE ANDREW SPRAGUE, OWNER, UNION COUNTY BIODIESEL CORPORATION, LLC; THOMAS PAQUIN, PRESIDENT, VICNRG, LLC; J.P. FJELD–HANSEN, MANAGING DIRECTOR, MUSKET CORPORATION; JOE JOBE, CHIEF EXECUTIVE OFFICER, NATIONAL BIODIESEL BOARD; AND CHARLES DREVNA, PRESIDENT, AMERICAN FUEL AND PETROCHEMICAL MANUFACTURERS

STATEMENT OF JENNIFER CASE

Ms. CASE. Good morning. Chairman Stearns, Ranking Member DeGette and members of the committee, thank you for having me here to testify today. My name is Jennifer Case. I am the CEO and one of the owners of New Leaf Biofuel in San Diego.

We began our company in 2006 with the mission to utilize a former waste stream, used cooking oil, and convert it into an energy source that would displace some of the petroleum used in our area and improve local air quality. Since selling our first batch of biodiesel in 2008, we have experienced some drastic ups and downs. As with any commodity business, we are at the mercy of ever-changing markets, which makes planning for the future challenging. The past few years have been even more unpredictable with the expiration of the biodiesel tax incentive, followed by its reinstatement, followed by its expiration once again.

With each policy change, our ability to price biodiesel competitively with petroleum diesel is affected. Fuel customers are eager to use renewable fuels, but not if it means they have to pay more per gallon.

The saving grace for the biodiesel industry was the Renewable Fuel Standard. Finally we had a long-term policy put in place by the Federal Government to ensure that biodiesel would be part of our energy future. The producers and importers of fossil fuels would be forced to blend renewable fuels made in the USA into the fuel supply, and over time the mandate would increase, which would encourage investment in our previously uncertain business.

2011 was a banner year for New Leaf Biofuel. We were able to produce and sell biodiesel with Renewable Identification Numbers, RINs, for a profit, and we were able to pass savings downstream to our distributors and the end users of our fuel. Finally biodiesel was cheaper than diesel. At New Leaf, we nearly tripled our workforce and finally obtained low-interest financing to increase production at our local plant.

Things took a devastating turn for our small business around November of 2011 when the EPA announced that there were individuals perpetrating fraud in the RIN market. Prior to the fraud announcement, New Leaf produced biofuel, generated RINs, and then transferred both the fuel and the RIN to our fuel distributors, who blended the biodiesel with petroleum diesel and delivered the blended fuel to customers such as the cities of San Diego and Chula Vista and the local military bases. The distributors would

then separate or monetize the RIN and sell them up the chain to the obligated parties.

Once the fraud was announced, my customers were no longer able to sell New Leaf RINs. Obligated parties now only buy from top-tier producers, producers who are financially capable of replacing RINs should they be deemed invalid. Despite the fact that New Leaf's RINs were generated at a legitimate plant that had been producing quality fuel for 4 years using approved feedstocks and technologies, our RINs were suddenly worthless, as if New Leaf was in the same category as the criminals who never produced a drop of biodiesel.

The months immediately following the fraud were very difficult. We had to adjust once again to a market without a tax incentive, and then we were stripped of the RIN value. Once again, petroleum diesel was cheaper than biodiesel, and many of New Leaf's customers switched back to fossil fuels.

2012 was supposed to be a year of growth for New Leaf, but unless our industry can come together to find a solution that will get New Leaf's RINs marketable again, our days and the days of the small biodiesel producers across the country are numbered.

The Renewable Fuel Standard is a good policy for businesses large and small. It creates jobs, it encourages the use of homegrown energy, and it reduces greenhouse gases from the transportation sector. As with any new policy, especially a policy this comprehensive, there are going to be issues to iron out. Clearly we need to figure out a way to avoid more fraudulent RINs entering the marketplace, and, most importantly, we need a system that will restore the confidence in the RIN market so that obligated parties will once again be willing to buy RINs generated at small plants like mine.

The private sector is already working on solutions that will likely resolve most of these issues. We have seen a plan introduced that would provide obligated parties with a subscription to a service that would allow them access to RINs produced at plants that have been audited by a third party, and they will have realtime data available as to the capacity of a given plant to produce quality biodiesel and RINs.

I believe the various industry representatives on this panel have the ability and the wherewithal to improve this system. What doesn't kill us makes us stronger, and with more due diligence and transparency in the market, biodiesel will be stronger in the end.

Thank you.

Mr. STEARNS. I thank you.

[The prepared statement of Ms. Case follows:]

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Written Testimony of Jennifer Case
Chief Executive Officer – New Leaf Biofuel
Submitted to the United States House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigations
"RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."
July 11, 2012

Chairman Stearns, Ranking Member DeGette and Members of the Committee, I appreciate the opportunity to testify on behalf of New Leaf Biofuel. I am Jennifer Case, Chief Executive Officer of a small biodiesel company located in San Diego, California.

Summary of Major Points:

- The Renewable Fuel Standard is a good policy that is working to increase the use of biomass-based fuels like biodiesel, and is creating good, green jobs in communities across the country.
- The fraud in the RIN market has dealt a devastating blow to small biodiesel producers, and the industry in general.
- The private sector has reacted to the crisis by creating various RIN validating programs meant to restore confidence in the RIN market.
- Small producers need the EPA's help to ensure Obligated Parties will be willing to purchase small producer RINS once the RINS have been validated.

Written Testimony of Jennifer Case

New Leaf Biofuel was formed by myself and 4 other individuals in March of 2006. While raising capital, we began securing feedstock by contracting with local restaurants, hospitals, casinos and other industrial kitchens for their cooking oil. In 2007, the California Air Resources awarded the Company a grant to build the biodiesel manufacturing plant, funds that were matched by a loan from the City of San Diego. New Leaf sold its first batch of fuel to the local alternative fuel station Pearson Fuels in November of 2008.

Today, we collect cooking oil from about 1500 restaurants in the San Diego area, and we employ 31 hardworking individuals. Some of the users of New Leaf's biodiesel include the Cities of San Diego, Chula Vista and Oceanside , as well as the Allied Waste Trash fleet, the Enterprise Airport Shuttles and dozens of others in California.

Since July 1, 2010, when the RFS2 program began in earnest for biodiesel and other advanced biofuels, our business has had quite a roller coaster ride. Generally, we think Congress did a good job in creating a consistent federal policy that adds cleaner burning, domestic renewable fuels to the petroleum diesel fuels market. The Renewable Fuel Standard provided our new industry the ability to price biofuels competitively with traditional fuels, and gave Obligated Parties a choice of how they would comply – either they buy wet gallons, or they purchase Renewable Identification Numbers (RINS). New Leaf Biofuel would "generate" the RIN and charge our distributors a premium for the RIN-attached biodiesel, and thereafter the distributor would monetize the RIN and sell it up the chain to obligated parties. 2011 was a great year for small biodiesel producers like New Leaf. We were sold out of biodiesel for the entire year, we nearly tripled our workforce, and we began a plan to expand production from 1.5 million to 5 million gallons per year.

Everything changed beginning around November of 2011 when the Environmental Protection Agency (EPA) announced it was bringing enforcement actions against people who fraudulently generated invalid RINS. Overnight, our customers were unable to sell the RINS we attached to our fuel, which meant New Leaf and other small producers lost the ability to sell biodiesel for a competitive price. Nearly 8 months later, New Leaf is still struggling to obtain a fair value for the RINs we generate. And although our plant is currently under construction to increase capacity, we have actually had to slow down production due to sluggish sales.

We are not here to specifically criticize the EPA. We understand the RFS is a tough program to regulate. As a small producer located 3,000 miles from Washington, D.C., and who doesn't have direct relationships with Obligated Parties, the most important thing that we need from the EPA is help in restoring confidence to the program so that Obligated Parties will, once again, purchase the RINS generated by small producers. If that doesn't happen, the fate of small producers is questionable at best.

Once the fraud was announced, the distributors who purchase New Leaf's fuel were unable to sell New Leaf's RINS. Neither the brokers, nor the obligated parties felt comfortable owning

RINS of any small producer. Obligated Parties decided that the best way to avoid owning fraudulent RINS was to purchase only from the large, well known producers—Companies that could and would be required to provide indemnity should the RINS turn out to be invalid.

New Leaf, for example, produces about 2 million gallons of biodiesel and generates 3 million RINS per year. At $1.50 a piece, these RINS are worth 4.5 million dollars in the marketplace. As a small biodiesel producer, Obligated Parties know it would be virtually impossible for us to replace those RINs in the event they were found to be fraudulent by the EPA.

As more rumors of fraud have spread, we have watched the RIN values fall to nearly half the value of this time last year. In the past couple of months, New Leaf has been unable to price biodiesel cheaper than petro-diesel, forcing many of our fleet customers to abandon biodiesel in favor of cheaper fossil fuel.

In February of this year, our industry met at its annual conference and the "fraudulent RIN crisis" was the primary topic of discussion. We formed a task force of industry leaders including obligated parties, large and small biodiesel producers, fuel suppliers and other stakeholders. Drawing on the experience of all involved, we devised both short term and long term solutions to get the markets moving again. Small producers like New Leaf have forged new relationships, some with brokers and traders willing to validate RINS using their own balance sheets to indemnify Obligated Parties. Some small producers have worked directly with Obligated Parties to validate their RINS—something that has led some small producers to sell biodiesel directly to Obligated Parties. In all cases, small biodiesel plants are working diligently to ensure full compliance with the RFS Program and have opened their plants and their books for quarterly RIN audits, all at their own expense. While these efforts have allowed some small producer biodiesel RINS to trade in the marketplace again, they are being sold for significant discounts to the already depressed market.

We believe that the private sector has done a good job putting in place a number of quality assurance plans that will establish the validity of New Leaf's and other small producers RINS, albeit at the cost of the small producers. The industry is now performing the due diligence that could have avoided this situation had it been performed all along. Although it is expensive, we believe it is the first step in getting small producer RINs back into the marketplace. My biggest concern is just that – That the small producers will spend money on internal audits and other programs to establish the validity of our RINS—And the Obligated Parties sill won't buy them from us. It may be awhile until I know the answer to this question.

The next few months will be crucial for small biodiesel producers. In order for us to survive, we need assurances that Obligated Parties will purchase our RINs. The fuels marketplace is wildly unpredictable with daily price fluctuations in crude oil and raw materials, not to mention State and Federal incentives that come and go year to year. The Renewable Fuel Standard was meant to provide the renewable fuels industry with a long-term plan—a reason to invest in these industries and create new jobs. Without the ability to sell RINS, our businesses will continue to lose cash flow and many of us will be forced to shut our doors.

The question we ask ourselves is this, "what can the EPA do to help the success of the New Leaf Biofuel over the short term (the next few months)." We doubt EPA can require Obligated Parties to purchase RINS from specific companies. However, we believe it would be useful if EPA did the following:

- Finalize every current fraud case from 2011 and promptly provide the marketplace with information on all fraudulent RINs actually in the marketplace. The sooner that all of the fraud is exposed, the better.

- Update the regulations in a way that creates a process other than a "notice of violation" (NOV) so that Obligated Parties and others in the chain of RIN ownership can address RIN replacement in a constructive way.

I hope you found my testimony helpful and I appreciated the opportunity to provide you with my insights. I look forward to working with this committee on any questions or comments you may have. Thank you.

Mr. STEARNS. Mr. Sprague.

STATEMENT OF GEORGE ANDREW SPRAGUE

Mr. SPRAGUE. Thank you, Chairman Stearns, Ranking Member DeGette and other committee members. My name is George Andrew Sprague. I am the owner of Union County Biodiesel along with my partner, Terry Zintel, who is here with me today. We represent three biodiesel plants, one that is currently located in Newburgh, Indiana; one in South Roxana, Illinois; and we have begun to work with a biodiesel plant that is owned by 300 farmers in Moberly, Missouri. So we employ about 30 people in our small biodiesel company.

For the purpose of this testimony, I am here, as Congressman Whitfield said, as a farmer, an engineer and now a biodiesel entrepreneur. I hate to say it, that part is not working out real good right now, and that's why we're obviously here before you.

As small producers and private business owners, we do not have corporate war chests to weather business and governmental calamities that occur. When these issues happen, we go to the bank. And many of you have reviewed issues with the banking industry, so you know how well that works right now, going to banks for loans. We have to liquidate personal assets. My children's college fund is invested in my biodiesel plant. While that is meant to tug on your heartstrings, and hopefully it does, it does bring light to the fact that this is a very, very serious issue, one that can't be taken lightly.

A little bit of history about the RIN fraud program. In 2011, we, like New Leaf, had a banner year. All of our facilities did well. We were selling our RINs to our customers via transfer of a wet gallon, and those RINs were being disposed of to the obligated parties either via brokers or through direct contracts with the obligated parties.

We had heard the rumblings of problems, of fraud, and that started to make everyone nervous. Literally January 2nd of this year, I had customers on the phone calling me saying, we can't sell your RINs. If we can't sell your RINs, we can't buy your biodiesel. So literally on January 2nd, we were out of business.

We did begin a process of our own due diligence with obligated parties, and were able to make contacts with obligated parties, and were able to get some obligated parties receiving our RINs again, and to date we are in business, but it's not as good as it should be.

As an example of how this problem is very serious, we had 1 customer who sold—or purchased 60 million gallons of biodiesel from many producers, obviously not from us specifically, who has yet to buy a gallon of biodiesel this year. That's a large quantity that's just taken out the markets.

In January, I spoke with my Congressman Mr. Whitfield to try to get an audience with EPA to discuss this problem, and he helped me get that audience with several members of EPA who are on the panel in the second panel. First I would like to say that my experience with them was very positive. They were very cooperative, they explained why things were the way they were, but they also said

they're bound by certain rules and restrictions that they have to operate under as well.

Cutting to the chase, we have a problem. We can point fingers. We can say who did what, and why we did it, and why we didn't do it. But ultimately we've got to fix the problem. The program is not broke. Many people may want to use this as a reason to abandon the program. This program is not broke.

In late 2011, most of us were quite surprised that it was working as well as it did. I hate to say this, but from the private sector, when something in government works really well, you kind of scratch your head a little bit and go, well, they did do a good job. So most of us in the industry felt like we had a good program. Industry-based, it was meeting the needs that it needed to, but we did have a problem. So hopefully here today through our testimonies, both written and oral, we can talk about those.

I think one thing we must admit is that nobody really saw this coming, and because nobody saw it coming, we really don't need to be pointing fingers. But the industry is coming up with an independent third-party verification program that is going to fix the problem if left to its own accord.

What we hope for is an even playing field, though. EPA needs to be involved in what the rules of this program are going to be. The private sector will solve this problem. The obligated parties, they did not do their due diligence as they should. We did not get calls from due diligence providers until late in 2011. That water is under the bridge. But obviously this independent third-party methodology will fix the program.

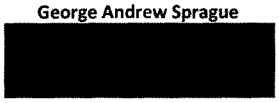
So we ask that you consider our testimonies and allow industry to step forth and fix this problem. Thank you.

Mr. STEARNS. I thank you.

[The prepared statement of Mr. Sprague follows:]

July 11, 2012

George Andrew Sprague



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CONGRESS OF THE UNITED STATES
House of Representatives
Committee on Energy and Commerce
2125 Rayburn House Office Building
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The Honorable Cliff Stearns, Chairman
Subcommittee on Oversight and Investigation
Hearing: "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

Dear Mr. Stearns,

My name is George Andrew Sprague; I am the owner of Union County Biodiesel Company, LLC (UCBC) and Midwest Biodiesel Products, LLC (MBP), along with my partner Terry Zintel. I am a 5th generation farmer, Licensed Civil Engineer and Land Surveyor, and most importantly for the purposes of this hearing and my testimony, I am a Biodiesel Entrepreneur. I started UCBC in 2004 and MBP in 2006, as a direct result of my interest in alternative fuels which grew from my time as a Director on the Kentucky Soybean Association.

My background in engineering and construction led me to believe that I could develop the technology to produce biodiesel and to construct and operate a small biodiesel manufacturing facility on my family farm in Kentucky. My on-farm biodiesel manufacturing facility was operated as a technology testing and manufacturing prototype facility from 2004 through June 2009. In 2006, I partnered with Terry Zintel of St. Louis, MO to design and construct a 12 million gallon per year biodiesel manufacturing facility located in South Roxanna, IL called Midwest Biodiesel Products, LLC. In 2009, we designed and constructed an 18 million gallon per year biodiesel manufacturing facility in Newburgh, IN named UCBC.

Terry Zintel and I are small businessmen and entrepreneurs. Every dollar we have invested in our biodiesel businesses has come from our savings or from banks where we have borrowed the money. We have no corporate war chests to weather market or government policy calamities. When unforeseen cash demands occur in our businesses, we borrow the money or liquidate other personal assets to keep our businesses afloat. It should also be understood that borrowing money in the current banking climate, and in particular with the current state of the biodiesel industry, is very simply impossible. Our greatest long term fear is that Congress and the EPA will take a position of inaction or lack of positive

corrective action and this course will most certainly doom the vast majority of small and midsized biodiesel manufacturers in our Country to a path of elimination and bankruptcy.

Congress enacted the Energy Policy Act of 2005 and the subsequent Energy Independence and Security Act of 2007, and the rules promulgated by EPA most recently revised in July, 2010. One of the basic premises of the RFS program is to displace hydrocarbon based fossil fuels, with renewable fuels, and thereby lessen the U.S. dependence upon foreign oil. To achieve the goals set forth by Congress, the EPA created a RIN-based program. The Renewable Fuel Identification Number (RIN) represents a gallon of renewable fuel and is attached to each gallon upon production of the fuel. The RIN has become the currency of the RFS program with RINs being attached to liquid gallons of renewable fuel, separated off once owned by the Obligated Parties or blended with transportation fuel, fuel oil, or jet fuel, and subsequently used to document the U.S. displacement of our fossil fuels. The RINs provide incentives for blending of renewable fuels and allows the EPA to track production and use in the USA.

The RIN program has been successful in many ways. First, it has allowed Obligated Parties (Refiners, Importers, and Blenders of refined fuel) to access RINs when the renewable fuel was not readily accessible. For example, the Midwest States have multiple renewable fuel production facilities; however, the transport of the renewable fuel to the markets on the coasts can be expensive. Rather than being forced to absorb the costs of the transportation of ethanol and biodiesel from long distances, the Obligated Parties have the flexibility to simply purchase RINs from gallons that have been blend in the Midwest. This has saved Obligated Parties billions of dollars in infrastructure, capital expenses and transportation costs. Furthermore, the RFS2 program allows the Obligated Parties to have the flexibility of importing and exporting renewable fuels to help them balance their market and financial plans. Very simply, the RINs are the currency of the RFS2 program and as such, have created the necessary economic incentives to continue blending renewable fuels in a profitable manner.

To monitor the generation, transfer, and use of renewable fuels, the EPA created the Moderated Transaction System (EMTS). The EMTS system is capable of tracking all transactions and allows the EPA and the renewable fuels industry to adjust to the changing economics and market demands surrounding the renewable fuels industry and their respective RINs. Unfortunately, the EMTS system has no way to validate or monitor renewable fuel production and EPA is blind to potential fraud until the end-of-year required audits which are due by February 28th of the following year of production. At the inception of the EMTS program the majority of the renewable fuel industry believed that the EPA would be the entity providing oversight, guidance and validation of all RINs transactions in the EMTS system. The industry believed the EPA was in control of the validity of the RINs being generated within their controlled system. Every single participant in the system was certified by the EPA. Every participant provided documentation to the EPA, was reviewed by the EPA, allowed access to the system by the EPA, was monitored by the EPA, and most importantly, approved by the EPA. It was quickly pointed out after the fact by EPA that this is not the case and that a "buyer beware" policy would be followed even though every single transaction surrounding RINs takes place within the EPA's controlled and monitored system.

The EPA now expects the renewable fuels industry to resolve the issues of fraud through the use of generally accepted industry practices and independent third party validation programs with little or no guidance or input from the EPA. This enormous gap of oversight from the EPA and their lack of direct involvement in monitoring the RIN program have allowed the abuse of an otherwise productive RIN program. Without either the EPA's participation in RIN validation or a completely independent third party industry validation for RIN integrity, the renewable fuels industry will continue to be at the mercy of the EPA for their "after the fact - buyer beware" method of enforcement and monitoring. The

renewable fuels industry will greatly suffer under this type of policy as it create an environment where blending renewable fuels no longer makes financial sense.

After much debate and lengthy rule writing, the RFS program, was launched in the 3rd Quarter of 2007. Most participants in the program only vaguely understood the rules and there was little help offered by the EPA in understanding the rules or knowing where the obstacles in the program would be encountered. For the first couple of years of the biodiesel RFS program, biodiesel RIN pricing was in the range of $0.10 to $0.50 and this range did not significantly influence the overall marketing of biodiesel due to the combined existence of the $1.00 per gallon Excise Tax Credit. The way the economics worked was the difference between the cost of production and the market price of the biodiesel, after the $1.00 per gallon Excise Tax Credit, was what determined the value of the biodiesel RINs. RINs began to have a significant value in 2010, continuing into 2011 where they reached a maximum value of $2 per RIN. With the value of RINs soaring in 2011, biodiesel was being produced and sold at record levels, and the young startup industry was well on its way to establishing itself in the overall fuel industry. The RIN markets appeared to be working well and it appeared Congress and the EPA had established an efficient and functional monitoring system for the renewable fuels industry. Most participants complained about the added document filings and cost of reporting, but were enjoying the financial benefits of a fluid and functional market. As a whole, the industry appeared to be following the course set forth by Congress and implemented by EPA.

Both UCBC's Newburgh facility and our facility in South Roxana, IL experienced their best year of production in 2011 along with their most profitable year in 2011. The EPA rules and their controlled system require all biodiesel manufactures to transfer all RINs to our downstream fuel customers. Our customers were selling UCBC and MBP RINs without difficulty throughout all of 2011. When these same customers returned to the RINs marketplace on January 2, 2012, every single customer of UCBC and most of the customers of MBP were told that small producer RINs were undesirable and furthermore, some of our customers were told they could not sell RINs because the RINs came from small or midsized biodiesel producers. We were informed by RIN Brokers and Buyers that the Obligated Parties only would purchase RINs from large biodiesel producers. We were even provided a list from one Broker that named 15 of the largest producers in the country and only RIN from these 15 plants were acceptable. We were told that the EPA's "Buyer Beware" methodology was being enforced on the Obligated Parties in response to the pending Notice of Violations which were to be issued in the near future by the EPA. We were also informed by RIN Brokers and Buyers that the Obligated Parties would be performing some kind of due diligence with all biodiesel producers that they wanted to purchase RINs from and that no transactions would occur until the Obligated Parties were confident that no potential invalid RINs could be created by the producers.

On January 2, 2012, we were effectively put out of business by the lack of confidence in the EPA's RIN program. Without the ability of our customers to sell our RINs, we could not sell our biodiesel. UCBC sold only a couple of truckloads of biodiesel in January and February of 2012, and Midwest Biodiesel did not sell much more. We have been facing financial ruin and the closure of our businesses because everyone in the biodiesel industry feared what action the EPA was going take on the innocent participants of the EPA's own RIN system. By March 2012, we had initiated direct contact with several Obligated Parties and re-established some sales of UCBC and MBP RINs. Unfortunately, the sale of biodiesel was extremely slow due to the overall uncertainty in the RIN market and the continued fear of what action the EPA was going to take. As an example, we have one customer who bought a total of 60 million gallons of biodiesel last year from multiple biodiesel manufacturers that decided to not buy a single gallon of biodiesel in 2012 until the RIN crisis is solved and the EPA determines how it is going to penalize the innocent participants in its own RIN system. Today, we are continuing to work with our

customers to assure them we are producing valid RINs and we are exploring every possible avenue to find ways to sell our biodiesel and help our customers move our RINs until the EPA finalizes their approach to the current RIN situation.

In January of 2012, I contacted my Congressman, Ed Whitfield to assist me in contacting EPA about this RIN situation. I am pleased to say that all of the conversations I have had with the EPA staff were very informative and helpful, the EPA personnel I have interacted with have been concerned about my personal situation and the root problem with their regulations. The EPA has sought my opinion about the problems and my opinion about potential solutions to make a better RIN program for all of the participants.

Listed below are my thoughts and ideas on how to correct the RIN program and handle the RIN fraud situation. Below are the primary issues as I see them and solutions to those issues:

1. All biodiesel RIN program participants assumed the EMTS system was safe and was being controlled, managed and monitored by the EPA. No one, including the Obligated Parties or even the EPA saw the fraud coming. When RINs became as valuable as they were in 2010-2011, criminals began to devise plans to defraud the system, the EPA, and our Federal Government. This type of fraud did not happen in the ethanol industry because ethanol RINs are only worth a few cents per gallon – apparently not enough money to attract the criminals.

   SOLUTION: The EPA could adopt a presumptive liability policy. Like the EPA Ultra Low Sulfur Diesel Rules, the EPA should adopt rules that allow innocent, non-complicit parties protection from EPA enforcement actions. In other words, if a party is purchasing biodiesel RINs through the EPA's own system and they are not directly involved with the creation of an invalid RIN; the innocent parties should be protected from EPA enforcement penalties. Furthermore, if RIN generators, owners, and obligated parties invest in a RIN quality assurance program, this likewise should afford the parties protection from EPA enforcement penalties.

2. Currently, RINs can be separated from wet gallons prior to being blended at the consumer level. As a matter of fact, we know of many biodiesel manufacturers that are currently separating RINs at the instant a biodiesel sale takes place – long before the separation should happen. To my knowledge, all of the biodiesel RIN fraud happened with RINs separated from the wet gallon of fuel. Obligated Parties prefer the flexibility of early separation but this is exactly what has caused all of the biodiesel RIN fraud.

   SOLUTION: RINs must remain connected to the wet gallon biodiesel from creation at the biodiesel manufacturer to final blending at the consumer's level. This process would most certainly eliminate the current biodiesel RIN fraud since most of the current RIN fraud is perpetuated by an isolated single party with a prematurely separated RIN. If RINs were required to remain with the wet gallon of biodiesel until final consumer blending, passing fraud forward to downstream participants would be extremely difficult and much less likely to be executed without immediate detection. This method would also stop the improper RIN separation for non-transportation fuel uses and the practice of exportation after RINs separated without properly retiring the RINs. If the Obligated Parties demand the freedom to separate RINs from wet gallons before they are blended at the consumer level, then the RIN program should require the biodiesel producers to sell RINs directly to the Obligated

Parties based upon the EPA biodiesel mandate and the actual gallons of biodiesel manufactured.

3. No "Due Diligence" was being performed by the Obligated Parties. EPA made it very clear, after the RIN fraud problem was discovered, that the Obligated Parties were responsible for verifying and certifying the quality of the RINs with the EPA's own RIN program. Everyone in the biodiesel industry assumed that the EPA was responsible for this function and furthermore that the Year End Attestment process would keep the system clean.

   SOLUTION: Biodiesel Producers and Biodiesel Marketers must create an independent RIN Integrity or RIN Verification Program which the EPA and the Obligated Parties accept as proof that RIN compliance is being adhered to by every biodiesel manufacturer which participates in the Program. This method does not need to be overly burdensome, but thorough enough to provide transparency in the Obligated Parties and the EPA. Because this effort will be paid by the biodiesel producers, it should have requirements that do not create unreasonable cost for the biodiesel producer.

4. There is no method to fix a problem with RINs once a situation or inadvertent problem occurs. Currently, the EPA issues a Notice of Violation once a problem occurs and does not provide a method or opportunity to correct the situation or problem. This type of methodology creates severe heartburn for the Obligated Parties.

   SOLUTION: The EPA should take the position that any unintended violation is fixable and provide a sufficient window of time to correct the situation. If corrective action is not taken, then a violation has occurred and the EPA should proceed with its normal enforcement procedures.

There are other problems with the EPA's RIN program that have no RIN fraud impact but are adversely affecting the small and midsized biodiesel manufacturer. Listed below are several suggested enhancements to the current RIN program that will significantly help small and midsized biodiesel manufacturers remain profitable and ensure the continued growth of this young industry.

5. Obligated Parties are required to meet their mandated RIN obligations on an annual basis. Obligated Parties even have the latitude to be non-compliant in one year if they correct the shortage and are compliant within the following year. This allows the Obligated Parties to be passive in the marketplace for extremely long periods of time. We have been informed that several of the largest Obligated Parties have bought very limited numbers of RINs in the first 6 months of 2012. The lack of regular purchasing of RINs invalidates the laws of supply and demand and quite simply, the Obligated Parties can manipulate the market in their favor and create non-market driven biodiesel pricing and RIN pricing scenarios.

   SOLUTION: The Obligated Parties should be required to meet their anticipated annual mandate of RINs on a monthly or quarterly reporting basis. This very simple change to the EPA's program rules would ensure a more stabilized biodiesel manufacturing environment and it would bring fewer extreme high and extreme low demands for biodiesel RINs. In turn, small and midsized biodiesel manufacturers would be operating in a more normalized demand market and it would pave the path for further expansion of the small and midsized biodiesel manufacturers in our Country.

6. The EPA's EMTS system was created to track RINs from their creation to final separation, as well as to preserve the integrity and identity of the RIN throughout the lifecycle of the process. If the Obligated Parties are allowed to isolate compliant biodiesel manufacturers thereby choosing and selecting which biodiesel manufacturer's RINs they obtain, the Obligated Parties will in fact have the power to put small and midsized biodiesel manufacturers out of business. The Obligated Parties will be free to collude with the handful of large biodiesel manufacturers to force out of business the small and midsized biodiesel manufacturers.

   SOLUTION: RINs verified by an independent verification program and properly entered into the EPA's EMTS system must always be considered valid for use by the Obligated Parties and priced at the same level as all other RINs. If the RINs were to be determined invalid at a later time by audit or EPA inspection, the Obligated Parties should not be subject to fines, penalties, or the requirement to purchase replacement RINs. Providing the Obligated Parties assurances that RINs obtained through the EPA's own EMTS system will ensure an environment where small and midsized biodiesel manufacturers can survive and grow.

7. Obligated Parties prefer to buy RINs in large batch sizes due to the cost of completing a financial transaction with RIN Brokers and RIN providers. Small producers and blenders receive a lower price for their RINs than to large producers due this market force. The lower prices offered to the small and midsized biodiesel manufacturer creates another economic disadvantage for the small and midsized biodiesel manufacturer who already struggles with the issues competition against the larger biodiesel manufacturer.

   SOLUTION: The EPA must endorse privately operated RIN exchanges to allow all RINs to be sold, without the discrimination of whether or not the RIN was generated at a large biodiesel manufacturer or a small biodiesel manufacturer. This very simple process will level the field for all biodiesel manufactures and ensure the fluid movement of RINs.

I believe that all of the suggested corrections listed above are capable of immediate implemented by the EPA. This Committee, Congress and the EPA must immediately act to preserve the biodiesel industry and to preserve the small to midsized biodiesel manufacturer. The Obligated Parties and large biodiesel manufacturers can play the waiting game to see what policy transpires, small biodiesel manufactures cannot wait. Please take action now; please direct the EPA to implement these simple yet effective changes to save jobs, save investments, and to save our biodiesel industry.

Respectively,

George A. Sprague

July 11, 2012

George Andrew Sprague

[redacted]

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Summary Outline

George A. Sprague:

1. Farmer, Engineer & Biodiesel Entrepreneur.
2. Formed Biodiesel Companies; UCBC in 2004 and MBP in 2006.
3. Biodiesel Companies are small producers with limited cash resources.
4. Inconsistent Government policies create severe cash shortages for my businesses.

RFS Program and RINs:

1. Congress created RFS program to lower dependence on foreign oil, strengthen US Alternative Fuel Industry, and to reduce pollution to our environment.
2. EPA created EMTS program for tracking and monitoring RIN activity.
3. EPA did not include the necessary program safeguards.
4. EMTS program worked well in past years but currently provides no assurances of RIN integrity to the renewable fuels industry.

RIN Fraud:

1. Neither the EPA nor the Obligated Parties anticipated current fraud situation.
2. EPA allowed RIN separation too early in the process which was a major contributing factor to the current fraud situation.
3. EPA's "Buyer Beware" policy and lack of "Due Diligence" by Obligated Parties created an opportunity for RIN fraud.
4. EPA rules result in violations and fines in lieu of positive corrective actions.

Solutions

1. Obligated Parties should be granted "Presumptive Liability".
2. Independent RIN Verification by Producers must be endorsed by the EPA.
3. No RIN separation should take place until the biodiesel is sold as transportation fuel.
4. All RINs must be considered valid once verified and entered into the EMTS system by the biodiesel producer.

Mr. STEARNS. Mr. Paquin.

STATEMENT OF THOMAS PAQUIN

Mr. PAQUIN. Good morning, Chairman Stearns, Ranking Member DeGette and members of the subcommittee. My name is Tom Paquin, president of VicNRG, LLC, headquartered in Keller, Texas. Thank you for allowing me the opportunity to discuss the current status of the renewable fuel industry, RIN fraud, and ensure that there are efforts to ensure RIN integrity.

VicNRG is a marketer and distributor of biofuels and other commodities. The company provides infrastructure and logistics solutions that are critical to the distribution of biofuels. We are a small business that has been expanding our national footprint by adding transit facilities, rail cars and other infrastructure assets. Each of our terminals offer high-quality, full-time employment, and economic benefit extends well beyond the fence of each of those facilities.

We are also an active participant in the RIN market. Our leadership in this market has been critical to identifying fraud and communicating our findings to the EPA. We consider ourselves a partner with the EPA, and I offer continued service.

To date, the fraud in the RIN market has resulted in serious hardship for many in the biofuel sector, including the ultimate fate of bankruptcy for numerous law-abiding businesses. Fraudulent RINs created a liability in the industry in excess of $200 million. Approximately 85 percent of the biodiesel producers are struggling to keep their doors open. Some, like R–3 Energy and Green Light Biofuels, have shut down operations completely. Biodiesel distributors and blenders are equally threatened with liabilities which they cannot meet.

Unfortunately, the fraud that has currently been discovered only addresses the low-hanging fruit. The EPA created an interim enforcement and response policy to restore faith in what was a dysfunctional RIN-trading system. However, this policy fails to restore the confidence required. Since the policy's release, the RIN market has actually become more dysfunctional. The obligated parties and, by default, marketing companies like ours cannot purchase fuel from small producers, just like the ones on the panel today. We cannot do this because the risk of being held liable to replace RINs is too great.

Because of these issues, VicNRG proposes the EPA broaden its interim policy. We feel the EPA has the flexibility and can use several regulatory approaches to restore confidence. To improve the situation, we offer the following proposal. First, we propose that the EPA revise its interim policy as it relates to invalid RINs so that no further RIN substitution would be required.

The congressional intent of the RFS is clear, and one of the key tenets is to build an alternative fuel industry and its related infrastructure. In fact, it is stated in the U.S. Code that many factors should be taken into consideration when setting volumetric goals, to include job creation.

Additionally, the EPA has the ability to average annual compliance, and according to the National Biodiesel Board's written testimony, the biodiesel industry exceeded last year's volumetric tar-

gets. One could argue that RFS goals have been met, and there is no reason to require RIN replacement. RIN replacement is destroying jobs today, which is 180 degrees out from the congressional intent. We also feel the EPA must continue to aggressively pursue and prosecute fraudulent activity.

Secondly, the EPA should undertake a 2013 rulemaking to establish a permanent due diligence process and an affirmative defense. Diligent and innocent companies should not be penalized for the acts of others. This affirmative defense may be structured by the EPA to impose reasonable compliance burdens on industry participants.

Clean Air Act case law establishes limits on EPA's authority to impose sweeping systems of presumptive liability. While Congress has delegated expansive powers to EPA to regulate, it is a fundamental tenet of American law that there must be at the very least the right to prove oneself innocent of an offense.

Finally, if EPA is willing to facilitate any of these remedies, the Agency should consider whether a petition to waive the RFS would be appropriate in these circumstances. The economic cost to U.S. businesses resulting from enforcement policy will force many legitimate companies that are currently operating out of business and eliminate countless jobs, at which point a severe harm threshold may have been met.

In summary, to immediately restore confidence in the RIN market and save tens of thousands of jobs, the EPA must consider immediate changes in the enforcement of the RFS program. Specifically, the EPA needs to expand its interim policy, to define due diligence, provide for affirmative defense, and eliminate the requirement to replace RINs for those who are good-faith participants. This is the foundation necessary to save the system, its associated investment and ultimately jobs in a struggling U.S. economy.

Thank you.

Mr. STEARNS. Thank you.

[The prepared statement of Mr. Paquin follows:]

VicNRG, LLC - Executive Summary
Thomas Paquin, President

VicNRG, LLC ("VicNRG") is a marketer and distributor of biofuels and other commodities whose infrastructure and logistics solutions are critical to the distribution of biofuels, as well an an active participant in the Renewable Identification Number ("RIN") market.

The fraud in the RIN market has resulted in serious hardship for many in the biofuels sector, including the ultimate fate of bankruptcy of numerous, law-abiding businesses. Fraudulent RINs created by Clean Green Fuels, Absolute Fuels and Green Diesel account for roughly 140 million invalid RINs, valued at hundreds of millions of dollars. The current issues as well has the future fraud threatens tens of thousands of jobs in the renewable fuel industry. Approximately 85% of the biodiesel producers are struggling to keep their doors open and biodiesel distributors and blenders are facing tens if not hundreds of millions of dollars in RIN replacement costs even though they have executed business in good faith.

The EPA has created an Interim Enforcement and Response Policy (IERP) to restore faith in a now dysfunctional RIN trading system, unfortunately, the IERP falls short of restoring the confidence required.

The EPA has the flexibility and can use several regulatory approaches to restore confidence. Three major points should be considered:

1. We propose that the EPA should revise its IERP as it relates to invalidity of all pending biomass-based diesel RINs so that no further RIN substitution would be required. In fact, 42 USC §7545 (o) (2) (B) (ii), specifically states that the EPA must take into account many factors, to include job creation, and in this case, demanding replacement of RINs is the basis for massive job destruction. EPA must also provide companies with the opportunity to present an affirmative defense to ensure that diligent and blameless companies are not penalized for the acts of others. This affirmative defense may be structured by EPA to impose reasonable compliance burdens on industry participants including affirmative duties to act. We also feel the EPA must continue with aggressive prosecution of current, and future pending fraudulent activity.

2. EPA should undertake a 2013 rulemaking to establish a permanent due diligence process and an affirmative defense. Clean Air Act (CAA) case law establishes limits on EPA's authority to impose sweeping systems of presumptive liability. While Congress has delegated expansive powers to EPA to regulate, it is a fundamental tenet in American law that there must be, at the very least, the right to prove oneself innocent of an offense.

3. If EPA is unwilling to facilitate any of these remedies, the Agency should consider whether a petition to waive the RFS would be appropriate in these circumstances. As an immediate alternative, it may be necessary to resort to the petition process established by 42 U.S.C. §7545(o)(7)(A)(i). This provision authorizes the Administrator to waive the requirements of the RFS after consultations with the Secretaries of Energy and Agriculture, in whole or in part, to avoid severe harm to the economy of a State, a region, or the U.S. Given that the economic costs to U.S. businesses resulting from OECA's enforcement policy may be anticipated to exceed $300 million and that EPA's enforcement policies may force legitimate biofuel producers and petroleum distributors out of business and eliminate countless jobs, this severe harm threshold may be met.

EPA must consider immediate changes to the RFS Program administration and enforcement; specifically, IERP. These assertions and requests are not made lightly but only because of the dire consequences caused by the current enforcement policy. We believe our immediate and short term solutions of modifying IERP, eliminating replacement of RINs for good faith purchasers, and the opportunity for affirmative defense is the foundation necessary to save the system, its associated investments, and, ultimately, jobs in a struggling U.S. economy. Anything other than that will only serve to reduce the effectiveness of the RFS program, as liabilities are much too significant for all but the largest industry participants. We stand ready to assist and contribute to find a solution to this critical problem.

Thomas Paquin
President, VicNRG, LLC

TESTIMONY FOR

Committee on Energy and Commerce

The Subcommittee on Oversight and Investigations

UNITED STATES HOUSE OF REPRESENTATIVES

RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program

Thomas Paquin

President, VicNRG, LLC

July 11, 2012

VicNRG, LLC ("VicNRG") is a marketer and distributor of biofuels and other commodities. We would like to thank you for the opportunity to testify as a representative of companies whose infrastructure and logistics solutions are critical to the distribution of biofuels, as well as an active participant in the Renewable Identification Number ("RIN") market.

The fraud in the RIN market has resulted in serious hardship for many in the biofuels sector, to include the ultimate fate of bankruptcy to numerous, law-abiding businesses. More broadly, the fraud committed in the RIN market to date highlights the need for all industry players, which include obligated parties, marketers, producers, and ultimately regulators to remain vigilant about industry practices and participants.

To that end, VicNRG continues to work with all of its counterparties in conducting a due diligence program which we believe is second to none. Furthermore, we have shared our experiences with industry leaders, which include industry organizations, obligated parties, and, ultimately, the Environmental Protection Agency (EPA). While the examination and review of the causes and implications of RIN fraud are ongoing, my testimony provides an overview of the

regulation of biofuels, their associated RINs, the key events leading up to our current situation and the future possibility of additional fraud. This testimony also describes the destabilizing effect the fraud has had on the market, as well as proposed solutions to right the ship known as the Renewable Fuel Standard (RFS), while getting the country back on its feet with regards to being a world leader in the development of next generation biofuels, energy independence and the creation of jobs.

Of critical importance, is our call for Congress and the EPA to revise the EPA Interim Enforcement Response Policy (IERP) dealing with enforcement of fraudulent RINs. The IERP, as addressed by the EPA to Chairman Upton on June 28, 2012, falls short of its goals to "...restore certainty in the market and ensure that the goals of Congress are met..." It is critical that confidence in the RIN market is restored to allow the RIN trading system to function as envisioned by the EPA, which in-turn will allow the industry to meet the Congressional intent of the RFS. The interim solution includes prosecuting the criminals, closing loopholes, defining due diligence and allowing an affirmative defense for good faith participants.

Company Background

VicNRG was started to pursue commercial biofuels opportunities as well as other commodities. The company's senior management is made up former Marine Corps Officers who have brought forward a culture of excellence, integrity and commitment to the company. Today, VicNRG still has a history of hiring veterans, among other highly qualified individuals, and are proud of the achievements of all members of the VicNRG team.

As the President of VicNRG and manager of other entities within the renewable fuels industry, I have seen tremendous growth of the industry over the last 5 years, one in which our

company has become an industry leader in marketing and the distribution of biodiesel. Our small business has grown significantly as we now employ nearly 40 full-time employees as well as sell more than 3 million gallons of biodiesel each month. Besides biofuels, our company has partnered with several businesses to establish a manufacturing and distribution business that produces a product called Diesel Exhaust Fluid ("DEF"). This fluid reacts with the emission of diesel engines and reduces the harmful compounds so effectively that the air going into the large tractor trailers is in many cases, is dirtier than the air being released from the tailpipe exhaust.

The economic impact of our daily business is much more significant, with many people indirectly employed, such as bankers, truck drivers, train engineers and insurance agents. While we're proud of our accomplishments, our goal is to continue growing our company, increasing employment opportunities and improving the communities in which we operate.

Under the RFS, biofuels, in this case biodiesel, and the RINs associated with the fuel are of significant importance to the EPA and its initiatives. VicNRG, LLC and the officers of the company view the EPA as a partner with parallel goals. In addressing this market, we intend to create hundreds of new jobs while improving our communities. This is only one example of how programs brought forth by Congress and EPA are working well to reduce our environmental impact.

Congressional Intent of the RFS and Background

The RFS, per Congress and the EPA, lays the foundation for achieving significant reductions of greenhouse gas (GHG) emissions from the use of renewable fuels, reduction of imported petroleum and further development and expansion of our nation's renewable fuels sector. It is extremely important to consider that the Congressional intent is not to just meet a

'volumetric' mandate; instead, the Congressional intent can be met even if the volumetric goal is not achieved. The RFS, per the EPA's Final Rule, was designed to encourage the blending of renewable fuels into our nation's motor vehicle fuel. This rule established the annual renewable fuel standards, responsibilities of refiners and other fuel producers; a trading system and other compliance mechanisms, recordkeeping and reporting requirements renewable fuels include ethanol, biodiesel and other motor vehicle fuels made from renewable sources. The program grants credit for both renewable fuels blended into conventional gasoline or diesel and those used in their neat (unblended) form as motor vehicle fuel.

Any party that produces gasoline for use in the U.S., including refiners, importers, and blenders (other than oxygenate blenders), is considered an obligated party (OP) under the RFS program. It is the obligated parties which are required to retire RINs against their respective Renewable Volume Obligation (RVO). They can do this by blending each category of fuel or purchasing RINs representing that blending. There are many reasons why an OP would purchase RINs instead of blending. The EPA recognized that fact and the challenges the OP's would have in acquiring renewable fuel, and as such, the EPA acknowledged in the Federal Registry, dated 1 May 2007, that the "...RFS program depends on a robust trading program."

The RFS program specifies compliance and enforcement provisions, such as for facility registration, recordkeeping and reporting requirements, program enforcement and various fuel tracking mechanisms. This rule also specifies who can generate RINs and under what conditions, how RINs may be transferred from one party to another and the appropriate value of RINs generated from different types of renewable fuel. These provisions were designed to enable the

RIN trading program to function properly, but have since been found to be inadequate in preventing fraud and, ultimately, creating confidence in the market.

It is critical to understand the basics of the Renewable Fuel Standard as it relates to production, RIN creation, separation, and retirement – evaluating the process cradle to grave.

Production

Biodiesel is made through a chemical process called transesterfication. The feedstocks used for the biodiesel, to meet the RFS requirement, have been determined by the EPA. Examples of qualifying feedstock are: used cooking oil, soybean oil and animal fat, just to name a few. The biodiesel portion of the transeterfication process is then available to be registered with the EPA. One and one half (1½ times) each gallon of bio-mass based diesel ("D4") RINs can then be generated by the producer for each gallon of biodiesel produced. At this point, the RIN is "assigned" to the fuel, and must be moved with the fuel until certain rules are met.

Separation

Typically separation of the RIN can occur when the biodiesel is blended with diesel at a percentage of 80% or less. The majority of users blend to the 5-20% levels, meaning 5-20% biodiesel (B5-B20) and 80-95% diesel. At that point, the RIN can be "separated". Today, under RFS-2, that action is completed in the EPA's Moderated Transaction System (EMTS), by selecting the method of blending. Other options include, receiving renewable fuel from an obligated party (who can separate RINs), designation of renewable fuel and used without further blending as a transportation fuel and use as a heating oil or jet fuel.

Retirement

After the RIN has been separated, it can then be freely traded among registered parties until, presumably, it will be purchased and retired by an OP against their respective RVO.

Economics

The economics of the transaction are best understood by providing an example. Biodiesel is priced off of the heating oil futures market (HO). HO is traded daily on the open markets, such as New York Mercantile Exchange (NYMEX). The price of biodiesel is also influenced by the price of the feedstock, for instance soybean oil. After a producer includes its cost of the refinery operation and profit margin, the price of biodiesel is typically offered as a premium to the HO market. For instance, it may cost a producer $4.50/gallon to make biodiesel, at which point they may sell for $4.75/gallon. The price of HO, for the purpose of simplicity, is $3.00/gallon. Let's also assume the RIN is trading for $1.50, which means that the RIN value of a gallon of biodiesel is $2.25 ($1.50 x 1.5 RINs per gallon). If we were to deduct the RIN value from the cost of a gallon ($4.75-$2.25), we would get a value of $2.50/gallon. In this example, the price is $0.50 less than the price of HO, or HO-50. At this level, blenders are incentivized to blend biodiesel into HO.

Again, this is a typical example in terms of blending margins over the past several years but is no longer the case. A loss of trust in the market is driving the RIN value lower and eliminating the blending margins, as we will examine. Furthermore, it shows the importance of a functioning RIN market; without it, the program will flounder.

Discovery, Enforcement of Fraud and The State of the industry

With the aforementioned background, we can fast forward to today's situation. To date, a local prosecutor has successfully prosecuted the COO of American Biofuels, a RIN offender in Alabama. Due to a quick identification and prosecution, the damage was limited to $100,000 in RIN replacement value. Similarly, the EPA has prosecuted one case successfully against Clean Green Fuels. Additionally, the EPA is investigating numerous cases dealing with RIN fraud beyond the three producers named by the EPA as offenders of producing invalid RINs – Clean Green Fuels, Absolute Fuels and Green Diesel (EPA took no action against American Biofuels)- ultimately affecting obligated compliance for both 2010 and 2011 compliance years. Based on EPA press releases of these 3 cases, roughly 140 million RINs have been deemed invalid, for which EPA has issued Notices of Violation (NOV) and is requiring replacement plus payment of cash penalties. The replacement cost of these fraudulent RINs is in excess of $200 million at current market values. As it currently stands, roughly 10-20% of the RIN market for 2011 volumes are fraudulent, and there is a belief by many in the industry this number could increase. This is significant by any standard. Arguments to the contrary stating that these incidents are isolated and minimal are downplaying the damage inflicted on the industry to date. The fraud in the RIN market has created an uncertainty and loss of credibility in the system that has damaged the effectiveness of the RFS program and its intent.

Prior to the RIN fraud surfacing, the industry was well on its way to achieving those goals. Unfortunately, today, we can no longer say that is the case. Instead, many of the small biodiesel producers, in excess of 85%, have shuttered their plants, reduced employee headcount and even claimed bankruptcy. Much of that has been driven by the lack of trust in the market and the inability of obligated parties and other market participants to truly understand the due diligence required by the EPA, a lack of an affirmative defense and loopholes in the regulations.

Like many industries, there has been a focus by some of the largest institutions to figure out how to operate in the "grey" areas, rather than focusing on the goal of the RFS which is to displace fuel consumed in the U.S. transportation sector. In the meantime, the damage to good faith market participants has been significant and will only increase.

Damages to Biodiesel Producers

One purpose of the RFS Program is to facilitate the growth and development of the domestic renewable energy sector, including the biodiesel production industry. The RFS Program created RVOs specifically to mandate the purchase of biodiesel and, thereby, create the demand to support biodiesel production plants. Today, only the top 10-15 plants are operating at significant levels, as they have large balance sheets that will support legal action from obligated parties if wrong doing is discovered. Effectively, a two-tiered system has developed, whereby major conglomerates are benefitting from the sale of OP "approved" RINs, while many small producers are unable to sell any of the RINs, and by default, fuel, which they can no longer produce. One can glean from filings of public companies in the biodiesel business that these companies have benefited handsomely in the 1st quarter since the NOV's were announced, with profits, sales and production almost doubling year over year. On the other hand, small producers are currently without the ability to sell their branded RINs and the economics of biodiesel production simply don't work. Not surprisingly, small biodiesel producers are now under tremendous financial pressure and some have been forced to shut down. The closure of small plants can be devastating to farming communities and entrepreneurs across United States as they have been firing tens of thousands of employees.

Damage to Market-Makers and Deterioration of the RINs Trading Program

The EPA has stated that the RFS program depends on a robust trading program. The RIN trading portion of the RFS Program, like any market-based approach, can only be successful if there are enough market-makers engaged in the program. Prior to EPA's announced enforcement approach to the RFS Program, there were many marketers, distributors, commodity trading companies, brokers and entrepreneurs purchasing, aggregating and selling RINs via EMTS. This system was created to support the EPA intent of providing RINs to those companies where biodiesel and their associated feedstock may not be as readily available. This created necessary liquidity for the RIN trading program to work, as many participants did not have the volumes or market expertise to monetize those RINs.

Unfortunately, enforcement of the RFS Program as it currently stands penalizes innocent, good faith purchasers of invalid RINs. As such, most of the obligated parties that submitted Clean Green, Absolute and Green Diesel RINs to the EPA, and who are being required by EPA to replace the invalid RINs with valid RINs, are seeking to require the market-makers that provided them with the RINs to compensate them for replacement or provide substitute valid RINs. Essentially, obligated parties are passing the penalty upstream to these good faith market-makers caught in the supply chain. Furthermore, as each OP negotiates directly with the EPA, those caught in the chain are unaware of the actual deals. The EPA, at the annual NBB meeting in 2011, stated that the intent of the penalties and program was not to bankrupt companies, as the maximum fine of $37,500 per day, per event (each RIN) actually could push fines into the stratosphere. They did want to send a clear message. The problem is that many participating in the program do not have the financial wherewithal to weather these penalties and replacement costs of invalid RINs. It's the marketers, distributors and travel centers, to name a few, that allows the market to function as intended. The current enforcement policies are having the

impact that the EPA stated they were trying to avoid, by actually bankrupting companies behind the scenes. The punishment and fines need to be directed at the criminals to deter the illegal activity. Instead the punishment is directed at those who make the program successful, while those who can survive the financial penalty will most likely be deterred from future participation in the RFS.

Furthermore, some have likened the fraudulent RIN issue to that of counterfeit currency. What many fail to acknowledge is that there is faith in the currency because the government actively prevents fraud, to the extent that counterfeit currency makes up 1/100 of one percent of all currency in circulation. Moreover, one can physically inspect a bill and make an informed determination. If doubt still exists, one can take the bill to a government agency which will definitively conclude the bill's authenticity. As for RINs, the EPA continues to state that it will not make a determination of validity, only invalidity, and may take years in its determination.

Now that obligated parties are seeking to recover damages from other market-makers up the supply chain, it is not surprising that market-makers are withdrawing from the market, and in many cases are at the risk of going out of business. In some cases, individual market-makers are exposed to tens of millions in damages from obligated parties, and may be forced to shut-down, shedding jobs and destroying the investments made as a consequence.

In any other market-based system, if there is fraud, the perpetrator of the fraud is the only party held liable. The victims of the fraud are not penalized. So long as EPA imposes liability on good faith purchasers of RINs, this liability will percolate through the supply chain and have a chilling effect on trading and liquidity.

Damage to Obligated Parties

Certainly, obligated parties are being damaged by EPA's decision not to exempt good faith purchasers of invalid RINs from penalties, as they are the ones being presented with the bills, in the form of NOVs, fines or behind the scenes deals. Although most OPs are large oil companies, there are many that are small, entrepreneurial refiners and importers that could suffer harm from the penalties imposed.

As it sits today, the market is not functioning. Eventually, the market may clear itself and begin to be operating in a more normal fashion, but that's after many jobs, businesses and investment have gone to zero, due to regulations which have harmed the industry.

We firmly believe the fraud associated with the invalid RINs presented to date has only addressed the low hanging fruit, defined in this case by the EPA having identified plants that did not exist, or, if so, did not produce any biofuels, just invalid RINs. The time required to identify, investigate and make public has been significant. The next round of fraud, to include feedstock and export issues, to name a few, will require greater time to investigate and unwind.

A significant amount of concern should be placed at levels downstream from just the producers. Many of the obligated parties now realize this, and are starting to ask even tougher questions regarding blending operations, such as, who the true end users are, where the fuel is going, domestic or export, etc. This is a positive step, but as the system currently stands, there is still not enough trust.

Implications of Current Policy and Potential Remedies from the EPA

At the outset, it is clear that Congress through the passage of EPAct and Energy Independence and Security Act (EISA) delegated broad authority to EPA to develop and implement the RFS program. Congress specifically authorized EPA to develop the RIN credit trading system to facilitate both the production of renewable fuels and market based compliance flexibility for the obligated parties. It was therefore necessary for EPA to fashion a regulatory structure that imposed strict requirements on the generation of RINs and the use of RINs for compliance purposes. The key issue that has arisen is to what extent can EPA administer and enforce the RFS program in a manner that drives diligent and law-abiding companies into insolvency.

Courts reviewing EPA's exercise of its rulemaking and enforcement discretion in other Clean Air Act (CAA) cases have invalidated EPA's regulatory programs that imposed presumption liability based on third party violations. Those courts mandated that EPA provide affirmative defenses in those settings to protect good faith and diligent market participants.

CAA programs consistently present EPA with daunting challenges in terms of rulemaking, enforcement and program efficacy. Protecting air quality presents one of the nation's most comprehensive and intractable problems. Congress' decision to also address America's dependence on foreign oil and GHG emissions under the CAA further expands the scope of EPA's challenges. While recognizing that EPA necessarily has very broad authority to enforce the CAA and RFS, this authority must be exercised in a manner that is consistent with the Constitution and is not an abuse of discretion. A review of this case law establishes that enforcing the RFS in a manner that drives a companies who blend, distribute and produce biofuels out of business and eliminates jobs violates the Constitution, is contrary to law, is

arbitrary and capricious, and an abuse of discretion. However, instead of examining the case law, we are proposing a three point proposal to immediately strengthen the RFS while not punishing good faith participants.

EPA's approach to RIN fraud to date has had a profound impact on the marketplace and has rendered all market participants highly sensitive to the importance of scrutinizing RIN validity to ensure compliance. EPA should take this opportunity to revisit Office of Enforcement and Compliance Assurance (OECA) enforcement policies and fashion a solution that improves the RFS Program in a manner consistent with CAA jurisprudence, beginning with the Green Diesel RINs. Our solution follows:

1. EPA should revise its Interim Enforcement Response Policy as it relates to invalidity of all pending biomass-based diesel RINs so that no further RIN substitution would be required.

The regulated community would welcome flexibility from EPA on this issue. The problems described above point to an immediate need to restore confidence in the RIN market which will allow the renewable industry to meet Congressional intent. Most importantly, it will allow all market participants to confidently purchase biodiesel and RINs from small producers. Improving IERP will make an immediate impact on the industry and save thousands of jobs. A more comprehensive and vetted policy can be address in a 2013 rule making. The immediate solution requires and interim policy be adopted by the EPA. The policy should include:

1. Continue to aggressively pursue criminal activity.
2. Define due diligence actions needed to meet minimum EPA standards to prevent fraud.

3. Require the criminals to replace the invalid RINs fraudulently provided to the market up to the maximum equivalent of fraud. Any shortfall will not be required to be substituted by good faith purchasers.

Criminal Prosecution

Intentional deception and fraudulent activity should be prosecuted to the maximum extent of the law. Holding people accountable for fraudulent activity will discourage future potential violators.

Due Diligence

EPA shall more clearly define due diligence and allow companies to comply with those guidelines in good faith. The initial due diligence definition should consist of a basic process that will eventually increase in complexity as the industry has the ability to refine programs like the one being developed by the National Biodiesel Board (NBB) through Genscape or other similar programs. Additionally, the companies that are participating in good faith and executing a due diligence program should be given an opportunity to defend against accusations of wrong doing. In other words, presumptive liability is an unacceptable path forward and one that must be replaced by affirmative defense.

Defining due diligence is needed because a company performing the due diligence process knows it has, in good faith, met all the requirements and is not liable for neglect. It also removes the risk of later re-defining or retrospectively applying due diligence methods that at the time could not have been anticipated or are not known to be required to detect improper activity.

Having this certainty is required for good faith blenders, marketers and obligated parties to immediately purchase renewable fuel and RINs from small producers.

While defining due diligence the EPA must balance the complexity to ensure the process is sufficient to detect fraudulent activity and not overly complex to make it impractical and costly for market participants to perform the needed process.

RIN Replacement

The Congress passed the Renewable fuel standard to reduce the nation's dependence on foreign oil, help grow the nation's renewable energy industry and achieve significant greenhouse gas emission reductions. The annual requirements set the minimum needed for renewable fuels which provide sufficient incentives for industry growth. This annual requirement should not be used as a measure of success, by saying the industry is successful if it meets the volumetric standard and unsuccessful if it does not. The true success of the program should be based on diversified fuel supply to reduce the dependency on foreign oil, jobs created, infrastructure investment and overall growth of the renewable industry. In fact, 42 USC §7545, Regulations of Fuels, specifically states that the EPA must take into account many factors, to include job creation, and in this case, demanding replacement of RINs is the basis for massive job destruction. The unintended consequences of RIN replacement is described above in the horrific examples of small businesses and renewable industry participants becoming insolvent and bankrupt good faith participants, which in turn will eliminate jobs and destroy the successes of the RFS to date. These are the companies that have invested in infrastructure, technology and created job growth. The entire industry is better served to obligate the criminals who created fraudulent RINs to sell off their assets to make the market whole.

Another incorrect assumption about this approach is that the producers who properly created valid RINs will be punished because there will be invalid RINs in the system and it will drive down the RIN price. In fact, the opposite is true as trust in the system has been broken. Most recently, the market has experienced a decrease in the value of all biodiesel RINs after the Green Diesel NOV was announced. Today, it is not profitable to blend biodiesel as a result. While the market may eventually correct, it's the uncertainty in the regulations and the distrust among counterparties that have prevented the market from improving. Additionally, it is impossible to go back and create biodiesel for the previous year. The increased demand for current year production will not increase the RIN value in 2012, as discussed earlier the pricing of the RIN is based on HO and soybean oil. The biodiesel industry has the ability to exceed the current mandate and the formula to determine RIN value will remain the same; feedstock cost minus RIN value is equal to a discounted HO value (just enough of a discount to incentivize blending). Lastly, the benefit of any increased production requirements will go to the 15% of the industry, the large producers discussed earlier, not the 85% of producers suffering as a result of the distrust.

One portion of the Congressional intent for the RFS is to help grow the nation's renewable energy industry and according to 42 USC §7545, create jobs. Meeting versus not meeting the volumetric goal due to fraud can be measured economically in 2 ways. Let's assume there are 100 million fraudulent RINs discovered.

1. The fraudulent activity displaces legitimate production. 150 million RINs represents 100 million gallons of biodiesel production. The average producer profit margin per gallon of production is approximately $.15 per gallon. If required to replace volumes and

associated RINs, the entire biodiesel industry will gain an additional profit of approximately $15 million – shared among only the top 10-15 producers. Those producers suffering now will continue to suffer.

2. The current RIN replacement policy requires one for one RIN replacement. 150 million RINs represent a $180 million replacement liability (RINs sales price as of July 6th of $1.20). This liability largely falls on good faith market participants. For example, if those who purchased fuel, such as travel centers, are exposed to bad RINs, there will be a disincentive to blend as the risk-reward equation tilts to the risky side.

If one assumes that there are an additional 90 million invalid RINs beyond the 60 million Green Diesel RINs already announced, the market will otherwise be required to replace 150 million RINs this year at an anticipated cost of over $180 million. This $180 million represents $180 million in unnecessary market costs for renewable fuel and will likely undermine rather than achieve the objectives of EISA by driving companies out of business. The money will go not to biofuel production but instead to RIN traders who hold inventories of 2011 RINs. It is the most conscientious market participants who will pay these costs. Fraudulent biofuel producers are either already out of business or will shortly be so. If the facts revealed by Clean Green Fuels and Absolute Fuels are any indication, the proceeds from the original RIN sales have been squandered already and there will be limited estate remaining. The remaining contractual liability will flow upstream until the last solvent and responsible company is found, and that company will be required to bear the entire replacement cost. By revising OECA's enforcement policy, EPA could limit further economic damage to the biofuels market, and scale back the scope of vicarious liability.

2. EPA should undertake a rulemaking to establish a permanent due diligence process and an affirmative defense.

As described in the preceding legal analysis, CAA case law establishes limits on EPA's authority to impose sweeping systems of presumptive liability. While Congress has delegated expansive powers to EPA to regulate, it is a fundamental tenet in American law that there must be, at the very least, the right to prove oneself innocent of an offense. Under the RFS Program as currently administered and enforced by EPA, no such right is recognized and innocent companies are subject to penalties and harsh economic burdens, even after performing due diligence and conforming to RFS regulations in all known respects. EPA must modify OECA's enforcement policies to establish an affirmative defense.

Specifically, the request is that in the event that EPA determines that a RIN was improperly generated and is therefore invalid, EPA should provide notice to the regulated community through the posting of an NOV on EPA's Civil Enforcement of the Renewable Fuel Standard Website. Upon the posting of such an NOV, any company that purchased RINs directly from the RIN generator ("RIN Purchaser") should be entitled to assert an affirmative defense to establish the affirmative defense as to the RINs purchased if the following elements are satisfied:

a. The RINs were purchased by written contract in an arm's-length transaction;

b. The RIN Purchaser was properly registered with the EPA;

c. The RIN Purchaser had affirmatively established a due diligence program to either evaluate RIN validity by its own efforts or had employed the services of a third-party service provider to evaluate RIN validity; and

d. The RIN Purchaser had not become aware of any indications that the RIN generator was not in compliance with RFS regulations. To the extent that the RIN Purchaser is able to satisfy the

elements of the affirmative defense, the RINs purchased should then be deemed valid RINs for RVO compliance purposes.

Separately, our company has been a strong partner with the EPA in helping to identify and eliminate fraud in the industry. The due diligence conducted by our company is second-to-none in the industry; to include RIN pattern analysis, informal charting of volumes, site visits, feedstock checks, etc. It is what many in the industry are pursuing today, such as the Genscape program, but it's not enough. As part of a longer term solution, the EPA must work with the private sector to come up with a better way forward, and much of has started and will be more formally addressed with the 2013 rulemaking process.

3. If EPA is unwilling to facilitate any of these remedies, the Agency should consider whether a petition to waive the RFS would be appropriate in these circumstances.

As an immediate alternative, it may be necessary to resort to the petition process established by 42 U.S.C. §7545(o)(7)(A)(i). This provision authorizes the Administrator to waive the requirements of the RFS after consultations with the Secretaries of Energy and Agriculture, in whole or in part, to avoid severe harm to the economy of a State, a region, or the U.S. Given that the economic costs to U.S. businesses resulting from OECA's enforcement policy may be anticipated to exceed $300 million and that EPA's enforcement policies may force legitimate biofuel producers and petroleum distributors out of business and eliminate countless jobs, this severe harm threshold may be met. This direct economic cost may be expected to be amplified to the extent that the renewable fuels industry is damaged. In our case, and many others similar to

us, our company is threatened with insolvency and will have to release 40 employees as a result of current enforcement actions where the company engaged in no wrongdoing.

Similarly, to the extent that there are significant additional invalid RINs found by EPA to exist in 2010 and/or 2011, the waiver process under 42 U.S.C. §7545(o)(7)(A)(ii) may become applicable. To the extent that obligated parties face a shortfall in replacing RINs, this establishes a strong factual showing that there is an inadequate domestic supply for that year. In such a scenario, the invalid RINs represent domestic supply that was illusory. Under these facts, it may be appropriate for the Administrator to waive any unfulfilled portion of the RFS for the applicable year.

Like the Unleaded Fuel Regulations, EPA has developed a regulatory system that holds all system participants presumptively liable for violations regardless of who caused the violation. As case law establishes, EPA must provide companies with the opportunity to present an affirmative defense to ensure that diligent and blameless companies are not penalized for the acts of others. This affirmative defense may be structured by EPA to impose significant compliance burdens on industry participants including affirmative duties to act, deploy personnel and expend resources. Thus EPA retains substantial discretion and the ability to administer and enforce a comprehensive and viable program.

Conclusion

EPA must consider immediate changes to the RFS Program administration and enforcement; specifically, IERP. These assertions and requests are not made lightly but only because of the dire consequences caused by the current enforcement policy.

It is because of this complexity in the market place and the fact the criminals are intending to deceive other companies, which no amount of due diligence or private sector solutions can make the market 100% secure. Instead, it requires a long-term solution from the EPA to offer some type of assurance through a published due diligence program that once RINs enter their system, they are valid. The foundation to return the system back to a functioning level would be set.

We believe our immediate and short term solutions of modifying IERP, eliminating replacement of RINs for good faith purchasers, and the opportunity for affirmative defense is the foundation necessary to save the system, its associated investments, and, ultimately, jobs in a struggling U.S. economy. Anything other than that will only serve to reduce the effectiveness of the RFS program, as liabilities are much too significant for all but the largest industry participants. We stand ready to assist and contribute to find a solution to this critical problem.

Mr. STEARNS. Mr. Fjeld-Hansen, you are recognized.

STATEMENT OF J.P. FJELD–HANSEN

Mr. FJELD-HANSEN. Thank you very much. Chairman Stearns, Ranking Member DeGette, thank you for the opportunity to appear before the subcommittee today. My name is Jon Peter Fjeld-Hansen, and I am the managing director of Musket Corporation. Musket is an affiliate company of Love's Travel Stop & Country Stores, Inc. Love's today owns and operates a nationwide chain of 300 travel centers and convenience stores in 39 States. Love's sells diesel fuel to the Nation's trucking fleets that deliver goods and services to businesses across the United States. We are committed to meeting, then exceeding the needs of our many customers by providing the highest-quality fuel at competitive prices. Biodiesel blends are an important part of that commitment.

One of the primary functions of Musket is to manage the fuel supply, including biodiesel, for Love's. Musket purchases biodiesel from a wide variety of producers and transports the product directly to the Love's Travel Centers or to various bulk facilities for blending into the diesel. In order to create blending capacity, Musket has completed 76 construction projects in 25 States since the inception of the Renewable Fuel Standard. Many of these projects have brought jobs to the constituents of the members of this committee.

Under RFS2, every properly produced gallon of biodiesel comes with 1.5 RINs. The value of the RIN is what creates sufficient value to make biodiesel cheaper than diesel. Upon blending biodiesel with clear diesel, Musket separates the RIN from the associated physical gallon of biodiesel and sells those RINs to obligated parties, which are typically large petroleum refiners. In short, the RINs create for Musket and discretionary blenders an economic incentive to provide biodiesel at a competitive price to our Nation's transportation system.

Musket believes the value and integrity of RINs are essential to the implementation of EISA; however, RIN fraud in its various forms frustrates the purpose of the law and perpetrates a theft upon those businesses who have invested jobs and capital in our Nation's biodiesel infrastructure, and reduces the economic incentive for Musket to make further investments.

We believe that fraud in the RIN market is damaging to the legitimate market participants, such as the participants on this panel, who have invested substantially to bring biodiesel into onroad diesel within the spirit and letter of RFS2.

To date, EPA has brought enforcement actions alleging the generation and sale of 130 million fraudulent RINs. As a participant in the market, Musket has been directly impacted by fraud. Having bought RINs from Clean Green, Absolute Fuels and Green Diesel, Musket has incurred significant expenses with respect to RINs deemed invalid by the EPA. However, Musket has responded aggressively to the EPA's buyer beware policy by scrutinizing every producer of biodiesel it transacts with, every RIN that it separates, and every counterparty with whom it transacts downstream.

Fraud in the RIN markets takes many forms, though, and Musket believes there's a problem that is considerably larger than the

above-mentioned cases, namely biodiesel exports. Musket believes there are many who are exporting biodiesel, either blended as diesel blend, blended into heating oil or bunker fuel, or as straight D100 biodiesel, and that they are not declaring their obligation to retire RINs pursuant to the rules. Internally we refer to this practice as "strip and ship" to extend to the "splash and dash" which we dealt with a few years back.

Musket believes the magnitude of this exporting activity far overshadows the fraud cases brought forth today. Although the statute mentions only gasoline and diesel blend exports specifically, we believe many people have exploited the lack of clarity in regard to heating oil and bunker fuel exports blended—having exported significant volumes of biodiesel without declaring an obligation to retire the RINs, in blatant contravention of the spirit and purpose of the RFS.

Since these exporters are not buying the RINs back from the market, an excess of RINs are left, depressing the RINs, and this is further threatening the existence of the small biodiesel producer and undermining the entire purpose of the EISA.

While some may have ignored the impact of the biodiesel exports on the market—I'll jump forward a little to the conclusion since I am running out of time.

To address this policy flaw, we recommend three commonsense changes for Congress to consider immediately. Require RINs to be retired immediately upon export of biodiesel and renewable diesel; require the EPA to coordinate monitoring and enforcement actions with U.S. Customs and Border Protection and the Department of Energy; and require all sellers of diesel sold in the U.S. to disclose the biodiesel content.

Under the current ASTM standard, wholesalers are not required to disclose biodiesel content up to 5 percent. This frustrates upstream buyers, blenders and ultimately truck owners. Accordingly, exporters of ASTM diesel may not know that they are exporting biodiesel and thereby creating an obligation to retire RINs.

We believe that if these changes are made, the true intent of the EISA will be upheld, and the U.S. biodiesel industry will remain vibrant.

Again, Chairman Stearns and Ranking Member DeGette, thank you for the opportunity to appear before the committee today.

Mr. STEARNS. Thank you.

[The prepared statement of Mr. Fjeld-Hansen follows:]

Jon P Fjeld-Hansen
Managing Director, Musket Corporation

Testimony on
RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program

Subcommittee on Oversight and Investigations
House Energy and Commerce Committee
2322 Rayburn House Office Building
July 11, 2012

Chairman Stearns, Ranking Member DeGette, thank you for the opportunity to appear before the subcommittee today. My name is Jon P Fjeld-Hansen and I am the Managing Director of Musket Corporation ("Musket"). Musket is an affiliate company of Love's Travel Stop & Country Stores, Inc. ("Love's"). Established in 1964, Love's today owns and operates a nationwide chain of 300 travel centers and convenience stores in 39 states. Love's sells diesel fuel for on the road trucks for the nation's trucking fleets and independent owner-operated trucks that deliver goods to businesses across the United States. We are committed to meeting then exceeding the needs of our many customers by providing the highest quality fuel at competitive prices. Biodiesel blends are an important part of that commitment.

One of the primary functions of Musket is to manage the fuel supply, including biodiesel for Love's. Musket purchases biodiesel from a wide variety of producers and transports the product directly to the Love's travel centers or to various bulk facilities for blending into the diesel. In order to create blending capacity, Musket has completed 76 construction projects in 25 states since the inception of the Renewable Fuel Standard. Many of these projects have brought jobs to the constituents of the members of this committee. From Calvert City, Kentucky to Baytown, Texas to Kankakee, Illinois the Renewable Fuel Standard has created American jobs.

On December 19th 2007 the President signed the Energy Independence and Security Act (EISA) into law with the stated purpose

> "To move the United States toward greater energy independence and security, to increase the production of clean renewable fuels, to protect consumers, to increase the efficiency of products, buildings, and vehicles, to promote research on and deploy greenhouse gas capture and storage options, and to improve the energy performance of the Federal Government, and for other purposes."

Under EISA the Renewable Fuel Standard ("RFS") program was expanded to include diesel and increased the volume of fuel required to be blended into transportation fuel. Under RFS2, every properly produced gallon of biodiesel comes with 1.5 Renewable Identification Numbers ("RINS"). The value of the RINS creates sufficient value to make biodiesel cheaper than clear diesel. Upon blending biodiesel with clear diesel to create a ratio of no greater than 20% biodiesel and 80% clear diesel, Musket separates[1] the RINS from the associated physical gallon of biodiesel and then sells those RINS. Musket sells RINS to obligated parties under RFS2, typically large petroleum refiners. In short, the RINS create for Musket and other discretionary blenders[2] an economic incentive to provide biodiesel at competitive prices to our nation's transportation system.

Musket believes the value and the integrity of the RINS are essential to the implementation of EISA. However, RIN fraud in its various forms frustrates the purpose of the law and perpetrates a theft upon those businesses who have invested jobs and capital in our nation's biodiesel infrastructure and reduces the economic incentive for Musket to continue investing in the biodiesel market. We believe that fraud in the RIN market is damaging to the legitimate market participants, such as the participants of this panel, who have invested substantially to bring biodiesel into on-road diesel within the spirit and letter of RFS2. To date, the EPA has brought enforcement actions alleging the generation and sale of 130 million fraudulent RINS. Clean Green was convicted of selling over 32 million fraudulent RINS. Absolute Fuels is alleged to have sold over 48 million fraudulent RINS. Green Diesel is alleged to have generated and sold over 60 million fraudulent RINS. As a participant in the market, Musket has been directly impacted by fraud in the RIN market. Having bought RINS from Clean Green, Absolute Fuels, and Green Diesel, Musket has incurred significant expense with respect to RINS deemed invalid by the EPA.

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[1] "Separate" with respect to RINS refers to detaching a RIN from the physical gallon (K-1 RIN) making it a K-2 RIN which can be bought and sold independent of the physical gallon.

[2] Love's is a discretionary blender of biodiesel and only blends biodiesel when economics are favorable to do so.

In response to this RIN fraud, Musket has responded aggressively under the purview of the EPA's Buyer Beware Policy by scrutinizing every producer of biodiesel it transacts with, every RIN that it separates, and every counter-party with whom it transacts downstream. However, fraud in the RIN market takes many forms and Musket believes there is a problem that is considerably larger than the above mentioned fraud cases, biodiesel exports. Musket believes there are many who are exporting biodiesel, either blended as a diesel blend (B5), blended into heating oil and bunker fuel, or as straight B100 (100% biodiesel) and are not declaring their obligation to retire/buy RINS pursuant to §80.1430 of EISA. Internally, we refer to this practice as "Strip and Ship." Currently there is no economic incentive to export biodiesel to Europe if the rules are properly followed. Freight costs to ship to Europe plus the countervailing duty make biodiesel substantially more valuable to blend and use in the US. However, if an exporter strips the RINS from the physical gallons of biodiesel, sells those RINS to the market, and ships the biodiesel overseas without retiring or buying back RINS as required under the rules[3] – an exporter can make a substantial profit.

Musket believes the magnitude of this exporting activity far overshadows the fraud cases brought forward to date. Although §80.1430 mentions only gasoline and diesel blend exports specifically, we believe many people have exploited the lack of specificity in regard to heating oil blended with biodiesel and have exported a significant volume of biodiesel without declaring an obligation to retire the RINS in blatant contravention of the spirit and purpose of the RFS. Since these exporters are not buying RINS back from the market, an excess of RINS are left depressing the price of

[3] 40 CFR § 80.1430 requires "any party that owns any amount of renewable fuel, whether in its neat form or blended with gasoline or diesel, that is exported from any of the regions described in §80.1426(b) shall acquire sufficient RINs to comply with all applicable Renewable Volume Obligations under paragraphs (b) through (e) of this section representing the exported renewable fuel." Exporters of biodiesel must declare and comply with an obligation to buy an amount of RINS (X 1.5) equivalent to the volume exported. 40 CFR § 80.1427 requires "each party that is an obligated party under §80.1406 and is obligated to meet the Renewable Volume Obligations under §80.1407, or is an exporter of renewable fuels that is obligated to meet Renewable Volume Obligations under §80.1430, must demonstrate pursuant to §80.1451(a)(1) that it is retiring for compliance purposes a sufficient number of RINs."

RINS and threatening the existence of small biodiesel producers and undermining the entire purpose of EISA.

While some may have ignored the impact of biodiesel exports on the market because US based biodiesel plants benefit by making the additional gallons, Musket believes this practice threatens all US based biodiesel producers in the medium and longer term. Musket suspects that a substantial volume of biodiesel has been exported since January 2011 for which no obligation has either been declared and/or satisfied through the purchase of RINS. Foreign producers are already approved to make biodiesel with RINS, and many more have applied for approval. Without effective policing of exports, RFS2 will increasingly become a foreign produced/foreign consumed program. Foreign produced biodiesel will make but a brief stop in our ports only for the purpose of stripping and selling the RIN.

To address this policy flaw, we recommend three common sense changes for Congress to consider immediately.

1. Require RINS to be retired immediately upon export of biodiesel and renewable diesel;
2. Require the EPA to coordinate monitoring and enforcement actions with US Customs and Border Protection and the U.S. Department of Energy on exports of biodiesel, diesel containing biodiesel, and heating oil containing biodiesel; and
3. Require all sellers of diesel sold in the US to disclose the biodiesel content.

Under the current ASTM standard, wholesalers and retailers are not required to disclose biodiesel content up to 5 percent. This frustrates up stream buyers, blenders and ultimately truck owners. Accordingly exporters of ASTM diesel may not know they are exporting biodiesel and thereby creating an obligation to retire RINS.

We believe that if these changes are made, the true intent of the EISA will be upheld and the US biodiesel industry will remain vibrant. Again Chairman Stearns and Ranking Member DeGette, thank

you for the opportunity to appear before the Committee today. At this time I will be happy to any questions you may have.

Mr. STEARNS. Mr. Jobe, you are welcome for your opening statement. And just pull the mic a little closer, if you don't mind.

STATEMENT OF JOE JOBE

Mr. JOBE. Chairman Stearns, Ranking Member DeGette and members of the committee, thank you for the opportunity to testify today regarding the Renewable Fuel Standard and our efforts to ensure RIN integrity in the fuel marketplace. I am Joe Jobe, CEO of the National Biodiesel Board. I represent the U.S. trade association for the biodiesel industry.

We are pleased to see that Congress is interested in the success of the Renewable Fuel Standard, which, as you know, was created just 7 years ago under the Bush administration with overwhelming bipartisan support here in Congress.

We are here to address a problem today, but the policy really has been an unquestioned success for the biodiesel sector. It is stimulating production. Last year, we exceeded over 1 billion gallons at plants across the country. We have plants in virtually every State.

Today you would like us to focus our discussion on improving the EPA's enforcement of the RIN trading. Make no mistake about it, we take this issue very seriously. As we've already heard, RIN fraud has caused significant disruptions in the distribution and marketing of biofuels, and we are committed to preventing it in the future.

Biodiesel is a renewable diesel replacement fuel made from an increasingly diverse mix of agricultural byproducts, including vegetable oils, recycled cooking oils and animal fats. It is the first and currently the only EPA-designated advanced biofuel that is produced on a commercial scale all across the county, meaning that it reduces greenhouse gas emissions by at least 50 percent. It meets strict fuel specifications and is used in any existing diesel engine without modification. It's primarily used in blends up to 20 percent where it actually exhibits premium diesel characteristics. In fact, the current diesel land speed record was set just last year using B–20.

Nobody is more interested in eliminating bad actors from the RFS program than we are, and we have gone to exceptional lengths in recent months to develop practical private-sector solutions. We believe the EPA has a difficult job ensuring RIN compliance, and overall we believe they have done a good job in cracking down on fraud, as was demonstrated with the recent conviction of Rodney Hailey in Maryland. We have strongly encouraged the EPA and other authorities to continue enforcement action so that the handful of bad actors who have disrupted the biodiesel marketplace are removed from the system and punished.

Additionally, we are not interested in seeing obligated parties being overly fined and penalized for unwittingly using RINs that they thought were valid. By the same token, however, we believe obligated parties should be required to exercise an appropriate level of due diligence before they submit RINs for compliance, and we're committed to ensuring that actual volumes of biofuels are produced and sold in the U.S. as envisioned by Congress. Last year the biodiesel industry exceeded those targets, and we hope to continue that success in the coming years.

Perspective is important, and we have to remember that the biomass-based diesel category in the RFS2 is effectively only 1 year old. Effectively, 2011 was really the first year that the program was implemented and came online. And the cases of fraud are isolated cases involving past activity. The vast majority of biofuel producers are honest companies producing quality fuels for the U.S. marketplace. What we have seen is no different from fraud in other financial markets where criminals have come in and found a way to take advantage of the system.

Looking forward, we believe the EPA's strong enforcement, along with increased due diligence and the private sector's RIN integrity efforts, will ensure that this kind of fraud doesn't happen in the future. Specifically, in the first case to be prosecuted, Mr. Hailey was quickly convicted last month in Baltimore and faces up to 32 years in prison. This conviction should send a strong signal to would-be fraudsters that this kind of criminal activity will be punished severely.

Separately, NBB responded quickly to allegations of fraud last year by forming a RIN Integrity Task Force, which includes a broad cross-section of stakeholders. The task force has been advising on, among other things, the development of a comprehensive auditing and realtime monitoring program.

Through the work of the task force, the private sector has launched the Genscape RIN Integrity Network Dashboard. We are confident that this third-party verification program that offers verification in real time electronically will be effective in protecting the system from bad actors and giving the market confidence. And I would say that we're hopeful that this program will respond in sort of an E–Verify way that Mr. Bilbray referred to.

We're also working closely with both the EPA and obligated parties to look at whether additional regulatory modifications can better focus enforcement efforts on bad actors while ensuring that the goals of the program are met.

To conclude, I want to repeat that we take RIN fraud very seriously and are committed to eradicating it. As we move forward, we anticipate continuing to work with our colleagues from the petroleum sector and the EPA to develop practical solutions.

We appreciate this opportunity and welcome any questions you have.

Mr. STEARNS. Thank you.

[The prepared statement of Mr. Jobe follows:]

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Written Testimony of Joe Jobe
Chief Executive Officer
National Biodiesel Board
Submitted to the United States House of Representatives
Committee on Energy and Commerce
Subcommittee on Oversight and Investigatians
"RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."
July 11, 2012

Chairman Stearns, Ranking Member DeGette and Members of the Committee, I thank you for the opportunity to testify today on behalf of the National Biodiesel Board (NBB) regarding the Renewable Fuel Standard, RIN Integrity and the efforts of the NBB, the petroleum sector and EPA to ensure market integrity.

We have appreciated the opportunity to meet with your staffs and provide information on industry issues relating to RIN integrity. We are pleased to see that Congress is interested in the success of the Renewable Fuel Standard (RFS), which as you all know was created just seven years ago under the Bush Administration with overwhelming bipartisan support here in Congress.

Today you would like us to focus our discussion on improving the Environmental Protection Agency's enforcement of Renewable Identification Number (RIN) trading. Make no mistake about it: We take these issues very seriously. RIN fraud has caused significant disruptions in the distribution and marketing of biofuels, and we are committed to preventing it in the future.

By way of background, NBB is the national trade association representing the biodiesel industry as the coordinating body for research and development in the U.S. NBB's membership is made up of biodiesel producers; state, national and international feedstock organizations; fuel marketers and distributors; and technology providers.

Biodiesel is a renewable, low-carbon diesel replacement fuel made from an increasingly diverse mix of feedstocks including agricultural oils, recycled cooking oil, and animal fats. It is the first and currently the only EPA-designated Advanced Biofuel that is produced on a commercial scale across the country. It meets a strict ASTM fuel specification and is used in existing diesel engines without modification. In 2011, our industry produced nearly 1.1 billion gallons of biodiesel in plants across the country, from California to Florida, and blended that fuel into the 55 billion gallon petroleum diesel market.

Nobody is more interested in eliminating bad actors from the RFS program than we are. We are also sincere in working with our customers, the obligated parties, on meeting the compliance requirements of the program. Nobody wins when fraud is present in the marketplace.

We are not interested in seeing obligated parties being fined or penalized for unwittingly using RINs they thought were valid. By the same token, we believe obligated parties should be required to exercise an appropriate level of due diligence before they submit RINs for compliance.

Additionally, we are committed to ensuring that actual volumes of biofuels are produced and sold in the U.S. as envisioned by Congress. Last year, the biodiesel industry exceeded those targets, and we hope to continue that success in the coming years.

As the regulation is written today, we believe the EPA has a difficult job when enforcing against bad actors. Given the experience of the Members of this Committee, we know you understand the process of enforcement is difficult – and unfortunately -- it often can slow or impede the marketplace.

Overall, we think the EPA has done an adequate job enforcing the regulation, and we encourage the EPA to continue enforcement actions so that the handful of bad actors who have disrupted the biodiesel marketplace are removed from the system and punished.

The RFS is still a relatively new program and strong enforcement will create disincentives for criminals to try to manipulate the system. Already we know the result of one criminal action, and if the other current RIN allegations are true, these individuals and companies have committed crimes and we urge the federal government to prosecute them to the fullest extent of the law.

Perspective is important, and we must remember that these are isolated cases and that the vast majority of biofuel producers are honest companies producing quality fuels for the U.S. marketplace. What we have seen is no different from fraud in other financial markets where criminals have come in and found a way to take advantage of the system. The only good news with these cases is that the scam has now come to light and will be very difficult to repeat going forward.

<u>In fact, the RIN Fraud we're discussing today is from previous years, and the private sector is already working with EPA to address it:</u>

> Current RIN Fraud issues took place in 2009, 2010 and 2011. EPA enforcement began in late 2011. In 2012, most obligated parties do not believe they have acquired invalid RINs, because they have only purchased RINs from biofuel producers who are risk averse. In 2012, obligated parties have done what they should have been doing in 2009, 2010 and 2011. They have been inspecting and requiring audits of the biofuel producers from which they purchase biodiesel and RINs.
>
> In essence, the Wild West of buying and selling RINs from market participants you don't know has ended, the wrongdoers are being rooted out, and everyone now knows that the deals that are too good to be true are in fact too good to be true.

Let me explain in numbers (chart attached):

- In the second half of 2010, 7.1 billion RINs were generated, of which EPA has indicated approximately 32 million – less than ½ of 1 percent – should not be used for compliance purposes.

- In 2011, 15.4 billion RINs were generated by biofuel producers, of which the EPA has indicated approximately 108 million – less than 1 percent – should not be used for compliance purposes. To the extent there may still be some cases EPA continues to review and this number increases, it will largely be contained to RINs generated in 2011. Further, as EPA has noted, these numbers have not undermined the ability of parties to meet the volume requirements of the statute. In 2011 a total of 1.895 billion RINs that could be used to satisfy the advanced biofuel standard were generated (1.675 billion biomass based diesel RINs and 0.220 advanced biofuel RINs), which significantly exceeds the required total of 1.35 billion advanced biofuel RINs for 2011.

- In 2012, we anticipate nearly an identical number of RINs will be generated as in 2011, and thanks to better due diligence that has been put in place by the private sector and EPA's continued enforcement efforts, we anticipate nearly zero fraudulent RINs being generated.

The bigger picture is that the Renewable Fuel Standard is working just as Congress intended to diversify our energy supplies and create American jobs – as demonstrated last year when the biodiesel industry produced a record of nearly 1.1 billion gallons of fuel and supported more than 39,000 jobs.

Looking forward, we believe the EPA's strong enforcement along with the private sector's ongoing RIN Integrity efforts will ensure that this kind of fraudulent activity doesn't happen in the future.

In addition to the issues listed above, the private sector has great responsibility in discovering fraudulent RINs. NBB's RIN Integrity Task Force helped support the development and deployment of a comprehensive auditing and real-time monitoring program that is being launched now to give the market restored confidence in any biodiesel producer that is participating in the program. This third-party, private-sector response has come together with impressive speed and innovation, and we are confident that it will be effective in preventing improper transactions and restoring liquidity to the RIN markets.

<u>In March we convened NBB's RIN Integrity Task Force:</u>

- NBB's RIN Integrity Task Force, which includes a broad cross-section of stakeholders, has been advising on the development of a comprehensive auditing and real-time monitoring program that is now being deployed. We're confident that this third-party verification program, once fully deployed, will be effective in protecting the system from bad actors and giving the market confidence.

- Through the work of the task force, the private sector has launched the Genscape RIN Integrity Network™ dashboard. The National Biodiesel Board's RIN Integrity Task Force has worked diligently with the petroleum industry to provide a solution to the uncertainties in the RIN market.

- Genscape's RIN Integrity Network™ dashboard allows obligated parties who subscribe to the service to do their due diligence with real-time information on participating biodiesel producers through a user-friendly, online information service. This "dashboard" allows subscribing parties to inexpensively and easily tell whether an individual biodiesel producer's RINs have been verified through the Genscape system.

- Currently there are more than 70 registered biodiesel producers and 15 obligated parties who have signed up to discuss this service with Genscape.

- There are other private-sector groups working on auditing and other programs that would assist obligated parties on ensuring RIN Integrity.

At a recent meeting your staff inquired as to NBB's input regarding how EPA could address RIN Integrity issues. We provide the following insights:

1. At this stage of the discussion it is difficult to make concrete determinations as to what additional tools could be put in place to eliminate fraudulent RINs. Nevertheless, we are working with both the EPA and obligated parties through the American Petroleum Institute (API) and the American Fuels and Petrochemical Manufacturers (AFPM) to consider whether additional regulatory modifications can better focus enforcement efforts on the bad actors, while ensuring that the goals of the program are met. *The RFS is a complex regulatory program, and review of additional means to address RIN Integrity should be done through the regulatory process, and we encourage EPA to seek public input on how the regulatory structure could be improved to address these issues.* We don't yet have an "agreed to" solution, but we are working hard to reach consensus.

2. Information is a key component to the fuels marketplace, and further discussions as to when and how EPA should communicate potential violations are necessary.

3. In 2011, enforcement procedures and Clean Air Act "Notices of Violation" (NOVs) were new to the biofuels industry. The lack of understanding by industry of the ramifications of the NOV's may have caused hardship to many in the fuels marketplace when the first NOV's were announced. More information about the NOV process would have allowed those in the fuels marketplace to react with greater certainty.

4. Information related to day-to-day RIN generation and usage is important to the fuels marketplace. The EPA has information on RINs generated, purchased and used for compliance, and further discussion is needed regarding the amount of information provided to RIN generators and purchasers so that the industry could assist in self-policing and in rooting out fraudulent RINs before they are ever purchased.

To conclude, I want to repeat that we take RIN fraud very seriously and are committed to eradicating it. We believe EPA's enforcement actions will eliminate the bad actors who are taking advantage of the system. Further we anticipate the private-sector solutions being implemented now, such as Genscape's RIN Integrity Network, along with the enhanced due diligence by the fuels marketplace, which was not being done when these fraud cases happened, will prevent this kind of fraudulent activity in the future.

Finally, as we move forward we anticipate continuing to work with our colleagues from the petroleum sector and EPA on updating the regulation to allow regulated parties additional options when faced with addressing fraudulent RINs.

We appreciate the opportunity to provide you with our insights and look forward to working with this committee on any questions or comments you may have.

Attachment 1

Bad Actors and The RFS2

EPA Enforcement IS Eliminating Bad Actors

Perspective is important, and it is important to remember that these are isolated cases and the vast majority of biofuel producers are honest companies producing quality fuels for the U.S. marketplace.

In 2012, we anticipate nearly as many RINs will be generated as in 2011, with nearly zero fraudulent RINs being generated, thanks to better due diligence in the private sector.

In 2011, the biodiesel industry produced a record amount—more than 1 billion gallons, supporting more than 39,000 jobs.

Second Half of 2010 Total RINs	Total 2011 "Biomass-Based Diesel" RINs	Total 2011 RINs	Anticipated 2012 RINs
0.45% (32 mil.) Fraudulent RINs	6.5% (108 mil.) Fraudulent RINs	.69% (108 mil.) Fraudulent RINs	0% (0) Fraudulent RINs (Estimated)

Attachment 2

Background on the Development of Genscape's RIN Integrity Network™

NBB, www.biodiesel.org, is the national nonprofit trade association representing the biodiesel industry. It serves as the central coordinating body for biodiesel research, development and education. It is organized exclusively to promote the common business interests of those parties seeking to advance the use of biodiesel as a fuel or fuel additive that meets ASTM standards.

America's biodiesel industry relies in part on strong government policy, mostly provided by the federal and state governments. Beginning in 2005 a $1-per-gallon biodiesel blender's tax credit greatly stimulated the biodiesel market. The credit expired December 31, 2009. Since then, although the tax credit was briefly reinstated, it again expired on December 31, 2011.

In the last two years, the tax credit has been replaced by RFS2, the regulatory mechanism for implementing the renewable fuels requirements of The Energy Independence and Security Act (EISA) of 2007. EISA requires the EPA to require statutory minimum targets for biodiesel consumption by Obligated Parties through future years. The EPA established the minimum biodiesel purchase targets of 800 million gallons for 2011 and 1 billion gallons for 2012.

The RFS2 program requires each of the major oil companies, as Obligated Parties under EISA, to purchase its assigned allocation of the required total gallons each calendar year. This requirement is enforced through the use of the RIN (Renewable Identification Number) numbering system. A RIN is credit that is created when biodiesel is produced. 1.5 RINs are created with each one gallon of biodiesel. A RIN has 38 digits which represent specifics about the relating gallon such as the biodiesel producer, plant location, date, feedstock, etc... After a gallon of biodiesel is blended, the RINs can be separated and sold separately from the gallon. Obligated parties can either buy wet gallons with RINs attached, or buy detached RINs or a combination. On February 28 of each calendar year, each Obligated Party must demonstrate to the EPA that it has the required number of RINs.

In 2009 and 2010, as the RFS2 program was implemented, the value of the RIN started as low as 20 to 30 cents per gallon. As both the biodiesel industry and the oil companies saw that the EPA was going to enforce the RFS2-mandated volumes, the value of the RIN increased to its more mature value today of about $1.15 per RIN or $1.725 per wet gallon equivalent ($1.15 x 1.5).

During the spring and summer of 2011, rumors of suspicious activities in the RIN markets began to surface. Concerns were exacerbated by production volume report differences between EPA and Census Bureau numbers raising the concern that fraud could be occurring. NBB Governing Board members and other members expressed an interest for NBB to address the problem. NBB encouraged the EPA to enforce the law by fully investigating and prosecuting any violators. NBB staff worked with the EPA's Enforcement Division to build a section of NBB's web site where information could be confidentially reported regarding potential wrongdoing in the RIN markets. NBB staff had a number of meetings with the EPA to investigate means of cooperating and strengthening efforts for RIN fraud detection and enforcement.

NBB explored the idea of creating a RIN quality assurance program as part of NBB's existing fuel quality assurance program, BQ-9000. Given the significant length of time estimated to develop a program as part of BQ-9000, it was determined that this option was not deployable in the time frame necessary. It was determined that a private sector solution or solutions would be necessary.

In late 2011, the EPA announced enforcement actions on a Maryland-based biodiesel

producer accused of selling fraudulent RINs. Subsequently, a Texas-based company was accused of fraud in December, 2011. EPA audits then resulted in more than 30 different Obligated Parties receiving notices of violations from EPA because of their purchase of fraudulent RINs. Criminal prosecution of the sellers of fraudulent RINs followed, with the first defendant, Rodney Hailey, convicted on 32 counts of fraud on June 25, 2012

As a result of the 2011 fraudulent RIN revelations, biodiesel producer members of NBB called upon the organization to take the lead in finding ways to restore RIN integrity and RIN liquidity to the markets. Small producers, especially, complained loudly that they had lost their markets because large oil companies (Obligated Parties under EISA) would not buy from them without some assurance that they did not represent fraudulent counterfeiters like the Maryland and Texas operations referred to above.

In the course of considering what NBB could do about this industry-wide problem, NBB leadership discussed the issue with a diverse array of stakeholders.

In September 2011, NBB was approached by a company who was developing RIN integrity audit/verification software. This company wanted NBB's input in the development of their software in order to better meet our member's needs. In late 2012, the software company brought on a development partner called Genscape. Genscape is one of the largest real-time monitoring service providers in the US, with a specialization in the energy sector. Thus, during December 2011 through February 2012, NBB engaged in discussions with executives of Genscape on the development, improvement and promotion of the RIN integrity program. Prior to December 2011, there were no publicly announced private sector RIN Integrity programs.

Simultaneous to the discussions with Genscape, NBB staff worked with an insurance broker to research the possibility of an insurance product that would enable a biodiesel producer to guarantee his RINs to potential purchasers. It was hoped that audit/monitoring standards could be adopted by the insurance company as its underwriting standard, thus enabling it to sell an affordable RIN-guaranteeing insurance product to biodiesel producers. These discussions commenced in late 2011 and terminated in March 2012 when NBB concluded that this option was price prohibitive.

Nevertheless as 2012 began, many Obligated Parties continued to refuse to buy RINs that were generated by smaller producers and producers less known to them. In January 2012, NBB formed its RIN Integrity Advisory Task Force, led by the chairman of the NBB governing board and co-chaired by a representative of a major oil company. This 10-member task force includes representatives from major oil companies, oil marketers, biodiesel producers, biodiesel blenders, biodiesel traders and included guest participation by EPA. The task force was charged with developing solutions to ensure the elimination of RIN fraud. Its charge states that "NBB anticipates developing or working with a service provider to develop such a program." At its annual biodiesel conference in Orlando, NBB leadership announced the formation of the RIN Integrity Advisory Task Force. The Task Force met weekly for approximately 3 months. The task force reviewed detailed elements of the Genscape program and provided input into the program. Genscape accommodated all of the task force's recommendations.

Simultaneously, other auditing companies began to develop and offer their own RIN integrity/audit programs. Among these are that are currently known to us include:

Lee Enterprises Consulting, Inc.
Genuine Energy Technologies
RINSTAR
Weaver, LLP
Eco-Engineers
Lyddy Martin Company Risk Management

Since then, Eco-Engineers and Lee Enterprises have entered into arrangements to provide contract services for Genscape. In addition, it appears that several large oil companies have been working on their own initiative to assure themselves of the integrity of the RINs they are purchasing from medium-sized and smaller producers.

Mr. STEARNS. Mr. Drevna, you are welcome with your opening statement.

STATEMENT OF CHARLES DREVNA

Mr. DREVNA. Chairman Stearns, thank you, Ranking Member DeGette, thank you, and members of the committee, for allowing me to testify here today. I am Charlie Drevna, president of AFPM, the American Fuel and Petrochemical Manufacturers. We are the obligated parties, my members, under the Renewable Fuel Standard. As such, we are required to blend ever-increasing volumes of biofuels into the transportation supply. There are several nested mandates within the RFS, including this—why we are here today, the 1 billion gallons of biomass-based diesel.

Each year obligated parties must submit a number of Renewable Identification Numbers, or RINs, as the Chairman stated, to EPA to demonstrate compliance with the program. RINs are created theoretically by biofuel producers and correspond to gallons, theoretically gallons, of biofuels. RINs can be separated from the biofuels and act as credits and are bought and sold, as was mentioned earlier, in a free and open market.

In order to facilitate RIN trading, EPA established the EPA Moderated Transaction System, EMTS, through which all RINs must be generated and traded. Only EPA-registered—that is, EPA-registered—biofuels producers that have submitted third-party engineering reports are eligible to generate RINs on the EMTS, although other EPA-registered parties are then able to trade the RINs, as has been mentioned earlier in the testimony.

Unfortunately, as we now know, some biodiesel producers have taken advantage of the weak oversight and have generated RINs without producing any biofuels. While EPA properly issued Notices of Violation to these so-called bad actors, the Agency went a step further and actually fined the obligated parties who unknowingly used these invalid RINs to comply with their 2010 biomass diesel obligations.

In one case, EPA responded to a tip and conducted a site visit of a registered biodiesel producer. During its visit EPA found the company did not even have biodiesel production machinery on site. It then took EPA about a year to issue a Notice of Violation to that company of 32 million invalid RINs. However, during its investigation of Clean Green Fuels, EPA provided no indication to obligated parties that they may be inadvertently—that they may be buying invalid RINs.

Now, I could give you any number of both criminal and jurisprudence kinds of analogies here, but I won't bore the committee with all of them.

In fact, EPA stood by while obligated parties accessed EMTS data and continued to purchase Clean Green RINs that EPA knew were invalid. Then to add insult to injury—I may more clearly say injury to injury—EPA issued NOVs not just to Clean Green, but also to the obligated parties that purchased these RINs.

Now, the obligated parties go through a wide spectrum; the biggest of the big companies, the household names, all the way down to the small refiners and everything in between.

And the free market today is working. It's working so well that we have a panel here of people saying that they can't get into the marketplace because the members, my members, are doing due diligence. They're out there looking at who they can trust and who they know can get validated RINs.

That's how the free market system is working today, ladies and gentlemen. We need to fix it. If you want this program to go on, as many of the Members said, stop pointing fingers. As you all know, we all have problems. My industry has problems with the total RFS, but right now this thing is the law of the land. And to categorize the refiners who were victims as either lazy or criminal is totally, in my opinion, our opinion, unfair.

Again, the free market is working because my members are being very careful who they buy the RINs from. And they are doing their due diligence. They are assuring each other that they're complying with the law so we don't get slapped with going backwards and buying RINs again and paying six-figure fines.

One hundred forty million gallons of this stuff just discovered this year, so if the system is working, I'd hate to see when it is not working, as some of the panelists have said.

Now, we have been discussing with the EPA and the obligated parties a way to go on this thing, how are we going to get out of this mess, how are we going to be assured that the program continues as long as Congress says it should continue. And the program protects not only small producers of biofuels, biodiesel, but everyone, everyone along the food chain.

In particular we appreciate the efforts of the next panel, Mr. Bunker and Mr. Brooks and their staff. We have been working diligently with them, with others on the panel trying to get a way out of this thing. But as mentioned previously, we need an affirmative defense. Now, the affirmative defense can either be let's work together and go through this system, or the affirmative defense is going to be the marketplace is going to say who's going to buy RINs from whom. That's the choice we have right now.

So, you know, we can get the RINs from somewhere. It depends upon how we are going to work with Congress, work with the EPA and work with the other folks.

So the promise of these talks have been no resolution. We're going into 2013 very quickly. So we have to get this solved, work together, figure out a way to do it.

Thank you, Mr. Chairman.

Mr. STEARNS. I thank the gentleman.

[The prepared statement of Mr. Drevna follows:]

WRITTEN STATEMENT OF

AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS

AS SUBMITTED TO THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

Committee on Energy and Commerce
United States House of Representatives

on

"RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program"

July 11, 2012

Testimony Summary of Charles Drevna, president of the American Fuel & Petrochemical Manufacturers (AFPM)

House Committee on Energy and Commerce – Subcommittee on Oversight and Investigations, Hearing on "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program"

AFPM's refinery members are the "obligated parties" responsible for meeting the requirements of the Renewable Fuels Stand (RFS), a law requiring obligated parties to blend increasing volumes of biofuels into the transportation fuel supply. There are several nested mandates within the RFS, including a requirement for 1 billion gallons of biomass-based biodiesel. In order to demonstrate compliance with the RFS, obligated parties submit a requisite number of renewable identification numbers (RINs) to EPA by the end of February following the compliance year. RINs essentially act as credits that can be bought and sold among biofuel producers, brokers and obligated parties.

In order to facilitate RIN trading, the EPA established the EPA Moderated Transaction System (EMTS), through which all RINs must be generated. Only EPA registered biofuel producers that have submitted third party engineering reports are eligible to generate RINs on the EMTS, although other parties are then able to trade RINs, and in particular biodiesel RINs.

Unfortunately, some bad actors are taking advantage of weakness in the system and have generated and sold more than 140 million fraudulent RINs that we know of. For context, 140 million RINs constitute between 5-12% of the biodiesel RIN market to date. EPA's handling of the fraud was concerning in several ways:

- After first getting a tip that Clean Green Fuels (the first fraudulent producer) was not producing biodiesel and after visiting the producer's site to confirm, it took EPA more than a year to inform obligated parties. In the meantime, obligated parties unknowingly purchased millions of fraudulent RINs.
- After announcing that Clean Green Fuels RINs were invalid, EPA informed obligated parties that they had 14 days to replace invalid RINs and subsequently issued Notices of Violations to 24 obligated parties for violating the Clean Air Act, effectively punishing the victims of the fraud.
- The same situation was repeated when a second producer, Absolute Fuels, was found to be producing fraudulent RINs.
- Despite multiple requests from obligated parties, EPA has declined to identify any due diligence steps that would, at minimum, provide an obligated party legal protection if they unknowingly purchase an invalid RIN. Again, this "buyer beware" policy amounts to punishing the victims of fraud.

In total, the cost of replacing all RINs (essentially forcing refiners to double comply with the RFS) is nearly $200 million, with additional cost to settle the NOVs. For the past several months, AFPM has been engaged in discussions with stakeholders – including association members, biofuel producers, and EPA– to attempt to resolve this situation. While those discussions have been very productive and AFPM appreciates EPA's engagement, obligated parties need resolution on legal certainty before the end of this year. Absent that legal certainty, the integrity of the RFS is in jeopardy, small biofuel producers will be squeezed, and obligated parties will continue to be subject to a punitive and costly regulatory regime that provides no protection, regardless of how much due diligence an obligated party undertakes.

I. Introduction

Chairman Stearns, Ranking Member DeGette and Members of the Committee, thank you for providing the opportunity to testify at today's hearing on fraud in the renewable identification number (RIN) trading system. I'm Charlie Drevna and I serve as president of AFPM, the American Fuel & Petrochemical Manufacturers.

AFPM is a 110-year old trade association that was known as the National Petrochemical & Refiners Association until early this year. Our association represents high-tech American manufacturers that use oil and natural gas liquids as raw materials to make virtually the entire U.S. supply of gasoline, diesel, jet fuel, other fuels and home heating oil, as well as the petrochemicals used as building blocks for thousands of vital products in daily life.

AFPM's members make modern life possible and keep America moving and growing as we meet the needs of our nation and local communities, strengthen economic and national security, and support 2 million American jobs. The entire oil and natural gas sector – including the producers of oil and natural gas – supports more than 9 million American jobs and pays more than $31 billion a year in taxes to the U.S. government, plus additional funds to state and local governments.

AFPM's refinery members are the "obligated parties" responsible for meeting the requirements of the Renewable Fuels Standard (RFS). These companies have been the *victims* of fraud perpetuated by EPA-registered biodiesel producers and have had to pay approximately $200 million as a result of EPA's punitive "buyer beware" enforcement policy. We are aware of no other government program that penalizes the victims of fraud[1] and we greatly appreciate the Committee's leadership in addressing the problem. We continue to believe that EPA must take

[1] EPA's regulations embrace a "Buyer Beware" approach and specify that "[i]nvalid RINs cannot be used to achieve compliance with the Renewable Volume Obligations of an obligated party or exporter, regardless of the party's good faith belief that the RINs were valid at the time they were acquired." 40 C.F.R. § 80.1431(b)(2).

responsibility for ensuring the integrity of the program that Congress has authorized it to administer and must make clear that obligated parties will not be punished for being the victim of fraud. We have been meeting with EPA and other affected parties to address these issues, but to date EPA has not clarified its idea of what constitutes adequate due diligence under the RFS.

II. Renewable Fuels Standard

The Energy Policy Act of 2005 established the first RFS, which requires refiners to blend increasing volumes of biofuels into the transportation fuel supply. The biofuel mandates were expanded greatly in the Energy Independence and Security Act of 2007. This law created multiple mandates for specific types of biofuel and established a requirement for obligated parties to blend, in aggregate, up to 36 billion gallons of biofuels into the fuel supply by 2022. One of the specific biofuels mandated under the law is biomass-based diesel. This year, obligated parties are required to blend a billion gallons of biomass-based diesel into the fuel supply, most of which is met by soybean-based biodiesel. Due to the high price and poor performance qualities of biodiesel, this mandate greatly disadvantages consumers.[2]

In order to demonstrate compliance with the RFS for the previous calendar year, obligated parties are required to obtain and submit to EPA the requisite number of renewable identification numbers (RINs) by February 28th of the following year. RINs are unique 38 digit serial numbers that biofuel producers create and assign to specific gallons of biofuels as they are produced. In the case of biodiesel, each gallon of biodiesel produced generates 1.5 RINs. In many cases, and particularly with biodiesel, a RIN may change hands many times through RIN aggregators and brokers before an obligated party purchases the RIN for compliance.

[2] Biodiesel derived from soybean oil costs significantly more to produce than diesel fuel (e.g., approximately $1.65 more per gallon) and has poor cold weather performance and a lower energy content compared to petroleum-derived ultra-low sulfur diesel fuel.

In order to facilitate RIN trading, the EPA created the EPA Moderated Transaction System (EMTS). EPA registers biofuel producers and importers to allow them to enter RINs into the EMTS. The agency also registers third parties, which allows them to own RINs and trade those RINs through the EMTS. The biodiesel producer registration process includes, among other requirements, reviews of third-party engineering reports to ensure only valid producers are able to generate RINs and list them on the EMTS. Unfortunately, EPA's review of these biodiesel producer engineering reports amounts to little more than a rubber stamp approval and has enabled biodiesel producers to game the system. Absent a "tip," EPA does not enforce its requirements and instead sits back and relies upon a "*buyer beware*" enforcement scheme that actually penalizes the victims of fraud.

III. Fraudulent Activity and Impacts

The largest problem, to date, is the prevalence of fraudulent RINs generated by biodiesel "producers" that in fact made no biodiesel or made significantly less biodiesel than the number of RINs they created. We discuss these fraudulent RINs in more detail below and while we do not believe that EPA is a party to the fraud, we are concerned that EPA's unreasonable delay in advising obligated parties as to the existence of fraud raises questions of the Agency's complicity in these instances of non-compliance. EPA's inability to adequately address the situation and provide obligated parties with assurances that it will not continue to be punished for being victims of fraud in the future is also creating significant uncertainty and concern in the marketplace.

A. *Clean Green Fuels - Biodiesel Producer Fraud.* Sometimes truth is stranger than fiction. Once upon a time, there was a Maryland-based, EPA-registered, biodiesel producer called Clean Green Fuels. In July 2010, after receiving complaints that Clean Green was selling

invalid RINs, EPA inspectors visited Clean Green's facility and discovered that the company did not even have biodiesel production equipment on site. While the following may sound like fiction, EPA took no steps to notify obligated parties that Clean Green's 32 million RINs were invalid until October 2011 (15 months after EPA's initial site visit). While discounting its role as the enforcement agency of biofuel producers, EPA wasted no time in enforcing the RFS against refiners that purchased these RINs in good faith. In fact, after EPA finally announced that the Clean Green RINs were invalid, it informed obligated parties that they had 14 days to replace the invalid RINs. EPA could have prevented obligated parties from purchasing these RINs in the first place by simply indicating on EMTS that Clean Green was not a biofuel producer in good standing. Instead, EPA chose to remain silent, allow RIN fraud that it knew was occurring to continue, require obligated parties to replace these invalid RINs at a cost in excess of $40 million, and then, as if to add insult to injury, EPA issued Notices of Violations and fines to the 24 obligated parties that purchased the Clean Green RINs even though they were the victims of fraud that EPA knew about and allowed to continue.

This case is but one glaring example of the problems with the RFS[3] and highlights the biased enforcement philosophy EPA embraces with respect to renewable fuel producers and petroleum refiners. Unfortunately, biodiesel producer fraud is not limited to a single isolated example.

B. *Absolute Fuels – Biodiesel Producer Fraud.* Absolute Fuels is a Texas-based, EPA-registered biodiesel producer. In December 2010, a biofuel broker notified EPA that

[3] When you consider the rampant fraud in biodiesel industry; dramatically higher prices for the mandated fuels; mandates to use cellulosic ethanol that does not exist; the introduction of high percentage blends of ethanol that damage engines in the existing fleet; and questionable environmental and ethical impacts, it is easy to conclude that the RFS is a broken policy in need of dramatic reform.

Absolute Fuels was generating RINs without producing biodiesel. A month after receiving this tip, EPA launched an investigation. In February 2012, 14 months after receiving a tip and more than a year after it had begun its investigation, EPA announced to obligated parties that Absolute Fuels had generated fraudulent RINs. Unfortunately, EPA's delay in announcing this fact allowed obligated parties to continue purchasing RINs from Absolute Fuels throughout 2011. In fact, EPA stood by while obligated parties purchased more than 48 million RINS that the agency will require obligated parties to replace at a cost in excess of $60 million.

C. *Green Diesel – Biodiesel Producer Fraud.* On April 30, 2012, EPA issued a Notice of Violation to Green Diesel for generating more than 60 million invalid RINs between July 2010 and July 2011. The full impact of this fraud is still unknown as is the exact cost to obligated parties of having to replace the RINs that were traded on EMTS during the pendency of EPA's investigation – although it likely will exceed $75 million. Also unknown is EPA's intent to initiate enforcement actions against obligated parties that possess Green Diesel RINs.

D. *Other Fraud in the System.* Putting aside the 140 million fraudulent RINs discussed above, the approximately $200 million in RIN replacement costs, and the two dozen settlement agreements with accompanying fines that EPA forced upon the victims of this fraud, obligated parties remain concerned with other investigations into fraudulent RINs and other examples of RIN transactions that could threaten the integrity of the program.

Unfortunately, fraud appears to continue among some biodiesel producers. On May 24th the FBI raided a Park Ridge, New Jersey building as part of its investigation into fraud in the biodiesel industry. The outcome of that investigation remains unknown.

Other issues that could implicate the validity of RINs occur downstream from the producer. For example, renewable fuel that is subsequently exported does not count toward the

RFS mandates. As such, the person that exports this fuel bears an obligation to cancel an equivalent number of RINs. Although in these cases the separated RINs remain valid, we believe that the regulations would benefit from additional clarity in this area to ensure that obligated parties with no ability to verify the validity of previously separated RINs are not ultimately held liable under EPA's buyer beware theory. The failure to address this potential liability will have negative impacts on biodiesel RIN liquidity.

IV. Current Status

On February 23, 2012, EPA replied to a letter from Chairmen Upton and Whitfield and emphasized that the principle of RIN ownership is "buyer beware." EPA also acknowledged that it does not does not certify or validate RINs, nor have specific written procedures or criteria for informing the RIN marketplace of allegations that RINs are invalid.

Although obligated parties have purchased RINs in good faith, EPA continues to enforce its "buyer beware" position and punish the *victims* of fraud in addition to the perpetrators. As recently as March 2012, EPA indicated that more aggressive enforcement against obligated parties would occur:

> We stress here again that it is incumbent upon all parties to undertake due diligence to ascertain the validity of RINs to be used to meet an RVO under the Renewable Fuels Standard (RFS) Program. We expect that parties will prevent future violations, and intend to take a more aggressive approach to violations arising from the use of 2012 and later RINs.[4]

[4] U.S. Environmental Protection Agency, Office of Enforcement and Compliance Assurance, *Interim Enforcement Response Policy to Resolve Violations Arising from the Use of Invalid 2010 and 2011 Biomass-Based Diesel Renewable Identification Numbers*, p. 1 (March 14, 2012).

AFPM is unaware of any other government agency that punishes the victims of fraud. To date, EPA has not identified an acceptable level of due diligence that would provide safe harbor for the innocent victims of biodiesel RIN fraud.

Since February, AFPM has worked collaboratively and in good faith with its members, stakeholders in the biofuels industry, with Congress, and with EPA to identify the causes of, and solutions to, the problem. While those conversations have been productive and AFPM appreciates EPA's engagement, AFPM's members need a solution this year that provides legal certainty and a defense for companies that unknowingly purchase invalid RINs. To date and to our great frustration, EPA has not identified what constitutes adequate due diligence and has not formally committed to providing obligated parties with a legal defense to fraudulent RINs that are acquired without knowledge of the fraud.

V. Conclusion

While AFPM has serious concerns with the structure and workability of the RFS as a program generally, the RIN system and EMTS is one component that must work for our members to know that they will be able to comply with the RFS without being punished for being the victims of fraud. At present, the uncertainty in the market for biodiesel RINs is particularly harmful to small biodiesel producers that are unfamiliar to obligated parties looking for certainty in their RIN purchases. Regardless of one's position on the RFS, there should be widespread agreement the current system needs to be fixed to avoid the perpetuation of fraud and increased costs to consumers. Our hope is that today's hearing will help identify areas of concern and provide some clarity on the steps needed to repair this broken system. AFPM appreciates the Committee's leadership and looks forward to working with the Committee to address this critical issue.

Mr. STEARNS. I will start with my opening questions. I just thought I'd put in perspective the question is how long has this been going on, and perhaps many of you might know better than I, but a Secret Service agent with Homeland Security testified under oath that on or about January 2010, and he names Absolute Fuels and Gunselman and others known and unknown at times fraudulently created and sold credits for renewable fuels that were never produced, thus violating the law. So it goes back to January 2010.

And I guess the question I would have for Mr. Jobe, recently the Renewable Fuels Association testified before our Energy and Power Subcommittee, yesterday, in fact, that the RIN fraud problem is overblown. Do you think that's true or not, yes or no?

Mr. JOBE. Um——

Mr. STEARNS. Yes or no?

Mr. JOBE. Yes.

Mr. STEARNS. Do you want me to repeat the question?

Mr. JOBE. Yes.

Mr. STEARNS. So you agree with the Renewable Fuel Association that this whole thing is overblown.

Mr. JOBE. I wouldn't characterize it exactly that way.

Mr. STEARNS. No, I'm asking the questions. So your answer is yes, it is overblown?

Mr. JOBE. Yes.

Mr. STEARNS. OK, I just want to—because your opening statement indicated that. Then as you moved to your closing, you sort of indicated differently, so I thought I'd put you on record.

And I think in this case, and it is Mr. Fjeld-Hansen—pull the mic up a little bit closer to you—and Mr. Paquin can tell me do you think the problem of RIN is overblown, yes or no?

Mr. FJELD-HANSEN. I think the problem has not fully surfaced until the export issues have been addressed as well.

Mr. STEARNS. So, is your answer yes or no, it's overblown?

Mr. FJELD-HANSEN. I would say it's not overblown.

Mr. STEARNS. Not overblown.

Mr. Paquin?

Mr. PAQUIN. Sir, the situation is not overblown.

Mr. STEARNS. OK. And this case, Mr. Sprague, what do you think about this fraud problem? Do you think—Mr. Jobe thinks it's overblown. What's your opinion? It is overblown, yes or no?

Mr. SPRAGUE. Yes, I think it's overblown.

Mr. STEARNS. You think it's overblown.

Ms. CASE. I think it's a serious issue, but it reflects a very small amount of the market, so it is overblown.

Mr. STEARNS. Does anyone feel a strong compunction that it is unfair for me just to put you on yes or no, that you would like to have an opportunity? If so, who would like to say?

OK, Mr. Jobe, can you make it in 30 seconds?

Mr. JOBE. Yes.

Mr. STEARNS. Normally if you're the gentleman from Michigan, Mr. Dingell, who has been chairman of this committee many years, he gives no opportunity to talk after he asks a yes or no, but I'm going to give you 30 seconds.

Mr. JOBE. It is a very, very serious issue, and we are committed to addressing it. I had to answer yes only to the extent that—only to the extent that it——

Mr. STEARNS. You said it is a serious issue. Who else? Mr. Paquin, did you want to say something? I have a lot of questions here, but keep moving.

Mr. PAQUIN. Yes, sir. At this point, yes, it is a definitely a serious issue. The fraud that is committed up to this point is significant. And I——

Mr. STEARNS. OK. Let me ask Mr. Fjeld-Hansen. Musket Corporation, I guess, is the second largest truck stop chain in the United States. Is that true?

Mr. FJELD-HANSEN. That's right.

Mr. STEARNS. They're a large player in the market for biodiesel fuel. Especially as compared in this case to Mr. Sprague's company, you're the big honcho here. But you say in your testimony that Musket is still, you are still greatly affected, just like Ms. Case talked about what has taken place. In what ways has Musket been impacted?

Mr. FJELD-HANSEN. Well, as you were saying, due to our size, when we have been in transaction chains of fraudulent RINs, we tend to be the epicenter of it. We are the ones who are buying the fuel from the producer. We also are the ones selling the RIN to the obligated party. And we are also the one making the investments in the blending equipment. And we are also the ones selling the fuel to the consumer. So we carry the quota risk of the consumer, the credit risk of the producer.

Mr. STEARNS. So you're involved with all the transactions.

Mr. FJELD-HANSEN. So we are where everything meets.

So our impact from a damage perspective has been that we have had to replace fraudulent RINs that we had sold to obligated parties. So whatever damages they incurred, we replaced RINs at our cost.

Mr. STEARNS. OK. Mr. Sprague, in your testimony you state that the inception of the EMTS program, which, I guess, is a computer system that the EPA set up, many in the industry thought that the EPA would be providing oversight, and guidance, and validation for all RIN transactions, but as you've pointed out quickly after the fact that EPA—this is not the case, and that caveat emptor is really what you're facing when you're dealing with this EMTS program. Is that correct that you had the impression somebody was looking after this?

Mr. SPRAGUE. Exactly. The general perception in the industry was through the third-party engineering studies that were done for each facility to become registered, through the attestment, through all of the documentation that we provide, which is quite extensive, that the EPA, for lack of a better word, was the gatekeeper, and that somehow the system—maybe that was the flaw that many of us had—somehow, without actually figuring out how, that the system would remain pure.

I think the obligated parties didn't take their due diligence job seriously. I don't think the EPA intentionally didn't provide the oversight that maybe we feel now that could have been more substantial, but I think we all kind of felt like the system was sound,

and we found that it's not. It has a few holes that need to be plugged.

Mr. STEARNS. All right. My time has expired.

The gentlelady is recognized for 5 minutes.

Ms. DEGETTE. Mr. Sprague, following up on that, this Clean Green case was a wake-up call for everybody, correct?

Mr. SPRAGUE. I'm sorry, ma'am.

Ms. DEGETTE. The Clean Green case was a wake-up call for everybody that due diligence needed to happen, and people need to pay attention, right?

Mr. SPRAGUE. That's correct.

Ms. DEGETTE. OK. Mr. Drevna, I want to ask you a couple of questions. I understand that numerous companies like ExxonMobil, Marathon, Shell, Sunoco and Tesoro bought invalid diesel RINs from Clean Green, which has now been convicted, and submitted them to the EPA for compliance with their with renewable fuel obligations, correct?

Mr. DREVNA. Yes, ma'am.

Ms. DEGETTE. And EPA's regulations clearly state, quote, "Invalid RINs cannot be used to achieve compliance with the renewable volume obligations of an obligated party or exporter." Is that correct?

Mr. DREVNA. The regulations say that, yes.

Ms. DEGETTE. They say that, yes.

Mr. DREVNA. Yes, ma'am.

Ms. DEGETTE. And, Mr. Drevna, EPA's regulations clearly say—or I just said that—that they can't be used to achieve compliance, and so here's my question: Do you know if those companies that I just talked about, ExxonMobil and the other ones, were aware of that EPA regulation, yes or no?

Mr. DREVNA. Yes, I'm assuming that they did, they do.

Ms. DEGETTE. I would think so.

And so here's my question: Yes or no, do you know think the companies have any responsibility to conduct due diligence and to investigate biofuel producers from whom they are buying RINs?

Mr. DREVNA. I believe that there has to be a system where——

Ms. DEGETTE. Yes or no, do you think they should be conducting due diligence?

Mr. DREVNA. Depending upon what your definition of due diligence is.

Ms. DEGETTE. Do you think they should be conducting due diligence, yes or no?

Mr. DREVNA. To a point.

Ms. DEGETTE. To a point. Only to a point? Which point?

Mr. DREVNA. The point where it makes sense.

Ms. DEGETTE. OK. Do you know whether those companies had due diligence processes in place before the Clean Green case?

Mr. DREVNA. I believe they must have looked at——

Ms. DEGETTE. Do you know whether they had due diligence in place?

Mr. DREVNA. I cannot address individual companies.

Ms. DEGETTE. You don't know.

Mr. DREVNA. No, I don't know.

Ms. DEGETTE. OK. Thank you.

Now, do you know if the company's attention to due diligence has increased since this Clean Green case came up?

Mr. DREVNA. As I said——

Ms. DEGETTE. Yes or no?

Mr. DREVNA. Yes.

Ms. DEGETTE. Thank you.

Now, I want to say to you, Mr. Paquin, due diligence is important to you, and I think you said in your testimony improving due diligence is important in the wake of this Clean Green case, correct?

Mr. PAQUIN. That is correct.

Ms. DEGETTE. OK. Now, I think you believe that there are certain red flags that one can identify in this whole process to tell if there's fraud in these RINs, correct?

Mr. PAQUIN. There are red flags and——

Ms. DEGETTE. Would you be willing to supplement your testimony—excuse me—would you be willing to supplement your testimony, Mr. Paquin, to tell us what those red flags could be as we work along this process?

Mr. PAQUIN. Actually there are many red flags and indicators that we can look at.

Ms. DEGETTE. Can you submit that to this committee? That would be really helpful.

Mr. PAQUIN. I can do that.

Ms. DEGETTE. Thank you very much.

[The information appears later in the hearing.]

Ms. DEGETTE. Now, Ms. Case and Mr. Sprague, you know, I listened so sympathetically to your testimony because you're—just like everybody else, you're victims in all of this because you're legitimate operators who are trying to operate under this law, and now your markets have fallen out because you're small producers, and people are worried, right? Ms. Case, yes or no?

Ms. CASE. Yes.

Ms. DEGETTE. And Mr. Sprague?

Mr. SPRAGUE. Yes, ma'am.

Ms. DEGETTE. Now, Ms. Case, you said that when the EPA announced this fraud, the market fell apart; is that right?

Ms. CASE. Yes.

Ms. DEGETTE. And you also said that there are solutions in the private sector that had been proposed because everybody's awareness has gone up since this Clean Green case; is that right?

Ms. CASE. Yes, that's correct.

Ms. DEGETTE. Would you be willing to supplement your testimony to talk about some of those private-market solutions that have been proposed?

Ms. CASE. Of course.

Ms. DEGETTE. Thank you very much.

[The information follows:]

Supplemental testimony by Jennifer Case, New Leaf Biofuel

At last week's hearing, Congresswoman Degette asked me to supplement my testimony with some of the recent private sector solutions to the RIN fraud issue.

Genscape Rin Integrity Network: The Genscape Rin Integrity Network ("Genscape") is a two phased approach developed by the RIN Integrity Task Force, a group of industry leaders representing the petroleum and biodiesel sectors, biodiesel blenders, and small and large producers. Genscape is currently a voluntary plan financed by obligated parties in the form of a subscription service. Biodiesel producers who wish to participate are required to pay an upfront fee, plus a "per RIN" charge for all RINS sold during the contract period.

In Phase 1, Genscape will dispatch an auditing firm to conduct a comprehensive audit of each biodiesel plant to verify compliance with the RFS. The firms include Lee Enterprises, Christianson & Associates, and Eco-Engineers. The audit includes a site visit, a fuel analysis, and review of a series of documents. The audit list was developed by the RIN Integrity Task Force and includes review of state and federal tax returns, RIN compliance reports, feedstock and alcohol purchases, fuel and co-product sales. Most auditors are performing a mass balance to ensure the products in justify the products/RINS out.

Genscape's Phase 2 will involve the installation of equipment at each biodiesel plant that will be able to remotely capture real time data such as energy and chemical usage. Genscape will use the data gathered from the plant to verify that plant is indeed in operation and (based on tank levels and energy) is capable of producing the volume of fuel that is reflected in that plant's EMTS RIN generation records. Phase 2 will also require Biodiesel Producers to submit periodic production and sales data. Biodiesel producers who have completed both Phase 1 and Phase 2, will be visible to obligated parties via Genscape's "Dashboard".

It is the hope of the National Biodiesel Board that the EPA view an Obligated Parties' participation in the Genscape RIN Verification System as proof of due diligence that would earn an OP an affirmative defense.

New Leaf Biofuel's perspective is that the Genscape program is a great idea – if, and only if, there is widespread participation by Obligated Parties and biodiesel producers, large and small. As it stands now, New Leaf and other small plants are able to move our RINS, but at sharp discounts to the market. We are viewed as much more risky, by both Obligated Parties, and any intermediaries such as blenders and RIN marketers. If Obligated Parties were granted an affirmative defense if they used Genscape, then (presumably), the RINS generated by plants who opted in to the Genscape Program would become more valuable than they are now...perhaps they'd be more valuable than the large producer RINS (many of whom are resisting the Genscape program because they do not currently need help selling their RINS).

The Petroleum Refiners Association (AFPM), has suggested that there should be multiple RIN Verification programs to encourage competition in the market. I understand their point, but I am concerned that if there are too many ways to comply, no one system will gain a large enough reputation to give obligated parties confidence.

To the extent that the EPA and this Committee agree that there should be more than one way to show due diligence, I think it is extremely important that there is an "audit the auditor" program. We simply cannot have Obligated Parties relying on an affirmative defense because they used an auditor who was not up to par. It is absolutely essential that the RIN market regains integrity, and this can only happen if we have a due diligence requirement that is AIR TIGHT! sssFor more information, please visit http://info.genscape.com/RIN

There are at least 6 other RIN Integrity Programs being introduced. I have not researched them extensively, so I have provided the names of the Companies below:

EcoEngineers

Frazier Barnes & Associates (RINtrust)

EM Biofuels (RINPlus)

Weaver & Associates

Ms. DEGETTE. Now, what can the EPA do to restore the confidence in the program so you can start selling your product again?

Ms. CASE. I think what we're doing right now, the National Biodiesel Board's obligated parties and the EPA working together, for example, on the RIN Integrity Task Force, is exactly what we need to do. We need to clarify what due diligence is absolutely. There needs to be more due diligence. And I think that the EPA just needs to make sure that all the information gets out there so that we can identify who the people are who are perpetrating the fraud and eliminate them from the system so we can move on. The more information we get, the better.

Ms. DEGETTE. OK, great.

Now, I'm sorry, Mr. Drevna, I forgot to ask you one question, and I don't know if you know the answer to this, but as I said, ExxonMobil, Marathon, Shell, Sunoco, and Tesoro and others bought these invalid RINs from Clean Green Fuels. And so my question is Clean Green was the one that was operating in Maryland with a few plastic tubes in a tiny ramshackle building. Do you know if those companies did the due diligence to find out about Clean Green before they bought the RINs?

Mr. DREVNA. I can't talk individual companies. I can't say.

Ms. DEGETTE. Well, I just listed a whole bunch of them.

Mr. DREVNA. Well, EPA was there a year before they announced that there was a lot of fraud.

Ms. DEGETTE. My question to you, sir, is do you know if those companies——

Mr. DREVNA. No, I don't. No, I don't know. No, I don't.

Ms. DEGETTE. Thank you very much.

Thank you, Mr. Chairman.

Mr. STEARNS. Mr. Terry is recognized for 5 minutes.

Mr. TERRY. Thank you, Mr. Chairman.

I came here under a different impression. I thought we were all getting together so we could figure out solutions here. I'm kind of stunned actually.

Anyway, a couple folks in a question, I think, by Mr. Stearns about whether the fraud was significant, just my little editorial before I ask questions. It may have been insignificant in the sense of the amount of fraud to the entire industry, but its consequences have been very, very significant, so therefore it is significant. And that's what we're trying to do here today, because as I mentioned in my opening, this is also then being used as the primary weapon against biofuels in general. Because there's fraud, eliminate biofuels. And so we need to have the discussion more about how do we correct the fraud, because any fraud should be dealt with swiftly and harshly.

Anyway, now I'll get to a couple of my questions. Mr. Paquin, I understand, though, that in validation you did your work and discovered fraud. Could you be more specific in what remedies then you brought to the table?

Mr. PAQUIN. Yes, sir, absolutely.

First of all, I want to correct the record. The first RIN fraud case was not in 2010 for Clean Green. Actually when I was the president of Paquin Energy & Fuel in 2009, we actually saw the first fraud case. So in July of 2009, we discovered through our due dili-

gence process that some of the numbers we were receiving for renewable credits did not make sense. They were rounded off, and those numbers just appeared to be inconsistent with any product we saw in the marketplace. In 2009, a local prosecutor actually immediately prosecuted an individual and limited the fraud to about 100,000 total dollars.

Mr. TERRY. This is a local prosecutor.

Mr. PAQUIN. This was a local prosecutor.

Mr. TERRY. And someone informed the local prosecutor of what they discovered?

Mr. PAQUIN. Yes, sir. At Paquin Energy & Fuel, when I was the president there, we immediately called the EPA as well as the local prosecutor to see if we can get some of the financial and some of the money back from the company. They responded immediately and, like I said, limited that case to about $100,000 total liability. He was convicted of a felony, so the case was successfully prosecuted.

Fast forward to Clean Green in 2010. Our company once again went through an extreme due diligence process and identified the fact that Clean Green was not producing product. We actually sent someone on site. They looked at that facility and identified the fact that it was nonexistent. We reported that to the EPA in July of 2010 and again in a meeting in August of 2010.

I will also say that the due diligence process that we execute, we rely on other individuals just based on information from brokers, the total amount of fuel that's used, and we also pass on that information to obligated parties. So they—and, in fact, default will rely on us to tell them and give them what due diligence we've done as we purchase and resell RINs.

So I think that's an important distinction to make that there is a significant due diligence process in the marketplace currently; however, it's nearly impossible to root out all the criminals who actually defraud other people and individuals in the system. That's why affirmative action or affirmative defense is extremely important as we move forward so an innocent, good-faith company has the ability, like ours who went out and did the due diligence, doesn't have that extreme liability.

Mr. TERRY. I appreciate that.

Ms. Case, I appreciate your position in the market. You had mentioned in your testimony, and so did Mr. Sprague, that when there is something like this fraud controversy, it tends to impact the smaller producers more significantly. Tell us specifically how it affected you and why you think it affects the smaller producers, in 42 seconds.

Ms. CASE. Sure. We sell—prior to the fraud we sold our RINs with the fuel, so our distributors would be the one who would actually separate the RIN and sell it up the chain to the brokers or to the obligated parties.

Once the fraud occurred, the ultimate owner of that RIN, an obligated party, doesn't know New Leaf. They've never been to my plant. They don't buy fuel directly from me. They would just get the RIN through some brokers. So once the fraud was discovered, they just put a stop to buying any RINs from any producers they didn't know about.

When the due diligence kind of got more intense, there were auditors that were sent out to verify that a plant like ours is in existence, and the marketplace has allowed at this point to start getting RINs moving again. However, obligated parties are still focusing on the plants that have the financial backing to replace those RINs, or maybe an intermediary, a broker, who can put their balance sheet on the line to say if these RINs do turn out to be invalid, they can replace them.

Nobody is going to look at my company and think I could replace $5 million worth of invalid RINs if they turn out to be invalid, so therefore obligated parties are still not buying directly from me. There are some market things that have been put together, verification purposes—for verification purposes, and I think eventually they will again.

Mr. TERRY. Thank you.

Mr. STEARNS. Mr. Green, you're recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

My colleagues, I appreciate your being here today. And unlike the chairman, I don't get to run over my 5 minutes, so I'm going to ask for a yes or no answer on my first question.

Conception. Do each of you agree that there should be some sort of affirmative defense for obligated parties as warranted, recognize that may depend on some sort of agreed due diligence criteria? If you could just answer yes or no.

Ms. Case, would that bring stability to your market.

Ms. CASE. I believe so, yes.

Mr. SPRAGUE. Yes, absolutely.

Mr. PAQUIN. Yes. It has to extend to all participants.

Mr. GREEN. Mr. Fjeld-Hansen?

Mr. FJELD-HANSEN. I'm not certain about it. I think the buyer beware is actually working quite well, and proper prosecution is going to clean up a lot of this.

Mr. STEARNS. Mr. Jobe?

Mr. JOBE. Yes.

Mr. DREVNA. Absolutely.

Mr. GREEN. And I guess my concern is that we've heard the questioning, and we'll get to the EPA panel in a few minutes, but for almost a year the EPA knew there was a fraudulent access out there, and didn't ring the bell, and said it is buyer beware. I'm just shocked that we're saying, wait a minute, Congress created this program, and yet we don't want some follow-up by someone other than a private sector to do it. It should be also verified. And I think due diligence with some kind of affirmative defense may be what we are looking for.

Mr. Drevna, do you think that the risk for invalid RINs could be significantly minimized if the EPA approved a third-party independent auditor that visited the facilities unannounced?

Mr. DREVNA. Well, that's the question, Congressman Green, about what due diligence is and what it isn't. We can't go out and look at 50,000 or how many different producers are out there. We need something that says, OK, we're in this together, we have to have an affirmative defense, we have to define what that due diligence is.

Now, we have been going back and forth with EPA, and actually we've been going forth with EPA, we haven't gotten a lot anything back—I mean, good conversation, but we haven't gotten anything back from the good folks at EPA about what they believe would be a due diligence, you know, how many boxes do you have to check in order for you to qualify for that affirmative defense? That's where we are right now.

Mr. GREEN. And I know and my ranking member is a good friend. Obviously your members are big boys. They can take care—and big ladies, too, I guess. They can take care of themselves. But the problem with these RINs is that you may not know from that purchaser you're buying from where it actually came from because these are traded. You know, it's almost like if I buy stock, no telling who else has had that stock. And that's my concern.

Does anyone else on the panel want to answer on do you think that the risk for invalid RINs would be significantly minimized if the EPA approved a third-party independent auditor that visited the facilities? Anybody else have a response?

Mr. SPRAGUE. I would like to make a comment on that, sir. We in the private sector have lots of audits by lots of different agencies, IRS, State and local, so we get audited a lot. By no means are we fearful of having that auditor come in. The question is is it really needed, and is it going to accomplish anything?

My greatest fear is that we create a bureaucracy to where——

Mr. GREEN. We already got one at EPA.

Mr. SPRAGUE. Yes, I guess that's true—where we create even more bureaucracy inside a program that was meant to be a private-sector, market-based type of approach. So my comment to that is that's not necessarily, in my opinion, needed, and that's just an opinion.

The one thing that——

Mr. GREEN. If somebody else on the panel may want to respond, because I'm down to a minute 15. Anybody else?

Mr. FJELD-HANSEN. Thank you.

You know, when you look at a lot of these increase or some kind of a process like you're talking about, an audit, I don't think we want to put a system in place that relieves people of liability. Everyone who's entering into this industry are doing it because of some kind of business idea or plan and some kind of return metrics, and with those come certain risks. You're mentioning all the traders that are in this——

Mr. GREEN. I only have a couple seconds. I need to ask Mr. Drevna, why is it critical for EPA to act by January 1st of 2013?

Mr. DREVNA. We don't want to see a redux of 2000, what we saw in 2012, Congressman Green. We have to have certainty out there. And in order to—you know, just a couple weeks ago the FBI raided another place. We don't know how many more are out there right now. We need to have certainty that whatever we do is going to be satisfactory, or, as I mentioned earlier and then probably in opposition here, the free market is working right now because we're not buying RINs from people we don't trust.

Mr. GREEN. Well, and that's the concern, because without that certainty you're hurting a lot of companies, and maybe we really

need somebody that's a traffic cop saying this is OK so some of these companies could actually participate.

Mr. Chairman, thank you for your patience.

Mr. STEARNS. Thank you.

Dr. Burgess, you're recognized for 5 minutes.

Mr. BURGESS. I thank the chair for the recognition.

Mr. Sprague, I was particularly taken with your testimony that—your observation that there were a lot of forms to fill out, there were a lot of people that you had to reply to. And it was your impression, whether it was rightly or wrongly, that someone really didn't have their hand on the tiller as far as all of this was concerned. Did I discern that correctly?

Mr. SPRAGUE. Yes.

Mr. BURGESS. And, Mr. Paquin, you have pointed out how as early as 2009 saw the numbers didn't add up. Were you the one that then alerted a local prosecutor?

Mr. PAQUIN. Well, in 2009, Paquin Energy & Fuel alerted the local prosecutor as well as the EPA at that time.

Mr. BURGESS. So I guess what I'm having trouble with here is EPA gave the impression that they were in charge. They gave you the impression, Mr. Sprague, that you got to fill out all this stuff, you got to do all these things in order to be in compliance, so surely there is a penalty or there is a problem—if a problem is found, they are going to fix it in short order. Did you have that impression?

Mr. SPRAGUE. That was definitely the impression. And I will go back to a comment Mr. Jobe said that this program is effectively 1 to 2 years old, and with any—with any system there is going to be problems, corrections. If anything, it's my opinion that the problem that is occurring is there's not a mechanism to address problems that are unforeseen.

Mr. BURGESS. Well, that's your impression today, but when you were filling out all those forms, having to answer all those questions, it really looked like the heavy hand of Big Brother was on this program, didn't it?

Mr. SPRAGUE. That is a true statement.

Mr. BURGESS. And that would have been my impression coming at it from the same angle, that here you have the heavy hand of the Federal Government, you'll have the full weight of the Department of Justices, inspector generals, Federal prosecutors, who know else, if you come in and do this incorrectly, so you better cross all the Ts and dot all the Is. Wasn't that your impression?

Mr. SPRAGUE. Yes.

Mr. BURGESS. And so it was kind of a shock.

I don't know, Ms. Case, did you have the similar impression when you applied for this program?

Ms. CASE. You know, on one hand yes. Obviously we had an engineering review. We had someone come out to the plant and make sure we had the technology in place. But on the other hand, you know, I'm sure in hindsight there could have been more. That's the benefit of hindsight.

Mr. BURGESS. Yes, but even at that level, could you have ever envisioned that someone could put a barrel in a church parking lot with a couple of hoses coming out of top and say, hey, I'm in the biodiesel business?

Ms. CASE. No, but I don't think like a criminal.

Mr. BURGESS. Yes, and that's a lot of our problems.

But here is the problem: You guys entered into this. You risked your own capital, your own time. You could have been doing other productive pursuits. I don't know whether it was a desire to make money or a desire for social justice, but you did what the government asked in producing these, and then in turn—I mean, you're—honestly, you're the bottom of the food chain. Mr. Drevna, his big boys and girls. They will be taken care of, they'll handle it, they can absorb those losses. But I don't know if you are at liberty to tell us, how did that affect your balance sheet, Ms. Case? What personally has been put at risk in your world from this?

Ms. CASE. It's been difficult, I can tell you that. Like I said, we had a good year last year, and this year has not been so good.

Mr. BURGESS. Well, can you give a range; do you feel like on a personal level you lost $1,000 or $10,000 or 100,000?

Ms. CASE. I can't speak to the exact dollar amounts, I don't have that with me. I can say that if you look at the RIN values right now as to where they were last year, and then you take a pretty significant percentage off of that, you'll see about what I'm getting for a RIN right now, whereas last year at this time we were all on a level playing field, my RIN was worth the same as a large-producer RIN.

Mr. BURGESS. So you're the one having to provide the discount in order to salvage the program.

Ms. CASE. Absolutely.

Mr. BURGESS. Mr. Paquin, can you give us an idea of the range of the losses that your company—you're kind of midlevel in this range. There are very small guys and very big guys.

Mr. PAQUIN. Yes, sir. After going through an extensive due diligence process, and without the opportunities and an affirmative defense to show our innocence. We are looking at a range of a 6- to $10 million loss of which we don't have. Our 40 employees will probably go away if that occurs. However, I think we can come up with solutions in order to move forward.

Mr. BURGESS. So if you have solutions, you can save 40 jobs in your company.

Mr. PAQUIN. I think the industry can save tens of thousands of jobs if we have an immediate solution and EPA actually adjusts its interim policies to allow for an immediate due diligence.

Mr. BURGESS. And, Mr. Drevna, just a quick follow-up. I'm not sure that I completely understood. And, now, has the EPA defined what due diligence is so going forward we all know?

Mr. DREVNA. No, sir, that's the problem right now. We've been trying to figure out what due diligence would be, having meetings with the assembled masses here going forward. But to date it's been, you know, tell us what you think due diligence is, and they'll look at it, and we don't hear anything back.

Mr. BURGESS. Well, we've defined the problem, and I hope we can apply a little pressure to get this done for you.

Mr. DREVNA. If I may, sir, there is a program out there that we've been living with since 1995 under the RFG program. It's a good template, why not look at it, the RFG survey.

Mr. BURGESS. OK, we'll look at that. Thank you.

Mr. SULLIVAN [presiding]. Ms. Castor, you're recognized for 5 minutes.

Ms. CASTOR. Thanks very much.

Well, thank you all very much for being here today. I think your testimony on the renewable fuels standard and the young biodiesel market has been very illuminating, and I really feel for what has happened with these crooks and bad actors that have entered into the market and caused so much damage to your companies.

I wanted to focus on some of the big picture, though, on—it's very interesting that almost everyone here said, Congress, continue on with renewable fuel standards; that the overarching goal there of creating jobs, of addressing—reducing greenhouse gas emissions, thereby addressing these extreme weather events, is important; and really reduce—decreasing our country's reliance on foreign sources of energy.

Except Mr. Drevna. Yes, you're right, I read your testimony where it says the renewable fuel standard is a broken policy in need of dramatic reform. I think you're in the minority, from the research I've been doing and the testimony here today.

Ms. Case, notwithstanding these crooks that entered into the market, would your company be profitable without the renewable fuel standard?

Ms. CASE. No.

Ms. CASTOR. And, Mr. Fjeld-Hansen, how has the Musket Corporation—I wasn't familiar that you had such a—what is it, 300 locations all across the country. We're doing transportation fuels. How has the Musket Corporation benefited from the renewable fuel standard?

Mr. FJELD-HANSEN. Well, as a retailer we are there to provide the fuel that our customer wants, so I think our customers have benefited.

Ms. CASTOR. You need to bring your microphone a little closer and turn it on.

Mr. FJELD-HANSEN. And also turn it on.

No, as a retailer the benefit of this is really coming to the customer more than anything where a lot of the value created from the renewable fuel and also whatever emissions benefits they have will be transferred to the customers. So we are kind of in the middle of the chain where it's additional fuel that we can offer to our customer.

Ms. CASTOR. Well, I know you're not saying the RFS is perfect, because these fraud cases have raised very significant concerns about the market impact of this fraud, and we need to learn the lessons now in order to prevent this fraud from occurring again. And I'm very pleased that the National Biodiesel Board and the petroleum refiners have been working to set up a third-party certification system that will help buyers verify the validity of the RINs before they purchase them.

Mr. Jobe, can you describe the auditing process that biofuels producers have to undergo to qualify as a certified producer under this program?

Mr. JOBE. Yes, thank you.

Prior to working in this job, I was actually a fraud investigator, I did training at the Federal Law Enforcement Training Center in

Glencoe, Georgia, where some of the Secret Service agents also train.

So we started working on this program back in October of last year in anticipation of EPA enforcement actions, and one of the conclusions that we came to fairly quickly was that we were going to need to address this problem in a very reasonable timeframe, in a very tight timeframe, because it was going to jeopardize, financially jeopardize, a whole lot of people, including my members, including Mr. Drevna's members, and everyone at this table.

And so we decided that a legislative fix was not—would not work in the proper reasonable timeframe; that even a regulatory fix was not what was needed, because regulations move at glacial speed. We needed the private sector to step forward with a private-sector fix. That's why we got with Mr. Drevna's organization. We formed a task force that was cochaired by an obligated party and a biodiesel producer and had a cross-section of all of the stakeholders, and advised and encouraged the development of the program.

They even developed the audit plan for the initial audit. So it's a two-phase program. First is an initial audit where actual audit teams go on site and audit the RINs that have been existing. And then the second phase is installation of special software with special data-collection algorithms and monitoring equipment, tank monitors, flow meter monitors, infrared camera devices, all of these sending realtime data to the software reconciling the data, and all that data then made available to obligated parties to use that information to do their due diligence.

We're confident that—and our members have taken—they're spending tens of thousands of dollars to do this and to put equipment on site.

Ms. CASTOR. Then are you confident that the producers will continue legitimate and high-quality operations after they receive that certification because of that investment?

Mr. JOBE. Absolutely.

Ms. CASTOR. And you also testified along with others that the EPA, businesses and key stakeholders are in serious discussions about how third-party verification systems like this one would work and how it would fit into EPA's enforcement approach. Have you—how would you characterize EPA's response to stakeholder concerns, and have they been a willing participant in the discussion?

Mr. JOBE. The EPA participated as guests on all of our—on many of our task force meetings. They reached out. They were very responsive to us when we reached out to them. They reached out to us separately, and they've been very responsive.

I will also just share, as far as the enforcement action, having done fraud cases, of course everyone would have liked things to have happened faster, but having prosecuted fraud cases, you have to get all of your facts very, very straight before you allege something about someone because you can ruin their reputation. So we think that this first prosecution case has gone on a relatively reasonable timeframe.

Ms. CASTOR. Thank you very much.

Mr. SULLIVAN. Thank you.

We recognize Mr. Bilbray for 5 minutes.

Mr. BILBRAY. Thank you, Mr. Chairman.

First of all, I think—I was just sitting here realizing I think the ranking member and I were the only ones around back in the '90s when we fought to get biodiesel equity and able to get a blender's credit back in those old days. I remember the battle over that, and I——

Ms. DEGETTE. We were in our teens then.

Mr. BILBRAY. Yes, yes.

So we have come a long way on a lot of issues. I am just concerned that we don't recognize that what our intentions were with the renewable fuel standard may not have grown or evolved the way we wanted to. And I really wanted to say I do agree that there are changes need to be made, and reform is not a bad word in a lot of episodes. But I think here we need to learn from our successes and our failures.

One of the places I think has been successful is the biofuel industry overall has provided a usable material with the BTUs, the energy that is needed, at the same time of avoiding environmental problems that some other aspects of the renewable mandate have applied. I mean, California, you actually have renewable fuels being outlawed for environmental reasons, and you've got renewables that are actually going to have to be imported because our domestic-produced renewables are not compatible with their greenhouse mandates. And so but I think there are the opportunity to learn from some of this.

The question I have for those of you that—especially the little guys that have to work with us. Those of us in government, the big guys always can accommodate one way or the other. It is the little guy who gets squeezed out by mistakes by big government. So how can we help the little guy?

Mr. Jobe, the issue of tracking who is a true credit—and this is really kind of near and dear to me, because when we were talking about so-called cap and trade, didn't have any cap, we were talking about international offsets. And I saw shysters going down to Latin America actually cutting deals with teak growers for stuff that wasn't going to reflect reality, but was going to make people money because they get shipped over.

How do we do something like what we're trying to do with our drug tracking of a pedigree so that a consumer can know that they have—that what they are buying is actually going to be credited under the Federal program? Do you have any ideas or have been thinking about that?

Mr. JOBE. Yes. And I appreciated your suggestion earlier about E–Verify and the analogies there, because I really think that the private-sector solution that we've developed in conjunction with the obligated parties, the blenders, the marketers, the retailers, and large, small and medium-sized biofuel producers, I think it is very similar and will work like that because it is going to initially audit the RINs that have been generated, and then it will be monitoring in real time so that an obligated party or other stakeholder can, through a subscription service—and the obligated parties on our task force actually believe that it's going to save the obligated parties money to pay for this subscription because they have auditors in—they have multiple—all of them have multiple auditors on the same site right now—but if they could just buy a subscription and

look at data that's being monitored in real time, it would be very, very powerful. So I really think that's a form of an electronic realtime verification that you can look at a particular RIN and see that it's been monitored.

Mr. BILBRAY. From the consumer's point of view, the purchaser, right now when it comes to illegal employment, we put the burden on the employer to check with an old I–9 system that has been so fraudulent that everybody knows it's just a scam for basically people who want to break the employment laws. But with E–Verify we are trying provide, as the President has expanded it, a vehicle for a consumer, the employer, to be able to check to make sure they are legally performing an activity.

Do you see an opportunity by using some kind of information that works to give the consumer the ability to know what they are actually buying and what they are getting for the dollar?

Mr. DREVNA. That's a great point, Congressman Bilbray. And to Mr. Jobe's thought, you know, the concept sounds really good, and always the devil's in those details, and we are working very closely.

One of the concerns we have, it can't be just one company. There has to be an EPA-approved, registered—any number of people. Let the free market decide who you want to go to to make sure that you can check your boxes and get it done. And the more entities that are involved in that, the better because, again, you can't just have one company saying, we're doing all this.

Mr. BILBRAY. No, I think Ms. Case would be the first one to say if you pick one company, you're going to be the—you're going to be left out, and some big guy is going to be in line for all the business. So I guess the two things you can agree on from both ends of the aisle, I got a constituent down at the end, but I think that we don't want to have that government pick one player, because that player tends to be the big guy who's got the lobbyist in Washington or is able to play. And the essential part of this program is the little guys being able to participate because they're closest to the community.

Ms. CASE. The point I would make with the work that we've been doing on the task force is that if all of our RINs are looked at on an even playing field, and the obligated party can look at the subscription service and see that I'm actually producing fuel at my facility, they would be more likely to buy my RINs, and that's why it's important for that system to be put in place.

Mr. BILBRAY. Thank you. And thank you for taking that 10-hour flight round-trip to come out to testify.

I yield back.

Mr. SULLIVAN. Mr. Markey, you are recognized for 5 minutes.

Mr. MARKEY. Thank you, Mr. Chairman, very much.

Yesterday I asked Jack Gerard, the president of the American Petroleum Institute, whether he supported the policy we've had in place in the United States over the last 37 years to prohibit exports of American crude oil. He apparently doesn't support that policy anymore. Even as American soldiers are fighting and dying to protect oil supplies in the Middle East, he thinks that it's the American Petroleum Institute—or we should really now just call it the World Petroleum Institute because that's really who he is rep-

resenting—thinks that we should seriously consider exporting American crude oil.

Last week the Carlisle Group purchased the Philadelphia refinery that was for sale, the oldest and largest oil refinery on the east coast. The previous owner, Sunoco, had planned to close the facility next month, leaving 850 workers unemployed. Instead the refinery will now be upgraded, and an additional 200 jobs will be created.

Now, why has that occurred? Well, in the past the Philadelphia refinery used high-priced imported Brent crude, which is more than $14 more expensive on the world market than domestic oil produced here in the United States. So the new strategy is to develop the infrastructure to bring in lower-priced, domestically produced oil from North Dakota and elsewhere to make 50 percent of its refined product.

Mr. Drevna, if we allowed unrestricted exports of crude oil, wouldn't that decrease the incentive to invest in domestic refineries here in the United States because it would be more dependent upon imported, higher-priced Brent crude at $14 a barrel higher?

Mr. DREVNA. Mr. Markey, I wasn't here yesterday to hear Mr. Gerard's testimony, but I can say that if we allow the access to all of our crude oil, and natural gas and natural gas liquids, if we open up—have the President open up the Keystone XL pipeline, not tomorrow or next week, within a few short years, we could have a serious discussion about what are we going to do with the excess crude oil that we have and the excess natural gas.

Mr. MARKEY. Thank you, Mr. Drevna.

The problem is that we already had that conversation here, and the head of the pipeline, the Canadian pipeline, the Keystone pipeline sat here, and I asked him just 3 months ago would he agree that the oil coming through the Keystone pipeline from Canada would stay in the United States.

Mr. DREVNA. Oh, and it will.

Mr. MARKEY. No, he said he would not agree to that. The head of the Canadian pipeline said he would not agree to it. So my concern is that it will come through the pipeline, get refined, and then just sent off to China. So why would we have——

Mr. DREVNA. First, Mr. Markey, I thought this hearing was about invalid RINs, but if we are going to have this discussion, we're more than willing to talk to you and your staff going forward.

Mr. MARKEY. I understand. Well, it is all part of kind of the same subject that, you know, is being opened up here in terms of the way in which we fuel our country.

So what we have here for this hearing is essentially a sort of ethanol eBay or biodiesel bazaar. Buyers can register, sellers can register, but no one ever said the sellers were all going to be scrupulous, and clearly they weren't.

When your companies buy real estate, whether it is refineries or factories or office space, do they make sure the seller actually owns the property and that there are no liens or other problems with it before closing in on the transactions? Meaning what about the companies—what about when companies buy actual biodiesel? Isn't it true that most companies have audit programs in place before fuels are purchased to ensure that the fuels being bought or sold meet

environmental and other specifications? Whoever wants to take that question. Mr. Paquin.

Mr. PAQUIN. Sir, when someone receives a wet gallon of biodiesel, they can actually look at the diesel and take a sample of it. In the current EPA system, moderated system, there is no way to look at that to see if it is valid or not, if it is a physical product. So if I were to buy a product from one of the producers to my right and blend that product, I would actually be able to see it. So I think that's a distinct difference between the two facts.

Mr. MARKEY. Well, I have documents from several companies that indicate that they do have checklists to catalogue the type of fuel, the type of technology, the purity of the final product, and all sorts of other information that should be used to validate a purchase. And so I'm just wondering what the thoroughness is of the industry just in ensuring that frauds are not being perpetrated in the same way in real estate or anything else that those checks are in place.

Mr. Paquin.

Mr. PAQUIN. Yes, sir. And I would say that there's probably not another company in the entire industry that has a more thorough due diligence process currently than ours. We have recognized the majority of the fraud that has occurred in this industry.

I will say, however, that it is extremely difficult to catch and find out who is trying to defraud you. They can make up fake documents. They can lie to you on the phone. You can show up to a facility that looks like it's operating. There are several ways in which one can be defrauded. I think that's why it is extremely important——

Mr. MARKEY. Let me just ask this very quickly. Yes or no, do you all agree that EPA should have the funds it needs to crack down on any company that violates regulations or defrauds other companies?

Ms. Case, do you think the EPA should have those revenues to crack down on fraud, yes or no?

Ms. CASE. I don't feel like I have enough information to answer that.

Mr. MARKEY. Mr. Sprague, yes or no, should the EPA have those policemen on the beat?

Mr. SPRAGUE. The private sector will monitor itself, in my opinion. No. The answer is no.

Mr. MARKEY. OK.

Mr. SULLIVAN. Mr. Griffith, you're recognized for 5 minutes.

Mr. GRIFFITH. Thank you, Mr. Chairman.

Mr. Drevna, biofuels eBay is the way that this was described, but in reality wouldn't your companies have been better off if they had been purchasing over eBay because eBay, once it discovers an actual fraud, takes the sale off the market; is that not true?

Mr. DREVNA. I have never purchased anything on eBay, sir, but I understand that is correct.

Mr. GRIFFITH. And so in reality, if I understand it correctly, the EPA actually knew for over a year that the Clean Green was just a shack with barrel with tubes coming out of it. Is that—I'm listening to testimony.

Mr. DREVNA. That is correct. That is my understanding again. They saw nothing and reported nothing to us.

Mr. GRIFFITH. And so they didn't put up any kind of a warning this company is suspicious, or under investigation, or being looked at?

Mr. DREVNA. No, Mr. Griffith. The first time we heard about it is when we got issued an NOV and a potential fine.

Mr. GRIFFITH. And, Mr. Paquin, you indicated that there was a prosecution in 2009, and it was a felony that was reduced down to an amount of $100,000 to make it easier for local prosecutor, and your company at the time, the company you were with, notified both the EPA and the local prosecutor. The local prosecutor took action. Did the EPA take any action?

Mr. PAQUIN. Sir, the EPA—the only action that I recall is to say that we were unable to use those RINs, and the rest of the facts I think are correct.

Mr. GRIFFITH. And did the EPA notify anybody else in the industry that this was a company that was under investigation before the conviction?

Mr. PAQUIN. Sir, I don't recall any Notice of Violation for that case, nor do I think the EPA issued one for that case. That was handled by the local prosecutor.

Mr. GRIFFITH. And do you know was there any kind of an EPA notification postconviction of the fraudulent perpetrator?

Mr. PAQUIN. I think the word got out through the industry itself, although apparently limited, because the other people who testified here claim Clean Green in 2010 was the first case. However, those of us that were close to that and lost money at that time were aware of it.

Mr. GRIFFITH. And what jurisdiction prosecuted, if you recall?

Mr. PAQUIN. It was in Alabama, sir. And I want to clarify one other thing as well. It was in conjunction with other officers of that company that had reported the fraud to the local prosecutor. I don't want to show that we made that actual call itself, although we did have a lawyer who may have made a call as well, but it was a group of people working the case at the time.

Mr. GRIFFITH. Mr. Fjeld-Hansen, without—and I know you didn't say you were against it, but without an affirmative defense would you instruct your buyers to buy Ms. Case's RINs, or would you instruct them to not purchase from somebody that didn't have the necessary financial wherewithal to reimburse you should they later be disqualified by the EPA?

Mr. FJELD-HANSEN. I think, again, philosophically if you believe in market forces and that things will find some kind of equilibrium, I think we are going down the right path now with prosecuting people. I think the next guy who is going to make a RIN out of his garage is going to think about it much more than Rodney Hailey did.

Also, I think on the enforcement side——

Mr. GRIFFITH. You think that the right step is to prosecute the wrongdoers and not reinvent the system?

Mr. FJELD-HANSEN. Yes. I think we want to—the resolution first is to keep the system intact as it is, but put more—and I didn't get to respond to the gentleman from Massachusetts, but put more

money into enforcement and investigation. And I think those monies will be recouped easily in formal fines.

Mr. GRIFFITH. And I would be happy to ship money out of the anticoal programs into enforcement on this one.

That being said, Mr. Drevna, back to you, is anybody looking at what happens if there is not enough renewables in order for American domestic supply to be used, because with the corn crop failing this year as a result of the weather conditions, is there a possibility or is anybody looking at the possibility that we may not have enough biofuels out there to meet the requirements, and thus some of the American production will actually have to be exported because it couldn't be sold in the United States?

Mr. DREVNA. A couple—if I may address a couple of things for that, Mr. Griffith. First of all, the panel here is focusing, rightfully so, on their particular business, their particular little one-fourth of the renewable fuel standard. The refining industry has obligated parties for four different we call them buckets, OK? This is one. This is a year or 2 old. Everything is going fine, but we've got 6, 7, 8 percent of the RINs fraud, but everything is OK.

On the ethanol side you got an E–10 blend wall we're going to hit. The auto manufacturers, the engine manufactures, whether it's a handheld power equipment or chainsaw, or mower, are saying, we're not going to warranty anything over E–10. EPA said, OK, it's OK to use E–15. On the cellulosic side, where there is a whole story in itself, where we're supposed to buy fuel that doesn't exist, and we can't—so we can't buy it, and we're fined for it.

So when I say—and, you know, I guess it was Ms. Castor or somebody said unanimous agreement minus one on the renewable fuel standard, and in my testimony when I said this thing has some serious problems, this program has serious problems. We're sitting here intertwining a free-market atmosphere with a mandate. They don't jive.

Mr. GRIFFITH. I have to yield back my time. Thank you, Mr. Chairman.

Mr. TERRY [presiding]. You don't have time.

The chair recognizes the gentlelady from Tennessee for 5 minutes.

Mrs. BLACKBURN. Thank you, Mr. Chairman, and I'm going to try to sum up quickly and not take 5 minutes.

Mr. Drevna, I think that we would agree with you many times free markets and mandates don't mix. What becomes particularly problematic is when the Federal Government tries to have a controlled situation where they are going to emulate free-market components, and then they slap these mandates on it, and it quickly becomes a mess. You all have certainly seen that in the RIN program, and we're here today reviewing it because we need to find some answer to this and figure out what did or didn't work.

Mr. Drevna and Mr. Jobe, I know you all have been negotiating with the EPA on trying to work this out. How are those going?

Mr. DREVNA. They need to go faster. Where as I said earlier, we're looking at EPA is supposed to come out with a regulation—it was supposed to be out the end of June, still isn't out—volumes for 2013.

Mrs. BLACKBURN. Are you going to have something in place that will help with the January 2013 season?

Mr. DREVNA. If EPA can bless it, we will try, but we have to have EPA blessing.

Mrs. BLACKBURN. Do you feel like you are on track to hit that or not?

Mr. DREVNA. It's a slow track.

Mrs. BLACKBURN. Mr. Jobe, do you want to add anything to that?

Mr. JOBE. I agree. It's a slow track. We have been engaged. We're committed to trying to find common ground and solutions. We have some differences in position that we're trying to work through.

Mrs. BLACKBURN. OK. Can you quantify those differences? Are they things where you're poles apart?

Mr. JOBE. So we have—we were approached by the groups. We have discussed the groups. They've said, we would like a regulatory solution to transition from a strict-liability structure to an affirmative defense, meaning we can use our due diligence to defend ourselves to show that we——

Mrs. BLACKBURN. OK. Let me talk about due diligence then for a moment, because, Mr. Paquin, you talked about that a little bit. I want you to list for me what would be the best practices in due diligence that you wanted to say this is the list of boxes that have to be checked with an affirmative answer in order for this transaction to proceed. Do you have that? Can you say, "This is our list"?

Mr. PAQUIN. Ma'am, I can submit a list in our opinion.

[The information follows:]

SUPPLEMENT TO THE TESTIMONEY PROVIDED ON JULY11, 2012 FOR
Committee on Energy and Commerce
The Subcommittee on Oversight and Investigations
UNITED STATES HOUSE OF REPRESENTATIVES
RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program
Thomas Paquin
President, VicNRG, LLC
August 11, 2012

During the hearing on July 11th, 2012, Congresswoman Blackburn requested that VicNRG, LLC provide the Committee a list of what we consider to be the best practices in conducting due diligence associated with the purchase of Renewable Identification Numbers (RINs). Additionally, Ranking Member DeGette asked VicNRG, LLC to provide the Committee a list of red flags that a company could utilize to identify the potential for fraud when purchasing RIN's.

When conducting a due diligence process one can ask many question in an attempt to verify the basic information that a production facility should have or be able to confirm. During the process the answers provided may highlight red flags. Below I have included a partial list of due diligent items one could ask and possible red flags.

Due Diligent Process Checks

1. Obtain the EPA Company ID and the EPA Facility ID for the RIN generator to determine if the EPA registration information is correct.
2. Determine if the EPA registration number for the wholesale counter party is correct
3. Determine if the facility address that is registered with the EPA is correct and a plant exists.
    a. Use tools like Google Maps, BING Maps and other satellite imagery; or
    b. Hire a third party inspector to visually inspect the street address; or
    c. Company employee to visit the address.
4. Request a tour of the facility, note the condition of the facility and identify the key components required to produce/transport biodiesel.
5. During any visit, note the activity. Does the activity, such as loading, feedstock delivery, etc., match the volume being sold out into the market?
6. Request details of approved feedstocks from the producer for each facility. If the producer is willing, provide feedstock sourcing details and general cost.
7. Confirm details of the EPA's permitted capacity for the facility.
8. Confirm that the biodiesel producer is registered as a producer under FFARS. Obtain their FFARS ID number. Obtain confirmation that their FFARS registration is not limited to "fuels additive producer".

9. Confirm the identity and status of the EPA Responsible Corporate Officer, RCO.

10. Obtain the IRS Form 637 registration number for the RIN producer. Confirm that this is up-to-date.

11. Request from the producer and confirm that IRS Form720 quarterly excise tax returns are up-to-date.

12. Identify the excise tax activity letter(s) for which the producer is registered. In particular, find out if they are registered for M, NB and/or AB.

13. If the RINs are separated under 80.1429(b)(2), obtain evidence that at least 20% petro-diesel was blended at the RIN separator's facility or other applicable regulations were met.

14. Request the local, state and federal fuel tax reporting and payments are reconciled with gallons produced than are claimed for RIN purposes.

15. Request receipts and proof that sufficient feedstocks are received to produce the amount of biodiesel for which the RINs are being claimed.

16. Confirm the type of feedstock received. Request quality tests for each incoming load of feedstock for the plants quality control purposes.

17. Attempt to identify if a biodiesel producer is selling RINs for quantities of fuel to two separate RIN purchasers, and could submit the same feedstock purchase records to each of them, thereby concealing the fact that insufficient feedstock had been purchased to account for the total amount of RINs sold.

18. Verify feedstock suppliers have the capacity to provide the feedstocks purchased by the biodiesel producer. Determine this for all feedstocks including methanol, consumables and catalysts.

19. Request the third party engineering report as required by the EPA. The generation of RINs results directly from the manufacture of biodiesel. Biodiesel must precede RINs.

20. Confirm that biodiesel batch records include batch size, quality approval and generation date and that this date pre-dates the RINs for that fuel.

21. Confirm that glycerin stock levels are recorded and that glycerin stocks and shipments/sales are cross-checked with biodiesel production.

22. Certificate of Analysis that shows the facility produces biodiesel that meets ASTM D6751.

23. Confirm that fuel Product Transfer Documents, Bills of Lading & Invoices comply with the requirements and match the designated use and blend records associated with the RINs.

Possible 'Red Flags'

1. RIN Product Transfer documents (PTD) have errors.

2. Brokers offer the producers RINs, however, physical biodiesel from that producer is not offered.
3. The producer or its employees do not have an in-depth understanding of the RFS program and its rules, and in-depth understanding of biodiesel production or they appear to be lacking in general business knowledge.
4. The volume of RINs exceeds the registered 'name plate' capacity of the plant
5. There are market rumors about the producer or RIN seller and validity of those RINs.
6. RIN sales price is excessively under the going market price.
7. When additional information about the production facility, blending procedures or other basic information is denied or not sent when requested.
8. The producer is purchasing luxury items such as airplanes, luxury automobiles, custom motorcycles, boats and jewelry.
9. The RINs under RFS1 were sold in even numbers or always rounded.
10. The documents requested proving production was confirmed to have been sent to several other counterparties.
11. Through the brokerage market, understanding the general level of RINs being offered, otherwise known as general market awareness.

These methods, in aggregate, will generally allow for potential fraud to be identified early. While there is usually no smoking gun, due diligence typical of many industries, is a continuous process. The process of conducting due diligence, examining for red flags and looking for any other cautionary signs must be done prior and subsequent to purchasing fuel or RINs. In the most recent fraud cases, the "red flags" emerged after several months of fraudulent activity took place. A significant problem was that it was allowed to continue for over 12 months after being reported, as was identified and outlined during the hearing. That said, we do believe the industry is more vigilant than ever in conducting due diligence. There will be future cases of fraud, but it is our hope that the collateral damage will be minimized due to the increased awareness and sharing of ideas.

Mr. PAQUIN. I would also like to add, though, to that that even if you do go through that list, there still has to be the affirmative defense on the back side to show that in good faith you have moved forward in an attempt to do the right thing.

Mrs. BLACKBURN. Right. And we understand that.

Mr. Jobe, if you had such a list that was well-defined and industry best practice standards, would that help?

Mr. JOBE. Yes. And our task force developed that list, and we're sharing that with the EPA, and they're working on that.

Mrs. BLACKBURN. Would you share it with us?

Mr. JOBE. Absolutely. And they're working on what's called the quality assurance plan. We're working all together to develop what that would be.

So if I may, you asked about the differences. We said we agree that an affirmative defense, to be able to show your due diligence to defend yourself, that's a fair and reasonable request, and we want to be fair and reasonable and operating in good faith, so we agree with that.

But we have some differences when we get into the details, because the petroleum folks are saying, well, we want the EPA to certify and preapprove third-party validation programs and multiple third-party validation programs, and anything that participates under that will be deemed valid even if it's invalid. So we have concerns about that.

Mrs. BLACKBURN. OK. Anyone want to add any other comment? We have 52 seconds left.

Mr. Paquin, go ahead.

Mr. PAQUIN. Yes, ma'am, thank you.

I think the National Biodiesel Board and the AFPM have done some great work for some of the due diligence process, and the process is moving forward. We can see the timing, however, has taken so long that we're not at a solution yet. That's why I think it's even more important and imperative that the EPA has an interim policy, or they modify their current interim policy, in order to solve issues today so we can save tens of thousands of jobs. If we don't do that now, and we wait for these two to talk and discuss and talk more and then discuss and talk more, we are going to have all of our small producers out of business, and the industry is going to crumble.

Mrs. BLACKBURN. OK. Is the EPA a help or a hindrance in this process?

Mr. DREVNA. In my opinion, Mrs. Blackburn, they have been a referee. They haven't come back at us on anything. They've been working with us, but it's always thrown back at us.

Mrs. BLACKBURN. The slow walk. OK.

Mr. PAQUIN. Ma'am, we view the EPA as a partner. We think that the EPA has the ability to solve this immediately. We just need to use those regulatory measures that they have available.

Mrs. BLACKBURN. Thank you. I yield back.

Mr. TERRY [presiding]. Thank you.

First of all, the gentlelady from Colorado has a request.

Ms. DEGETTE. I move to strike the last word.

Mr. TERRY. The gentlelady is recognized.

Ms. DEGETTE. I just wanted the record to be clear. I thought this was an excellent panel and excellent testimony, kind of clarifying the issues, and I just want my position to be clear, which is I'm not opposed to an affirmative defense. I actually think it's a good idea, so long as we come up with clear requirements on the due diligence. And I think that's what Mr. Paquin and others on this committee are saying.

So I want to thank everybody for their testimony, Mr. Chairman, and I thought it was a really excellent panel.

Mr. TERRY. Thank you.

Does the gentleman from Texas have a request?

Mr. BURGESS. Yes. I have an a unanimous consent request to ask one additional follow-up question of Mr. Jobe.

Mr. TERRY. Is there any objection? Hearing none——

Mr. BURGESS. Mr. Jobe, is this something that could be done administratively at the EPA, or would this require legislative action on the part of the House and Senate and President, which takes a long time?

Mr. JOBE. To answer your question, not a legislative fix, but a combination of what we've come up with in a private-sector solution, and then looking at ways that we can—on a regulatory basis that we can make the program better.

Mr. BURGESS. So the EPA needs to quit slow walking, and you don't need legislative action.

Ms. DEGETTE. I'm going to object to further questions.

Mr. TERRY. OK. Nice try, though.

The gentleman from California, do you have——

Mr. BILBRAY. To strike the last word. One question.

Mr. TERRY. Without objection.

Mr. BILBRAY. Mr. Markey really sparked a concern I have, and I would ask, I guess, Mr. Jobe and the representative of the industry, if the corn crop fails, as some are worried now, and there is not enough ethanol to fulfill the renewable fuel mandate 10 percent, what happens to that domestically produced oil that may not be able to be sold in the United States?

Mr. DREVNA. Congressman, right now we're about at E10. I think there's enough capacity in the ethanol industry to keep it at E10. The question is how expensive is it going to be.

Mr. BILBRAY. OK. So you think we do have a——

Mr. DREVNA. Plus we get imports.

Mr. TERRY. I'm sorry, we're going to keep this to your promised one question.

Mr. Jobe, the gentlelady from Tennessee, you answered that there are some documents regarding your standards, and she asked to you produce those. You have 30 days. We would appreciate that. That would be very helpful.

[The information follows:]

NBB RIN Integrity Task Force

Audit Plan to Assist in Determining RIN Validity:

Categories	Description of activities
1. **Overview:** • **The Audit Process will be a confidential process. The audited party will need the trust and confidence of the party completing the audit.** • **The Audit will cover an Audit of Approved Procedures as approved by the RIN Integrity Task Force.** • **A standard final report will be created.** ○ **A format and determination for the final report will be finalized where the necessary information from the audit would be made available to Obligated Parties, marketers and others who are seeking the information.**	
2. **Physical Plant - Basic Plant Information and Infrastructure**	

• Visit to the facility to:
  ○ Evaluate nameplate capacity of the plant (volume)
  ○ Compare/contrast infrastructure with 3rd Party Engineering Review Reports on file with EPA.
  ○ Evaluate size of biodiesel storage tanks and observe point measurement of volumes in tanks.
  ○ Evaluate size of blending tanks
  ○ Determine whether RFS2 Compliance Reports have been completed and submitted to EPA
  ○ Determine whether most recent Annual RIN Attestation Audits have been completed.
  ▪ As a matter of efficiency, convenience and in an attempt to decrease the cost to producers, if the Annual Attest Engagement Audit has not been completed, then incorporate the RIN Attestation Engagement Audit into this site visit.
	Site visit, plant map, photos, tank farm summary, technology summary, PE report copy, review of CDX registration sheet
	
	Goal is to verify installed plant has technology /capacity to produce / store/ blend biodiesel at registered levels.
	
	Including general audit to insure general compliance with the RFS2 program
	
	The 3rd Party Engineer, in transparent documents, would be made available to information users.

NBB RIN Integrity Task Force

Audit Plan to Assist in Determining RIN Validity:

Categories	Description of activities
▪ The RIN Attestation Audit will be completed by an independent certified auditor or independent CPA pursuant to the regulatory requirements of the RFS2 (see Attachments 1 and 2).	
• Process Rate	Analysis of process rate to determine if process rate is consistent with the annual production of the facility.
• Process Documentation	
• RFS2 Quarterly and Annual Reports	Analysis to insure general compliance with the RFS2 program.
3. Monitoring of Plant Operations	
• Reports: o EIA M22 Survey Monthly o State Reports. Example: California Report – Liquid Terminal Report required by the Board of Equalization • Tax Returns – State and Federal o Includes required information on gallons sold, which can then be compared with RIN Generation information. o Federal Quarterly Returns o State Returns (Monthly) • Association Dues Reports • Monthly RIN Generation Reports submitted through the EMTS system.	Flexibility is important. Already, producers complete a number of reports, including those listed. It is important to maintain an ongoing updated list of all the federal and state reports already required. The producer would be required to provide copies of updated reports, rather than be required to complete new reports. The auditor would analyze copies of each of the reports to determine whether the producer is reporting volumes consistently. It is not necessary to have all of the reports; however, at least two of the five must be available. If the reports are not available, then a satisfactory explanation must accompany the missing report. If there are discrepancies between volumes reported and process rate(Section 2), then the auditor would investigate further to determine the cause.

NBB RIN Integrity Task Force

Audit Plan to Assist in Determining RIN Validity:

Categories	Description of activities
4. Monitoring of Feedstock Purchases, Production and Sales Data - Inputs, Outputs	
• Oil collection operations ○ Feedstock supplier – Purchase Order ○ Sample of oil collection logs ○ Sample of restaurant names (feedstock supplier)	Waste oils: In analyzing oil collection operations it is necessary to determine when the feedstock becomes measurable – for example, when the feedstock is dewatered and clean oil is available to the plant. The waste stream from the "clean up" process should also be measurable. Incoming feedstock reports may not equal gallons produced due to the "clean up" process.
• Glycerin production • Glycerin sales (BOLs) • Biodiesel production • Biodiesel sales (BOLs) • Methanol Used • Feedstock inputs – quantity and receipts ○ Determine quantity of oil used for production.	Summary of total inputs by quarter; conversion ratios for plant and feedstock; summary of outputs by quarter; compare against RIN generation; call random suppliers and customers to verify sales/purchases Goal is to verify mass/energy balance of inputs-outputs/ that actual production happened at levels permitted by plant technology / capacity. Whether the facility is capable of and based on inputs actually generated the RINs it is generating. Note: Integrated facilities may not have internal sales receipts for feedstock usage. Alternative paper trails may be required.
• Energy usage ○ Electric ○ Natural gas ○ Fuel oil ○ Water ○ Waste removal	Energy usage may be able to be calibrated on a facility basis and provide historic validation that production occurred. Note: integrated facilities will likely have energy usage that is not directly related to biofuel production.
Biofuel producers not producing biodiesel will have different co-products, feedstocks, and other inputs, which will lead to parallel lists being created. For example, rather than tracking glycerin production and methanol usage other inputs will be used when producing ethanol, renewable diesel or bio-jet fuels. However, qualifying feedstocks and energy usage will be	

NBB RIN Integrity Task Force

Audit Plan to Assist in Determining RIN Validity:

Categories	Description of activities
consistent attributes for the production of all renewable fuel s.	
5. Verification of RIN Generation and Reporting	
• EMTS RIN gen/activity reports (in excel or XML)and RIN activity summary in PDF	Goal is verify RINs generated match wet gallons sold.
• Production data for each renewable fuel type by month	Compare EMTS RIN generation data and quarterly reported data to production / sales data at plant.
• PTDs for all RIN activities (buy/sell)	
• Feedstock purchase BOLs and whether renewable biomass requirements are met o Note: Integrated facilities may not have BOLs – determine reasonable alternative • Sampling of legitimacy of feedstock suppliers •	Compare EMTS reports, production data and EPA quarterly reports (102, 701 and 801 if applicable). Review random sample of PTDs; review feedstock purchases for renewable biomass verifications.
• Q reports 102, 701, 801	
• Review and incorporate Attestation Engagement Audits	
• Temperature correction formula to determine RIN batch (at Sale or Production?)	Auditor Activities: o Verify the accuracy of the RIN generation reports by obtaining production data for each renewable fuel batch produced or imported during the year and identifying any discrepancies. o Verify the proper number of RINs generated and assigned o Verify equivalency values and whether any non-renewable fuel content

NBB RIN Integrity Task Force

Audit Plan to Assist in Determining RIN Validity:

Categories	Description of activities
6. RIN Separation, Reporting	
• EMTS reports and Q 102	Identify a representative sample of each transaction type included in the RIN transaction reports required for the compliance year, including: RINs purchased, sold and retired. Contracts, invoices and PTDs to verify the type of product sold and the number of RINs transferred If RINs converted from K1 to K2 RINs, then documentation to establish the conversion\separation - What are the possible scenarios? - Small blenders – Upward Delegation - Blending Records if B80 or below - If biodiesel is exported = proof of export BOL Whether producer separates RINs in accordance with the provisions outlined by EPA in 40 CFR 80, Subparts K and M Whether the company has ever had any RINS deemed to be invalid; and a description of the reasons, numbers, timeframe, and remediation
• Who are customers using fuel w/o further blending and what is end use of customers? • Where is the product being blended? • If offering separate RINs, does the company also have attached RINs? • RIN Separation and Reporting is a two part analysis: a. RIN generation and "first party" separation at the facility; and b. whether a producer has acquired separated RINs from other sources. i. If separated RINs have been acquired and not separated by the facility being audited then a process will need to be put into place to determine whether the RINs were validly separated. c. Attestation Engagement Audits should be reviewed for RIN separation activity	

Mr. TERRY. But that concludes the testimony from our first panel. I would agree with the gentlelady from Colorado, I thought each of you were excellent and provided us great insight. A very successful first panel. You leave with our gratitude and thanks for being here today. Thank you.

We'll take a few seconds to let our first panel leave and gather their papers, and then we'll go to our second panel, which includes the main testifier, Mr. Byron Bunker, Acting Director of Compliance Division, Office of Transportation and Air Quality, Office of Air Radiation. He is accompanied by Mr. Phillip Brooks, Director, Air Enforcement Division, Office of Enforcement and Compliance Assurance, U.S. Environmental Protection Agency.

As I understand, Mr. Bunker will be the primary person to testify, and Mr. Brooks will be there to assist if there's a dropped ball or something.

But as you two understand how O&I works, you know that the testimony that you're about to give is subject to Title XVIII, section 1001 of the U.S. Code, so when holding an investigative hearing, this committee has the practice of taking testimony under oath.

Do you have any objections—and since one will be providing assistance to the other, we need both of you to answer the question. Do you have any objections?

Mr. BUNKER. No objection.

Mr. BROOKS. No objection.

Mr. TERRY. All right. Then the chair advises you, if you will stand, that you are under House rules and the rules of the committee. You are entitled to be advised by counsel. Do you desire to be advised by counsel during your testimony here today?

Mr. BUNKER. No.

Mr. BROOKS. No.

Mr. TERRY. No. Both saying no.

In that case, will you please raise your right hand and swear, and I will swear you in.

[Witnesses sworn.]

Mr. TERRY. Both having affirmed.

Chairman, you may sit down, Mr. Bunker. You can go ahead with your 5-minute testimony.

STATEMENTS OF BYRON BUNKER, ACTING DIRECTOR, COMPLIANCE DIVISION, OFFICE OF TRANSPORTATION AND AIR QUALITY, OFFICE OF AIR RADIATION, ENVIRONMENTAL PROTECTION AGENCY, ACCOMPANIED BY PHILLIP BROOKS, DIRECTOR, AIR ENFORCEMENT DIVISION, OFFICE OF ENFORCEMENT AND COMPLIANCE ASSURANCE, ENVIRONMENTAL PROTECTION AGENCY

STATEMENT OF BYRON BUNKER

Mr. BUNKER. Committee members, Ranking Member DeGette——

Mr. TERRY. Is your microphone on?

Mr. BUNKER. Thank you.

Members of the subcommittee, we appreciate the opportunity to appear before you today. I am Byron Bunker from EPA's Office of Transportation and Air Quality, and I will deliver the statement on

behalf of EPA, and both I and Phil Brooks, my colleague from EPA's Office of Enforcement and Compliance Assurance, will be happy to answer your questions.

Biofuels play an important role in reducing our dependence on foreign oil, decreasing greenhouse gas emissions, and improving rural economies. In July 2010, in compliance with the Energy Independence and Security Act, EPA began implementing revisions to the Renewable Fuel Standard Program, commonly called the RFS.

The Energy Independence and Security Act established new annual volume standards for renewable fuel, reaching a total of 36 billion gallons in 2022, including volume standards for new categories of renewable fuel. If EISA's mandate is fully implemented, the RFS program would displace about 7 percent of projected annual gasoline and diesel fuel consumption in 2022. This would decease oil imports by $41.5 billion and provide additional energy security benefits of $2.6 billion. The program is also expected to reduce transportation greenhouse gas emissions equivalent to the emissions from 27 million vehicles per year.

EPA developed the implementing regulations for the RFS program through extensive collaboration with renewable-fuel producers, fuel distributors, petroleum refiners and other parties to ensure that the program would be compatible with the existing fuels market and business practices in that market.

The RFS regulations allow petroleum producers and importers subject to the program known as obligated parties to demonstrate compliance with renewable fuel volume requirements in one of two ways. They can do so either by acquiring the required volumes of renewable fuels together with the renewable fuel credits known as Renewable Identification Numbers, or RINs, or by acquiring the RINs without fuel. EPA instituted these options in response to requests from refiners for flexibility and to implement the statutory provisions for a credit program.

As the committee is aware, EPA is pursuing criminal investigations and civil enforcement proceedings against companies suspected of fraud and of violating the Clean Air Act in connection with the RIN market.

While the focus of EPA's enforcement has been on fraudulent RIN generators, the RFS regulations do not allow invalid RINs to be used for compliance with the renewable volume obligations mandated by the program. Obligated parties are the parties ultimately responsible for ensuring the program's volume requirements are met, even if they comply solely by acquiring RINs. If an obligated party acquires invalid RINs, those RINs cannot be used to demonstrate compliance with the program as this would undermine the requirements established by Congress.

EPA has also instituted an interim enforcement policy to provide a clear message that obligated parties who unknowingly use invalid RINs to meet their compliance obligations, and who timely remove those invalid RINs from their compliance reports, will be offered an opportunity to resolve violations at a very modest and capped amount.

Since the enforcement actions became public, the regulated community has begun to improve its due diligence and acquisition of RINs. In addition, a number of private companies, as you heard in

the first panel, are now offering services designed to verify the validity of RINs for potential purchasers.

EPA has also reached out to the oil industry and biofuel producers to discuss ways to improve the RFS program and RIN validity in particular. All parties in our discussion share a common goal to improve the RFS program in a way that's fair to all parties, and that meets the renewable fuel volume targets envisioned by Congress. EPA believes the discussions so far have resulted in a number of promising options for consideration, including a proposal to establish a third-party verification system to help ensure that RINs are valid.

In closing, EPA understands the seriousness and urgency of the fraudulent RIN issue and has been diligently working with industry to alleviate uncertainties in the renewable fuels market for obligated parties and producers alike. EPA's goal now is the same as it has always been: successful implementation of the RFS established by Congress. We are working closely with affected and interested stakeholders to explore potential options for improving the RFS. We are committed to taking action to make necessary adjustments to the program in a timely manner.

We appreciate the opportunity to testify today. Thank you.

Mr. TERRY. Thank you. We appreciate your testimony here today.

[The prepared statement of Mr. Bunker follows:]

Byron Bunker
Acting Director
Compliance Division
Office of Transportation and Air Quality
Office of Air and Radiation
and
Phillip Brooks
Director
Air Enforcement Division
Office of Civil Enforcement
Office of Enforcement and Compliance Assurance
U.S. Environmental Protection Agency

Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
U.S. House of Representatives
July 11, 2012

Written Statement

Mr. Chairman, Members of the Subcommittee, we appreciate the opportunity to appear today to testify on the EPA's program for renewable transportation fuel.

Biofuels are a critical part of the evolving renewable transportation fuel landscape. As directed by Congress in the Energy Independence and Security Act (EISA) of 2007, the EPA published on March 26, 2010, regulations after public notice and extensive comment to implement revisions to the national renewable fuel standard program, commonly called the RFS program. EISA established new year-by-year specific volume standards for renewable fuel reaching a total of 36 billion gallons by 2022. In addition, EISA established volume standards for new categories of renewable fuel (biomass-based diesel fuel, cellulosic biofuel, and advanced biofuel). The revised statutory requirements include new definitions and criteria for both renewable fuels and the feedstocks used to produce them, including new greenhouse gas emission (GHG) reduction thresholds. The regulatory requirements went into effect on July 1,

2010, and apply to domestic and foreign producers and importers of gasoline and diesel fuel, and renewable fuel used in the United States.

The RFS program will provide both energy security and environmental benefits. The EPA estimated in its 2010 rulemaking that the greater volumes of biofuels required by EISA, if fully implemented, would displace about seven percent of expected annual gasoline and diesel fuel consumption in 2022, decrease oil imports by $41.5 billion, and result in additional energy security benefits of $2.6 billion that relate to reducing risk to the economy from oil supply disruptions. The RFS would also reduce GHG emissions from the transportation sector by an average of 138 million metric tons of carbon dioxide equivalent per year when the program is fully implemented in 2022—equivalent to annual emissions produced by 27 million vehicles.

Since the program's inception, there has been a dramatic increase in the production and use of biodiesel fuel. Production out-paced the volume standards required by EISA for 2011 and is on track to meet or even out-pace the 2012 standard of one billion gallons. The market continues to respond to many elements of this important policy, despite the fraudulent conduct of a few bad actors.

As described in greater detail below, the EPA has initiated and continues to pursue criminal investigations and civil enforcement proceedings against the companies suspected of fraud and violations of the Clean Air Act. At the same time, we have settled with and instituted an interim policy to cap the penalties EPA will require from obligated parties who violated the regulations by using invalid RINs to meet their statutory obligations. The regulated community has already taken steps to improve its due diligence and tracking of renewable identification numbers (RINs), including the creation of at least three programs designed to validate the

authenticity of RINs. The EPA is concurrently discussing with all affected parties additional market and regulatory measures that may be taken to ensure these problems do not recur.

Understanding the statutory basis and history of the RFS program is essential to understanding the agency's recent enforcement actions and how the program might be changed and refined in the future. Congress established the RFS program to reduce the nation's reliance on imported petroleum by requiring that transportation fuel sold in the United States contain a minimum volume of renewable fuel. The statute placed the responsibility of achieving the annual minimum volume requirements on petroleum refiners and importers. The EPA developed implementing regulations through extensive collaboration with renewable fuel producers, fuel distributors, petroleum refiners and others to ensure that the new program would work in concert with the existing fuels market and business practices.

The RFS regulations allow obligated parties – the producers and importers of gasoline or diesel fuel – to demonstrate compliance with renewable fuel volume requirements in one of two ways. Obligated parties can demonstrate compliance either by acquiring the required volumes of renewable fuels together with their associated RINs or by acquiring just the RINs without the associated fuel. The EPA instituted these options in response to requests from refiners for flexibility and to implement the statutory provision for a credit program. The EPA also worked closely with refiners and renewable fuel producers to develop a centralized, electronic data transaction system designed to accommodate the new EISA standards. This new system, the EPA Moderated Transaction System, or "EMTS" supports real time submission of RIN transactions (approximately 20,000 per day).

A key factor in the development of the current RFS program and RIN system is that obligated parties are responsible for ensuring their volume obligations are met even if they

procure no renewable fuel volume themselves and comply solely by acquiring RINs. If an obligated party acquires RINs that are invalid because they don't represent actual fuel or RINs that do not represent the proper fuel type, those RINs cannot be used to demonstrate compliance with the obligated party's annual obligations. The use of invalid RINs would undermine the volume requirements established by Congress, which is why the EPA's Office of Enforcement and Compliance Assurance and the Office of Air and Radiation are working together to address issues regarding fraudulent RINs. By enforcing the renewable fuel standard, the EPA is curtailing fraud and abuse, maintaining a level playing field, and protecting legitimate renewable fuel producers and an important program that benefits all Americans.

As the Committee is aware, the EPA recently investigated and pursued a criminal action against Clean Green and the civil enforcement office has issued Notices of Violation alleging the generation of invalid RINs to two producers of fraudulent RINs, Absolute Fuel in Texas, and Green Diesel in Texas. Other enforcement activities continue. While we are not able to discuss the details of these cases because the release of such information could jeopardize ongoing investigations, we can report that on June 25, 2012, the owner of Clean Green was convicted on 42 counts of violations of the Clean Air Act, wire fraud and money laundering. As a part of the recent criminal prosecution, federal law enforcement authorities have seized approximately $3 million in assets that are believed to represent proceeds of illegal conduct by Clean Green.

While the focus of the EPA's enforcement efforts has been on the parties that actually generated invalid RINs and defrauded purchasers out of significant sums of money, the RFS regulations do not allow invalid RINs for compliance with Renewable Volume Obligations. Buyers and sellers in the market place are under an affirmative obligation to ensure that the credits they use or sell represent real renewable fuel volume. Accordingly, petroleum refiners

and importers are expected to exercise good business judgment and use due diligence when acquiring RINs from third parties.

After the criminal investigation of Clean Green had reached a point where assets had been seized and a public charge had been made, the status of RINs generated by Clean Green had to be addressed. Obligated parties that used the invalid RINs to meet their RFS obligations were in violation of the governing regulations which specifically provide that: "[i]nvalid RINs cannot be used to achieve compliance with the Renewable Volume Obligations (RVO) of an obligated party or exporter, regardless of the party's good faith belief that the RINs were valid at the time they were acquired [40 CFR 80.1431(b)(2)]." As a result, in November 2011, the EPA notified the obligated parties that used those RINs that they were required to adjust their compliance records by removing the invalid RINs from their RVO compliance accounts and ensure sufficient valid RINs are in the accounts by the regulatory deadlines.

After issuance of the notices, the EPA met at least once with every obligated party that used RINs generated by Clean Green as well as biodiesel producers, brokers and traders. Many parties that we met with urged the EPA to ease market uncertainty by promptly providing guidance on the potential civil penalty exposure related to the use of invalid RINs. In March 2012, to expedite a quick resolution of the matter and bring needed stability to the RIN trading market, the EPA offered each involved obligated party a settlement to resolve its potential civil penalty liability for the use of invalid RINs generated by both Clean Green and Absolute. The settlement had two components. First, the parties needed to replace the invalid RINs to satisfy their RVOs at their own expense. Second, although the regulations place the burden on obligated parties to ensure that RINs they use are valid, based upon all the facts and circumstances the EPA offered to resolve violations arising from the use of invalid RINs for 10 cents per RIN, with

a cap on the maximum penalty of $350,000. The settlement policy also provided a mechanism to prevent obligated parties from being price gouged by allowing them to replace 2010 or 2011 RINs with RINs generated in 2012. A cost of 20 cents per RIN was established for this option to encourage the use of the appropriate vintage RINs while allowing the obligated party a price relief option if needed.

The EPA's Office of Enforcement and Compliance Assurance simultaneously issued an Interim Enforcement Response Policy (Enforcement Response Policy) to provide a streamlined approach to, among other things, allow parties who used any invalid RINs generated before 2012 to correct their violations without the EPA commencing a formal enforcement action. As of this time, 31parties have accepted the offer. In the Enforcement Response Policy, the EPA also explained that going forward, it intends to notify the regulated community that it has alleged that RINs are invalid by posting information on its website when the agency has developed what it determines is sufficient proof to warrant a public allegation and determined that such notification will not unduly impair ongoing investigations. We have posted information on our website alleging that Clean Green, Absolute Fuel and Green Diesel have generated invalid RINs.

After the announcement of the recent enforcement actions relating to fraudulent RINs, participants in the biodiesel market undertook substantial new efforts to investigate and otherwise ensure the RINs they acquire represent actual renewable fuel volumes. The EPA is aware of at least three third-party private sector programs that have been developed to help companies involved in the RIN market evaluate the validity of RINs. The agency also has reached out to the oil industry and biodiesel producers to discuss ways to improve the RFS program, and RIN validity in particular. All parties in our discussions share a common goal to improve the RFS program in a way that is fair to all parties, and meets the renewable fuel

volume targets envisioned by the Congress. While the approach to fulfilling this goal is still under consideration, the EPA believes the discussions so far have resulted in a number of promising options for consideration, including a proposal to establish a third party verification system to help industry participants ensure that RINs are valid.

In closing, the EPA understands the seriousness and urgency of the fraudulent RIN issue and has been diligently working with industry to alleviate uncertainties in the renewable fuels market for obligated parties and producers alike. Our goal now is the same as it has always been – successful implementation of the program established by Congress in 2007 under EISA. We are working closely and continuously with industry and other stakeholders to explore all options that could improve implementation of the RFS program. We are committed to taking action to make necessary adjustments to the program in a timely manner.

Mr. TERRY. And at this time the chair recognizes the gentleman from Texas, Mr. Burgess, for 5 minutes.

Mr. BURGESS. I thank the chair for the recognition and thank Mr. Bunker for being here.

You heard the testimony of the first panel, and we really appreciate you sitting in and hearing that, because I think this is an important part of today's activities. I heard you use the words "serious" and "urgent" in your summation, and I will take you at your word that you meant the two words that you spoke.

I guess really the question now that remains after hearing the testimony, and hearing your testimony and the questions and answers from the previous panel, what is it going to take to get the EPA to do what's necessary to make sure this program has integrity, to bless the program, and give an affirmative defense to those people we had at the table today?

Mr. BUNKER. So as I said in the testimony, and as you heard from the panelists in the first panel, we are actively working with all the parties. I think you heard both there is considerable agreement among the parties that and some issues remain to be seen, I think.

Mr. BURGESS. With all due respect, because I know time is limited, their phrase "referee" was used in conjunction with the EPA's activity. Someone else used the term "slow walk." You know, honestly, serious and urgent mean serious and urgent. You got people who are hurting here. The poor lady from San Diego at the end of the table, I mean, she's basically in possession of a nonperforming asset right now. As a small businessman I know what that means. It means you are going broke, and you put your own money on the line, and now you can't sell the product. So that's like having a see-through office building. It is a bad deal, and your cash flow is in serious jeopardy, and you are probably not going to survive for long if that's not fixed.

So serious and urgent, we got to get past the slow walking part. I can't emphasize enough, you got to help these guys now, and it is serious, and it is urgent.

This isn't the biggest program administered by the EPA, it's not the biggest program in the Federal Government, but it's important. And we got real people out there. Mr. Paquin testified that there are 10,000 jobs on the line. I mean, look, wouldn't the President have liked to have another 10,000 jobs a week ago Friday? That's a yes or no question. I'll answer for you: Yes, he would.

How do we get to the point—well, you're right now what? You're operating under what, an interim rule, an interim policy?

Mr. BUNKER. I think we're mixing two pieces. The interim policy is an enforcement policy, but what everyone is talking about is changing the regulations that we put in place in 2007 and 2010. So this would be a new regulatory program. We would make amendments to that proposal.

Mr. BURGESS. How quickly can that be done?

Mr. BUNKER. The goal the industry has is to be ready for the start in January 2013, and I think that's a reasonable goal. But how we accomplish that, all the pieces that have to be done between now and then are great. As you heard from the panel,

there's a lot of work to be done, and I think that's a goal we should work towards.

Mr. BURGESS. Well, with all due respect to the Agency, and I do want you to—I mean, I take that serious and urgent, and I take seriously the fact that you say that this is going to happen. But would the committee be out of line for asking you to—I don't want to take the pedal off the metal on this one. We got to work on this for these guys. So I'm going to suggest you report back to the committee within 90 days on the progress that you're making concerning resolving the problems in the industry.

Mr. BUNKER. I understand the request. Yes.

Mr. BURGESS. Could we have the Office of the Director and the Administrator confirm this action within 14 days' time to the committee?

Mr. BUNKER. I will follow back and ask, yes.

Mr. BURGESS. Will you transmit that request?

Mr. BUNKER. Yes, I will.

Mr. BURGESS. All right.

Mr. Chairman, thank you for your indulgence. I am going to yield back my time.

Mr. TERRY. The gentleman yields back his time.

The gentlewoman from Colorado, Ranking Member DeGette, is recognized for 5 minutes.

Ms. DEGETTE. Thank you, Mr. Chairman.

Mr. Bunker, I think you heard from Mr. Burgess that we're all concerned about these small producers, and I guess in the way that the program has been—the RIN program has been structured, can the EPA require people to buy RINs from the small producers?

Mr. BUNKER. No. There is no mechanism——

Ms. DEGETTE. And that's because it's a market-based system; is that correct?

Mr. BUNKER. That's exactly the case.

Ms. DEGETTE. And so I think what people are saying to us is we need some certainty that these RINs are going to be valid, correct?

Mr. BUNKER. I think it's basically they want to have the same standing as all the producers.

Ms. DEGETTE. Right. But having the same standing as all the producers would mean there's some certain level of certainty that the RINs are OK, right?

Mr. BUNKER. That's exactly correct.

Ms. DEGETTE. And the EPA's credit-trading program has been a buyer beware program from the beginning. Everybody that participated knew that that was the construction of it, correct?

Mr. BUNKER. It was clear from the start, yes.

Ms. DEGETTE. Now, has the EPA ever certified and validated the credits bought and sold in the RIN market?

Mr. BUNKER. The Agency has not.

Ms. DEGETTE. The program's not set up that way; is that right?

Mr. BUNKER. That is correct.

Ms. DEGETTE. So if we wanted to set it up so that the EPA was certifying certain RIN providers, that would require a whole 'nother program to be established within the EPA; is that correct?

Mr. BUNKER. And different oversight and a number of other aspects would be different.

Ms. DEGETTE. Different oversight. And it would really be going away from the market-based solution that we're trying to achieve; is that right?

Mr. BUNKER. We would be picking the winners and losers, I think.

Ms. DEGETTE. You'd be picking which people did it, and it would be a whole new program. And it would give certainty, but it would be taking that more into a government program and away from a market-based program; is that right?

Mr. BUNKER. I think that's an accurate characterization.

Ms. DEGETTE. OK. Now, I want to know if the EPA has ever represented to people that they intended to certify or validate any credits that were bought and sold in the RIN market?

Mr. BUNKER. Not to my knowledge.

Ms. DEGETTE. OK. Now, here's a really valid question that I thought was raised, though, in the last panel, which is even though it's a buyer beware system, people are upset that after this fraud was discovered, the EPA waited a year to let people know. Why did the EPA wait a year to let people know?

Mr. BUNKER. Maybe I should have explained before. The reason we have the two panelists is Mr. Brooks is from our enforcement office.

Ms. DEGETTE. Oh, good. Maybe Mr. Brooks can tell us why the EPA waited a year.

Mr. BROOKS. Yes, Congresswoman.

The time lapse from the initial discovery, we got a tip, we sent inspectors out, we had to follow up on some information. And what we did was we brought in the criminal prosecutors, because it was obvious to us that we weren't dealing with the run-of-the-mill kind of civil enforcement issue that my shop handles.

So we brought in the criminal specialists. They brought in the Department of Justice. And at that point Criminal takes the lead when there are concerns about flight risk, destruction of evidence and seizure of assets. So in this case all of those things were at play, and the Criminal Division took the lead.

Ms. DEGETTE. So there was a criminal investigation going on, and it's your testimony that it took a year to secure the evidence they needed so that they could then do their prosecution; is that correct?

Mr. BROOKS. Well, what I understand from this is, of course, what the Criminal Division tells us, and they asked us to hold off. And we acted as soon as they said——

Ms. DEGETTE. So you held off because the Criminal Division told you to hold off; is that correct?

Mr. BROOKS. Yes.

Ms. DEGETTE. OK. So I'm trying to ask simple questions here, because I think it's a valid concern that people have.

Mr. BROOKS. Yes.

Ms. DEGETTE. Now, there's been a lot of discussion about this affirmative defense, and my first question is, Mr. Bunker, what do you think of the idea if there was a—if you and the industry agreed on a due diligence process, if they checked all those boxes, would your Agency object to an affirmative defense then?

Mr. BUNKER. I don't want to prejudge any outcome, but it's plainly one of the pieces that's fully in front of everyone and being robustly discussed. So I don't want to imply I know the outcome from that, but it seems clear——

Ms. DEGETTE. But it's on the table, it's one of the things on the table?

Mr. BUNKER. Very much so, yes.

Ms. DEGETTE. And that's my next question is does the Agency have the legal authority through rulemaking to establish an affirmative defense, or do you need congressional legislative action to do that?

Mr. BUNKER. No. We think the existing authority we have under the act allows us to do so.

Ms. DEGETTE. That's good to hear. Thank you very much.

Mr. TERRY. Thank you. Good questions.

We'll go to—next on the list would be the gentleman from California Mr. Bilbray.

Mr. BILBRAY. Mr. Bunker, I think you and everybody else that's required to enforce either a law or regulation understands that when the Legislature passes a law, there's always the assumption of discretionary enforcement. There's always the assumption that an intelligent way of applying the regulation or law will be the mode used. Maybe that's a big mistake we make. But my concern here is talking about one of the victims in the process, and that is the person who has purchased with good faith a bogus product.

My concern is that, and let's be very frank about that, the Agency has a burden to bear here because of recent history. I'd like to think that you're not going—you're not addressing the concerns of the people who were purchasing bogus products and actually victimizing them again with an attitude of we can't let anybody slip through because somebody might take advantage of the system.

To be blunt with you, I'm concerned that there might be a mindset of let's crucify one guy on the front gate, and anybody who would try to buy these bogus things purposely will be scared to death.

My question really is how can you not reflect to these victims that we knew a year ago that you were probably purchasing bogus, but because our prosecution system needed to work through 12 months, we see you as somebody that should not have enforcement or should not be denied what you legally with good intention purchased?

Do you follow what I am saying is that you knew these certain consumers probably were doing this in good faith. You've got an investigation, and that's totally understandable that you've got to hold off a year until everything wraps. But doesn't that give you an obligation to go back and cut some slack for the people that you knew were purchasing at the time you were doing the investigation?

Mr. BROOKS. Should I answer that question?

Mr. BILBRAY. Yes.

Mr. BROOKS. I think you're absolutely right, and that's what we did. When we sent out the Notice of Violation, we sent it out and said, you——

Mr. TERRY. Can you pull your mike closer to you?

Mr. BROOKS. When we sent out the Notice of Violation, what we told folks was you need to correct your accounts, you need to remove the invalid RINs because they're invalid, you can't use them for compliance. We didn't make a penalty demand. Instead what we did was we met with everybody. We met with every single one of these guys, and we talked about the circumstances. And what we learned was is that the vast majority had not done any due diligence.

Now, I'm not pointing fingers at them, but they didn't. They had a different business plan, they thought that was good enough, but they didn't do what was required.

Mr. BILBRAY. Mr. Brooks, let me just say this. If you're investigating a counterfeiter, and you know he's producing it for a year, but because for the good of the general public you allow the $100 bills to continue to go out, and people in good faith invest their life savings in money that's not worth a cent, don't you think there's a little bit of obligation of the general public that is getting the general good of that year delay to go back and say, "We'll hold you harmless for this because we knew about it, and this was a sacrifice all of us should bear, not just you"?

Do you follow what I am saying is that you're actually sitting there telling somebody that you're just a victim of not only the bogus operation, but you're a victim of our process, and we're not going to make you whole or not even going to mitigate it.

Mr. BROOKS. Congressman, I think that what you're saying makes sense. I think it's what we did. The feedback that we got from the obligated parties was that they thought that we were being reasonable. We came up with a penalty structure that instead of $37,500 per day per violation was 10 cents a RIN. So we had some guys that paid 440 bucks.

Mr. BILBRAY. But that is like saying that the people that are a victim of counterfeit isn't going to be prosecuted as counterfeiters when the fact is they're losing value down the line. So I appreciate the fact that you've gone there, but I am worried. And let's be really frank about it. The Agency has a responsibility that you do not have the mentality of crucifying people that may not be too guilty, but you've got to make your point. And I think you have a greater obligation than a lot of other agencies right now to show you're trying to be cooperative and understanding.

And for the record, I hope my wife was watching this hearing, because it's the one time she'll ever hear somebody say that I had a good point. So thank you very much.

I yield back.

Mr. TERRY. That's probably a true statement.

The gentleman from Texas Mr. Green is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and I don't know how to follow my friend from San Diego. But I appreciate you being here.

Mr. Bunker, it is my understanding a series of meetings has been taking place with representatives of the biodiesel producers, refinery sector, blenders, advanced biofuel producers and potential RIN validators. I've also heard these negotiations yielded to an agreement on several points: One, a solution to the RIN fraud issue in the form of a rulemaking is appropriate; two, a more robust cer-

tification and validation program for biodiesel RIN producers is called for; and, three, a participation in such a program that would allow the EPA to shift from a strict liability to an affirmative defense that could be asserted by an obligated party.

I'm glad to hear EPA is working with the stakeholders to expeditiously fix the problem, and I've been monitoring the issue. You know, Congress can pass a law. It would be much better if everybody sat down and worked on it, because I don't know if we can do something by the end of December of this year.

I just want to update—get an update on where the process is. Do you think the negotiations can be finished by the end of this year and something in place from the EPA?

Mr. BUNKER. So I think you're very well informed on where we are and kind of the context of those. I think that's a fair and accurate condition that we're in. And we certainly are working towards that goal of having something that can work for the 2013 year. Whether it's totally finished by then or we have a process that accommodates that, I don't know how we accomplish that goal, but I think that's a reasonable goal that we can work toward.

Mr. GREEN. OK. Can EPA actually decide now to provide an affirmative defense for a purchaser? Do you have the authority to do that?

Mr. BUNKER. Sir, we have the authority. I think it will take a rulemaking process to change our regulations. I don't think we can do that with another administrative process, but I think we can do it through rulemaking.

Mr. GREEN. OK. Believe me, if Congress tells EPA to do it, it would be much quicker if you did it on your own instead of us passing legislation.

Conceptually the EPA would commit to providing a legal defense that companies that unknowingly purchased RINs and submit compliance, fraudulent RINs. I recognize you feel that depends on due diligence. Would the EPA commit to approving some form of criteria that would constitute due diligence for obligated parties?

Mr. BUNKER. That's very, very much on the table, and I think it's in front of everyone to figure out what role each party plays in this process. I think the first panel really did a good job of characterizing the breadth of interests here, and I think we have to find a way for each party to play their role in that. And that's what we're working through.

Mr. GREEN. And again, we know we have a timeline, the end of this year, before we get into 2013. EPA considered increasing verification requirements for biofuels RIN generators to ensure the integrity of the marketplace. Have you done that?

Mr. BUNKER. I think largely that's been done through third parties that are into the market now and providing that service to make a more frequent process than the EPA process.

Mr. GREEN. OK. Does that include a physical independent audit to verify that RIN generators produced the biofuels they claim?

Mr. BUNKER. Most of them are doing it by some kind of monitoring or by visiting facilities and an audit function, as you described.

Mr. GREEN. I know my colleagues already talked about the Clean Green Fuels, visiting Clean Green Fuels in July of 2010, and it

took a good amount of time. And I appreciate your response on why the investigation and action didn't go forward because of the criminal prosecution. But weren't the companies that purchased those false RINs fined and also told they had to go buy more, you know, RINs?

Mr. BROOKS. Yes, Congressman. Do you want me to answer that?

Mr. GREEN. Yes.

Mr. BROOKS. Yes. Thank you.

There are two aspects to that. Did they have to replace the RINs? Yes, because they were invalid, so they couldn't use them, and that's what the regs say.

And the second aspect is did they pay a penalty. And, yes, the regulations placed an affirmative obligation. Unlike, say, counterfeit currency where you're just out the value of the money, this system has an affirmative obligation on the obligated parties so that we can meet the congressional mandate. It's basically the "skin in the game" kind of aspect that says they're going to be careful with what they do and use only valid RINs.

But in light of all the circumstances, as have been pointed out here, we talked to them, and we came up with what we thought was a fair penalty, and obviously they thought so, too, because we resolved the issue.

Mr. GREEN. Well, I would encourage you to work on getting those negotiations and the rulemaking started before we get into the fall, knowing the problems we'll have, because it's really important. Some of us would not have voted for this legislation if it hadn't have been for the first time in 30 years we could vote to increase CAFE standards. And it seemed like some of those compromises we have to make here may be coming back and biting us, particularly in this situation.

Mr. Chairman, thank you.

Mr. TERRY. Thank you, Mr. Green.

The gentlelady from Tennessee is recognized for 5 minutes.

Mrs. BLACKBURN. Thank you, Mr. Chairman, and thank you for staying with us for the hearing.

Mr. Brooks, I got to tell you, when I hear you talk about the penalty, I think about these individuals that were on that first panel. You know, when they hear you say this, basically what they're hearing is you can tell people what you're going to do to them; it's just you can't tell them what they need to do. And I think you've got things backwards. And you focused on the penalty, but getting the due diligence piece right and letting them know exactly what to do, what compliance looks like, is where you guys are dropping the ball.

Now, from the first panel we heard Mr. Jobe and Mr. Drevna and Mr. Paquin talk about they can define due diligence. They've got a list of what would be industry best practice standards and review. They're waiting on you to sign off on this, to take an action. They defined your participation basically as being a referee. You've heard frustrations with slow walking.

So, how long is it going to take you to sign off on an accepted industry standard of best practices; how long is it going to take you to do that to provide some guidance?

Mr. BUNKER. Thank you. If you don't mind, I'll answer that. That's sort of my responsibility for delivering that piece. There's a couple of pieces I would like to speak to.

I think there is a broad understanding in industry for how the due diligence could be done. As you said, several parties have brought forward ideas. I think they've shared them with this committee. They've certainly shared them with the Agency.

The part that we are in, I am not going to say it is inaccurate to say we are a referee at this point. Many of the parties have different views of how each of them fit into that due diligence work. They agree what work needs to be done, but what role each party in the chain plays in that is an important question for all of those parties, and, of course, for the Agency. So we're working to understand the pros and cons, the trade-offs that come from——

Mrs. BLACKBURN. Mr. Bunker, please. You know, how long? I mean, they've talked about your slow walking. We're talking about a deadline coming up. How long is it going to take? Do you need 2 weeks? Do you need 30 days? How long is this going to take to make a decision? Somebody's got to bring some leadership to bear at some point.

Mr. BUNKER. That's a very fair question, and I appreciate that.

This group, the stakeholders, basically the parties that you heard from, they came to the Agency and proposed some kind of concept to start this work in June '12. That was the first time they came in with this kind of proposal. So in less than a month, it's mushroomed into a very productive, very useful dialogue to move this forward. So I don't think it's accurate to call it slow walking.

I do think the goal of having something for the 2013 year is a good goal and one we can work towards.

Mrs. BLACKBURN. Are you going to meet the deadline?

Mr. BUNKER. I think there's too many variables for me to give it a firm deadline.

Mrs. BLACKBURN. Let me ask you this. I am going to run out of time, and I'm trying to be sensitive to that. The interim enforcement policy that you have, why don't you adjust that so that the actions of the bad actors are not going to negatively impact your small businesses and smaller participants in the marketplace? As you're focused on the long term, and Dr. Burgess talked with you about that, why don't you go in here and make an adjustment to your interim enforcement policy?

Mr. BROOKS. Thank you.

We're engaged in a conversation right now that I think informs how we think about enforcement, but there are—some of the requests are not as transparent as they might seem. A lot of the requests are for forgiveness of what the law required, say, for 2010, 2011 RINs that were invalid.

The concern that we're trying to focus on right now is what can we do to help the system so that the folks who are actually producing the fuel out there have an opportunity to sell this stuff? And it apparently depends on confidence. And that's why I've spent a lot of time talking with the National Biodiesel Board and producers and a lot of these other folks about what is it that can be done so that there is enough comfort out there. It's really the comfort of the obligated parties that's the focus of this.

Now, they know that if they went through these kind of processes, they don't have to worry about whether they get hit for penalties, because they know that—you know, they talk to their best lawyers in the country, right, and the best lawyers in the country will tell them, look, if you've gone through a system like this, EPA is not going to bother with you about whether you have done due diligence. You clearly have. So they can solve that problem.

But really, I think, the focus is on the future here, on how it is that we can make sure that we've got a level playing field so that the small producers have the same opportunity to sell as the big guys.

Mrs. BLACKBURN. Well, what you're going to see happen is that your small guys are out of business, and you only have a few producers. Maybe that's what your goal is, I don't know.

I yield back.

Mr. TERRY. All right. Thank you.

At this point the gentleman from West Virginia.

Mr. GRIFFITH. Western Virginia.

Mr. TERRY. Southern Virginia—western Virginia.

Mr. GRIFFITH. Thank you, sir. Thank you, Mr. Chairman.

There may be different shades to what you're hearing here today, but I think both Democrats and Republicans want to get this problem solved. I'm a little frustrated, and I will always be frustrated with Washington, at least I hope I will be, because having come out of the Virginia Legislature, we could deal with all kinds of problems in 60 days and go home. Dr. Burgess asked you all to deal with this problem, see if you could deal with it in 90 days and go home.

This first panel indicated by and large they need an answer. They're willing to work with you, you know. And you may be missing it a little bit when you say that, you know, they seemed to be happy. One, you're dealing with the end product users and not the people who are trying to sell the RINs. Two, you know, if you have the right to cut off both their right and their left hand, and you only cut off their right hand, they may be happy you didn't take the left hand, or vice versa, but they're still not real happy about it.

You know, you all need to come up with a fix for this. There's a problem. Nobody wants to scrap this program. I haven't heard that from at least any of the folks up here. That's not the issue. The issue is how do we make it fair for everybody. And, unfortunately, based on what I've heard from the testimony today and yesterday, I'm not sure some of these companies will make it to January of next year.

And I got to tell you, you know, things like what is due diligence and that kind of stuff, you know, come by the office this afternoon, and we'll figure that out. I mean, we ought to be able to put that definition down in a few hours. I don't understand why it takes the Federal Government so long to come up with simple things when you have a couple hundred years of case law out there. And I understand the EPA is different and doesn't have that length of history, but, you know, you can borrow from other people.

So I ask you to do that, and I ask you to get back to Dr. Burgess and let him know within 14 days or let this committee know within

14 days if you can do that in 90 days, because I just don't know that these folks can make it.

It's interesting, and I've only been doing this—I'm one of the freshmen, and I've only been doing this a little while compared to some of the other folks, but when you see people from the panel before stay and the panel from yesterday show up to hear what's going on, this is a big issue to them. And some of these companies won't survive if you all don't fix it.

You have the power to fix it. If you need our help, I think I speak for everybody on this committee, we're happy to help you. If you think you need a change in the code, bring it to us, we'll make that change. And we can get it done, I hope—I don't know about the Senate, but we can get it done in a relatively reasonable period of time.

So I ask you to do that, because I think you are just glossing over when the companies that bought the end product are happy, clearly the companies that are making it aren't, when they are doing the legitimate thing, and it really does strike against the American sense of fairness when you know that there's a bad actor out there, and you let people go get harmed and let their businesses be put in jeopardy.

So I don't really have any questions. I do appreciate you all being here. And I do appreciate, very much so, that you all came to hear the first panel. But they seemed like reasonable people to me that you all ought to be able to get this thing worked out on. And I think everybody would agree that if you make a little mistake to correct the big problems that we've had, we can fix that easier if we have to do that next year.

Sometimes you just have to act. You can't always be 100 percent certain that that act is going to be perfect. But if you fix 95 percent of the problem, I think these folks would be happy.

Mr. Chairman, if anybody wants the rest of my time?

Ms. DEGETTE. I do.

Mr. TERRY. Yes, the gentlelady from Colorado.

Mr. GRIFFITH. I yield to the gentlelady from Colorado.

Ms. DEGETTE. Thank you so much, Mr. Griffith.

I just have a quick question for you, Mr. Brooks, because the law says that it's a strict liability standard if there's fraudulent RINs, correct?

Mr. BROOKS. Yes, Congresswoman.

Ms. DEGETTE. But yet I think I heard you say the EPA has enforcement discretion—if someone is using these invalid or fraudulent RINs unknowingly, or knowingly, they have discretion about what the enforcement is; is that right?

Mr. BROOKS. We have inherent discretion.

Ms. DEGETTE. You have discretion, so you can throw the book at them, or you cannot take an action at all; is that right?

Mr. BROOKS. I think there are parameters. Obviously there are congressional goals that we have to adhere to. There are some hard edges on the regulations. But essentially you're right.

Ms. DEGETTE. All right. So you had said that the Agency decided with the people who were using the invalid RINs that to go ahead with a penalty, but not as strict a penalty as you could have, right?

Mr. BROOKS. That is correct.

Ms. DEGETTE. And something piqued my interest. You said that was because they hadn't done due diligence.

Mr. BROOKS. That's correct.

Ms. DEGETTE. Can you explain what you found in terms of the due diligence by the companies?

Mr. BROOKS. I could sum it up this way: The vast majority of the players had simply relied on their contract of purchase, and so they had an indemnity agreement, right? And so rather than ask, "Are these good RINs?," they were satisfied with the purchase document that said, "If they're not good RINs, I'm coming back to you."

Ms. DEGETTE. And they're not doing that anymore, are they?

Mr. BROOKS. They are not to my knowledge.

Ms. DEGETTE. Thank you.

Mr. TERRY. Thank you.

The gentleman's time from western Virginia has ceased, and I recognize myself for 5 minutes.

So in that regard, carrying on Diana's questions, what is the current definition of due diligence, and is that part of what is going to be worked on in the next few months?

Mr. Bunker?

Mr. BUNKER. Yes. I think broadly it's understood it's a process to both look at the facility and look at both the feedstock that goes into a facility and the production that goes out, and if you do effectively a mass balance, an energy balance, a waste products balance, that you can have high confidence those volumes exist.

And I think actually to the question that was asked before, I think getting that resolved among the parties, what are good parameters, that's actually the easy part. It's each party's role then in fulfilling those that where there is differences of opinion among the industry partners.

Mr. TERRY. And that will be part of the process that you engage in in the next few months to make sure that that is more clearly set out in the language, and they know their obligations.

Mr. BUNKER. Exactly. That's the most important piece.

Mr. TERRY. In that respect I think it was Mr. Jobe from the biodiesel board or biofuels board—biodiesel board—that mentioned that they have already drafted their industry standards in this respect. Have you seen those yet?

Mr. BUNKER. Yes. We both participated in this RIN Integrity Task Force that was described, and they've shared both their phase 1 and phase 2 programs. We think those are good programs, and there are several others in the industry that are similarly structured, different approaches in some cases. All seem very good, frankly.

Mr. TERRY. Well, will those type of industry standards then be adopted at the completion of your efforts, or at least the negotiated language changes?

Mr. BUNKER. Yes, I think that's the big question. I think it's generally assumed that we should leverage those third-party systems; don't create a new government system that is one size fits all, but let the market choose the participants that—basically mitigate risk in a way that satisfies people that are at risk. That seems to be everyone's goal.

So you heard there were some people that think that should be fully in the private sector and not be part of the government at all, and some people that frankly think it needs to be basically leveraged in the regulations. And that's what we're working through quickly is to figure out the how.

Mr. TERRY. Well, we appreciate you working quickly. I think one of the messages that you've heard from this panel here today or the Members sitting up here is that this is a time-sensitive matter. And we go do agree with the January 1st, 2013, goal.

So in that regard could you walk us through what procedures, what work really has to be done between now and January 1st so that we've got that document of here's the rules or whatever technical language you want to use?

Mr. BUNKER. Yes. So we will have to go through a notice and a proposal process, a public comment, and then a final action. I think what's still open——

Mr. TERRY. What's the timeline in between each one of those. Don't those have 30- and 60-day requirements?

Mr. BUNKER. So the minimum requirement, I think, after it's in the Federal Register is at least 30 days. I can check the numbers. And we usually have to give a 30-day period for comments. And when you add all those pieces up, it may not be possible to have a final action in advance of January 1. I don't know if that can happen. But it may well be that we can have the system in place.

One thing we should think about is the actual compliance for 2013 will be February of 2014. So the Agency has a very clear message of what you need to do, what the process is. And everyone starts doing that process maybe January 1, maybe in December, and then we have a final action that decides what's the outcome of having done that process. They will have already fulfilled the elements of the work that is done up front.

So it's my belief we could have a process that both follows our regulatory process in the fullness of a notice and comment, but also gives some path to people to implement early by being transparent about where it's going.

Mr. TERRY. And I think you've stated it, but I want it more clearly as your final comment here, and we close, but you understand, the Division understands, that inaction right now is hurting the small producers. Would you agree with that?

Mr. BUNKER. We absolutely do. We said that's a big issue for us, absolutely.

Mr. TERRY. Very good. Then not a question, but a comment. Mr. Burgess, Dr. Burgess, mentioned 90 days to have something ready for us, kind of, I would assume, just at least the skeleton. But Diana, the ranking member, and our side are discussing having a second hearing about that 90-day period, because we want to make sure this stays on track. So it is important to us.

Mr. BUNKER. I understand.

Mr. TERRY. She said 120 days. We'll figure that out. That's part of our negotiations.

So at this time I ask unanimous consent to enter into the record our subcommittee binder.

[The information appears at the conclusion of the hearing.]

Mr. TERRY. In conclusion, I would like to thank our two witnesses here today. Both of you were very helpful. I remind Members that they have 10 business days to submit questions for the record, and I ask that the witnesses agree to respond promptly to those questions, if submitted.

All right. Thank you. The subcommittee is now adjourned.

[Whereupon, at 12:51 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

Opening Statement of the Honorable Fred Upton
Subcommittee on Oversight and Investigations
Hearing on "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program"
July 11, 2012
(As Prepared for Delivery)

In February of this year, this committee opened an investigation into EPA's handling of fraud under the Renewable Fuel Standard program. Specifically, we sought more information about EPA's discovery that a substantial number of tradable credits for renewable fuels – RINs – have been fraudulently created and sold. Fraud in the RIN market jeopardizes the underlying integrity of the RFS program. Regardless of how one views that program, the EPA and this committee have a responsibility in its working.

Since the initial information request to EPA, the agency has publicly identified another 108 million fake credits – that's four times more than EPA's original accounting. While RIN fraud may not be leading the nightly newscasts, it is a serious problem that ultimately costs consumers money and threatens jobs.

While it is EPA's contention that the most egregious fraud appears to have been discovered, this misses the point. Was the agency negligent in its oversight and management of this aspect of the RFS program from the outset? What is the agency doing today to make sure that this never happens again and that the RINS market functions properly? Finally, and perhaps most importantly, is this unfortunate situation a symptom of a larger problem – the government's inherent inability to intervene in, and successfully manage markets?

I look forward to testimony this morning that will help us clearly identify the risks of additional fraud and get a better understanding of how EPA has managed these troubling developments. Our aggressive oversight on behalf of American taxpayers will continue, because no matter what the market, fraud and abuse have serious consequences and will not be tolerated.

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FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States
House of Representatives
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WASHINGTON, DC 20515–6115

Majority (202) 225–2927
Minority (202) 225–3641

August 6, 2012

Ms. Jennifer Case
Co-Founder and CEO
New Leaf Biofuel
2285 Newton Avenue
San Diego, CA 92113

Dear Ms. Case :

Thank you for appearing before the Subcommittee on Oversight and Investigations on Wednesday, July 11, 2012, to testify at the hearing entitled "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for 10 business days to permit Members to submit additional questions to witnesses, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and then (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Monday, August 20, 2012. Your responses should be e-mailed to the Legislative Clerk, in Word or PDF format, at Nick.Abraham@mail.house.gov.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Cliff Stearns
Chairman
Subcommittee on Oversight and Investigations

cc: The Honorable Diana DeGette, Ranking Member,
Subcommittee on Oversight and Investigations

Attachment

Question from The Honorable Cliff Stearns:

As you have had time to reflect on your hearing testimony, do you have anything you wish to clarify or to elaborate relating to your testimony or in response to issues discussed at the hearing?

Answer:

1) Quantification of Losses: At one point, one of the Honorable Members of Congress asked me if New Leaf was able to quantify the monetary losses stemming from the fraud in the RINS Market. This is what I have come up with:

New Leaf produces about 2 million gallons of biodiesel per year, which means we produce 3 million RINS. Prior to the RIN fraud, New Leaf would typically be offered a penny or two less than the market price of RINS. This price differential accounted for the fact that the brokers would have to pool credits from small plants in order to sell larger blocks to obligated parties for the market price, and the brokers would take a cut of a penny or so.

Today's RIN value is approximately $1.15. Last year, New Leaf would likely have been offered 1.13. Since the fraud, small producers like New Leaf have been discriminated against. So for the past 6 months, New Leaf has been offered between .12 and .15 below the market price. Using 1.15 as the market value again, New Leaf would be offered $1.00 per RIN today.

At 3 million RINS per year, the .13 per RIN differential equates to a **$390,000 loss.** In addition, small producers are now being asked to hire auditors to certify their RINS, at a cost of approximately $3500 per quarter or $14,000 per year.

So New Leaf's estimated loss from RIN fraud this year is $404,000. This value is the low estimate because it does not take into account that prior to the RIN fraud, RIN values were significantly higher. (September 2011, New Leaf sold RINS for 1.64 each, whereas today, the market value is about $1.15)

2) Regulatory Action, not Legislative Action

I think it was pretty clear during the hearing, but I'd like to repeat that everyone on the panel, including the representative from the petroleum industry and the EPA, agreed that the improvements to the RFS to reduce potential for fraud can be, and should be, handled by the regulatory process as opposed to the Legislative process. I hope that this Committee understands that the EPA has the ability through regulatory action to define the obligated parties' due diligence requirement. Legislative Action is not necessary, nor is it prudent, for this volatile industry.

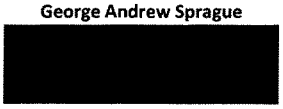
3) Continued Improvement

Finally, I would like to keep the Committee updated on the industry's efforts to bring integrity to the market. As I explained in my testimony, after the fraud, many of my fuel distributors were unable to move New Leaf RINS. Just in the past few weeks, many of these customers have started accepting New Leaf RINS again. This is fantastic for New Leaf, and it is proof that market forces are working. The

Obligated Parties are performing due diligence, and my plant has been subject to a number of audits. I think there is still room for some improvement, but we are certainly headed in the right direction. Thank you for your time.

August 20, 2012

George Andrew Sprague



Union County Biodiesel Company, LLC
5700 Prospect Drive
Newburgh, IN 47630
812-842-2960

Midwest Biodiesel Products, LLC
7350 State Route 111
South Roxana, IL 62087
618-254-2920

CONGRESS OF THE UNITED STATES
House of Representatives
Committee on Energy and Commerce
2125 Rayburn House Office Building
Washington, DC 20515-6115

The Honorable Cliff Stearns, Chairman
Subcommittee on Oversight and Investigation
Hearing: "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

Dear Mr. Stearns,

This letter is in response to your request for follow-up questions to my July 11, 2012 testimony before your Subcommittee. First, let me thank you and the Subcommittee for the invitation and the opportunity to testify. It was a memorable experience and I sincerely hope my testimony will help contribute to a positive outcome of your hearings. I also want to thank all of the Members for their concern in addressing RIN fraud in the biodiesel industry and specifically how it is affecting the future of small biodiesel producers. My additional comments are as follows:

I would like to further state to original testimony that small biodiesel producer RIN transactions with obligated parties are just as valid as the RIN transactions of large biodiesel producers. However, within today's RIN markets the valve of RINs from the small biodiesel producers has a lower value than the identical RINs from a large biodiesel producer. The EPA and the Subcommittee must find a method to ensure that a valid and properly produced RIN is treated like all other RINs, "a RIN is a RIN" regardless of whether or not it comes from a large biodiesel producer or a small biodiesel producer.

An independent, Third Party Validation program will create a more transparent system. However, it must be understood that criminals will not mimic the past in future fraud scenarios. Expenses incurred with these validations will be predominantly born by the producers. The testimony of several on the panel illustrated that fraud is occurring downstream from the producer, primarily at the distribution,

blending and retail levels. Future control systems to prevent fraud and improper handling of RINs must take into account these other methods and opportunities for fraud to occur. If the EPA and the Subcommittee does not address the opportunities for fraud to happen downstream from the biodiesel producer, the corrective actions employed will not ultimately protect the biodiesel industry and the RIN program.

One way to ensure there is very little opportunity for RIN fraud to take place is to only allow RIN separation to take place at the time the biodiesel is blended at the retail, final sale level. This type of control would ensure the "Strip and Ship" as well as the "Splash and Separate" methods of illegal RIN separation would be eliminated.

Changing the obligate parties RIN obligations from a two year obligation to a monthly or quarterly obligation will bring stability to the biodiesel and RIN markets. Currently, the obligated parties can combine RIN over a two year period to meet their EPA obligation. If that same obligation was required to be met on monthly or quarterly basis, the biodiesel industry would have a more stable market place and the small biodiesel producers would have a better opportunity at success within this stabilized market.

Finally, an "Affirmative Defense" should protect both buyer and seller when operating within an EPA Registered Validation program. The EPA must immediately provide guidance on the standards for the Third Party Validation program standards for the biodiesel industry. Every day that goes by that the EPA fails to release this guidance puts the small biodiesel producers at further risk of being put out of business. The large biodiesel producers and the obligated parties currently have the upper hand in the RIN markets and are successfully driving the small biodiesel producers out of business.

If there is another opportunity to testify before the Subcommittee, I will be glad to offer my insight. Please encourage the EPA to act as swiftly as possible since the small biodiesel producers are at great risk.

Sincerely,

George Andrew Sprague

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States
House of Representatives
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WASHINGTON, DC 20515–6115

Majority (202) 225–2927
Minority (202) 225–3641

August 6, 2012

Mr. Tom Paquin
President
VicNRG, LLC.
1670 Keller Parkway
Suites 246 & 247
Keller, TX 76248

Dear Mr. Paquin:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Wednesday, July 11, 2012, to testify at the hearing entitled "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for 10 business days to permit Members to submit additional questions to witnesses, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and then (3) your answer to that question in plain text.

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Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Cliff Stearns
Chairman
Subcommittee on Oversight and Investigations

cc: The Honorable Diana DeGette, Ranking Member,
Subcommittee on Oversight and Investigations

Attachment

The Honorable Cliff Stearns

1. As you have had time to reflect on your hearing testimony, do you have anything you wish to clarify or to elaborate relating to your testimony or in response to issues discussed at the hearing?

SUPPLEMENT TO THE TESTIMONEY PROVIDED ON JULY11, 2012 FOR
Committee on Energy and Commerce
The Subcommittee on Oversight and Investigations
UNITED STATES HOUSE OF REPRESENTATIVES
RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program
Thomas Paquin
President, VicNRG, LLC
August 20, 2012

Chairman Stearns,

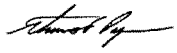
The importance of an immediate change to the EPA's Interim Enforcement and Response Policy (IERP) is critical to the success of the Renewable Fuel Standard (RFS). Specifically, the EPA should revise its IERP as it relates to all pending invalid biomass-based diesel RINs so that no further RIN substitution would be required for good faith participants of the RFS. EPA must provide companies with the opportunity to present an affirmative defense to ensure that diligent and blameless companies are not penalized for the acts of others. We also feel the EPA must continue with aggressive prosecution of current, and future pending fraudulent activity.

During the July 11th, 2012 hearing before the committee, it was determined that the EPA report back to the committee within 90-120 days. We are extremely encouraged by the EPA's response to the hearing and the work toward solving the issues. Prior to the follow-up hearing, we are anxious to see the expanded IERP that will allow for good faith companies, like VicNRG, LLC, to show the ability to defend against the requirement to replace RINs. The interim policy should cover all offenses committed prior to December 31, 2012, and could include provisions to pool the violations and rolling the obligation forward a year. By doing this, the EPA will meet its goals of achieving a certain volume of renewable fuel produced, blended correctly and ultimately provide stability to the biodiesel industry.

We appreciate Congress' willingness to evaluate the immediate changes to the RFS Program administration and enforcement; specifically, IERP. High expectations during the November hearing are

needed to avoid the dire consequences caused by the current enforcement policy. We believe the immediate and short term solutions of modifying IERP, eliminating replacement of RINs for good faith purchasers, and the opportunity for affirmative defense is the foundation necessary to save the system, its associated investments, and, ultimately, jobs in a struggling U.S. economy. Anything other than that will only serve to reduce the effectiveness of the RFS program, as liabilities are much too significant for all but the largest industry participants.

Sincerely,



Thomas Paquin
President, VicNRG, LLC

MUSKET

August 14, 2012

The Honorable Cliff Stearns
Chairman,
Oversight and Investigations Subcommittee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Stearns,

I am responding to your letter dated August 6, 2012, in which you asked if upon further reflection of the testimony I provided on July 11th, whether I wish to clarify or elaborate on any of the issues raised during that hearing. I will take this opportunity to elaborate on four points which I believe deserve further consideration.

First, regarding the matter of affirmative defense, I respectfully submit that while many believe affirmative defense may have merit, we think it may unnecessarily excuse sloppy behavior in the RIN market. If affirmative defense provisions are applied retroactively, we believe it unjustly rewards those parties who conducted little if any due diligence on the source of RIN acquisitions. At Musket, we've been penalized for transacting fraudulent RINs and in accordance with the well-established "buyer beware" principles of the RFS since its inception, we incurred the financial penalties then strengthened our RIN source-verification. Also, we believe that further complications of the regulations may create additional loopholes perpetuating fraudulent activities.

We agree that clearer, more instructive "buyer beware" guidance from the EPA will be useful. But, simply relying upon purchase agreements, as some parties have done, to justify purchasing bogus RINs sounds more like an excuse than a valid reason for failing to perform even basic levels of due diligence now routine for virtually all business.

Second, we believe that biodiesel producers of all sizes will make a vibrant, enduring biodiesel industry. That is why we will continue doing business with producers that help us meet our ultimate goal which is to deliver high-quality fuel to our customers at competitive prices. RIN fraud has forced all parties in the industry to know better the people that they are doing business with. That's a good thing and while some assert that recent fraud has had a devastating impact; Musket is set to double the amount of biodiesel we blend in 2012 versus any prior year. Regulatory updates should always be examined as a

matter of perfecting law but the vast majority of market participants are operating well within the existing regulatory framework.

Third, we believe regulatory updates are needed in the areas governing exports and disclosure. With respect to exports, we believe the volume of biodiesel leaving our ports without meeting necessary RIN buyback provisions may triple or even quadruple the gallon equivalent number of RINs implicated in current enforcement action. This 'strip and ship' activity frustrates the purpose of the RFS and generates ill-gained profits totaling hundreds of millions of dollars. 'Strip and ship' rewards law breaking and could undercut all domestic producers by allowing transshipment of foreign biodiesel through the U.S. The EPA, without further legislation, can immediately clarify that all biodiesel exported from the U.S., in whatever form, creates an obligation to retire or purchase a commensurate number of RINs. We believe that by auditing data already available to the EPA, the violators can be identified and prosecuted.

Finally, requiring greater disclosure of biodiesel content as well as requiring registration for those selling RIN-less biodiesel will maintain product quality and transparency for the end-consumer. Moreover, these requirements will further the goal of ensuring that the benefits of renewable fuels accrue first to those in this country. Greater biodiesel content and sales disclosure are matters the Committee must consider if Congress is serious about stamping out RIN fraud and upholding the purpose of the RFS.

Thank you for the opportunity to testify and thank you for allowing me to elaborate further.

Sincerely,

JP Fjeld-Hansen

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States
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COMMITTEE ON ENERGY AND COMMERCE
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WASHINGTON, DC 20515–6115

Majority (202) 225–2927
Minority (202) 225–3641

August 6, 2012

Mr. Joe Jobe
Chief Executive Officer
National Biodiesel Board
1331 Pennsylvania Avenue, N.W.; Suite 512
Washington, D.C. 20004

Dear Mr. Jobe:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Wednesday, July 11, 2012, to testify at the hearing entitled "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

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Sincerely,

Cliff Stearns
Chairman
Subcommittee on Oversight and Investigations

cc: The Honorable Diana DeGette, Ranking Member,
Subcommittee on Oversight and Investigations

Attachment

NBB Response to the Honorable Lee Terry

1. **The NBB is putting together a program to try and ensure that a facility is actually producing biofuel to ensure RIN Integrity.**

    a. **Is this program just for NBB Members?**

When will non-NBB members be welcomed into the program?

A: The program is a privately sponsored business venture and program that is independently owned and operated by Genscape. From what we understand Genscape is offering it to all industry participants, it is not limited to Members of the National Biodiesel Board (although we represent approximately 95 percent of the biodiesel marketplace.

For more information on the product Genscape is offering, please go to: http://www.genscape.com/biodiesel-rin-integrity-network

    b. **How much will it cost a facility to implement the monitoring system you're trying to establish and who pays for it?**

A: Genscape is creating the system, not the NBB. From what we understand, Genscape is charging biodiesel producers 1 cent per RIN, up to an annual cap of $40,000. The fee is imposed at the point the RIN is generated (sold) in the marketplace. If a RIN is not generated, then there is no fee. The biodiesel producer pays the fee.

Charles T. Drevna
President

American
Fuel & Petrochemical
Manufacturers

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August 20th, 2012

The Honorable Cliff Stearns
Chairman
U.S. House Committee on Energy and Commerce
Subcommittee on Oversight and Investigations
2125 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Stearns:

AFPM, the American Fuel & Petrochemical Manufacturers, appreciated the opportunity to provide its views during the Subcommittee on Oversight and Investigations' July 11, 2012 hearing entitled "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program." The following answers are in response to questions submitted by Rep. Lee Terry.

1. **AFPM and API are working with a number of biofuel organizations such as Advanced Biofuel Association and Biotechnology Industry Organization (BIO), on an approach to restore confidence to the market for ALL biofuels, not just biodiesel. How is that process going and what does it entail? What is the estimated cost for such a program and who would pay?**

   AFPM and API have had joint meetings and conference calls with several biofuel organizations and EPA. AFPM has advocated for a regulatory change that would create an affirmative defense for obligated parties that purchase RINs that have been subjected to an EPA-approved plan. This would be a voluntary program that minimizes the risk of producing invalid RINs and creates certainty and liquidity in the RIN market. While AFPM is pleased with the progress of those discussions, there is still significant work to be done. In particular, while EPA indicated in an August 14th letter to Rep. Gene Green that it will likely provide obligated parties with an affirmative defense and that it is seeking to have a regulatory solution in place in early 2013, it has not defined the scope of such a defense or the associated validation performance standards. Furthermore, EPA has not yet committed to including protection for obligated parties from being compelled to replace validated RINs later found to be invalid. This is a vital issue to obligated parties that were the victims of the fraud, and one that must be rectified in order to restore liquidity to the RIN market.

AFPM cannot estimate the costs of a RIN validation program because EPA has not yet announced the steps necessary to validate RINs. Ultimately, the costs will be determined by independent third parties that establish programs capable of meeting an EPA list of RIN validation performance standards.

2. **There are biomass-based diesel producers approved under the RFS2 that are NOT biodiesel producers filling the biomass-based diesel pool. It appears that the NBB approach would only cover biodiesel entities, not other "biomass-based diesel" producers or other Advanced Biofuel producers, isn't that true?**

   Biodiesel is a subset of biomass-based diesel. Biodiesel is made from a chemical process called transesterfication and yields a fuel that has a lower energy content than diesel fuel, poor cold weather performance and is incapable of meeting the ASTM diesel fuel specification. Renewable diesel (sometimes referred to as second generation biodiesel), also qualifies as biomass-based diesel under the RFS and is made using fats and oils in a process similar to a modern petroleum refinery. Renewable diesel performs comparably to diesel fuel derived from petroleum. In 2011, EPA reported that about 885 million biomass-based diesel RINs were created. About 836 million of these were created by biodiesel producers, while renewable diesel producers accounted for about 49 million RINs, or about 5.5%.

   AFPM does not know if the NBB approach would be available to entities other than biodiesel producers.

3. **How does the approach proposed by the AFPM, obligated parties and biofuel industry at large to RIN integrity differ in cost compared to the NBB proposal?**

   Most significantly, NBB's approach to RIN certification would not solve the RIN liquidity problem and could disadvantage small biofuel producers. This is because NBB opposes the concept of providing a true affirmative defense for certified RINs that would attach at the time of biofuel production. Instead, NBB would make the obligated party prove to EPA that they have embraced adequate due diligence in the event that EPA determines that they possess invalid RINs. By not providing certainty at the time the RIN is first purchased, obligated parties will be incentivized to only purchase RINs from trusted biofuel producers. This is very similar to the situation we are in today and would make it very difficult for small biofuel producers that are not known to the obligated parties to market their RINs. From a cost perspective, the NBB program is likely to be more expensive than allowing multiple entities that demonstrate the ability to meet EPA's RIN validation performance standards to compete for validation business.

a. **Are the costs allocated to just the obligated parties or both the biofuel producer and the obligated party?**
The market will determine who pays the RIN validator, but in many cases the initial contract for validation services will be between the biofuel producer and the RIN validator. Obligated parties ultimately will pay the costs associated with certifying RINs. These costs will be passed on to obligated parties in the form of increased RIN prices.

b. **Would such a program include any biofuel technology/pool? If it's just for biomass-based diesel, will it include the non-biodiesel technologies as well?**
The AFPM approach could apply to all renewable fuel technologies. EPA's performance standards and individual validator's quality assurance plans would be adjusted to account for differences in technologies and the varying risks of RIN invalidity among biofuel categories.

Please feel free to contact me or my staff with any questions. Again, thank you for the opportunity to share AFPM's views.

Sincerely,

Charles T. Drevna
President

cc: The Honorable Lee Terry
The Honorable Diana DeGette

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6115

Majority (202) 225–2927
Minority (202) 225–3641

August 6, 2012

Mr. Byron Bunker
Acting Director, Compliance Division
Office of Transportation and Air Quality
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, D.C. 20460

Dear Mr. Bunker:

Thank you for appearing before the Subcommittee on Oversight and Investigations on Wednesday, July 11, 2012, to testify at the hearing entitled "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

Pursuant to the Rules of the Committee on Energy and Commerce, the hearing record remains open for 10 business days to permit Members to submit additional questions to witnesses, which are attached. The format of your responses to these questions should be as follows: (1) the name of the Member whose question you are addressing, (2) the complete text of the question you are addressing in bold, and then (3) your answer to that question in plain text.

To facilitate the printing of the hearing record, please respond to these questions by the close of business on Monday, August 20, 2012. Your responses should be e-mailed to the Legislative Clerk, in Word or PDF format, at Nick.Abraham@mail.house.gov.

Thank you again for your time and effort preparing and delivering testimony before the Subcommittee.

Sincerely,

Cliff Stearns
Chairman
Subcommittee on Oversight and Investigations

cc: The Honorable Diana DeGette, Ranking Member,
Subcommittee on Oversight and Investigations

Attachment

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

AUG 24 2012

OFFICE OF CONGRESSIONAL
AND INTERGOVERNMENTAL RELATIONS

The Honorable Cliff Stearns, Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Stearns:

Thank you for your letter of August 6, 2012, requesting responses to Questions for the Record following the July 11, 2012, hearing before the Subcommittee on Oversight and Investigations entitled, "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."

The responses to the questions are provided as an enclosure to this letter, as well as an update on the progress that EPA is making to resolve the problem of RIN fraud impacting the renewable fuels industry requested by Dr. Burgess. If you have any further questions, please contact me, or you staff may contact Carolyn Levine in EPA's Office of Congressional and Intergovernmental Relations at (202) 564-1859.

Sincerely,

Laura Vaught
Deputy Associate Administrator
for Congressional Affairs

Enclosure

cc: The Honorable Diana DeGette, Ranking Member
Subcommittee on Oversight and Investigations

EPA Responses to Questions for the Record
From the July 11, 2012 Hearing: "RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program."
House Committee on Energy and Commerce
Subcommittee on Environment and the Economy

The Honorable Lee Terry

1. **What is the approximate capacity of the non-biodiesel, biomass-based diesel facilities? That is, of the facilities categorized as biomass-based diesel, how much or what percent is not biodiesel?**

   Response: Based on the production information reported to EMTS, the volume in the biomass-based diesel category that was not biodiesel was approximately 4.1% in 2011. The 2012 year-to-date production information for volume that is not biodiesel is approximately 5%. These non-biodiesel volumes are comprised primarily of non-ester renewable diesel.

2. **I find it curious that there can be this much fraud when it is so difficult to actually get a new process approved to participate in the RFS. Why is it that biodiesel facilities get "in" the program so much easier than non-biodiesel technologies? How did the biodiesel facilities that weren't actually producing fuel get through the engineering review?**

   Response: The RFS regulations are not intended to create a higher or lower approval burden for different manufacturing processes. For defined fuel pathways, the registration process should be consistent and relatively quick once the required engineering review and other application requirements are completed. For many new pathways, we undergo a rulemaking process to elicit and consider public comments which lengthens the time for pathway approval.

   While the independent third-party engineering review gives us confidence a producer has the facilities necessary to produce a specific volume of fuel, it does not provide visibility to the actual volume of feedstock brought into the facility each day nor to the actual volume of fuel produced each day through the year. The "buyer beware" nature of the current RFS regulations were intended to ensure that RIN purchasers in the market were providing oversight on a day-to-day basis. Unfortunately, as we have seen, without ongoing due diligence it is possible to have significant fraud occur. There are now independent third-party vendors in the market that provide ongoing oversight to obligated parties. The agency is working with all interested stakeholders to see how the work of these independent businesses can be leveraged to provide the protection and market liquidity desired by market participants.

3. **Given that there are a number of different biofuel categories within the Renewable Fuel Standard, some, such as the ethanol industry, is well established and RINs are very low in value. How will EPA address such disparities and will there be flexibility for the biofuel producers and the obligated parties to determine what best approach might be taken to ensure RIN integrity? In other words, not just the NBB approach?**

   Response: We recognize and agree that there are important differences between the established ethanol industry, with low value RINs currently, and the other RIN categories as your question highlights. We are meeting with a wide range of stakeholders to gather input on multiple ways to address these differences, and expect that we will need a flexible solution or set of solutions in order to address these differences.

Dr. Burgess

Followup to the request during the July 11, 2012 hearing for an update by October 9, 2012 on the progress that EPA is making to resolve the problem of RIN fraud impacting the renewable fuels industry:

The Agency is committed to meeting the statutory goals of the RFS program. We have been engaged in productive conversations with stakeholders to discuss various approaches to reducing the likelihood of RIN fraud and stabilizing the marketplace. Working with the regulated industry, the EPA has already developed a general framework for a proposed regulation. While a proposal would go through further refinement as well as interagency review prior to public comment, we have identified a number of elements we would expect the proposal to contain. For example, it would create an affirmative defense for parties who find they are holding invalid or fraudulent RINs despite their best efforts to ensure the RINs were valid. This best effort would be demonstrated by purchasing RINs that have been validated through an independent third party auditor executing an EPA approved Quality Assurance Program (QAP). The affirmative defense would ensure that refiners and other program participants who meet the conditions of the affirmative defense will not face civil penalties.

The new elements described above would be fully voluntary additions to the existing program. The existing program elements would remain in place for market participants who obtain RINs that are not validated under the QAP. Early indications from the industry are that obligated parties prefer the option of buying validated RINs from small producers and keeping the existing program for RINs purchased from the largest, most well established producers.

We understand that many in industry are seeking a resolution to these market uncertainties before making purchasing decisions for RINs in the new year. To that end, on an expedited basis, the EPA expects to issue a proposal before the end of 2012, with a final action as soon as possible in 2013. Furthermore, since the Agency understands that purchasing decisions made before a final rule need to reflect the certainty the rule will provide, EPA is investigating mechanisms that would allow the industry to implement the QAP program as soon as the proposal is made, allowing all RINs produced in 2013 to be covered under the new policy.

The House Committee on Energy and Commerce

July 11, 2012

Subcommittee on Oversight and Investigations

Document Binder

Committee on Energy and Commerce
Subcommittee on Oversight and Investigations
RIN Fraud: EPA's Efforts to Ensure Market Integrity in the Renewable Fuels Program

Exhibits Index

TAB	DESCRIPTION	DATE
1	Letter from Representatives Upton and Whitfield to Ms. Margo Oge, Director of the Office of Transportation and Air Quality at U.S. Environmental Protection Agency	02/03/2012
2	EPA response to the Committee's February 3, 2012 letter	02/23/2012
3	Letter to from Representatives Upton, Stearns, Whitefield, and Burgess to EPA Administrator Jackson	05/24/2012
4	EPA response to the Committee's May 24, 2012 letter	06/28/2012
5	EPA letter in further response to the Committee's May 24, 2012 letter	07/05/2012
6	EPA internal memorandum from Mario Jorquerea, EPA Inspector, regarding the "Documentation of Clean Green Case Involving Possible Fraudulent Generation of Biodiesel RIN Credits"	08/24/2010
7	Affidavit in Support of Seizure Warrant Applications regarding alleged criminal violations by Absolute Fuels, LLC and its owner/CEO Jeffery David Gunselman	10/14/2011

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HENRY A. WAXMAN, CALIFORNIA
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Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
2125 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6115

Majority (202) 225-2927
Minority (202) 225-3641

February 3, 2012

Ms. Margo Oge
Director
Office of Transportation and Air Quality
Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, D.C. 20460

Dear Ms. Oge:

The Renewable Fuel Standard (RFS) was created in the Energy Policy Act of 2005, and greatly expanded with the Energy Independence and Security Act of 2007. The Committee on Energy and Commerce is responsible for oversight of the Environmental Protection Agency's (EPA) administration of the RFS under the Clean Air Act, and a number of issues has emerged that warrant attention. Among them is a serious problem of fraud that, if not properly addressed by the agency, could cause significant problems in the nation's motor fuels markets.

Specifically, after a lengthy investigation, EPA has discovered that a considerable number of tradable credits for renewable fuels, called Renewable Identification Numbers (RINs), may have been fraudulently created and sold. Legal proceedings have been launched against Clean Green Fuel LLC (Clean Green), a company that was registered with EPA and that allegedly sold 9 million dollars of fraudulent biodiesel RINs on the agency's computerized trading system. These RINs were supposed to represent 21 million gallons of actual fuel produced, but Clean Green allegedly had no facilities to make biofuels and all of its RINs were invalid, according to EPA. On November 7, 2011, EPA sent 24 Notices of Violation (NOVs) to refiners, distributors, and other obligated parties who were purchasers of these invalid RINs.

Along with other penalties, EPA is requiring the recipients of these NOVs to replace the invalid RINs with a sufficient number of valid ones in order to meet their respective Renewable Volume Obligations (RVOs) under the RFS. However, doing so is greatly complicated by the fact that EPA is believed to be investigating other companies, and it is very difficult to know which biofuel RINs are valid.

As a result, the risk of unknowingly buying problematic RINs is great and so the renewable fuels marketplace is in turmoil. Further compounding an already difficult situation are settlement agreements EPA sent in January to NOV recipients in the Clean Green matter. The Committee understands that additional NOVs resulting from other investigations were issued this week, roiling the RIN markets further. Many market participants – including small biofuel producers whose continued existence is possibly jeopardized through no fault of their own – have been adversely impacted. The costs of this turmoil ultimately will be borne by consumers. These fraud and abuse issues in the RFS, and our understanding of EPA's related enforcement practices, may lead to a need for Congressional action.

Given current statutory mandates for renewables in the nation's fuel supply, eliminating uncertainty and restoring the proper functioning of RIN markets is vital for a competitive fuels marketplace—an essential ingredient to ensure consumers have ample and affordable fuel. We want to be sure restoring functional RIN markets is done expeditiously and in an equitable manner.

Accordingly, pursuant to Rules X and XI of the Rules of the U.S. House of Representatives, we seek information regarding EPA's administration of the RFS as it relates to renewable fuels markets. We request that you provide Committee staff a briefing on current investigations into program fraud and written responses to the following questions and the requested documents by February 15, 2012:

1. Please provide a detailed chronology of EPA's actions with regard to Clean Green as well as the agency's communication of these actions with the regulated community, including, but not limited to, when EPA first learned that the company's RINs may be invalid, and when the purchasers of these RINs were notified.

2. Does EPA consider its communications with the regulated community prior to the NOVs to have been adequate?

   a. Is there a risk that obligated parties may purchase RINs from companies currently under investigation by EPA but for which the agency has not informed the marketplace?

   b. Explain EPA's process, procedures, or criteria for informing, including when to inform, the RIN marketplace of other potentially fraudulent RINs and include a description of when and how this process was developed.

   c. Provide all documents relating to the development of the agency's process, procedures, or criteria for informing the RIN market of potentially fraudulent RINs.

3. Explain the basis for EPA's apparent position that participants in EPA's Moderated Transaction System (EMTS) should have known or been able to ascertain that Clean Green was a fraudulent operation.

a. Explain EPA's process for registering and validating producers that participate in the EMTS.

b. Explain what controls EPA has put in place to protect program integrity, particularly in relation to participation in the EMTS.

4. EPA has stated that the buyers of RINs, regardless of their reliance on the EMTS and on EPA's registration process for biodiesel producers, must nonetheless perform "due diligence."

   a. What does due diligence require?

   b. Please describe the measures that could have been undertaken by obligated parties that would have prevented the purchase of invalid RINS such as those allegedly originating from Clean Green.

5. What investigative resources and time were expended by EPA to ascertain that Clean Green's RINs were invalid?

   a. Do smaller obligated parties have the resources to conduct such investigations?

   b. What analysis has EPA performed to ensure smaller obligated parties are able to compete in the EMTS under EPA's due diligence standards?

6. What specific steps is EPA taking to reduce uncertainty in the renewable fuels markets since the issuance of the NOVs and to reduce the impact on RIN sales and prices?

   a. Is EPA considering structural changes to RIN markets in order to reduce the likelihood of fraud? If so, please describe these potential changes.

7. Obligated parties have until February 28, 2012, to comply with their Renewable Volume Obligation (RVOs) for 2011. Given the current challenge of finding valid biofuel RINs, has EPA considered an extension of this deadline or any other near-term measures that may facilitate compliance?

   a. Given the difficulties finding valid RINs to replace invalid ones, has EPA considered expanding the universe of allowable replacement RINs, broadening the carryover provisions, or foregoing the requirement of procuring replacement RINs?

   b. Does EPA believe that there is sufficient latitude under existing law to create such flexibility?

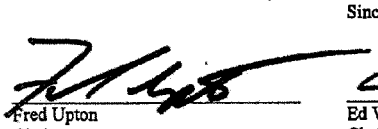
8. In EPA's January 9, 2012, Final Rule for the 2012 RFS, the agency recognized the problems caused by invalid RINS being bought and sold and thereby creating violations at each step. In the section entitled "RIN Retirement Provision for Error Correction," EPA included measures allowing improperly generated RINS to nonetheless be used for

compliance by obligated party purchasers, while EPA focused on addressing the source of the invalid RINs. Although this solution was only contemplated for RINs generated in error rather than fraud, have you considered expanding this flexibility to the current situation?

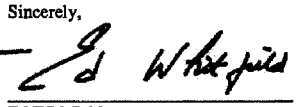
9. In the preamble to EPA's March 26, 2010, Final Rule on the RFS program, the agency made clear that it "would normally look first to the generator or seller of the invalid RINSs both for payment of penalty and to procure sufficient valid RINs to offset the invalid RINs." However, the agency's NOVs focused first on the ultimate purchasers as the parties to be penalized and made responsible for procuring valid RINs. What is the reason for this approach?

We request that you adhere to the instructions relating to the requests for documents attached to this letter. Thank you for your prompt attention to this request. Should you have any questions, please contact Ben Lieberman or Peter Spencer of the Majority Committee staff at (202) 225-2927.

Sincerely,



Fred Upton
Chairman



Ed Whitfield
Chairman
Subcommittee on Energy and Commerce

Attachment

cc: The Honorable Henry A. Waxman, Ranking Member

The Honorable Bobby L. Rush, Ranking Member
Subcommittee on Energy and Power

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

FEB 23 2012

The Honorable Ed Whitfield
Chairman
Subcommittee on Energy and Power
Committee on Energy and Commerce
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Whitfield:

Thank you for your January 26, 2012 letter and your February 3, 2012 letter, co-signed by Chairman Fred Upton, regarding the Environmental Protection Agency's (EPA's) administration of the Renewable Fuels Standard (RFS) program and Renewable Identification Number (RIN) fraud. We appreciate your interest in this matter. The Agency's responses to your specific questions regarding EPA investigations into RFS program fraud are enclosed.

We understand that EPA staff spoke with your constituent, Mr. Andy Sprague of Union County Biodiesel, on February 7, 2012, to understand his situation and recommendations. In addition, EPA staff met with Committee staff on February 10, 2012 to discuss the RFS program more broadly. We trust that those discussions were productive and we welcome this opportunity to address the important issues raised in your letter.

As you know, Congress established the RFS1 program in the Energy Policy Act of 2005 to reduce the nation's reliance on imported petroleum by requiring that transportation fuel sold in the United States contain a minimum volume of renewable fuel. Congress expanded the program (RFS2) in the Energy Independence and Security Act of 2007 (EISA) to require significantly higher volumes of renewable fuel, lay the foundation for achieving significant reductions in greenhouse gas emissions, and to encourage the development and expansion of the nation's renewable fuels sector. The EPA developed the regulations for implementing the RFS program in collaboration with renewable fuel producers, distributors and obligated parties (gasoline and diesel producers and importers) to work largely in concert with the fuels market and existing business practices. Consistent with the statutory provisions concerning the RFS program and the long history of fuel programs from unleaded gasoline to ultra-low sulfur diesel fuel, the EPA placed the obligation to meet the RFS volume mandates on gasoline and diesel fuel producers and importers.

The EPA also included in the RFS regulations the flexibility sought by obligated parties to demonstrate compliance with renewable fuel volume requirements either by acquiring renewable fuel and the associated RINs or by purchasing RINs without also purchasing the renewable fuel.

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RINs were created to implement that flexibility, as well as to implement the statutory provision for a credit program that would allow obligated parties to generate and use credits for over compliance with the annual requirement.

The RFS regulations make clear that it is the responsibility of obligated parties to ensure that they use valid RINs to demonstrate compliance and that there is not a safe harbor provision with regard to invalid RINs. The regulations, as revised to implement EISA, maintained that the underlying principle of RIN ownership is "buyers beware." As the EPA explained in establishing the regulations, the agency would not validate or certify the actual production of renewable fuel and associated RINs prior to their transfer and use for compliance purposes.

At the same time, RFS regulatory requirements and compliance efforts are not focused exclusively on obligated parties. The EPA's Office of Enforcement and Compliance Assurance and the Office of Transportation and Air Quality are working together to identify and pursue fraudulent RIN generators. The fact that the agency is pursuing fraudulent RIN generators demonstrates our commitment to an effective RFS program and a level playing field for all renewable fuel producers, obligated parties, and other RIN owners and users. As you are aware, the EPA has issued Notices of Violations (NOVs) to companies that used invalid RINs. We are now working with obligated parties that used invalid RINs to resolve their liability and come into compliance. The RIN market structure depends on the volume mandate to drive demand and hence renewable fuel production. If fraudulent RINs could be used, there would be no market for valid RINs, which would cause serious problems for legitimate renewable fuel producers.

Again, thank you for your letter. If you have further questions, please contact either of us or your staff may call Diann Frantz in the Office of Congressional and Intergovernmental Relations at 202-564-3668 or Carolyn Levine at 202-564-1859.

Sincerely,

Cynthia Giles
Assistant Administrator for
Enforcement and Compliance Assurance

Gina McCarthy
Assistant Administrator for
Air and Radiation

Enclosures

Enclosure 1

EPA Responses to February 3, 2012 letter

1. *Please provide a detailed chronology of EPA's actions with regard to Clean Green as well as the agency's communication of these actions with the regulated community, including, but not limited to, when EPA first learned that the company's RINs may be invalid, and when the purchasers of these RINs were notified.*

   On July 15, 2010, the EPA's Office of Civil Enforcement received a tip from a competitor indicating that Clean Green may have been illegally generating RINs. On July 22, 2010, and on July 28, 2010, EPA conducted inspections of Clean Green. On December 14, 2010, EPA sent an information request to Clean Green. Clean Green responded to this information request on January 4, 2011, and on February 4, 2011. On May 12, 2011, the United States executed multiple criminal search and seizure warrants at Clean Green facilities. On October 3, 2011, the United States filed criminal charges alleging that Clean Green's owner fraudulently generated RINs, and on November 11, 2011, the United States issued a superseding indictment against the owner of Clean Green. On November 7, 2011, EPA issued NOVs to parties that used Clean Green RINs to meet their obligations under the RFS program. The EPA did not inform the regulated community about its investigation into Clean Green until the Agency issued these NOVs. Pursuant to the EPA's September 24, 2007, Parallel Proceedings Policy, the Office of Civil Enforcement and the EPA's Office of Criminal Enforcement, Forensics and Training "coordinated decisions by the civil and criminal programs as to the timing and scope of their activities."

2. *Does EPA consider its communications with the regulated community prior to the NOVs to have been adequate? Is there a risk that obligated parties may purchase RINs from companies currently under investigation by EPA but for which the agency has not informed the marketplace? Explain EPA's process, procedures, or criteria for informing, including when to inform, the RIN marketplace of other potentially fraudulent RINs and include a description of when and how this process was developed. Provide all documents relating to the development of the agency's process, procedures, or criteria for informing the RIN market of potentially fraudulent RINs.*

   The EPA does consider its communications with the regulated community prior to issuing NOVs relating to the Clean Green RINs to be adequate. The EPA conducted extensive outreach to the regulated community regarding the RFS program, and has been clear from the beginning of the program that invalid RINs cannot be used for compliance, regardless of a party's good faith belief that the RINs are valid. The Agency has also been clear that it does not validate RINs. The EPA issued NOVs to parties that used Clean Green RINs when we developed sufficient proof that the Clean Green RINs were invalid, and after appropriate consultation with the Office of Criminal Enforcement and Forensics Training (OCEFT). After issuing the NOVs, the EPA sent an EnviroFlash to the regulated community to inform parties about the allegations in the EPA's NOV. An EnviroFlash is a service that allows the EPA to communicate with those interested in receiving EPA Fuels Programs alerts.

It is incumbent upon obligated parties to undertake due diligence to ascertain the validity of RINs to be used to meet a renewable volume obligation under the RFS program. This is both commercially feasible and reasonable, and it is what most obligated parties are doing now. The EPA does not seek to make public many of its activities in civil or criminal investigations, both to maximize the effectiveness of the investigation and to minimize the potential harm to parties under investigation who may not have violated the law. The EPA will generally notify the regulated community that it has alleged that RINs are invalid when the agency has developed sufficient proof and determined that such notification will not unduly impair ongoing investigations. There is always a risk that an obligated party will unknowingly purchase RINs from a company under investigation by the EPA and that the purchased RINs are ultimately found to be invalid.

The EPA does not have specific written procedures or criteria for informing the RIN marketplace of allegations that RINs are invalid. For cases that involve both civil and criminal proceedings, the EPA follows its September 24, 2007, Parallel Proceedings Policy and determines the appropriate time and method of informing the regulated community about invalid RINs on a case-by-case basis. The premature disclosure of information regarding a pending or prospective law enforcement proceeding could interfere with active law enforcement investigations. Furthermore, the fact that the EPA has commenced an investigation into potentially invalid RINs does not necessarily mean that the target of the investigation generated invalid RINs. A copy of EPA's Parallel Proceedings Policy is enclosed with this letter (Enclosure 2).

3. *Explain the basis for EPA's apparent position that participants in EPA's Moderated Transaction System (EMTS) should have known or been able to ascertain that Clean Green was a fraudulent operation. Explain EPA's process for registering and validating producers that participate in the EMTS. Explain what controls EPA has put in place to protect program integrity, particularly in relation to participation in the EMTS.*

The RFS regulations are clear that invalid RINs may not be used for compliance. The EPA does not certify or otherwise validate RINs. In providing regulated parties with the flexibility of purchasing RINs to meet RFS requirements, the EPA stated that the buyer must beware. The Agency launched the EPA Moderated Transaction System (EMTS) in July 2010 as part of the RFS2 program. EMTS was developed and implemented to manage the tens of thousands of RIN transactions (generation, buy/sell, and retirement) that occur each day. Clean Green participated in the RFS1 program but did not re-register to participate in RFS2. Therefore, it was not part of EMTS.

While the EPA expects the regulated industry to exercise due diligence as it would with any commercial transaction, the Agency did include a number of provisions in the RFS2 program to help ensure program integrity. In the RFS2 program, renewable fuel producers must provide information on the renewable fuel product they produce, the production process employed, the feedstocks they are capable of using, and their facility production capacity in order to register with EPA. Producers must also provide certain documentation, including evidence that their fuel has been registered with the EPA's fuel and fuel additives registration system, copies of air permits, a feedstock plan, and an independent engineer's review and report confirming that they are capable of producing the renewable fuel product they plan to

produce. Some producers (e.g., those claiming an exemption from the 20% minimum lifecycle greenhouse gas reduction requirements, foreign renewable fuel producers) must supply additional information.

In general, the EPA reviews each party's registration submission package to ensure that it contains the information required under the EPA's regulations and that the information is consistent with the registrant's proposed plan for RIN generation. The EPA accepts the registration application if it determines that the application is complete and that it contains the requisite information and supporting documentation. After the EPA accepts the registration application, it allows generation of RINs in the EMTS, the electronic RFS2 reporting and RIN tracking tool.

Two third-party elements were designed into the RFS2 program to minimize fraud. First, an independent engineering review and report is required as part of the registration. Second, an independent auditor's attestation report is required to be completed annually by a certified public accountant (CPA) or certified auditor. For U.S. producers, the third-party engineering review must be conducted by a Professional Chemical Engineer who is based in the United States and is licensed by an appropriate state agency (40 CFR § 80.1450(b)(2)(i)(A)). For foreign producers, the third party engineering review must be conducted by an independent third party who is a licensed professional engineer or foreign equivalent who works in the chemical engineering field for a foreign production facility (40 CFR § 80.1450(b)(2)(i)(B)). The attest process requires that a party that is engaged in the RIN system as a RIN generator, obligated party, and/or RIN owner hire an independent auditor to review the party's records and reports according to the schedule provided in the regulations. This audit helps ensure that information reported to the EPA is backed by documents such as purchase receipts for feedstocks, bills of lading for delivery, invoices, laboratory test results, etc., as required by the program.

Additionally, the EMTS is tied into the registration system to ensure that only registered renewable fuel producers or importers generate RINs and only for the specific products for which they are registered. For example, a registered ethanol producer would not be able to generate biomass-based diesel RINs without additional registration submissions and EMTS authorization. The EMTS also allows an obligated party to block RINs that might come from renewable fuel sources that it considers questionable or that it has not verified, and it also allows a RIN owner to "lock" out RINs it owns and believes may not be valid to avoid those RINs from being traded and used for compliance.

4. *EPA has stated that the buyers of RINs, regardless of their reliance on the EMTS and on EPA's registration process for biodiesel producers, must nonetheless perform "due diligence." What does due diligence require? Please describe the measures that could have been undertaken by obligated parties that would have prevented the purchase of invalid RINs such as those allegedly originating from Clean Green.*

Congress created the RFS program to increase the production and use of renewable fuels in our transportation system. The legislation obligates refiners and fuel blenders to use an increasing volume of renewable fuels. One way to do this is for refiners or importers to buy and use the renewable fuel. At the request of the refiners and importers, EPA added greater

flexibility for refiners and importers, by allowing them to acquire RINs that represent a volume of renewable fuel. The ability to show compliance using a RIN-based system rather than through the purchase and sale of actual renewable fuel volumes came at the refining industry's request.

EPA's fuel programs for decades have relied on a regulatory system that calls for each party in the fuel delivery system to do its due diligence to ensure that fuel quality (gasoline sulfur, diesel fuel sulfur, etc.) is maintained. Each party in the chain takes seriously its obligations to ensure that the fuel it buys is of the appropriate quality, and exercises appropriate business oversight and diligence to achieve this result. The industry implements and maintains this system of checks on its own in a highly efficient manner that is tailored to the size and characteristics of each of the market participants.

Just as EPA does not direct parties in the fuel supply chain how to ensure that the fuel they buy and sell meets the sulfur requirements, we do not direct the industry on the most efficient way to validate RINs as they pass them through the system. Each party in the system must make its own assessment of the most appropriate business practices. Experience to date has shown that fact checking, diligent questioning, and site visits by potential RIN buyers can identify possible problems. In the case of Clean Green, had the RIN purchasers conducted the same sorts of due diligence they would have conducted if they were buying a volume of renewable fuel instead of buying a RIN, they would have likely discovered the fraudulent producer before it came to the EPA's attention. A simple site visit would have revealed that the company was not producing renewable fuel.

Industry participants in the RIN market are in the best position to develop best practices for identifying properly or improperly generated RINs. Several private sector systems are now under development to assist market participants in evaluating whether the fuel offered for sale qualifies as renewable fuel under the EPA's RFS2 regulations and whether the RINs associated with that fuel are valid. Additionally, the National Biodiesel Board has formed a RIN Integrity Advisory Task Force to identify a solution or solutions to enhance RIN integrity.

While due diligence is not an affirmative defense to liability under the EPA's RFS regulations, the EPA may consider the level of due diligence in determining an appropriate penalty for any particular violation.

5. *What investigative resources and time were expended by EPA to ascertain that Clean Green's RINs were invalid? Do smaller obligated parties have the resources to conduct such investigations? What analysis has EPA performed to ensure smaller obligated parties are able to compete in the EMTS under EPA's due diligence standards?*

Because of the sensitivity of information regarding investigative resources and time expended by the EPA to ascertain that Clean Green's RINs were invalid, the EPA does not disclose such information because it could jeopardize enforcement actions.

EMTS allows obligated parties to block RINs generated by specific renewable fuel producers, or conversely allows only transactions involving RINs generated by trusted producers. Smaller obligated parties can choose to only purchase RINs generated from

producers they trust. In the case of Clean Green, had smaller obligated parties exercised the same due diligence used in the normal course of business involving buying actual renewable fuel volumes, we believe that they would have recognized that no fuel was being produced by Clean Green. Because the volume of RINs necessary to be purchased is proportional to an obligated party's total fuel production and directly equivalent to the volume of renewable fuel obligation they would have to purchase in order to comply with the program, we do not believe that the buyer-beware nature of the RIN program places any higher burden on small producers than they would have borne in simply purchasing actual renewable fuel volumes. Of course, the option of purchasing actual renewable fuel volumes is available to all obligated parties.

6. *What specific steps is EPA taking to reduce uncertainty in the renewable fuels markets since the issuance of the NOVs and to reduce the impact on RIN sales and prices? Is EPA considering structural changes to RIN markets in order to reduce the likelihood of fraud? If so, please describe these potential changes.*

   The settlement offers extended by the EPA in January 2012 were one step toward providing some certainty to the obligated parties who used invalid RINs generated by Clean Green Fuels, LLC, protect RIN market integrity, and reinforce the need for companies to ensure they are using only valid RINs for compliance purposes. EPA actions against violators are a deterrent against future fraud and send the message the Agency is monitoring whether RINs that are transferred or retired represent actual renewable fuel.

   EMTS already provides several tools that can help RIN purchasers determine the validity of RINs (e.g., by allowing them to identify the generator of RINs) and avoid buying RINs from sources they question (i.e., by blocking receipt of RINs from such sources). We also post on our website monthly aggregated renewable fuel production information and we plan to post facility-specific production information in the future (pending determination that such production information is not entitled to treatment as confidential business information). We believe any structural changes the Agency could make to the program to reduce the likelihood of fraud would most likely reduce program flexibility. However, we have reached out to the regulated community through meetings and conference calls to solicit regulatory changes to address the RIN fraud situation and we are awaiting their input.

7. *Obligated parties have until February 28, 2012 to comply with their Renewable Volume Obligation (RVOs) for 2011. Given the current challenge of finding valid biofuel RINs, has EPA considered an extension of this deadline or any other near-term measures that may facilitate compliance? Given the difficulties finding valid RINs to replace invalid ones, has EPA considered expanding the universe of allowable replacement RINs, broadening the carryover provisions, or foregoing the requirement of procuring replacement RINs? Does EPA believe that there is sufficient latitude under existing law to create such flexibility?*

   We believe the existing flexibilities provided by the RFS2 regulations are more helpful to obligated parties required to meet their RVOs than changing the reporting deadline would be, especially at this point in time. Specifically, the RFS2 regulations provide the ability to carry a RIN deficit so obligated parties and renewable fuel exporters that have used invalid RINs

may be able to show that they meet their RVOs for 2011 by carrying a deficit forward in accordance with the limitations specified in the regulations and making up the deficit with valid RINs in the 2012 compliance year.

The statute currently limits deficit carry forward to the calendar year following the year in which the renewable fuel deficit is created. Therefore, extending the deficit carry forward provisions for an additional year would require a change in the statute.

Congress' goals in establishing the RFS program would not be met if fraudulent RINs could be used for compliance. The RIN market structure depends on the volume mandate to drive demand and hence renewable fuel production. If fraudulent RINs can be used, that will undercut the market for valid RINs. Requiring obligated parties to replace fraudulent RINs they have purchased will drive demand for valid RINs from real, legitimate producers. Failure to require replacement of the fraudulent RINs could have a devastating effect on small biodiesel producers as the small producers in particular may find themselves holding good RINs that no one needs and that will in the end expire without ever being sold. Therefore, the Agency has no plans to forego the requirement for obligated parties to procure valid replacement RINs.

8. *In EPA's January 9, 2012, Final Rule for the 2012 RFS, the agency recognized the problems caused by invalid RINs being bought and sold and thereby creating violations at each step. In the section entitled "RIN Retirement Provision for Error Correction," EPA included measures allowing improperly generated RINs to nonetheless be used for compliance by obligated party purchasers, while EPA focused on addressing the source of the invalid RINs. Although this solution was only contemplated for RINs generated in error rather than fraud, have you considered expanding this flexibility to the current situation?*

The RIN retirement provision for error correction was put in place to address instances where renewable fuel producers or importers may improperly generate RINs in EMTS as a result of calculation errors, meter malfunctions, or clerical errors. As stated in the regulations, improperly generated RINs are invalid, and cannot be used to achieve compliance with any RVO. This provision allows certain RINs that were improperly generated to nevertheless be transferred and used for compliance provided the RIN generator retires an equivalent number of valid RINs of the same vintage (fuel category and RIN year) in order to make the market whole. This flexibility may only be used under certain conditions, though, in order to mitigate harm to the RIN market. For the reasons discussed in our response to question 7, above, Congress' goals in establishing the RFS program would not be met if fraudulent RINs could be used for compliance purposes, except under very limited circumstances.

9. *In the preamble to EPA's March 26, 2010, Final Rule on the RFS program, the agency made clear that it "would normally look first to the generator or seller of the invalid RINs both for payment of penalty and to procure sufficient valid RINs to offset the invalid RINs." However, the agency's NOVs focused first on the ultimate purchasers as the parties to be penalized and made responsible for procuring valid RINs. What is the reason for this approach?*

The EPA is focusing its enforcement authority on Clean Green and is taking appropriate action to ensure that the invalid RINs generated by Clean Green are not used to meet the Congressionally mandated renewable fuel standards. The United States filed criminal charges against Clean Green and has seized about $7.8 million in assets from the company that may be available for restitution to victims that purchased invalid Clean Green RINs. The preamble and regulations make it clear that obligated parties are liable for violations if they use invalid RINs. While the preamble states that the EPA "would normally look first to the generator or seller of the invalid RINs both for payment of penalty and to procure sufficient valid RINs to offset the invalid RINs," the EPA also issued NOVs to parties that used Clean Green RINs because these parties failed to meet their compliance obligations, and to ensure that the renewable fuel mandates were met in a timely manner.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 24 2007

ASSISTANT ADMINISTRATOR
FOR ENFORCEMENT AND
COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Transmittal of Final OECA Parallel Proceedings Policy

FROM: Granta Y. Nakayama

TO: Regional Administrators
Regional Counsel
Regional Enforcement Directors
OECA Office Directors

Attached is the final revised Parallel Proceedings Policy which supersedes both the Memorandum, *Parallel Proceedings Policy*, Steven A. Herman, Assistant Administrator, Office of Enforcement (June 21, 1994), and the Memorandum, *Coordinated Settlement of Parallel Proceedings: Interim Policy and Procedures*, Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance (June 9, 1997).

This Policy reaffirms and clarifies the earlier policies, while adding procedural mechanisms to enhance effective communications between the Agency's civil and criminal enforcement programs. The Policy was developed through extensive coordination between the Office of Enforcement and Compliance Assurance's civil and criminal programs, consulting with Regional Counsels and the Department of Justice, Environment and Natural Resources Division's Environmental Enforcement Section and Criminal Enforcement Section.

Should you have any questions, please contact me at (202) 564-2440, or your staff may contact Melissa Marshall at (202) 564-7971 in the Office of Civil Enforcement, or Bette Ojala at (202) 564-4226 in the Office of Criminal Enforcement, Forensics and Training.

Attachment

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 24 2007

ASSISTANT ADMINISTRATOR
FOR ENFORCEMENT AND
COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Parallel Proceedings Policy

FROM: Granta Y. Nakayama *Granta Y. Nakayama*

TO: Regional Administrators
Regional Counsel
Regional Enforcement Directors
OECA Office Directors

Introduction

Most statutes administered by EPA include both civil and criminal enforcement authorities; effective protection of human health and the environment requires appropriate use of the full range of these authorities to identify and resolve violations. This Parallel Proceedings Policy up-dates the Agency's earlier policies regarding coordinated use of EPA's civil and criminal authorities to achieve environmental compliance.[1]

Although the great majority of EPA's enforcement actions are brought as either civil or criminal matters, there are instances in which both enforcement responses are appropriate. These include situations where the violations merit the deterrent and retributive effects of criminal enforcement, yet a civil action is also necessary to obtain an appropriate remedial result, and where the magnitude or range of the environmental violations and the available sanctions make both criminal and civil enforcement appropriate.

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[1] The following are hereby superseded: Memorandum, Parallel Proceedings Policy, Steven A. Herman, Assistant Administrator, Office of Enforcement, June 21, 1994; Memorandum, Coordinated Settlement of Parallel Proceedings: Interim Policy and Procedures, Steven A. Herman, Assistant Administrator, Office of Enforcement and Compliance Assurance, June 9, 1997.

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Definitions

EPA defines parallel proceedings very broadly to mean civil and criminal enforcement activities taken with respect to the same or related parties, dealing with the same or a related course of conduct.

- Proceedings include enforcement activities at both the investigative stage (including the use of entry and information-gathering authorities) and the litigation stage.

- Parallel proceedings are simultaneous or sequential enforcement actions taken with respect to the same or related parties and dealing with the same or a related course of conduct.

- Enforcement includes actions for criminal sanctions, civil penalties, injunctive relief, compliance orders and cost-recovery.

Consultation and Cooperation

Active consultation and cooperation between EPA's civil and criminal programs, consistent with all legal requirements, are critical to the success of EPA's overall enforcement program. The success of any parallel proceedings depends upon coordinated decisions by the civil and criminal programs as to the timing and scope of their activities. For example, it will often be important for the criminal program to notify civil enforcement managers that an investigation is about to become overt or known to the subject. Similarly, the civil program should notify the criminal program when there are significant developments in the civil matter that might change the scope of the outcome being sought. In every parallel proceeding, communication and coordination should be initiated at both the staff and manager levels and should continue through the resolution of all parallel matters.

In all parallel proceedings, the civil and criminal programs should initially meet to weigh the options and determine how to achieve the most complete and appropriate relief. In those instances where it is decided that only the criminal matter will go forward, the criminal enforcement program must ensure that the civil program is timely advised if the criminal matter will not be charged. That notification should occur no later than a year before the expiration of the statute of limitations in the civil matter.

Consistent with legal restrictions, emphasis should be placed on ensuring that the activities of each program complement – but do not interfere with – the other program and that information is gathered in such a way that it may be shared to the maximum extent appropriate. Communication and consultation with the Department of Justice (DOJ) should occur regarding all parallel proceedings. In matters where EPA's civil action is purely administrative, EPA's

criminal enforcement personnel should discuss the parallel proceeding with DOJ prosecutors. In matters involving a potential or filed civil judicial action, EPA civil and criminal enforcement personnel should each consult with their DOJ colleagues.

Each Region must establish a system for communication and coordinated decision-making that includes staff and managers from the Criminal Investigation Division (CID) and the Office of Regional Counsel and Regional enforcement office (RC). Similarly, the Headquarters Office of Enforcement and Compliance Assurance (OECA) must establish such a system between the Office of Criminal Enforcement and Forensics Training (OCEFT), the Office of Civil Enforcement (OCE) and/or the Offices of Site Remediation Enforcement (OSRE) and Federal Facilities Enforcement (FFEO), as appropriate, for proceedings where OCE, OSRE or FFEO has the lead or where a significant national interest has been identified. If there is disagreement between Regional civil and criminal enforcement managers as to whether parallel proceedings are appropriate or the order in which the actions will go forward, the applicable OCE, OSRE, FFEO and OCEFT Office Directors should be notified. The Directors will either resolve the issue or refer it to the Principal Deputy Assistant Administrator for OECA.

Types and Management of Parallel Proceedings

There are essentially two types of parallel proceedings. The more frequent parallel proceedings involve criminal actions where a parallel civil administrative compliance or cleanup order is also required for protection of human health or the environment. In these situations, a civil penalty action ordinarily should not be brought unless the criminal proceeding does not go forward.[1]

The other type of parallel proceedings is where the nature of the conduct is sufficiently egregious that both civil and criminal responses are appropriate. These parallel proceedings are infrequent. They tend to be significant and complex enforcement actions, requiring careful case-by-case management and on-going effective communication and coordination. There are a number of ways to approach management of this second type of parallel proceedings, including:

- Deciding that either the civil or criminal action will be sufficient to achieve the

[1] In exceptional instances where the respondent/defendant refuses to comply with an order, it may be necessary to impose civil penalties for that failure in order to achieve a timely cleanup. Such action must be jointly decided upon by the civil and criminal programs and subject to the considerations discussed in this section and should be managed pursuant to the procedures used in the more complex type of parallel proceedings.

Agency's interests;[3]

- Deferring the civil proceeding until the criminal case is resolved;
- "Carving-out" civil or criminal claims where allegations in either proceeding do not overlap or where the defendants are not the same;
- Proceeding simultaneously while attempting to resolve the civil matter through negotiation, rather than filing the civil action;
- Filing a civil action where it is necessary to preserve a claim and moving to stay the action; or
- Proceeding with the civil and criminal matters simultaneously.

If a determination is made to file a civil complaint before resolution of the criminal matter, the civil and criminal programs should meet to decide whether to request a stay of any part of the civil case pending resolution of the criminal case. This meeting is not required where the civil matter has been resolved either administratively or through a judicial consent decree or other settlement agreement that will be lodged with the filing of a complaint.

Legal and Practical Implications of Parallel Proceedings

In deciding whether parallel proceedings are appropriate and how best to manage them, the enforcement team should be aware of the legal and practical issues affecting related proceedings, as well as the timing of enforcement activities. Factors that favor bringing the criminal proceeding to conclusion first include:

- The significant deterrent and punitive effects of criminal sanctions;
- The ability to use a criminal conviction as collateral estoppel in a subsequent civil case;
- The possibility that imposition of civil penalties might undermine a prosecution or the severity of a subsequent criminal sentence;
- Preservation of the secrecy of a criminal investigation, including completion of covert sampling;
- Prevention of a defendant's premature discovery of evidence in the criminal case, through a defendant's exploitation of the civil discovery process to obtain evidence regarding the criminal proceeding;
- Avoidance of unnecessary litigation issues, such as unfounded defense claims of misuse of process in the civil or criminal action;
- Avoidance of duplicative interviews of witnesses and subjects;

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[3] Generally, if a criminal proceeding can accomplish complete relief the matter should go forward criminally. However, where the civil proceeding has been significantly developed and the criminal proceeding is relatively undeveloped and speculative, then the civil matter should continue, maintaining coordination with the criminal program.

- The Speedy Trial Act requirements that trial be held within specified time frames after indictment.

Factors supporting the initiation or continuation of the civil judicial or administrative action prior to conclusion of the criminal action include:

- A threat to human health or the environment that should be expeditiously addressed through preliminary injunctive relief or response action;
- A threat of dissipation of the defendant's assets;
- An immediate statute of limitations or bankruptcy deadline;
- Where only a marginal relationship exists between the civil and criminal actions;
- The civil case is in an advanced stage of negotiation or litigation when the potential criminal liability is discovered;
- The civil case is integral to a national priority and a decision to postpone the case could substantially and adversely affect implementation of the national effort.

Memorialization

Once the civil and criminal programs decide to pursue parallel proceedings and agree upon their timing, they should promptly memorialize these decisions in a case-specific Parallel Proceedings Memorandum. The Memorandum should provide only essential information, including a description of the key factual allegations and potential statutory and regulatory violations. Most importantly, the Memorandum must contain a summary of the decision(s) regarding the timing and scope of the parallel proceedings.

The Memorandum must be signed by the appropriate CID Special Agent in Charge and the RC. In identified cases of national interest or those in which OCE, OSRE or FFEO has the lead for the civil matter, the Memorandum should be signed by the OCEFT and OCE, OSRE or FFEO Office Directors. It should be written as a memorandum to the case file and distributed to all members of the civil and criminal case teams. In cases of national interest, a copy of the Memorandum should also be provided to the Principal Deputy Assistant Administrator of OECA. As parallel proceedings are developed and moved toward resolution, it may be necessary to revisit the decisions recorded in the Memorandum; any new or modified changes should be documented and then distributed to the civil and criminal case teams. The Memorandum should be marked as Attorney/Client Privileged and Work Product and be maintained as an enforcement confidential record.

Legal Guidelines

Parallel proceedings present specific legal issues regarding investigations, discovery and litigation. In addition to complying with all legal and ethical requirements, enforcement personnel should follow practices that avoid even the appearance of overreaching or unfairness.

These guidelines apply to all parallel proceedings.

Grand Jury Materials

EPA criminal investigative personnel obtain access to grand jury materials only if permitted by a federal prosecutor. Agency personnel must comply with the prosecutor's directions in order to assure their compliance with the law and procedures of that judicial district.

Rule 6(e) of the Federal Rules of Criminal Procedure prohibits disclosure of any matter occurring before a grand jury or information that is part of a grand jury's record except in very limited circumstances, usually involving an authorizing order from the court. EPA personnel must take utmost care not to violate this secrecy rule; violators may be subject to civil and/or criminal sanctions. The Rule prohibits using grand jury information for any purpose other than assisting the prosecutor in the criminal proceedings; for example, knowledge drawn from the grand jury record must not be used in civil enforcement activities, absent a court order authorizing the use. To avoid either the release of grand jury information or the appearance of misuse, EPA personnel to whom Rule 6(e) grand jury information has been disclosed should not be assigned to any parallel civil enforcement matter.

Criminal investigative information that is not subject to grand jury secrecy and use rules may be shared with the civil program without violating Rule 6(e). However, once grand jury proceedings are initiated, such information sharing should not occur unless the prosecutor agrees that the disclosure or use will not violate Rule 6(e). When this information sharing does occur, a record should be made in the criminal case file of DOJ's agreement that the information could be shared; what material was transmitted; the source of that information (*i.e.*, a description of its non-grand jury status), and who may receive it.

Information Requests and Inspections

The criminal program does not direct the civil program's investigative activities, nor does the civil program direct the criminal program's investigative activities. It is entirely appropriate for the civil enforcement personnel to bring information to the attention of the criminal program and for criminal enforcement personnel to bring information to the attention of the civil program, subject to the restrictions discussed in this Policy's section on grand jury materials, above.

EPA's regulatory inspections, including administrative searches with a warrant, must be objectively reasonable and properly limited within the scope of the authorizing statute and warrant. In every situation, the government has a duty to act in good faith and must ensure that its use of administrative entry authorities is properly within the mandate of the Fourth Amendment.

EPA's information-gathering authorities must be used in accordance with authorizing

statutory provisions. There is no general legal bar to using administrative mechanisms to investigate suspected criminal matters. However, the government must not intentionally mislead a person as to the possible use of any responsive information in the criminal context in such a way as to violate the Fifth Amendment Due Process Clause or the Self-Incrimination Privilege.[4] Accordingly, although not a legal requirement, it is a common EPA practice to include a warning in EPA information requests that all information sought may be used in an administrative, civil judicial or criminal action. Furthermore, it is EPA policy that any information request issued by EPA's criminal enforcement program must clearly reflect that the information is being sought by that program.

Civil Discovery

Any information obtained as a result of a legitimate civil purpose, including discovery, may be shared with criminal enforcement personnel.[5]

In responding to civil discovery, government attorneys may assert a law enforcement privilege to protect responsive files in a parallel criminal case. If there is a motion to compel production of the criminal files, the law enforcement privilege must be asserted by a high EPA official (such as the Assistant Administrator or Deputy Assistant Administrator for OECA) explaining the harm that would be caused by disclosure of the records. This is a qualified privilege, however, and can be overcome if a litigant's need outweighs the government's interests in keeping the information confidential. Thus, the possibility that criminal investigation files might have to be produced is a factor to consider when determining whether civil litigation should go forward while the criminal proceeding is pending. Prior to informing a defendant of a decision by EPA not to assert this privilege, the civil attorney should coordinate closely with the EPA and Department of Justice criminal programs to ensure that the privacy interests of individuals mentioned in the criminal case records are fully protected.

Double Jeopardy

Parallel proceedings under the environmental laws do not give rise to double jeopardy

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[4] The Fifth Amendment privilege against self-incrimination may only be raised by individuals, not by business entities. A business must respond to an information request, even if individuals within that entity claim the privilege and refuse to respond in their individual capacities.

[5] United States v. Kordel, 397 U.S. 1 (1970). Note that protected Confidential Business Information can only be disclosed to those authorized to receive it.

concerns.[6] The Double Jeopardy Clause of the Fifth Amendment only protects against the imposition of multiple *criminal* punishments of the same person for the same offense. To raise even a question about possible double jeopardy arguments, a civil penalty would have to be so punitive in form and effect that it transforms an intended civil remedy into a criminal penalty.

Disproportionate Penalties

Civil penalties should not be imposed that, taken together with criminal sanctions, are so grossly disproportionate to the underlying violations that they violate the constitutional prohibition of excessive fines.[7]

Ethical Considerations

Attorneys and other persons representing EPA in enforcement actions must never use the threat of criminal prosecution to obtain a civil settlement, nor may they use the threat of civil enforcement to resolve a criminal matter. This ethical rule is important in every case, and is particularly important in the context of parallel proceedings to avoid even the appearance of impropriety.

Coordinated Resolutions

A coordinated resolution is the simultaneous resolution of both civil and criminal liability in a parallel proceeding.[8] Although not required by law, it is EPA policy that only the defendant may make this proposal. In such an event, EPA, in conjunction with DOJ, should consider whether coordinated settlements of civil and criminal liability would be a timely, practical and appropriate resolution of the violations and in the best interests of the United States. A coordinated resolution would not be appropriate if, for example, the process of negotiating civil relief would unduly delay or interfere with the criminal proceeding. It would also be inappropriate if the negotiations regarding the criminal case limited EPA's ability to respond to an environmental or human health threat or limited the Agency's ability to obtain appropriate injunctive relief.

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[6] Hudson v. United States, 522 U.S. 93 (1997).

[7] Id., 522 U.S. at 103.

[8] Simultaneous resolutions of a defendant's civil and criminal liability were formerly known as "global" settlements. That term is now applied to civil settlements that resolve similar violations at most or all of a defendant's facilities. The term "coordinated" resolutions more accurately describes the simultaneous conclusion of parallel civil and criminal proceedings.

When EPA approves a coordinated resolution, the following limitations apply:

- The settlement documents must be negotiated separately;
- EPA will not agree to release criminal liability in a civil settlement;
- EPA will not approve the waiver or discharge of civil liability in a criminal plea agreement; and
- The civil and criminal resolutions must conform to all applicable policies; and must be memorialized in separate settlement documents.

Reservation of Rights

This Policy provides internal guidelines for the Environmental Protection Agency. It is not intended to, and does not, create any rights, substantive or procedural, that are enforceable at law by any party. No limitations are hereby placed on otherwise lawful prerogatives of the Environmental Protection Agency.

FRED UPTON, MICHIGAN
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MEMBER

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON ENERGY AND COMMERCE
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WASHINGTON, DC 20515–6115

Majority (202) 225-2927
Minority (202) 225-3641

May 24, 2012

The Honorable Lisa Jackson
Administrator
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, D.C. 20460

Dear Administrator Jackson:

The Committee on Energy and Commerce is investigating the Environmental Protection Agency's (EPA or "Agency") administration of the Renewable Fuel Standards (RFS) Program. On February 3, 2012, Committee Chairman Fred Upton and Energy and Power Subcommittee Chairman Ed Whitfield wrote EPA seeking information relating to concerns about EPA's handling of fraud in the program.

In the system developed and administered by EPA to track compliance with RFS, the agency relies on Renewable Identification Numbers (RINs), created by EPA-registered renewable fuels producers. RINs serve as credits for specific amounts of renewable fuels produced and blended into the nation's fuel supply, consistent with statutory requirements. RINs can be traded, much like currency, to allow for producers and importers of gasoline and diesel to meet RFS blending obligations. Unfortunately, the production of and trade in fraudulent or invalid RINs has developed into a large and growing problem. And EPA's efforts to address the problem so far appear ineffective, and in some respects have harmed the renewable fuels marketplace.

Since the Committee's February 3, 2012, letter and EPA's February 23, 2012, response, there have been further troubling developments which have intensified the Committee's concerns. For example, the number of biodiesel RINs that EPA has now publicly identified as invalid has increased from approximately 80 million to nearly 140 million,[1] with credible sources indicating to Committee investigators that the number could double in the coming months. However, it does not appear that the EPA has taken any steps to actually solve the problem.

[1] See EPA's April 30, 2012, announcement concerning invalid RINs produced by Green Diesel, LLC.

EPA has informed the Committee that it has no plans to modify or forego its requirement that forces companies that purchased invalid RINs in good faith to also purchase valid replacement RINs. Yet these re-purchases must take place through an EPA-administered system in which EPA professes no responsibility for ensuring what are and what are not valid RINs – thereby escalating uncertainty in the market place. This uncertainty is particularly devastating to smaller producers and market participants, as the "obligated parties" who must purchase the RINs back away from all but the largest and most well-known producers. This, in turn, has drastically distorted pricing in the RIN marketplace, making RINs more expensive and driving up costs for the obligated parties.

We write today to request additional information relating to EPA's handling of RIN fraud in the RFS program. Accordingly, and pursuant to Rules X and XI of the U.S. House of Representatives, please provide the requested documents and written responses to the following questions by June 7, 2012. We ask that you follow the instructions for responding to the Committee's document requests, included as an attachment to this letter.

1. Please provide a detailed chronology of EPA's actions with regard to Green Diesel, including a description of the Agency's communication of these actions to the regulated community, including, but not limited to, (i) when and how EPA first learned that Green Diesel's RINs may be invalid, and (ii) when and how the Agency first notified the purchasers that the Agency believed that the Green Diesel RINs were invalid.

    a. Did EPA know of the potential invalidity of the Green Diesel RINs prior to the April 20, 2012, settlement agreement with 31 companies?

    b. If so, why did EPA wait to issue a Notice of Violation (NOV) against Green Diesel until 10 days after announcing the settlement agreements with respect to the invalid RINs identified from Clean Green and Absolute Fuels?

2. Please provide any registration and/or re-registration applications and accompanying materials submitted by Green Diesel, Absolute Fuels, or Clean Green and any related companies. Please describe EPA's review and approval process of any such applications.

    a. Were engineering reviews and site visits by independent third parties conducted, as required by 40 C.F.R. § 80.1450, before the Agency approved registration applications for any of these companies?

    b. Please provide all documents that were submitted to EPA to satisfy these regulatory requirements and all documents relating to such reviews and visits.

    c. Did these companies submit any attestation reports, pursuant to 40 C.F.R. § 80.1464, for the years 2010 and 2011? Please provide all such reports.

3. Under the EPA Moderated Transaction System (EMTS), it is possible for participants to block transactions with certain RIN producers within the system from which they choose not to purchase RINs. Please provide any registration and/or re-registration applications,

including all documents submitted to EPA as part of these applications, for the ten most-frequently blocked registrants on EMTS as of the date of this letter. For each registrant, please describe EPA's application review and approval process.

4. The Committee has been informed that there may be additional fraudulent RINs currently in the marketplace. Please describe EPA's plan for managing and investigating the possibility of additional invalid RINs within the RFS program.

   a. Are there presently participants in the RFS program under investigation for invalid, fraudulent, or otherwise improper RINs, regardless of whether the investigation is preliminary, partial or complete?

   b. If so, how many?

   c. When does EPA expect to complete any pending investigations of companies participating in the RFS program? When does EPA expect to fully inform impacted parties and the regulated community of its findings?

5. What regulatory approaches would the Agency be able to implement so that an obligated party operating in good faith can avoid penalties and/or NOVs under the RFS program as a result of using fraudulently generated RINs? Is a regulatory change necessary? Why or why not?

6. Was EPA statutorily obligated to impose strict liability for RIN compliance or is this a product of EPA's policy choice(s)?

   a. Provide all documents relating to EPA's decision to impose strict liability for RIN compliance.

7. How, if at all, does EPA believe that the "buyer beware" approach helps to ensure reliability of the RINs purchased in the renewable fuels marketplace in the instance of fuel that is produced but is perhaps off-specification?

   a. If a RIN purchaser buys RINs from a broker, how can that purchaser obtain the necessary due diligence information regarding the fuel supplier?

   b. The RFS program allows separation of RINs from the gallon of biofuel. As a consequence, might a RIN purchaser that exercises due diligence be unable to discern whether a RIN was properly generated and appropriately coded in EMTS?

8. In EPA's February 23, 2012, response to the Committee, the Agency invoked low-sulfur fuels as an example of industry participants engaging in due diligence to ensure that the sulfur tolerances of each batch are met. But physical fuel can be inspected and tested by each buyer, while separated RINs cannot. Given that RINs are essentially a currency created under the supervision of EPA, is there an additional obligation on the part of the Agency to ensure validity of the RINs?

9. Why has EPA moved forward with enforcement actions against good faith purchasers? Does EPA make any distinction between good faith and bad faith purchasers?

   a. Under what circumstances would EPA decide *not* to bring an enforcement action?

   b. On what basis will EPA decide to bring or not bring an enforcement action against a purchaser in the future?

We appreciate your prompt attention to this request. Should you have any questions, you may contact Peter Spencer or Sam Spector of the Majority Committee staff at (202) 225-2927.

Sincerely,

Fred Upton
Chairman

Cliff Stearns
Chairman
Subcommittee on Oversight and Investigations

Ed Whitfield
Chairman
Subcommittee on Energy and Power

Michael C. Burgess
Vice Chairman
Subcommittee on Health

Attachment

cc: The Honorable Henry A. Waxman, Ranking Member

The Honorable Diana DeGette, Ranking Member
Subcommittee on Oversight and Investigations

The Honorable Bobby L. Rush, Ranking Member
Subcommittee on Energy and Power

RESPONDING TO COMMITTEE DOCUMENT REQUESTS

In responding to the document request, please apply the instructions and definitions set forth below:

INSTRUCTIONS

1. In complying with this request, you should produce all responsive documents that are in your possession, custody, or control or otherwise available to you, regardless of whether the documents are possessed directly by you.

2. Documents responsive to the request should not be destroyed, modified, removed, transferred, or otherwise made inaccessible to the Committee.

3. In the event that any entity, organization, or individual named in the request has been, or is currently, known by any other name, the request should be read also to include such other names under that alternative identification.

4. Each document should be produced in a form that may be copied by standard copying machines.

5. When you produce documents, you should identify the paragraph(s) and/or clause(s) in the Committee's request to which the document responds.

6. Documents produced pursuant to this request should be produced in the order in which they appear in your files and should not be rearranged. Any documents that are stapled, clipped, or otherwise fastened together should not be separated. Documents produced in response to this request should be produced together with copies of file labels, dividers, or identifying markers with which they were associated when this request was issued. Indicate the office or division and person from whose files each document was produced.

7. Each folder and box should be numbered, and a description of the contents of each folder and box, including the paragraph(s) and/or clause(s) of the request to which the documents are responsive, should be provided in an accompanying index.

8. Responsive documents must be produced regardless of whether any other person or entity possesses non-identical or identical copies of the same document.

9. The Committee requests electronic documents in addition to paper productions. If any of the requested information is available in machine-readable or electronic form (such as on a computer server, hard drive, CD, DVD, back up tape, or removable computer media such as thumb drives, flash drives, memory cards, and external hard drives), you should immediately consult with Committee staff to determine the appropriate format in which to produce the information. Documents produced in electronic format should be organized, identified, and indexed electronically in a manner comparable to the organizational structure called for in (6) and (7) above.

10. If any document responsive to this request was, but no longer is, in your possession, custody, or control, or has been placed into the possession, custody, or control of any third party and cannot be provided in response to this request, you should identify the document (stating its date, author, subject and recipients) and explain the circumstances under which the document ceased to be in your possession, custody, or control, or was placed in the possession, custody, or control of a third party.

11. If any document responsive to this request was, but no longer is, in your possession, custody or control, state:

a. how the document was disposed of;
b. the name, current address, and telephone number of the person who currently has possession, custody or control over the document;
c. the date of disposition;
d. the name, current address, and telephone number of each person who authorized said disposition or who had or has knowledge of said disposition.

12. If any document responsive to this request cannot be located, describe with particularity the efforts made to locate the document and the specific reason for its disappearance, destruction or unavailability.

13. If a date or other descriptive detail set forth in this request referring to a document, communication, meeting, or other event is inaccurate, but the actual date or other descriptive detail is known to you or is otherwise apparent from the context of the request, you should produce all documents which would be responsive as if the date or other descriptive detail were correct.

14. The request is continuing in nature and applies to any newly discovered document, regardless of the date of its creation. Any document not produced because it has not been located or discovered by the return date should be produced immediately upon location or discovery subsequent thereto.

15. All documents should be bates-stamped sequentially and produced sequentially. In a cover letter to accompany your response, you should include a total page count for the entire production, including both hard copy and electronic documents.

16. Documents should be delivered to the Committee majority staff in Room 316 of the Ford House Office Building. You should consult with Committee majority staff regarding the method of delivery prior to sending any materials.

17. In the event that a responsive document is withheld on any basis, including a claim of privilege, you should provide the following information concerning any such document: (a) the reason the document is not being produced; (b) the type of document; (c) the general subject matter; (d) the date, author and addressee; (e) the relationship of the author and addressee to each other; and (f) any other description necessary to identify the document and to explain the basis

for not producing the document. If a claimed privilege applies to only a portion of any document, that portion only should be withheld and the remainder of the document should be produced. As used herein, "claim of privilege" includes, but is not limited to, any claim that a document either may or must be withheld from production pursuant to any statute, rule, or regulation.

18. If the request cannot be complied with in full, it should be complied with to the extent possible, which should include an explanation of why full compliance is not possible.

19. Upon completion of the document production, you should submit a written certification, signed by you or your counsel, stating that: (1) a diligent search has been completed of all documents in your possession, custody, or control which reasonably could contain responsive documents; (2) documents responsive to the request have not been destroyed, modified, removed, transferred, or otherwise made inaccessible to the Committee since the date of receiving the Committee's request or in anticipation of receiving the Committee's request, and (3) all documents identified during the search that are responsive have been produced to the Committee, identified in a privilege log provided to the Committee, as described in (17) above, or identified as provided in (10), (11) or (12) above.

DEFINITIONS

1. The term "document" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded, and whether original or copy, including but not limited to, the following: memoranda, reports, expense reports, books, manuals, instructions, financial reports, working papers, records, notes, letters, notices, confirmations, telegrams, receipts, appraisals, pamphlets, magazines, newspapers, prospectuses, interoffice and intra-office communications, electronic mail ("e-mail"), instant messages, calendars, contracts, cables, notations of any type of conversation, telephone call, meeting or other communication, bulletins, printed matter, computer printouts, invoices, transcripts, diaries, analyses, returns, summaries, minutes, bills, accounts, estimates, projections, comparisons, messages, correspondence, press releases, circulars, financial statements, reviews, opinions, offers, studies and investigations, questionnaires and surveys, power point presentations, spreadsheets, and work sheets. The term "document" includes all drafts, preliminary versions, alterations, modifications, revisions, changes, and amendments to the foregoing, as well as any attachments or appendices thereto. The term "document" also means any graphic or oral records or representations of any kind (including, without limitation, photographs, charts, graphs, voice mails, microfiche, microfilm, videotapes, recordings, and motion pictures), electronic and mechanical records or representations of any kind (including, without limitation, tapes, cassettes, disks, computer server files, computer hard drive files, CDs, DVDs, back up tape, memory sticks, recordings, and removable computer media such as thumb drives, flash drives, memory cards, and external hard drives), and other written, printed, typed, or other graphic or recorded matter of any kind or nature, however produced or reproduced, and whether preserved in writing, film, tape, electronic format, disk, videotape or otherwise. A document bearing any notation not part of the original text is considered to be a separate document. A draft or non-identical copy is a separate document within the meaning of this term.

2. The term "documents in your possession, custody or control" means (a) documents that are in your possession, custody, or control, whether held by you or your past or present agents, employees, or representatives acting on your behalf; (b) documents that you have a legal right to obtain, that you have a right to copy, or to which you have access; and (c) documents that have been placed in the possession, custody, or control of any third party.

3. The term "communication" means each manner or means of disclosure, transmission, or exchange of information, in the form of facts, ideas, opinions, inquiries, or otherwise, regardless of means utilized, whether oral, electronic, by document or otherwise, and whether face-to-face, in a meeting, by telephone, mail, e-mail, instant message, discussion, release, personal delivery, or otherwise.

4. The terms "and" and "or" should be construed broadly and either conjunctively or disjunctively as necessary to bring within the scope of this request any information which might otherwise be construed to be outside its scope. The singular includes the plural number, and vice versa. The masculine includes the feminine and neuter genders.

5. The terms "person" or "persons" mean natural persons, firms, partnerships, associations, limited liability corporations and companies, limited liability partnerships, corporations, subsidiaries, divisions, departments, joint ventures, proprietorships, syndicates, other legal, business or government entities, or any other organization or group of persons, and all subsidiaries, affiliates, divisions, departments, branches, and other units thereof.

6. The terms "referring" or "relating," with respect to any given subject, mean anything that constitutes, contains, embodies, reflects, identifies, states, refers to, deals with, or is in any manner whatsoever pertinent to that subject.

7. The terms "you" or "your" mean and refers to

For government recipients:

"You" or "your" means and refers to you as a natural person and the United States and any of its agencies, offices, subdivisions, entities, officials, administrators, employees, attorneys, agents, advisors, consultants, staff, or any other persons acting on your behalf or under your control or direction; and includes any other person(s) defined in the document request letter.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUN 28 2012

The Honorable Fred Upton
Chairman, Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Upton:

Thank you for your May 24, 2012 letter, to Administrator Lisa Jackson, co-signed by your colleagues, regarding the United States Environmental Protection Agency's administration of the Renewable Fuels Standard (RFS) program and Renewable Identification Number (RIN) fraud. We appreciate the Committee's questions and concerns and we have been actively following up on addressing those concerns.

The Agency is committed to meeting the statutory goals of the RFS. Since our February 23, 2012, correspondence with the Committee, we have been meeting and corresponding with industry stakeholders to discuss various approaches to improve the RFS program. In addition, over the last several months, a number of companies have started to provide RIN verification services to market participants. The Agency is continuing its dialogue with representatives from the affected and interested industry sectors to discuss a number of options currently under consideration, including the concept of a third-party RIN certification process.

EPA staff also met with Committee staff on June 13, 2012, in regard to many of the concerns raised in your letter and the options under consideration. The Agency is very cognizant of the concerns regarding the recent enforcement actions, and we are making every effort to address such concerns and to develop constructive and effective solutions where necessary.

Initial responses to your questions are enclosed, and as noted, the additional information and documents will be provided as soon as practicable.

Again, thank you for your letter. If you have further questions, please contact us or your staff may call Carolyn Levine in EPA's Office of Intergovernmental and Congressional Relations at 202-564-1859.

Sincerely,

Cynthia Giles
Assistant Administrator
Office of Enforcement and Compliance Assurance

Gina McCarthy
Assistant Administrator
Office of Air and Radiation

Enclosures

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUN 28 2012

The Honorable Cliff Stearns
Chairman, Subcommittee on Oversight and Investigations
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Stearns:

Thank you for your May 24, 2012 letter, to Administrator Lisa Jackson, co-signed by your colleagues, regarding the United States Environmental Protection Agency's administration of the Renewable Fuels Standard (RFS) program and Renewable Identification Number (RIN) fraud. We appreciate the Committee's questions and concerns and we have been actively following up on addressing those concerns.

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Sincerely,

Cynthia Giles
Assistant Administrator
Office of Enforcement and Compliance Assurance

Gina McCarthy
Assistant Administrator
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Enclosure

EPA Responses to May 24, 2012 letter

1. *Please provide a detailed chronology of EPA's actions with regard to Green Diesel, including a description of the Agency's communication of these actions to the regulated community, including, but not limited to, (i) when and how EPA first learned that Green Diesel's RINs may be invalid, and (ii) when and how the Agency first notified the purchasers that the Agency believed that the Green Diesel RINs were invalid.*

While EPA's actions regarding Green Diesel involve matters currently under active investigation and/or preparation for enforcement action, we are providing responses to the Committee to address your interest in understanding EPA's actions while not disclosing information that might adversely affect a pending enforcement action, overall enforcement policy, or the rights of individuals.

The RFS 2 program began on July 1, 2010. On July 16, 2010, Green Diesel began generating RINs under the RFS 2 program based on information EPA received. On July 18, 2011, EPA's Office of Civil Enforcement sent a letter to Green Diesel that informed the company that the EPA intended to conduct an inspection and identified the types of documents that the EPA intended to review. On August 3rd and 4th, 2011, the EPA's Office of Civil Enforcement (OCE) conducted an inspection of Green Diesel.

Shortly after the inspection of Green Diesel was conducted, OCE informed EPA's Office of Criminal Enforcement, Forensics and Training (OCEFT) about information obtained during the inspection. Further investigation proceeded in accordance with EPA's September 24, 2007, Parallel Proceedings Policy.

On December 7, 2011, OCE sent an information request to Green Diesel under the authority of Section 114 of the Clean Air Act. Green Diesel responded to this information request through three submissions received by EPA on January 13, 2012, January 16, 2012 and January 23, 2012.

On April 30, 2012, the EPA issued a Notice of Violation to Green Diesel alleging that all of the RFS 2 RINs that it generated from July 16, 2010 through July 15, 2011 were invalid. The NOV alleges the company generated more than 60 million invalid biomass-based diesel RINs without producing any qualifying renewable fuel and transferred the majority of these invalid RINs to others. As soon as the EPA issued this NOV, the Agency 1) posted the NOV on its website at: http://www.epa.gov/compliance/civil/caa/fuel-novs.html, 2) called all obligated parties that used Green Diesel RINs to inform them that the Agency issued an NOV and to direct them to the EPA's Interim Enforcement Response Policy (IERP), and 3) sent an email to the obligated parties with a link to the EPA's website where the NOV and IERP is posted.

The EPA's Office of Transportation and Air Quality followed up with each obligated party that used Green Diesel RINs, and provided them with instructions regarding how to remove these RINs from their annual compliance reports and resubmit corrected reports. The EPA also

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contacted all parties who owned, but did not use, Green Diesel RINs, and informed these parties that the Agency issue an NOV alleging that Green Diesel generated invalid RINs.

a. *Did EPA know of the potential invalidity of the Green Diesel RINs prior to the April 20, 2012 settlement agreement with 31 companies?*

Yes.

b. *If so, why did EPA wait to issue a Notice of Violation against Green Diesel until 10 days after announcing the settlement agreements with respect to the invalid RINs identified from Clean Green and Absolute Fuels?*

The timing of the Green Diesel Notice of Violation (NOV) was based solely on the facts of EPA's investigation of Green Diesel and the implementation of the EPA's Parallel Proceedings Policy, and was independent of other enforcement actions, including the announcement of the Clean Green and Absolute settlements. The EPA advances each of its investigations according to the facts of that case. In our Interim Enforcement Response Policy, the EPA explains that it intends to notify the regulated community that it has alleged that RINs are invalid "when the agency has developed what it determines is sufficient proof to warrant a public allegation and determined that such notification will not unduly impair ongoing investigations." The Agency also needs to balance the desire for quick action with the responsibility to protect the rights of the parties under investigation. Prior to issuing the Green Diesel NOV, the EPA (1) obtained sufficient evidence to support the allegations, and (2) worked with OCEFT and the United States Department of Justice to ensure that the issuance of the NOV would be consistent with EPA's Parallel Proceedings Policy.

2. *Please provide any registration and/or re-registration applications and accompanying materials submitted by Green Diesel, Absolute Fuels, or Clean Green and any related companies. Please describe EPA's review and approval process of any such applications. Were engineering reviews and site visits by independent third parties conducted, as required by 40 C.F.R. 80.1450, before the Agency approved registration applications for any of these companies? Please provide all documents that were submitted to EPA to satisfy these regulatory requirements and all documents relating to such reviews and visits. Did these companies submit any attestation reports, pursuant to 40 C.F.R. 80.1464, for the years 2010 and 2011? Please provide all such reports.*

We are collecting documents responsive to question 2 and will provide these to the Committee, together with responses to the questions, as soon as practicable. Please note that these documents will contain confidential business information.

3. *Under the EPA Moderated Transaction System (EMTS), it is possible for participants to block transactions with certain RIN producers within the system from which they choose not to purchase RINs. Please provide any registration and/or re-registration applications, including all documents submitted to EPA as part of these applications, for the ten most-frequently blocked*

registrants on EMTS as of the date of this letter. For each registrant, please describe EPA's applications review and approval process.

We are collecting documents responsive to question 3 and will provide these to the Committee, together with responses to the questions, as soon as practicable. Please note that these documents will contain confidential business information.

4. *The Committee has been informed that there may be additional fraudulent RINs currently in the marketplace. Please describe EPA's plan for managing and investigating the possibility of additional invalid RINs within the RFS program.*

   a. *Are there presently participants in the RFS program under investigation for invalid, fraudulent, or otherwise improper RINs, regardless of whether the investigation is preliminary, partial or complete?*

      Yes. EPA's Criminal Investigation Division (CID) is investigating alleged fraudulent RIN violations in conjunction with other federal law enforcement partners.

   b. *If so, how many?*

      EPA currently has open criminal investigations involving potentially fraudulent RINs. One of these – Clean Green – has been formally charged, and its President, Rodney Hailey was convicted on all counts during his recently concluded trial in U.S. District Court in Maryland.

5. *What regulatory approaches would the Agency be able to implement so that an obligated party operating in good faith can avoid penalties and/or NOVs under the RFS program as a result of using fraudulently generated RINs? Is a regulatory change necessary? Why or why not?*

   EPA is meeting with a wide range of industry stakeholders to hear their suggestions regarding potential regulatory changes involving good faith purchasers, and we look forward to a solution that improves the RFS program and effectively implements statutory requirements.

   The Agency understands the concerns that obligated parties have with the potential liability of good faith purchasers who submit invalid RINs to fulfill their annual renewable fuel obligation. As an initial response to those concerns, the Agency has implemented an Interim Enforcement Response Policy (IERP) to address violations arising from the use of invalid RINs. The IERP is described in more detail in the response to question 9, below.

6. *Was EPA statutorily obligated to impose strict liability for RIN compliance or is this a product of EPA's policy choice(s)? Provide all documents relating to EPAs decision to impose strict liability for RIN compliance.*

   EPA is evaluating its current policy and discussing alternative policy choices with a wide range of stakeholders. To date, EPA has strived to develop an enforcement system for the RFS

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program that allows the Agency to meet its statutory mandate. The Clean Air Act requires EPA to promulgate regulations to "ensure" that transportation fuel sold or introduced into commerce in the United States contains a minimum volume of renewable fuel, advanced biofuel, cellulosic biofuel, and biomass-based diesel on an average annual basis. 42 U.S.C. §7545(o)(2)(A)(i). The Act further requires that these regulations contain compliance provisions to ensure that the annual minimum RFS goal is met. 42 U.S.C. §7545(0)(2)(A)(iii).

While the statute does not specify a particular legal standard of responsibility by name, the annual RFS goals are met by obtaining compliance from obligated fuel producers and importers. If obligated parties fall short of their renewable fuel obligations, the Agency falls short of its statutory obligation to ensure the minimum RFS goals are met.

The EPA's decision to impose strict liability for RIN compliance is explained in the Preamble to the RFS1 Rule, Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program; Final Rule, 72 Fed. Reg. 23900-23993 (May 1, 2007); the Preamble to the RFS 2 Rule, Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program, 75 Fed. Reg. 14670-14863 (March 26, 2010); and the Summary and Analysis of Comments for the RFS 2 Rule, February 2010, EPA-420-R-10-003, 4-42. We are providing the relevant excerpts from these documents as separate attachments to this letter.

7. *How, if at all, does EPA believe that the "buyer beware" approach helps to ensure reliability of the RINs purchased in the renewable fuels marketplace in the instance of fuel that is produced but is perhaps off-specification? If a RIN purchaser buys RINs from a broker, how can that purchaser obtain the necessary due diligence information regarding the fuel supplier? The RFS program allows separation of RINs from the gallon of biofuel. As a consequence, might a RIN purchaser that exercises due diligence be unable to discern whether a RIN was properly generated and appropriately coded in EMTS?*

The Agency is meeting with a wide range of industry stakeholders to hear suggestions regarding potential regulatory changes to the RFS program, and is committed to working to improve the system and make changes as appropriate to help ensure that the goals of the RFS program are met.

As the RFS program was being developed, industry expressed the need for the flexibility to separate RINs from actual fuel volumes so the obligated parties could comply without necessarily directly blending the renewable fuel into their product. The "buyer beware" approach was based on EPA's belief at the outset of the program that the participants in the RIN market, those with the most control and experience, were in the best position to assess particular RINs and gauge their level of risk without EPA intervention.

Recently, EPA has been meeting with obligated parties and industry stakeholders to discuss how the system is working, and how it could be improved. In light of these meetings and recent developments, EPA understands that a reassessment of this approach may be needed. As stated in the preamble to the RFS 2 regulations, "[w]hile we believe that EMTS will simplify and reduce burdens on the regulated community, it is important to point out that EMTS is strictly a

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RIN tracking and managing tool designed to facilitate reporting under the Renewable Fuel Standard program." 75 Fed. Reg. 14731-1432 (March 26, 2010). Therefore, while EMTS cannot presently guarantee validity of a RIN, each RIN recorded in EMTS does contain information that may help regulated parties evaluate whether the RIN is valid. This information includes, but is not limited to, the name of the company that generated the RIN, the location of the facility where the RIN was generated, and the date that the RIN was generated.

8. *In EPA's February 23, 2012, response to the Committee, the Agency invoked low-sulfur fuels as an example of industry participants engaging in due diligence to ensure that the sulfur tolerances of each batch are met. But physical fuel can be inspected and tested by each buyer, while separated RINs cannot. Given that RINs are essentially a currency created under the supervision of EPA, is there an additional obligation on the part of the Agency to ensure validity of the RINs?*

Recognizing the strong desire of all parties to find a better approach for ensuring RIN validity, EPA is continuing to meet with a wide range of industry stakeholders on this subject. To date, those meetings have focused on identifying which aspects of the current system are working and which aspects can be improved. The Agency is committed to working to improve the system and to make changes as appropriate to help ensure the goals of the RFS program are met.

9. *Why has EPA moved forward with enforcement actions against good faith purchasers? Does EPA make any distinction between good faith and bad faith purchasers?*

The purpose of the renewable fuel standard program is to reduce the nation's dependence on foreign oil, help grow the nation's renewable energy industry and achieve significant greenhouse gas emissions reductions. When RINs are used that do not represent actual renewable fuel, regardless of a company's good faith belief that the RINs were valid, it undermines Congress' goals in creating the RFS program, creates market uncertainty and is a violation of the standard. To help restore certainty in the market and ensure that the goals of Congress are met, the EPA has implemented an Interim Enforcement Response Policy (IERP) to resolve violations with arising from the use of invalid 2010 and 2011 Biomass-based diesel RINs.

The IERP does not explicitly refer to "good faith purchasers" of RINs. However, in light of the widespread failure of obligated parties to conduct adequate due diligence in the relatively new RIN market, the IERP implements a streamlined approach for parties who used invalid RINs to correct violations and provides a fair and efficient mechanism for the prompt resolution of a party's liability for those violations. The IERP allows obligated parties to resolve their violations by paying modest civil penalties, and includes penalty caps to limit the penalty exposure for parties who unknowingly used invalid RINs. The IERP applies to all parties if 1) at the time they used the RINs, they had not yet learned that the RINs were invalid, and 2) they have implemented the remedial actions identified in the IERP.

As noted above, the EPA continues to have productive discussions with industry stakeholders to identify options for improving the current approach of assuring RIN validity.

a. *Under what circumstances would EPA decide not to bring an enforcement action?*

There are many factors taken into consideration before EPA initiates an enforcement action. EPA intends to continue to bring enforcement actions against renewable fuel producers and importers who generate invalid RINs. The EPA also intends to resolve violations arising from the use of invalid 2010 and 2011 biomass-based diesel RINs under the IERP. The EPA intends to informally reach out to parties that used invalid RINs to provide them with an opportunity to amicably resolve their violations in accordance with the IERP and without bringing an enforcement action, and if requested, without issuing a Notice of Violation.

b. *On what basis will EPA decide to bring or not bring an enforcement action against a purchaser in the future?*

The EPA expects that regulated parties will take steps to ensure that the RINs that they are purchasing are valid. If a party violates the RFS regulations by transferring or using an invalid RIN, the EPA will consider all of the circumstances surrounding the violation to determine the appropriate response, including whether the invalid RINs have been replaced with valid RINs and whether the party acted in good faith and conducted an appropriate level of due diligence.

Although the regulations establish strict liability for the use or transfer of invalid RINs, the EPA routinely prioritizes its enforcement resources based upon many factors including the culpability of parties who have violated the regulations, the seriousness of the violation and the need for effecting deterrence of specific behaviors. EPA has used criminal enforcement authorities to address what are alleged to be significant violations of the RFS rules relating to the generation of RINs. Property has been seized from alleged violators under these authorities. In contrast, no enforcement actions have been filed against parties that used invalid RINs. In fact, the EPA has resolved almost all outstanding issues with the parties that used the invalid RINs on the basis of 10 cents per RIN, as opposed to the statutory maximum penalty of $37,500, per violation, per day. These matters were resolved without the filing of an enforcement action and without any admission of wrongdoing on the part of the settling party.

In general, participants in the biodiesel market have initiated substantial efforts to investigate and otherwise ensure the validity of RINs purchased subsequent to the announcement of the recent enforcement actions relating to fraudulent RINs. The Agency has also reached out to the participants to continue discussions that began last fall on ways to potentially improve the RFS program, and RIN validity in particular. While every enforcement decision is dependent upon the facts of a particular violation, the EPA would consider in deciding whether to take enforcement action all actions taken by a RIN user or transferor to verify the validity of those RINs.

Federal Register

Tuesday,
May 1, 2007

Part II

Environmental Protection Agency

40 CFR Part 80
Regulation of Fuels and Fuel Additives: Renewable Fuel Standard Program; Final Rule

Equivalence Value less than 1.0 has become greatly simplified. We are therefore finalizing our proposed approach in which renewable fuels having an Equivalence Value less than 1.0 result in fewer assigned gallon-RINs than gallons in a batch.

Following release of the NPRM, we also identified some cases in which the generation of RINs for a partially renewable fuel or blending component would result in double-counting of RINs generated. For instance, ethyl tertiary butyl ether (ETBE) is made from combining ethanol with isobutylene. The ethanol is generally from corn, and the isobutylene is generally from petroleum. The ETBE producer may purchase ethanol from another source, and that ethanol may already have RINs assigned to it. In such cases it would not be appropriate for the ETBE producer to generate additional RINs for the ETBE made from that ethanol. Even if the ETBE producer purchased ethanol without assigned RINs, our program design ensures that either RINs were generated for the ethanol and separated prior to purchase by the ETBE producer, or RINs were legitimately not assigned to the ethanol. The NPRM did not address the potential for generating RINs twice for the same renewable fuel in these cases. Therefore, we are finalizing a provision prohibiting a party from generating RINs for a partially renewable fuel or blending component that it produces if the renewable feedstock used to make the renewable fuel or blending component was acquired from another party. Any RINs acquired with the renewable feedstock (e.g. ethanol) must be assigned to the product made from that feedstock (e.g. ETBE). This approach is consistent with comments submitted by Lyondell Chemical Company.

c. Cases in Which RINS Are Not Generated

Although in general every batch of renewable fuel produced or imported must have an assigned batch-RIN, there are several cases in which a RIN may not be assigned to a batch by a producer or importer. For instance, if the renewable fuel was consumed within the confines of the production facility where it was made, it would not be acquired by either an obligated party or a gasoline blender. In such cases, the RIN could not be separated from the batch and transferred separately since producers do not have this right. A RIN is assigned to renewable fuel when ownership of the renewable fuel is transferred to another party. Since no such transfer would occur in this case, no RIN should be generated.

A second case in which some renewable fuel would not have an assigned RIN would occur for small volume producers. We are allowing renewable fuel producers who produce less than 10,000 gallons in a year to avoid the requirement to generate RINs and assign them to batches. Such producers would not contribute meaningfully to the nationwide pool of renewable fuel, and we do not believe that the very small business operations involved should be subject to the burden of recordkeeping and reporting. Although two commenters disagreed that these small volume producers should be exempt from the requirement to generate RINs, they did not provide compelling evidence that the exemption would create a problem in the distribution system or provide an unfair advantage to small producers. As a result we are finalizing this provision as proposed. Note that if a small producer chooses to register as a renewable fuel producer under the RFS program, they will be subject to all the regulatory provisions that apply to all producers, including the requirement to assign RINs to batches.

In the NPRM we proposed that a renewable fuel producer which also operated as an exporter would not be required to generate and assign a RIN to any renewable fuel that it produced and exported. However, one commenter pointed out that this approach could lead to confusion regarding which gallons should have an assigned RIN and which should not, given the complex nature of tracking volumes of renewable fuel. As a result we have determined that this provision should be eliminated. Our final regulations require that producers assign RINs to all renewable fuel, regardless of whether it is exported. Exports of renewable fuel are discussed further in Section III.D.4.

3. Calculating and Reporting Compliance

Under our program, RINs form the basis of the volume accounting and tracking system that allows each obligated party to demonstrate that they have met their renewable fuel obligation each year. This section describes how the compliance process using RINs works. Our approach to the distribution and trading of RINs is covered separately in Section III.E below.

a. Using RINs To Meet the Standard

Under our program, each obligated party must determine its Renewable Volume Obligation (RVO) based on the applicable percentage standard and its annual gasoline volume as described in Section III.A.4. The RVO represents the volume of renewable fuel that the obligated party must ensure is used in the U.S. in a given calendar year. Since the nationwide renewable fuel volumes shown in Table I.B–1 are required by the Act to be consumed in whole calendar years, each obligated party must likewise calculate its RVO on an annual basis.

Since our program uses RINs as a measure of the amount of renewable fuel used as motor vehicle fuel that is sold or introduced into commerce within the U.S., obligated parties must meet their RVO through the accumulation of RINs. In so doing, they will effectively be causing the renewable fuel represented by the RINs to be consumed as motor vehicle fuel. Obligated parties are not required to physically blend the renewable fuel into gasoline or diesel fuel themselves. The accumulation of RINs is the means through which each obligated party shows compliance with its RVO and thus with the renewable fuel standard.

For each calendar year, each obligated party is required to submit a report to the Agency documenting the RINs it acquired and showing that the sum of all gallon-RINs acquired is equal to or greater than its RVO. This reporting is discussed in more detail in Section IV. In the context of demonstrating compliance, all gallon-RINs have the same compliance value. The Agency can then verify that the RINs used for compliance purposes are valid by simply comparing RINs reported by producers to RINs claimed by obligated parties. We can also verify simply that any given gallon-RIN was not double-counted, i.e., used by more than one obligated party for compliance purposes. In order to be able to identify the cause of any double-counting, however, additional information is needed on RIN transactions as discussed in Section IV.

If an obligated party has acquired more RINs than it needs to meet its RVO, then in general it can retain the excess RINs for use in complying with its RVO in the following year or transfer the excess RINs to another party. The conditions under which this is allowed are determined by the valid life of a RIN, described in more detail in Section III.D.3.b below. If, alternatively, an obligated party has not acquired sufficient RINs to meet its RVO, then under certain conditions it can carry a deficit into the next year. Deficit carryovers are discussed in more detail in Section III.D.3.d.

The regulations prohibit any party from creating or transferring invalid RINs. Invalid RINs cannot be used in demonstrating compliance regardless of

the good faith belief of a party that the RINs are valid. These enforcement provisions are necessary to ensure the RFS program goals are not compromised by illegal conduct in the creation and transfer of RINs.

As in other motor vehicle fuel credit programs, the regulations address the consequences if an obligated party is found to have used invalid RINs to demonstrate compliance with its RVO. In this situation, the refiner or importer that used the invalid RINs will be required to deduct any invalid RINs from its compliance calculations. The refiner or importer will be liable for violating the standard if the remaining number of valid RINs is insufficient to meet its RVO, and the obligated party may be subject to additional monetary penalties if it used invalid RINs in its compliance demonstration. See Section V of this preamble for further discussion regarding liability for use of invalid RINs.

Just as for RIN generators, we are also requiring that obligated parties conduct attest engagements for the volume of gasoline thay produce and the number of RINs procured to ensure compliance with their RVO. In most cases, this should amount to little more than is already required under existing EPA gasoline regulations. In the case of renewable fuel exporters, the attest engagement will verify the volume of renewable fuel exported and therefore the magnitude of their RVO. Attest engagement reports must be submitted to the party that commissioned the engagement and to EPA. See Section IV of this preamble for further discussion of the attest engagement requirements.

b. Valid Life of RINs

The Act requires that renewable fuel credits be valid for showing compliance for 12 months as of the date of generation. This section describes our interpretation of this provision in the context of our program wherein excess RINs fulfill the Act's requirements regarding credits.

As discussed in Section III.D.1.a, we interpret the Act such that credits would represent renewable fuel volumes in excess of what an obligated party needs to meet their annual compliance obligation. Given that the renewable fuel standard is an annual standard, obligated parties will determine compliance shortly after the end of the year, and credits would be identified at that time. Obligated parties will typically demonstrate compliance by submitting a compliance demonstration to EPA. Given the 12-month life of a credit as stated in the Act, we interpret this provision as meaning that credits would only be valid for compliance purposes for the following compliance year. Hence if a refiner or importer overcomplied with their 2007 obligation they would generate credits that could be used to show compliance with the 2008 compliance obligation, but the credits could not be used to show compliance for later years. Since RINs fulfill the role of credits, the statutory provisions regarding credits apply to RINs

The Act's limit on credit life helps balance the risks between the needs of renewable fuel producers and obligated parties. Producers are currently making investments in expanded production capacity on the expectation of a statutorily guaranteed minimum quantity demanded. Under the market conditions we are experiencing today that make ethanol use more economically attractive, the annual volume requirements in the RFS program will not drive consumption of renewable fuels. However, if the price of crude oil dropped significantly or the use of ethanol in gasoline became otherwise less economically attractive, obligated parties could use stockpiled credits to comply with the program requirements. As a result, demand for renewable fuel could fall well below the RFS program requirements, and many producers could end up with a stranded investment. The 12 month valid life limit for credits minimizes the potential for this type of result.

For obligated parties, the Act's 12 month valid life for credits provides a window within which parties who do not meet their renewable fuel obligation through their own physical use of renawable fual can obtain credits from other parties who have excess. This critical aspect of the trading system allows the renewable fuels market to continue operating according to natural market forces, avoiding the possibility that every single refiner would need to purchase renewable fuel for blending into its own gasoline. But the 12 month life also provides a window within which banking and trading can be used to offset the negative effects of fluctuations in either supply of or demand for renewable fuels. For instance, if crude oil prices were to drop significantly and natural market demand for ethanol likewise fell, the RFS program would normally bring demand back up to the minimum required volumes shown in Table I.B–1. But in this circumstance, the use of ethanol in gasoline would be less economically attractive, since demand for ethanol would not be following price but rather the statutorily required minimum volumes. As a result, the price of credits as represented by RINs, and thus ethanol blends, could rise above the levels that would exist if no minimum required volumes existed. The 12 month valid life creates some flexibility in the market to help mitigate price fluctuations. The renewable fuels market could also experience a significant drop in supply if, for instance, a drought were to limit the production of the feedstocks needed to produce renewable fuel. Obligated parties could use banked credits to comply rather than carry a deficit into the next year.

In the context of our RIN-based program, we have been able to accomplish the same objective as the Act's 12 month life of credits by allowing RINs to be used to show compliance for the year in which the renewable fuel was produced and its associated RIN first generated or for the following year. RINs not used for compliance purposes in the year in which they were generated will by definition be in excess of the RINs an obligated party needed in that year, making excess RINs equivalent to the credits referred to in the Energy Act. Excess RINs are valid for compliance purposes in the year following the one in which they initially came into existence.[36] RINs not used within their valid life will expire. This approach satisfies the Act's 12 month duration for credits.

Thus we are requiring that every RIN be valid for the calendar-year compliance period in which it was generated or the following year. If a RIN was created in one year but was not used by an obligated party to meet its RVO for that year, the RIN can be used for compliance purposes in the next year (subject to certain provisions to address RIN rollover as discussed below). If, however, a RIN was created in one year and was not used for compliance purposes in that year or in the next year, it will expire. In response to the NPRM, this approach was supported by a number of obligated parties and their representative associations. These commenters agreed that allowing RINs to be used for the year generated or the following year was not only supported by the statutory language, but was also an element of program flexibility that would be critical for offsetting the negative effects of potential fluctuations in either supply of or demand for renewable fuels.

[36] The use of previous-year RINs for current year compliance purposes will also be limited by the 20 percent RIN rollover cap under today's final rule. However, as discussed in the next section, we believe that this cap will still provide a significant amount of flexibility to obligated parties.

comply with the attest engagement procedures in proposed § 80.1164(b), and that applying the requirements in § 80.1164(b) to renewable fuel importers is a logical outgrowth of the proposed regulations. As a result, the regulations have been modified to include renewable fuel importers in the parties required to comply with the attest procedures in § 80.1164(b).

In addition to obligated parties, exporters and renewable fuel producers and importers, we believe that an attest engagement requirement is necessary for any party who takes ownership of a RIN. As discussed above, attest engagements provide an appropriate and useful tool for verifying the accuracy of the information reported to us. Like obligated parties and renewable fuel producers and importers, the final rule requires RIN owners to submit information regarding RIN transaction activity to us. We believe that attest engagement audits are necessary to verify the accuracy of the information included in these reports. Therefore, this final rule includes an attest engagement requirement for RIN owners who are not obligated parties or renewable fuel producers or importers. We believe that inclusion of the requirement in the final rule is a logical outgrowth of the proposed attest engagement requirements for other parties who are required to submit similar information regarding RIN transaction activity to us.

V. What Acts Are Prohibited and Who Is Liable for Violations?

The prohibition and liability provisions applicable to the RFS program are similar to those of other gasoline programs. The final rule identifies certain prohibited acts, such as a failure to acquire sufficient RINs to meet a party's renewable fuel obligation (RVO), producing or importing a renewable fuel without properly assigning a RIN, creating, transferring or using invalid RINs, improperly transferring renewable fuel volumes without RINs, improperly separating RINs from renewable fuel, retaining more RINs during a quarter than the party's inventory of renewable fuel, or transferring RINs that are not identified by proper RIN numbers. Any person subject to a prohibition will be held liable for violating that prohibition. Thus, for example, an obligated party will be liable if the party fails to acquire sufficient RINs to meet its RVO. A party who produces or imports renewable fuels will be liable for a failure to properly assign RINs to batches of renewable fuel produced or imported. A renewable fuels marketer will be liable for improperly transferring renewable fuel volumes without RINs or retaining more RINs during a quarter than the party's inventory of renewable fuels. Any party may be liable for creating, transferring, or using an invalid RIN, or transferring a RIN that is not properly identified.

In addition, any person who is subject to an affirmative requirement under the RFS program will be liable for a failure to comply with the requirement. For example, an obligated party will be liable for a failure to comply with the annual compliance reporting requirements. A renewable fuel producer or importer will be liable for a failure to comply with the applicable renewable fuel batch reporting requirements. Any party subject to recordkeeping or product transfer document requirements would be liable for a failure to comply with these requirements. Like other EPA fuels programs, the final rule provides that a party who causes another party to violate a prohibition or fail to comply with a requirement may be found liable for the violation.

The Energy Act amended the penalty and injunction provisions in section 211(d) of the Clean Air Act to apply to violations of the renewable fuels requirements in section 211(o).[42] Accordingly, under the final rule, any person who violates any prohibition or requirement of the RFS program may be subject to civil penalties for every day of each such violation and the amount of economic benefit or savings resulting from the violation. Under the final rule, a failure to acquire sufficient RINs to meet a party's renewable fuels obligation will constitute a separate day of violation for each day the violation occurred during the annual averaging period.

Because there are no standards under the RFS rule that may be meesured downstream, we believe that a presumptive liability scheme, i.e., a scheme in which parties upstream from the facility where the violation is found are presumed liable for the violation, would not be applicable under the RFS program. As a result, the RFS rule does not contain such a scheme.

The regulations prohibit any party from creating, transferring or using invalid RINs. These invalid RIN provisions apply regardless of the good faith belief of a party that the RINs are valid. These enforcement provisions are necessary to ensure the RFS program goals are not compromised by illegal conduct in the creation and transfer of RINs.

Any obligated party that reports the use of invalid RINs to meet its renewable fuels obligation may be liable for a regulatory violation for use of invalid RINs. If the obligated party fails to meet its renewable fuels obligation without the invalid RINs, the party may also be liable for not meeting its renewable fuels obligation. In addition, the transfer of invalid RINs is prohibited, so that any party or parties that transfer invalid RINs may be liable for a regulatory violation for transferring the invalid RINs. In a case where invalid RINs are uncovered and used, EPA normally will look each party that committed a violation responsible, including both the user and the transferor of the invalid RINs. For this reason, obligated parties and RIN owners should use good business judgment when deciding whether to purchase RINs from any particular seller and should consider including prudent business safeguards in RIN transactions, such as requiring RIN sellers to sign contracts with indemnity provisions to protect the purchaser in the event penalties are assessed because we find the RINs are invalid. Similarly, parties that sell RINs should take steps to ensure any RINs they sell were properly created to avoid penalties that result from the transfer of invalid RINs.

As another means to help identify problems, the regulations require that the recordkeeper if an obligated party is found to have used invalid RINs to demonstrate compliance with its RVO, in this instance the obligated party that used the invalid RINs will be required to deduct any invalid RINs from its compliance calculations. As discussed above, the obligated party will be liable for not meeting its renewable fuels obligation if the remaining number of valid RINs is insufficient to meet its RVO, and the obligated party may be subject to monetary penalties if it used invalid RINs in its compliance demonstration. In determining an appropriate penalty, EPA will consider a number of factors, including whether the obligated party did in fact procure sufficient valid RINs to cover the deficit created by the invalid RINs. A penalty may include both the economic benefit of using invalid RINs and a gravity component.

Although an obligated party may be liable for a violation if it uses invalid RINs for compliance purposes, we normally will look first to the generator or seller of the invalid RINs both for payment of penalty and to procure sufficient valid RINs to offset the invalid RINs. However, if EPA is unable to

[42] Section 1501(b) of the Energy Policy Act of 2005.

obtain relief from that party, attention will turn to the obligated party who may then be required to obtain sufficient valid RINs to offset the invalid RINs.

We received several comments on the prohibition regarding use of invalid RINs. Some commenters believed that an obligated party that uses RINs which are later found to be invalid should be given an opportunity to "cure" the shortfall caused by the invalid RINs without penalty. As indicated above, a penalty for a good faith purchaser is not automatic. Where an invalid RIN was created by another party, such as the producer or marketer of the renewable fuel, the party responsible for the existence of the invalid RIN would be liable and would be required to purchase a RIN to make up for the invalid RIN and pay an appropriate penalty. If the responsible party cannot be identified or is out of business, or if EPA is otherwise unable to obtain relief from the party, then the obligated party that used the RIN would be required to purchase a RIN to make up for the invalid RIN. However, any penalty for a good faith purchaser would likely be small, particularly where EPA is able to obtain relief from the party that was responsible for the invalid RIN. Where a RIN was originally believed to be valid but is later found to be invalid, whether a current year RIN may be used to make up for the prior-year invalid RIN would be determined in the context of the enforcement action.

Another commenter suggested that an obligated party should not be liable for a violation unless the party knowingly used the invalid RINs to demonstrate compliance. Where the suspect RINs are later proved to be valid, the party should be able to use the RINs in the subsequent year regardless of the year of generation or any rollover cap. For the reasons stated above, we believe that it is appropriate to hold an obligated party responsible for using invalid RINs even where the party in good faith believed the RINs to be valid. Normally, suspect RINs will be not be replaced until the RINs are proved to be invalid. In the unlikely circumstances that a RIN is first determined to be invalid and then later found to be valid, the ability to use the RIN in a subsequent year would be determined in the context of the enforcement action.

Finally, parties that are predominately renewable fuel producers or importers, but which must be designated as obligated parties due to the production or importation of a small amount of gasoline, should not be able to separate RINs from all renewable fuels that they own. To address such circumstances, we are prohibiting obligated parties from separeting RINs that they generate from volumes of renewable fuel in excess of their RVO. However, obligeted parties must separate any RINs generated by other parties from renewable fuel if they own the renewable fuel.

VI. Current and Projected Renewable Fuel Production and Use

While the definition of renewable fuel does not limit compliance with the standard to any one particular type of renewable fuel, ethanol is currently the most prevalent renewable fuel blended into gasoline today. Biodiesel represents another renewable fuel which, while not as widespread as ethanol use (in terms of volume), has been increasing in production capacity and use over the last several years. This section provides a brief overview of the ethanol and biodiesel industries today and how they are projected to grow into the future.

A. Overview of U.S. Ethanol Industry and Future Production/Consumption

1. Current Ethanol Production

As of October 2006, there were 110 ethanol production facilities opereting in the United States with a combined production capacity of approximately 5.2 billion gallons per year.[43] All of the ethanol currently produced comes from grain or starch-based feedstocks that can easily be broken down into ethanol via traditional fermentation processes. The majority of ethanol (almost 92 percent by volume) is produced exclusively from corn. Another 7 percent comes from a blend of corn and/or similarly processed grains (milo, wheat, or barley) and less than 1 percent is produced from waste beverages, cheese whey, and sugars/starches combined. A summary of ethanol production by feedstock is presented in Table VI.A.1–1.

TABLE VI.A.1–1.—2006 U.S. ETHANOL PRODUCTION BY FEEDSTOCK

Plant feedstock	Capacity MMgy	Percent of capacity	Number of plants	Percent of plants
Cheese Whey	8	0.1	2	1.8
Corn[a]	4,780	91.6	90	81.8
Corn, Barley	40	0.8	1	0.9
Corn, Milo[b]	244	4.7	8	7.3
Corn, Wheat	90	1.7	2	1.8
Milo, Wheat	40	0.8	1	0.9
Sugars, Starches	2	0.0	1	0.9
Waste Beverages[c]	16	0.3	5	4.5
Total	5,218	100.0	110	100.0

[a] Includes two facilities proceseing seed corn and another facility processing corn which intends to transition to corn stalks, switchgrass, and biomass in the future.
[b] Includes one facility processing small amounts of molasses in addition to corn and milo.
[c] Includes two facilities processing brewery waste.

[43] The October 2006 ethanol production capacity baseline was generated based on the June 2006 NPRM plant list and updated on October 18, 2006 based on a variety of data sources including: Renewable Fuels Association (RFA), Ethanol Biorefinery Locations (updated October 16, 2006); Ethanol Producer Magazine (EPM), plant list (downloaded October 18, 2006) and monthly publications (June 2006 through October 2006); ICF International, Ethanol Industry Profile (September 30, 2006); BioFuels Journal, News & Information for the Ethanol and BioFuels Industries (breaking news posted June 16, 2006 through October 18, 2006); and ethanol producer Web sites. The baseline includes small-scale ethanol production facilities as well as former food-grade ethanol plants that have since transitioned into the fuel-grade ethanol market. Where applicable, current ethanol plant production levels have been used to represent plant capacity, as nameplate capacities are often underestimated. This analysis does not consider ethanol plants that may be located in the Virgin Islands or U.S. territories.

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 80

[EPA–HQ–OAR–2005–0161; FRL–9112–3]

RIN 2060–A081

Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: Under the Clean Air Act Section 211(o), as amended by the Energy Independence and Security Act of 2007 (EISA), the Environmental Protection Agency is required to promulgate regulations implementing changes to the Renewable Fuel Standard program. The revised statutory requirements specify the volumes of cellulosic biofuel, biomass-based diesel, advanced biofuel, and total renewable fuel that must be used in transportation fuel. This action finalizes the regulations that implement the requirements of EISA, including the cellulosic, biomass-based diesel, advanced biofuel, and renewable fuel standards that will apply to all gasoline and diesel produced or imported in 2010. The final regulations make a number of changes to the current Renewable Fuel Standard program while retaining many elements of the compliance and trading system already in place. This final rule also implements the revised statutory definitions and criteria, most notably the new greenhouse gas emission thresholds for renewable fuels and new limits on renewable biomass feedstocks. This rulemaking marks the first time that greenhouse gas emission performance is being applied in a regulatory context for a nationwide program. As mandated by the statute, our greenhouse gas emission assessments consider the full lifecycle emission impacts of fuel production from both direct and indirect emissions, including significant emissions from land use changes. In carrying out our lifecycle analysis we have taken steps to ensure that the lifecycle estimates are based on the latest and most up-to-date science. The lifecycle greenhouse gas assessments reflected in this rulemaking represent significant improvements in analysis based on information and data received since the proposal. However, we also recognize that lifecycle GHG assessment of biofuels is an evolving discipline and will continue to revisit our lifecycle analyses in the future as new information becomes available. EPA plans to ask the National Academy of Sciences for assistance as we move forward. Based on current analyses we have determined that ethanol from corn starch will be able to comply with the required greenhouse gas (GHG) threshold for renewable fuel. Similarly, biodiesel can be produced to comply with the 50% threshold for biomass-based diesel, sugarcane with the 50% threshold for advanced biofuel and multiple cellulosic-based fuels with their 60% threshold. Additional fuel pathways have also been determined to comply with their thresholds. The assessment for this rulemaking also indicates the increased use of renewable fuels will have important environmental, energy and economic impacts for our Nation.

DATES: This final rule is effective on July 1, 2010, and the percentage standards apply to all gasoline and diesel produced or imported in 2010. The incorporation by reference of certain publications listed in the rule is approved by the Director of the Federal Register as of July 1, 2010.

ADDRESSES: EPA has established a docket for this action under Docket ID No. EPA–HQ–OAR–2005–0161. All documents in the docket are listed in the *http://www.regulations.gov* Web site. Although listed in the index, some information is not publicly available, *e.g.*, confidential business information (CBI) or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, is not placed on the Internet and will be publicly available only in hard copy form. Publicly available docket materials are available either electronically through *http://www.regulations.gov* or in hard copy at the Air and Radiation Docket and Information Center, EPA/DC, EPA West, Room 3334, 1301 Constitution Ave., NW., Washington, DC. The Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Public Reading Room is (202) 566–1744, and the telephone number for the Air Docket is (202) 566–1742.

FOR FURTHER INFORMATION CONTACT: Julia MacAllister, Office of Transportation and Air Quality, Assessment and Standards Division, Environmental Protection Agency, 2000 Traverwood Drive, Ann Arbor, MI 48105; *Telephone number:* 734–214–4131; *Fax number:* 734–214–4816; *E-mail address: macallister.julia@epa.gov*, or Assessment and Standards Division Hotline; telephone number (734) 214–4636; E-mail address *asdinfo@epa.gov*.

SUPPLEMENTARY INFORMATION:

General Information

I. Does This Final Rule Apply to Me?

Entities potentially affected by this final rule are those involved with the production, distribution, and sale of transportation fuels, including gasoline and diesel fuel or renewable fuels such as ethanol and biodiesel. Regulated categories include:

Category	NAICS [1] codes	SIC [2] codes	Examples of potentially regulated entities
Industry	324110	2911	Petroleum Refineries.
Industry	325193	2869	Ethyl alcohol manufacturing.
Industry	325199	2869	Other basic organic chemical manufacturing.
Industry	424690	5169	Chemical and allied products merchant wholesalers.
Industry	424710	5171	Petroleum bulk stations and terminals.
Industry	424720	5172	Petroleum and petroleum products merchant wholesalers.
Industry	454319	5989	Other fuel dealers

[1] North American Industry Classification System (NAICS)
[2] Standard Industrial Classification (SIC) system code.

This table is not intended to be exhaustive, but rather provides a guide for readers regarding entities likely to be regulated by this final action. This table lists the types of entities that EPA is now aware could potentially be regulated by this final action. Other types of entities not listed in the table could also be regulated. To determine whether your activities would be regulated by this final action, you should carefully examine the applicability criteria in 40 CFR part 80. If you have any questions regarding the applicability of this final action to a

we are finalizing Production Outlook Reports, and the required elements at § 80.1449.

L. What Acts Are Prohibited and Who Is Liable for Violations?

The prohibition and liability provisions under this rule are similar to those of the RFS1 program and other fuels programs in 40 CFR part 80. The rule identifies certain prohibited acts, such as a failure to acquire sufficient RINs to meet a party's RVOs, producing or importing a renewable fuel that is not assigned a proper RIN category (or D Code), improperly assigning RINs to renewable fuel that was not produced with renewable biomass, failing to assign RINs to qualifying fuel, or creating or transferring invalid RINs. Any person subject to a prohibition is liable for violating that prohibition. Thus, for example, an obligated party is liable if the party failed to acquire sufficient RINs to meet its RVO. A party who produces or imports renewable fuels is liable for a failure to assign proper RINs to qualifying batches of renewable fuel produced or imported. Any party, including an obligated party, is liable for transferring a RIN that was not properly identified.

In addition, any person who is subject to an affirmative requirement under this program is liable for a failure to comply with the requirement. For example, an obligated party is liable for a failure to comply with the annual compliance reporting requirements. A renewable fuel producer or importer is liable for a failure to comply with the applicable batch reporting requirements. Any party subject to recordkeeping or product transfer document (PTD) requirements is liable for a failure to comply with these requirements. Like other EPA fuels programs, this rule provides that a party who causes another party to violate a prohibition or fail to comply with a requirement may also be found liable for the violation.

EPAct amended the penalty and injunction provisions in section 211(d) of the Clean Air Act to apply to violations of the renewable fuels requirements in section 211(o). Accordingly, any person who violates any prohibition or requirement of this rule is subject to civil penalties of up to $37,500 per day and per each individual violation, plus the amount of any economic benefit or savings resulting from each violation. Under this rule, a failure to acquire sufficient RINs to meet a party's renewable fuels obligation constitutes a separate day of violation for each day the violation occurred during the annual averaging period.

As discussed above, the regulations prohibit any party from creating or transferring invalid RINs. These invalid RIN prohibitions apply regardless of the good faith belief of a party that the RINs are valid. These enforcement provisions are necessary to secure the RFS2 program goals and not compromised by illegal conduct in the creation and transfer of RINs.

As in other motor vehicle fuel credit programs, the regulations address the consequences if an obligated party is found to have used invalid RINs to demonstrate compliance with its RVO. In this situation, the obligated party that used the invalid RINs will be required to deduct any invalid RINs from its compliance calculations. An obligated party is liable for violating the standard if the remaining number of valid RINs was insufficient to meet its RVO, and the obligated party might be subject to monetary penalties if it used invalid RINs in its compliance demonstration. In determining what penalty is appropriate, if any, we would consider a number of factors, including whether the obligated party did in fact procure sufficient valid RINs to cover the deficit created by the invalid RINs, and whether the purchaser was indeed a good faith purchaser based on an investigation of the RIN transfer. A penalty might include both the economic benefit of using invalid RINs and/or a gravity component.

Although an obligated party is liable under our proposed program for a violation if it used invalid RINs for compliance purposes, we would normally look first to the generator or seller of the invalid RINs both for payment of penalty and to procure sufficient valid RINs to offset the invalid RINs. However, if, for example, that party was out of business, then attention would turn to the obligated party who would have to obtain sufficient valid RINs to offset the invalid RINs.

III. Other Program Changes

In addition to the regulatory changes we are finalizing today in response to comments received on the proposed rule and EISA (which are designed to implement the provisions of RFS2), there are a number of other changes to the RFS program that we are making. We believe that these changes will increase flexibility, simplify compliance, or address RIN transfer issues that have arisen since the start of the RFS1 program. Throughout the rulemaking process, we also investigated impacts on small businesses and we are finalizing provisions to address the impacts of the program on them.

A. The EPA Moderated Transaction System (EMTS)

The EPA Moderated Transaction System (EMTS) emerged as a result of our experiences with and lessons learned from implementing RFS1. Recognizing that the addition of significant volumes of renewable fuels and expansion of renewable fuel categories were adding complexity to an already stressed system, EMTS was introduced as a new approach for managing RINs in our NPRM. We received broad acceptance of the EMTS concept in the public comments as well as support for its expeditious implementation. This section describes the need for EMTS, implementation of EMTS, and an explanation of how EMTS will work. By implementing EMTS, we believe that we will be able to greatly reduce RIN-related errors while efficiently and accurately managing the universe of RINs. EMTS will save considerable time and resources for both industry and EPA. This is most evident considering that the system virtually eliminates multiple sources of administrative errors, resulting in a reduction of costs and effort expended to correct and regenerate product transfer documents, documentation and recordkeeping, and resubmitting reports to EPA. Use of EMTS will result in fewer report resubmissions and easier reporting for industry, while leaving fewer reports to be processed by EPA. Industry will spend less time and effort validating the RINs they procure with greater assurance and confidence in the RIN market. EPA will spend less time tracking down invalid RINs and working with regulated parties on complex remedial actions. This is possible because EMTS removes management of the 38-digit RIN from the hands of the reporting community. At the same time, EPA and the reporting community will be working with a standardized system, reducing stresses and development costs on IT systems.

We received comments suggesting that EPA remove the attest engagement requirements and certain recordkeeping requirements due to the use of EMTS. While we believe that EMTS will simplify and reduce burdens on the regulated community, it is important to point out that EMTS is strictly a RIN tracking and managing tool designed to facilitate reporting under the Renewable Fuel Standard program. Product transfer documents are the commercial documents used to memorialize transactions of RINs between a buyer and a seller in the market. The EMTS will rely on references to these

documents, which can take many forms, but it is not capable of replacing those documents. Attest engagements are used to verify that the records required to be kept by regulated parties, including information retained by a regulated party as well as information reported to EPA such as laboratory test results, contracts between renewable fuel/RIN buyers and sellers, feedstock documentation, etc. is correctly maintained or reported. The information reported via EMTS is but e subset of the information required to be maintained in a regulated party's records, and both PTDs and attest engagements are necessary to ensure that the information collected and tracked in EMTS concurs with actual events.

1. Need for the EPA Moderated Transaction System

In implementing RFS1, we found that the 38-digit standardized RINs proved to be confusing to many parties in the distribution chain. Parties made various errors in generating and using RINs. For exemple, parties transposed digits within the RIN and incorrectly referenced volume numbering. Also, parties created alphanumeric RINs, despite the fact that RINs were supposed to consist of all numbers.

Once an error is made within a RIN, the error propagates throughout the distribution system. Correcting an error can require significant time and resources and usually involves many steps. Not only must reports to EPA be corrected, underlying records and reports reflecting RIN transactions must also be located and corrected to reflect discovery of an error. Because reporting related to RIN transactions under RFS1 was only on a quarterly hasis, a RIN error could exist for several months before being discovered.

Incorrect RINs are invalid RINs. If parties in the distribution system cannot track down and correct errors in a timely manner, then all downstream parties that traded the invalid RIN are in violation. Because RINs are the basic unit of compliance for the RFS program, it is important that parties have confidence when generating and using them.

All parties in the RFS1 and the RFS2 regulated community are required to use RINs. Under RFS2, we foresee thet regulated party community will substantially expand. Newer regulated parties of en already complex system necessitate EMTS. These parties include renewable fuel producers and importers, obligated parties, exporters, and other RIN owners; (typically marketers of renewable fuels and blenders). Under RFS1, all RINs were used to comply with a single standard. With RFS2, there are four standards. RINs must be generated to identify one of the fuel categories: cellulosic biofuel, cellulosic diesel, biomass-based diesel, advanced biofuel, and renewable fuels (e.g., corn ethanol). (For a more detailed discussion of RINs, see Section II.A of this preamble.) The different types of RINs will be managed in the EMTS.

2. Implementation of the EPA Moderated Transaction System

We proposed that EMTS would be an opt-in for the calendar year 2010 and mandatory for calendar year 2011. We received many comments strongly supporting EMTS implementation with the start of the RFS2 program to ensure confidence and simplicity in an increasingly complex progrem. We also received comments that EMTS implementation with RFS2 is necessary so industry would not have to create a new system to handle RFS2 RINs for 2010 and then move to EMTS for 2011 while still handling RFS1 RINs. Potentially, three RIN transaction systems would exist during transition from RFS1 to RFS2 if EMTS could not be implemented with the start of the RFS2 program. EPA agrees that this three system issue would be an undue burden to industry as it would require industry to creata two systems within a 12 month period. EMTS development started with the introduction of the NPRM, and has been in beta testing since early November with a select group of different industry stakeholders. Industry feedback has been overwhelmingly strong for the implementation of EMTS with the start of RFS2. With this final rule, EPA decided that EMTS will start on the same date when RFS2 RINs are required to be generated. In addition, to ensure that parties will have enough time to incorporate RFS2 and EMTS requirements into private RIN tracking systems, the generation of RFS2 RINs will begin on July 1, 2010. Therefore, all RFS regulated parties are required to use EMTS starting July 1, 2010.

RIN transactions are required to be verified and certified on a quarterly basis. EMTS will provide summaries for parties to verify, report, and certify transactions to EPA through the fuels reporting system, DCFuels. Additional information may be required to be added to the EMTS provided summary. This additional certification step allows parties to verification that the information sent to EMTS is accurate. However, parties may choose to review their data by checking their EMTS account at anytime.

With EMTS, RIN transactions are required to be verified and certified on a quarterly basis. EMTS will provide summaries for parties to verify, report, and certify transactions to EPA through the fuels reporting system, DCFuels. Additional information may be required to be added to the EMTS provided report. This additional certification step allows parties to verify that the information sent to EMTS is accurate. However, parties may choose to review their data by checking their EMTS eccount at any time.

3. How EMTS Will Work

EMTS will be a closed, EPA-moderated system that provides a mechanism for screening RINs and a structured environment for conducting RIN transactions. "Screening" of RINs means that parties can have greater confidence that the RINs they handle are genuine. Although screening cannot remove all human error, we believe it can remove most of it.

We received comments opposing the 3 day time window for reporting transactions to the EMTS. One commenter requested 7 days from the event for sellers to report a transection and 7 days after that for the buyer to accept the transaction. In order for this to be a "real time" system, we must require that the information comes in a timely menner. One commenter requested 10 days from the event to send information to EMTS. EPA has concluded that five days, or a business week, is an appropriate amount of time for both parties to receive or provide necessary documentation in order to interact with EMTS accurately and timely. "Real time" will be defined as within five (5) business days of a reportable event (*e.g.*, generation and assignment of RINs, transfer of RINs).

Parties who use EMTS must first register with EPA in accordance with the RFS2 registration program described in Section II.C of this preamble. Parties will also have to create an account (i.e., register) via EPA's Central Data Exchange (CDX), as users will access EMTS via CDX. CDX is a secure and central electronic portal through which parties may submit compliance reports. Parties must establish an account with EMTS by July 1, 2010 or 60 days prior to engaging in eny transaction involving RINs, whichever is later. Once registration occurs, individual accounts will be established within EMTS and the system will enable a party to submit transactions hased on their registration information.

In EMTS, the screening and assignment of RINs will be made at the logical point, i.e., the point when RINs

are generated through production or importation of renewable fuel. A renewable producer will electronically submit, in "real time," a volume of renewable fuel produced or imported, as well as a number of the RINs generated and assigned. EMTS will automatically screen each batch and either reject the information or allow RINs created in the RIN generator's account as one of the five types of RINs.

We received comments supporting the RFS1 approach that allows producers and importers to generate RINs at the renewable fuel point of sale. EPA realizes that this is an industry practice and this flexibility will still be allowed for RIN generators, but only if applied consistently.

After RINs have entered the system, parties may then trade them based on agreements outside of EMTS. One major advantage of EMTS, over the RFS1 system, is that the system will simplify trading by allowing RINs to be traded generically. Only some specifying information will be needed to trade RINs, such as RIN quantity, fuel type, RIN assignment, RIN year, RIN price or price per gallon. The unique identification of the RIN will exist within EMTS, but parties engaging in RIN transactions will no longer have to worry about incorrectly recording or using 38-digit RIN numbers. The actual items of transactional information covered under RFS2 are very similar to those reported under RFS1. The RIN price is one of the new pieces of transactional information required to be submitted under RFS2.

We received several adverse comments strongly opposing the collection of price information due to Confidential Business Information (CBI) concerns, other services being able to provide this information, marketplace delays and undue stress on the EMTS from disagreements in RIN price. We received one comment strongly supporting EPA collecting this information. EPA decided that the price information has great programmatic value because it will help us anticipate and appropriately react to market disruptions and other compliance challenges, assess and develop responses to potential waivers, and assist in setting future renewable fuel standards. In addition, EPA decided that highly summarized price information (e.g., the average price of RINs traded nationwide) may be valuable to regulated parties, as well, and may help them to anticipate and avoid market disruptions. Also, EPA will not require the matching of the exact RIN price to alleviate the burden of resubmission due to price mistakes. However, the price information must be accurate and rounded to the nearest cent (U.S. Dollar) at the time of sending the transactional information to EMTS.

We received one comment requesting publication of security precautions taken by EPA to protect EMTS from attacks. EPA cannot provide security information to the public because providing such information may create security vulnerabilities. However, EMTS will be compliant with the appropriate security requirements for all federal agency information technology systems.

Also as with RFS1, there is no "good faith" provision to RIN ownership. An underlying principle of RIN ownership is still one of "buyer beware" and RINs may be prohibited from use at any time if they are found to be invalid. Because of the "buyer beware" aspect, we will offer the option for a buyer to accept or reject RINs from specific RIN generators or from classes of RIN generators.

4. A Sample EMTS Transaction

This sample illustrates how two parties may trade RINs in EMTS:

(1) Seller logs into EMTS and posts a sale of 10,000 RINs to Buyer at X price. For this example, assume the RINs were generated in 2010 and were assigned to 10,000 gallons of "Renewable fuel (D=6)". Seller's RIN account for "Renewable fuel (D=6)" is put into a "pending" status of 10,000 with the posting of the sale to Buyer. Buyer receives automatic notification of the pending transaction.

(2) Buyer logs into EMTS. Buyer sees the sale transaction pending. Assuming it is correct, Buyer accepts it. Upon acceptance, Buyer's RIN account for "Renewable fuel (D=6)" RINs is automatically increased by 10,000 2010 assigned RINs sold at X price.

(3) After Seller has posted the sale and Buyer has accepted it, EMTS automatically notifies both Buyer and Seller that the transaction has been fully completed.

Under EMTS, the seller will always have to initiate any transaction. The specific amount of RINs are put into a pending status when the seller posts the sale. The buyer must confirm the sale in order to have the RINs transferred to the buyer's account. Transactions will always be limited to available RINs. Notification will automatically be sent to both the buyer and the seller upon completion of the transaction. EPA considers any sale or transfer as complete upon acknowledgement by the buyer. We will also allow buyers to submit their acknowledgement prior to a seller initiating the transaction. However, these buy transactions will not initiate any RINs being put into a pending status from a seller's account. Instead, the buy transactions will be queued and checked periodically to see if a "sell" transaction was posted by the seller. If a buy is posted without a matching sell transaction, then the seller will be notified that a buy transaction is pending. Both buy and sell transactions must be matched within a set number of days from the submission date or they will expire. Transactions will expire 7 days after the submission of the file. Since both parties are required to submit information within 5 days, we allow the full 5 days to expire plus 2 days in the case of late submissions.

In summary, the advantage to implementing EMTS is that parties may engage in RIN transactions with a high degree of confidence, errors will be virtually eliminated, and everyone engaging in RIN transactions will have a simplified environment in which to work, which should minimize the level of resources needed for implementation.

B. Upward Delegation of RIN-Separating Responsibilities

Since the start of the RFS program on September 1, 2007, there have been a number of instances in which a party who receives RINs with a volume of renewable fuel is required to either separate or retire those RINs, but views the recordkeeping and reporting requirements under the RFS program as an unnecessary burden. Such circumstances typically might involve a renewable fuel blender, a party that uses renewable fuel in its neat form, or a party that uses renewable fuel in a non-highway application and is therefore required to retire the RINs (under RFS1) associated with the volume. In some of these cases, the affected party may purchase and/or use only small volumes of renewable fuel and, absent the RFS program, would be subject to few (if any other) EPA regulations governing fuels.

This situation will become more prevalent with the RFS2 rule, as EISA added diesel fuel to the RFS program. With the RFS1 rule, small blenders (generally farmers and other parties that use nonroad diesel fuel) blending small amounts of biodiesel were not covered under the rule as EPAct mandated renewable fuel blending for highway gasoline only. EISA mandates certain amounts of renewable fuels to be blended into all transportation fuels—which includes highway and nonroad diesel fuel. Thus, parties that were not regulated under the RFS1 rule who only blend a small amount of renewable fuel (and, as mentioned above, are generally not subject to EPA fuels regulations) will now be regulated by the RFS program.

Renewable Fuel Standard Program (RFS2) Summary and Analysis of Comments

EPA United States Environmental Protection Agency

Document No.: EPA-HQ-OAR-2005-0161-2341
Organization: Noble Americas
Comment:
The commenter (2341) noted that the rules governing the assignment of the advanced categories are complicated such that errors could result, which would invalidate the RIN. The commenter believes that rather than invalidate the advanced RIN entirely, it should be instead downgraded to category 4 (assuming that it meets those lesser requirements). This would partially preserve the economic value of the RIN and reduce disruptions to Obligated Parties. (2341, p.1)

Document No.: EPA-HQ-OAR-2005-0161-2505
Organization: Shell Oil Products US
Comment:
The commenter (2505.2) noted that while the EMTS system will be a helpful new tool, participation in the program should be voluntary. Where parties purchase RINs that have been cleared through the EMTS system, they should be able to rely on those RINs and held harmless if the RIN is later found to be invalid for some reason. The commenter believes that liability for the invalid RIN should fall on the party that caused the RIN to be invalid, not a party that innocently acquires an invalid RIN. (2505.2, p.)

Our Response:

Shell Oil, SIGMA and NACS argue that parties should not be liable for invalid RINs that they receive in good faith. However, EPA believes these enforcement provisions are necessary to ensure the RFS2 program goals are not compromised by illegal conduct in the creation and transfer of RINs. As with RFS1, under RFS2 there is no "good faith" provision to RIN ownership. An underlying principle of RIN ownership is still one of "buyer beware" and RINs may be prohibited from use and retired at any time if they are found to be invalid. However, because of the "buyer beware" nature of the program, EPA is offering the option, thought EMTS, for a RIN buyer to protect themselves by accepting or rejecting RINs from specific RIN generators or from specific classes of RIN generators.

Commenter Noble Americas argues that improperly generated advanced RINs should not be invalidated, but should instead be downgraded to a lower category of RIN. EPA believes that in order to maintain the integrity of the RIN program, improperly generated RINs must be considered invalid, and, therefore, must be retired. EPA believes that the registration process, combined with the safeguards in EMTS will greatly limit situations in which a RIN is generated in an incorrect category.

PMCI questions EPA's jurisdiction over foreign producers of renewable fuel that is imported into the U.S. In order for a foreign producer to generate RINs under the RFS2, the producer must commit to allow EPA inspections of their facilities and records, and are subject to U.S. substantive and procedural laws for civil and criminal enforcement under the Clean Air Act. If an importer plans to generate RINs for renewable fuel produced by a foreign producer, the importer is responsible for ensuring that the RINs are properly generated and would be liable for a violation if the RINs improperly generated.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUL 05 2012

OFFICE OF CONGRESSIONAL
AND INTERGOVERNMENTAL RELATIONS

The Honorable Fred Upton
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This is in further response to your letter of May 24, 2012, in which you requested detailed information and documents regarding the U.S. Environmental Protection Agency's (EPA) administration of the Renewable Fuels Standard (RFS) program and Renewable Identification Number (RIN) fraud.

In a letter dated June 28, 2012, the EPA provided detailed responses to your question as well as a number of responsive documents. We are now providing on the enclosed disc the documents requested in items 2 and 3 of your May 24 letter. We have also enclosed narrative responses to the questions associated with these documents.

These documents include material claimed as Confidential Business Information (CBI). You wrote to Administrator Lisa Jackson on June 20, 2012, requesting that the EPA release the requested documents without providing notice to the affected businesses. We are producing the enclosed documents in accordance with your request, pursuant to 40 C.F.R. § 2.209.

Although the EPA has not made any final determinations regarding the confidentiality claims relating to the enclosed documents, the agency respectfully requests that you treat the information as if it were confidential and that you not publicly disclose the contents of the information to which the EPA is granting you access. The EPA's release of the information is being made pursuant to the Freedom of Information Act, 5 U.S.C. § 552(d), and EPA regulations at 40 C.F.R. § 2.209(b), and does not constitute a waiver of any confidentiality claims. The information claimed as CBI is clearly identified with the watermark "Enforcement Sensitive Document Containing Confidential Business Information, Property of the U.S. Environmental Protection Agency, Disclosure Authorized Only to Congress for Oversight Purposes " pursuant to 40 C.F.R. § 2.203(b).

If you have further questions regarding this letter, please contact me or your staff may contact Carolyn Levine in my office at (202) 564-1859.

Sincerely,

Laura Vaught
Deputy Associate Administrator

Enclosures

cc: The Honorable Henry Waxman
Ranking Member

Enclosure

EPA Responses to May 24, 2012 letter
Committee on Energy and Commerce

2. *Please provide any registration and/or re-registration applications and accompanying materials submitted by Green Diesel, Absolute Fuels, or Clean Green and any related companies. Please describe EPA's review and approval process of any such applications.*

   The EPA reviews each party's registration submission package to ensure that it contains the information required under the EPA's regulations and that the information is consistent with the registrant's proposed plan for RIN generation. The EPA accepts the registration application if it determines that the application is complete and that it contains the requisite information (e.g., the types of fuel that may be produced at the facility, feedstocks that may be used in production, production processes, co-products that are produced, and any other facility specific information as applicable) and supporting documentation, including an independent third party engineering review. After the EPA accepts the registration application, it allows generation of RINs in the EPA Moderated Transaction System (EMTS), the electronic RFS2 reporting and RIN tracking tool.

   a. *Were engineering reviews and site visits by independent third parties conducted, as required by 40 C.F.R. 80.1450, before the Agency approved registration applications for any of these companies?*

      Engineering reviews, including site visits, were conducted as required under the regulations for Absolute Fuels and Green Diesel. Clean Green only participated under RFS1 and was therefore not required to submit an engineering review.

   b. *Please provide all documents that were submitted to EPA to satisfy these regulatory requirements and all documents relating to such reviews and visits.*

      Please see the enclosed disc for the requested documents.

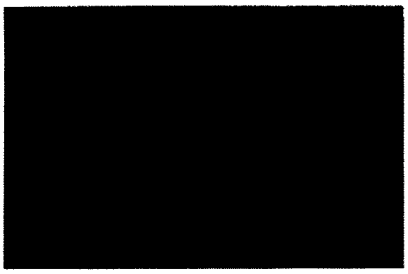
   c. *Did these companies submit any attestation reports, pursuant to 40 C.F.R. 80.1464, for the years 2010 and 2011? Please provide all such reports.*

      Clean Green, Absolute Fuels and Green Diesel did not submit 2010 or 2011 attest engagement reports. The 2010 reports were due on May 31, 2011. EPA conducted inspections of Clean Green and Absolute Fuels before this date, and sent a letter to Green Diesel on July 18, 2011, informing the company that it intended to conduct an inspection. The 2011 attestation reports were required to be submitted to EPA on or before May 31, 2012, but have not yet been received from any of these companies.

3. *Under the EPA Moderated Transaction System (EMTS), it is possible for participants to block transactions with certain RIN producers within the system from which they choose not to purchase RINs. Please provide any registration and/or re-registration applications, including all documents submitted to EPA as part of these applications, for the ten most-frequently blocked registrants on EMTS as of the date of this letter. For each registrant, please describe EPA's applications review and approval process.*

The EMTS was built with a RIN blocking feature that RIN purchasers may use at their discretion to assist them in controlling from whom they purchase RINs. This feature allows a buyer to accept or reject RINs from specific RIN generators or from classes of RIN generators. For instance, an obligated party might choose to block RINs from all importers or from renewable fuel sources that it has not yet verified. Therefore, caution should be used when reviewing the provided list of the ten most frequently blocked registrants as blocking can occur for any number of reasons and is not necessarily indicative of fraudulent behavior.

The list of the ten most frequently blocked registrants is as follows in order of most to least blocked. Registration documents for each of the companies are contained on the enclosed disc. The EPA followed the review and approval process described in the response to question 2.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460
OFFICE OF ENFORCEMENT AND COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Documentation of Clean Green Case Involving Possible Fraudulent Generation of Biodiesel RIN Credits

FROM: Mario Jorquera, EPA Inspector

TO: File

DATE: August 24, 2010

First Visit, July 22, 2010

On July 22, 2010, at 1:45 p.m., I, Mario Jorquera and Ross Ruske, both duly commissioned EPA Enforcement Officers, drove to an office park in White Marsh, Maryland and rang a doorbell at a facility located at 9940 Franklin Square Drive, Suite E. The plaque by the front door of the office identified the tenant as Clean Green Fuel. We were granted entrance by a young gentleman, and asked what we wanted. We identified ourselves as being EPA inspectors and requested to see Mr. Rodney R. Haley, CEO and President of Clean Green. We were escorted to some lobby chairs and asked to wait. After a few minutes, another gentleman emerged from an office and identified himself as Rodney Haley. We identified ourselves as EPA inspectors, and presented our credentials to Mr. Haley, who examined them. He also asked what we were after, and we replied that we were interested in his company's process of producing biofuel and generating RINs. He escorted us to a meeting room, where we presented and explained the Small Business notification to him.

Mr. Haley then proceeded to describe his company's process. He explained that Clean Green Fuel has a production facility located in Curtis Bay, near the Canton railroad on Shell Road. He explained that this is a full-blown plant that operates 24-hours a day, 7 days a week. The plant processed waste vegetable oil obtained from 2700 restaurants in the Baltimore, Washington, Virginia and New Jersey areas. When asked, he stated that his raw material was all fryer grease, not agricultural or other waste oil. We asked him if he could provide us with a list of these restaurants, and he said that he could not, because his drivers knew where they had to go, and he did not direct them. He said his drivers and one contractor drove his 2 collection "grease trucks" to the back of the restaurants, where they emptied the waste oil stored in outside tanks. He reported that they were recently having difficulty because others were stealing the oil before his drivers got there. He reported having several tanker trucks and two waste oil collection trucks.

Mr. Haley explained that his company was no longer producing biofuel, because of the theft issues and because changes in the law had made the process no longer profitable (now only 2 to 3 cents per gallon profit). He said his current business consists of brokering of petroleum diesel fuel (purchasing in bulk from terminals and selling it to truck stops and similar facilities. He reported that he stopped producing biodiesel and stopped generating RINs on or about June 29, 2010. He reported that he operated two plants, with a second facility leased on Route 40, which he said is used as overflow for already blended B5 or B10, etc.

He stated that upon biodiesel production, he kept the RINs for a while and the sold them to a broker. He stated that all production was for highway use, and that no non-road fuel was produced. We asked to see his production and sale records, and he stated that the records were not located at the office park where we were interviewing him, but rather on-site at the production facility. We requested that he take us to that facility so we could look at the records, and he said he was uncertain as to its location, and said that his operations production manager, who's name is Kevin Opher, would be better able to do so. When we asked to speak to Mr. Opher, he made what appeared to be cellular phone calls to Mr. Opher, he said that Mr. Opher was on the road on Interstate 97 and would not be reachable for a long time.

We asked Mr. Haley to elaborate on the location of his production facility, and he was unable to do so. . We then asked him if perhaps he could show us on "Google Maps" where his facility was located, and he said his computers were having connectivity issues. I offered to bring in my personal computer with a mobile internet connection, and did so. However, when we pulled up Shell road, he was unable to point to his facility, even when we traveled the entire length of Shell road using the "Street View" feature of Google Maps. He excused his inability to find the facility by saying that he did not often travel to the facility and let his operations manager handle the production process. We told Mr. Haley that we would like to visit the production facility and inspect the records, and would be back on Monday, July 26 at 10:00 a.m. to do so. Mr. Haley agreed to this, and said he would call if there was any problem with the new site visit.

On the way home, we drove through Curtis Bay along the full length of Shell Road, and found no buildings that resembled the facility that Mr. Haley described.

Attorney's Call, July 23, 2010

On Friday, July 23, 2010, I received a call from an attorney who identified himself as Steven E. Bers, of the law firm Whiteford, Taylor, Preston in Baltimore, Maryland. He said he was representing Clean Green Fuel. He said that he needed to have some time to get up to speed on the regulatory requirements, and asked for some assistance in finding what was information Clean Green was required to provide EPA. I sent him a list of materials gleaned from the regulations prepared by Erv Pickell, EPA's team leader for fuels enforcement. Mr. Bers also asked if it would be possible for Ross and me to come up on Wednesday July 28 instead of Monday, as originally scheduled, so that Clean Green could get its records in order for our examination. He said we could also visit the facility after meeting at Clean Green headquarters in White Marsh. After consultation with Mr. Ruske, I agreed to this second meeting time and location.

Second visit, July 28, 2010

Mr Ruske and I visited the Clean Green office in White Marsh for a second time on July 28, 2010, at 10:00 a.m. Again, we were let in ans asked to wait for Mr. Haley in the lobby area. After a few minutes, a gentleman walked out and identified himself as Mr. Bers. He apologized that Mr Haley was not yet available, and said he would be there in a few minutes. After 15 minutes or so, Mr. Haley appeared and we were escorted to the same meeting room we had used a week earlier.

Mr. Haley had a laptop and projectopr set up in the room, and displayed XL spread sheets that essentially showed the same data that EPA has in its records for Ocean Connect. Mr. Haley referred to this data, reporting that Clean Green had produced its first batch of fuel in November of 2009, and its last batch in June of 2010.

We asked Mr. Haley to show us the records of his fuel sales, but he replied that he did not have any such records, because Glean Green gave the fuel away to various companies, and no records were kept. He explained that trucks came to the plant "warehouse" and just picked up the free biodiesel–no records or names were taken.

We also asked Mr. Haley whether he could give us the name and address of any of the restaurants where his drivers picked up the vegetable oil, and he again replied that he was unable to do so. He explained that all of the oil was picked up by his contractors, and only they knew the routes they took and restaurants they serviced. He said all blending occurred at the plant.

We asked for further elaboration on the records that Clean Green Fuel produced and submitted to EPA. Mr. Haley explained that he contracted with an individual in Kansas City to file the RIN reports with EPA. Mr. Haley identified the company as Ad Astra Energy, and the individual involved as Bob Casey. He explained that this company did all the filing for Clean Green on their behalf, including what he referred to as the "100" and "400" reports. Mr. Haley reported that he sold the RINs only to one party, a company called Ocean Connect, both in 2009 and 2010.

We asked Mr. Haley to elaborate on the agreement with Ocean Connect, and he described the process thus:

"Ocean Connect just purchased RINs. We gave away the blended biodiesel because the cost was too high to sell, and it did not catch on until later on. Drivers came in with 4000 gallons and emptied their tankers, blended the biodiesel, and gave it away. It cost 15 to 20 cents per gallon to produce. We put the word out that we were giving away biodiesel. They picked it up at the plant. We did lose some money at times, but it was a test.

Ocean Connect is a brokerage firm that found Clean Green from access lists and offered to buy our RINs. They are Clean Green's only source of funds, since the biodiesel fuel was given away at no cost. Volume of production is obtained from batch tank movements. No records are kept of our diesel production or distribution. The only records would be those produced

elsewhere for the companies that came into our production facility already loaded with mineral diesel fuel, then we blended our product into their trucks.

Batch volumes were written down with the waste oil actually used to produce biodiesel. We used lined paper, then we transferred the records into the computer, and then produced the spread sheets."

Upon questioning, Mr. Haley added, "The lined paper log sheets were not kept after entering the data into the computer."

The attorney, Mr. Bers, said:

"Volume data was input on the computer on a daily basis. People would come in and blend the biodiesel into their pre-loaded mineral diesel fuel, and that fraction would come out of a batch volume that is recorded on the spreadsheet. Volume data was figured to determine how much was to be loaded depending on existing mineral diesel in the truck."

Mr. Haley elaborated further:

"We had a big blending tank that was used to offload the mineral diesel to blend with the biodiesel, then the blend was pumped back onto the customer's truck. We didn't provide the customer with a loading ticket to show the added amount of biodiesel.

Feed stock contractor delivered fuel to plant, Clean Green paid him but kept no record of volume or payments. All payments were based on volume of waste oil delivered to the plant.

No imported raw material feedstock was used. All waste oil came from restaurants.

For 2010, reports have not been filed, but may be getting filed today by Bob Casey. For 2009, RFS1 was filed out of three main reports

We are not producing any more biodiesel because waste oil is not available at restaurants and it is no longer profitable without subsidies.

Mr. Ruske asked for copies of all the documents presented to us, including two photographs that Mr. Haley had presented as showing the biodiesel facility during its production phase. Mr. Haley explained that the facility we were about to visit no longer looked like the pictures, because the biodiesel tanks had been recently removed and disposed of since they were no longer being used for production.

I asked to see any permits related to the installation of the tanks or use of the production facility. Mr. Haley brought in several framed permits and licences pertaining to his operation, and I asked that copies of these documents be provided to us, as well.

Mr. Haley described these documents thus:

"We have tank licencing from the State, bonds, and have those documents here. Rodney is having copies made of the licensing certificates, some of which were received on 7/28/2010 today."

Mr. Haley agreed to send electronic copies of the RIN report spreadsheet and copies of all reports sent to EPA directly to me.

At the conclusion of the interview, we took separate vehicles to examine the facility where Mr. Haley said the bodiesel had been blended. The address of the facility is 7521 Pulaski Highway. The building turned out to be a warehouse with a garage door large enough to admit a semi truck. Mr Haley said that trucks pulled alongside the building to receive the fuel loads.

Upon opening the door, we noted a large open space and and a concrete floor. Three large metal tanks constructed on moveable skids were located to the left of the entrance, and a smaller plastic tank was towards the back to the right. A dilapidated desk was on the far left wall, with a CRT monitor but no CPU. Mr. Haley pointed out some deep scratches on the concrete floor that appeared fairly recent, and indicated these had been made when the biodiesel equipment was removed. When I asked where the equipment had gone, he said he had sold it but would not be able to name the buyer, since he had not kept records of the transaction. Ross and I saw no anchors on the floor, which seemed evident on the picture of the biodiesel tanks. Mr. Bers used the picture of the biodiesel facility and indicated where stains on the floor in the picture matched the stains on the floor of the warehouse. However, Ross noticed that the skylights in the warehouse we were examining did not have roofing scalloping as the ones in the pictures. Later examination of the numerous pictures I took of the warehouse showed the placement of the overhead lights was inconsistent, as well. Mr Haley said that the desk and monitor were part of the computer used for data entry. When I asked to see the CPU, he said that it had been disposed of when the biodiesel operation was terminated.

A subsequent examination of copies of the permits submitted by Mr. Haley revealed that the tank permit issued to Clean Green by the City of Baltimore for installation of tanks was issued on July 1, 2010.

Preliminary Conclusions of Investigation

In light of the observations cited above and statements collected, and the lack of any normal business documentation that demonstrates acquisition of raw materials, production of fuel or sale/distribution to customers, Mr. Ruske and I found no evidence that supported Mr. Haley's claim of having produced any biodiesel fuel in 2009 or 2010. Accordingly, we found no indication that Clean Green Fuels had any actual production of biodiesel fuel that would generate RINs.

United States District Court

U.S. DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FILED
OCT 14 2011
CLERK, U.S. DISTRICT COURT
By

NORTHERN DISTRICT OF TEXAS

In the Matter of the Seizure of

APPLICATION FOR SEIZURE WARRANT

2011 Cadillac Escalade, VIN
1GYS4DEF1BR378760.

CASE NUMBER: 5-11MJ0081

I Michael Fiveash, Special Agent, USSS being duly sworn depose and say:

I am a(n) Special Agent with the United States Secret Service and have reason to believe that in the Northern District of Texas there is now certain property which is subject to forfeiture to the United States, namely

2011 Cadillac Escalade, VIN 1GYS4DEF1BR378760.

which is property subject to seizure and forfeiture pursuant to 18 U.S.C. § 981(b) and 21 U.S.C. § 853(f) and 18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) concerning a violation or violations of 18 U.S.C. § 1343.

The facts to support a finding of Probable Cause for issuance of a Seizure Warrant are as follows:

See Attached affidavit.

Continued on the attached sheet and made a part hereof. X Yes _ No

Signature of Affiant

Sworn to before me, and subscribed in my presence

October 14, 2011
Date

NANCY M. KOENIG
United States Magistrate Judge

AFFIDAVIT IN SUPPORT OF SEIZURE WARRANT APPLICATIONS

I, Michael J. Fiveash, being duly sworn, depose and state the following:

Affiant's Background

1. I am a Special Agent (S/A) with the Department of Homeland Security (DHS), United States Secret Service (USSS), currently assigned to the Lubbock Resident Office. I have been employed as a federal criminal investigator since January 5, 2009, and have an additional twelve (12) years experience in municipal government. In my official capacity, I have participated in a variety of investigations ranging from simple, single-party investigations to complex conspiracies. I have provided instruction to universities, banks, and municipalities regarding financial crimes, identity theft, and related fraud schemes. In addition to my first-hand law enforcement experience, I have attended DHS/USSS schools where I received training in detecting methods and techniques utilized by individuals to defraud victims using various schemes. Additionally, I am currently tasked as the Asset Forfeiture Coordinator for the USSS, Lubbock Resident Office.

2. I have participated in criminal fraud investigations of violations of the laws of the United States on many occasions. I am familiar with and have participated in all the normal methods of investigation, including, but not limited to, electronic surveillance; visual surveillance; general questioning of witnesses; use of search warrants; use of grand jury subpoenas; use of confidential informants; and also cooperating and coordinating with other federal, state, and local law enforcement

officials.

3. This Affidavit is being submitted for the purpose of establishing probable cause for seizure warrants; therefore, it does not include all the facts that I have learned during the course of this investigation. Where the contents of conversations of others are reported herein, they are reported in substance and part.

Property for Seizure

4. This Affidavit is made to obtain seizure warrants for the following property:

a. 1984 Gulfstream Aerospace Aircraft, Model G-1159A, Series GIII, Tail #N431JG.

b. 2006 Ford F250, VIN 1FTSX21P66EB28637.

c. 2011 Toyota Sequoia, VIN 5TDDW5G11BS045265.

d. 2010 Lexus RX450H, VIN JTJZB1BA3A2403387.

e. 2010 Mercedes Benz S65 AM, VIN WDDNG7KBXAA345501.

f. 2011 Ford F250, VIN 1FT7W2BT7BEA35253.

g. 1972 Chevrolet Crevalle, VIN 1D37F2B681366.

h. 2000 Dodge 2500 Van, VIN 2B4JB25Y5YK149598.

I. 2006 Ford F250, VIN 1FTSW21P66ED39517.

j. 1999 Chevrolet G3500 Van, VIN 1GCHG35R8X1133200.

k. 2011 Bentley, VIN SCBCU7ZA2BC067564.

l. 2011 Cadillac Escalade, VIN 1GYS4DEF1BR378760.

Legal Authority for Seizure

5. 18 U.S.C. § 981(a)(1)(C) provides for civil forfeiture of property constituting or derived from the proceeds traceable to any offense, or conspiracy to commit an offense, constituting "specified unlawful activity" as defined in 18 U.S.C. § 1956(c)(7). Per 18 U.S.C. § 1956(c)(7)(A), specified unlawful activity includes a violation of 18 U.S.C. § 1343 (wire fraud). Property subject to civil forfeiture pursuant to 18 U.S.C. § 981(a)(1)(C) may be seized by warrant pursuant to 18 U.S.C. § 981(b).

6. 28 U.S.C. § 2461(c) makes criminal forfeiture possible where a criminal law has been violated and civil forfeiture is authorized in connection with the criminal offense. Property subject to criminal forfeiture may be seized by warrant pursuant to 21 U.S.C. § 853(f).

Facts Supporting Seizure

Introduction

7. I am currently investigating alleged criminal violations of the laws of the United States by Absolute Fuels, LLC (AF); AF owner/CEO Jeffrey David Gunselman (Gunselman); other business entities associated with AF; and others known and unknown at this time, for their actions in fraudulently creating and selling credits for renewable fuels that were never produced. The Lubbock Resident Office of the USSS and the Dallas Office of the Environmental Protection Agency (EPA), Criminal Investigation Division, have jointly been investigating AF and Gunselman since May 2011, for criminal violations of the environmental statues administered by EPA, including the

Clean Air Act (42 U.S.C. § 7401 et seq.), and other statutes, specifically 18 U.S.C. § 1343. Based on the investigation in this case, including information provided by and through a variety of sources, there is probable cause to believe the following:

a. From on or about January 2010, to the present, AF, Gunselman, and others known and unknown at this time have fraudulently created and sold credits for renewable fuels that were never produced, thus violating the false statement provision of the Clean Air Act (42 U.S.C. § 7413 (c)(2)(A)), and defrauding the United States, as well as the purchasers of the credits.

b. From on or about January 2010, to the present, AF, Gunselman, other business entities associated with AF, and others known and unknown at this time, having devised a scheme or artifice to defraud, and to obtain money or property by means of false and fraudulent pretenses, representations, and promises, transmitted and caused to be transmitted by means of wire communication in interstate commerce, certain writings and signals for the purpose of executing such scheme or artifice, in violation of 18 U.S.C. § 1343 and 42 U.S.C. § 7413 (c)(2)(A).

c. From on or about January 2010, to the present, AF, Gunselman, other business entities associated with AF, and others known and unknown at this time, obtained money through the wire fraud

scheme and used it to purchase real and personal property.

Relevant Environmental Statutes/Background

8. The Energy Policy Act of 2005 established a Renewable Fuel Standard (RFS1), which mandated that a minimum of 4 billion gallons of Renewable Fuels be used in 2006, and that this minimum usage volume rise to 7.5 billion gallons by 2012. Two years later, the Energy Independence and Security Act of 2007 established an expanded Renewable Fuels mandate (RFS2). RFS2 required the annual use of 9 billion gallons of Renewable Fuels in 2008, rising to 36 billion gallons annually in 2022. RFS2 applies to all transportation fuel used in the United States, including diesel fuel intended for use in highway motor vehicles, non-road, locomotive, and marine diesel.

9. "Renewable fuels" are fuels produced from feedstocks derived from biological sources, such as corn-based ethanol and bio-diesel derived from plant oils and animal fats.

10. The EPA is responsible for implementing regulations to ensure that the national transportation fuel, heating oil, and jet fuel supply sold in the United States during a given year contains the mandated volume of Renewable Fuels. Under RFS2, producers and importers of gasoline and diesel fuel have a "Renewable Volume Obligation", an amount of Renewable Fuels they are required to blend into non-renewable (fossil) fuel for retail sale per year. Fuel producers and importers must demonstrate their compliance with RFS2 or incur civil penalties.

11. EPA established a system of tradable credits for producers of Renewable

Fuels, known as Renewable Identification Numbers (RINs). Each RIN is a unique identifier for a gallon of renewable fuel. The RIN is used to track volumes of Renewal Fuels. A RIN is a 38-character alpha-numeric code that is generated by the producer or importer of renewable fuel, representing gallons of renewable fuel produced or imported, and is assigned to batches of renewable fuel that are transferred to others. The RIN is the basic currency for the RFS program, used by non-renewable fuel producers and importers to demonstrate compliance, and used to track the volumes of renewable fuels from the renewable fuel producer to the producer or importer.

12. A producer or importer of conventional fuels would purchase renewable fuel, and the associated RINs, from a renewable fuels producer. The renewable fuel would be blended into conventional fuel for distribution. The associated RINs are eventually used by the conventional fuel producer or importer to demonstrate compliance to the EPA, that is, the fulfillment of the "Renewable Volume Obligation."

13. Since renewable fuels' supply and demand can vary over time and across regions, a market has developed for RINs. The marketability of RINs allows producers and importers, who have not bought enough bio-fuels, to fulfill their Renewable Volume Obligation by purchasing RINs as a replacement for the actual purchase of renewable fuels.

14. EPA RFS2 regulations require that RINs may be generated and transferred only though the EPA Moderated Transaction System (EMTS), an Internet-accessible transaction platform used by regulated parties to generate, separate, trade, and retire

RINs. All EMTS activity is conducted through a Central Data Exchange (CDX) account.

15. RFS2 imposes reporting and record keeping requirements for all producers of Renewable Fuel. As of July 1, 2010, pursuant to 40 C.F.R. 80.1454, any RIN-generating producer must keep product transfer documents, copies of all reports submitted to EPA, records related to each RIN transaction, and records related to the generation and assignment of RINs, including batch volume, batch number, type and quantity of feedstocks, type and quantity of fuel used for process heat, feedstock energy calculations, and all commercial documents related to details of RIN generation.

The Absolute Businesses

16. It was determined from Texas Secretary of State records that AF is a Limited Liability Company registered with the Secretary of State on April 24, 2009. AF's business address is 2517 74th Street, Lubbock, Texas. Gunselman is named as Governing Person and as Registered Agent.

17. Based on the investigation in this case, including information provided by and through a variety of sources, it has been determined that, in addition to AF, Gunselman operates multiple business entities. For example, Gunselman formed Absolute Insulation, LLC in August 2008; Absolute Milling, LLC in January 2010; Uneeda Carwash, LLC in August 2010; and YGOG Holdings, LLC and Absolute Commercial Realty, LLC in May 2011. Further, in March 2011, Gunselman, as Governing Person and Registered Agent, registered Ellipse Energy, LLC with the Texas Secretary of State. All these businesses have the business address of 2517 74th Street,

Lubbock, Texas.

18. Based on the investigation in this case, including information provided by and through a variety of sources, it has been determined that the following persons work with AF: President David Powell; Absolute Insulation Account Executive Ty Porter; UNEEDA Wash Account Executive Logan Mclean; Absolute Milling Account Executive Matthew Woodruff; Logistics Officer Brad Rothwell; Plant Manager Johnny Porras; Director of Philanthropy Jason Jennings; Human Resource Manager Haley Hays; Director of Agriculture Stacy Hardin; EPA Compliance Manager Verna Kell; Chemist Srividya Ayalasomayajula; Absolute Office Manager Taryn Atchley; Marketing Director Ronald Cherry; and UNEEDA Wash Manager Margaret Furr.

19. Based on the investigation in this case, including information provided by and through a variety of sources, it has been determined that from 2009 to January 2010, AF produced bio-diesel through Double Diamond Biofuels, a plant in Dimmit, Texas, owned by Glenn Odom. Gunselman and Odom agreed that AF would supply all raw materials, pay wages for all employees, and pay Odom $0.25 per gallon of bio-diesel produced there. From 2009 to January 2010, Gunselman's Double Diamond bio-diesel production showed a loss of approximately $500,000.00. AF produced no bio-diesel at Double Diamond after January 2010.

20. In February 2010, AF was sued in Cause No. 2010-551142 (99th District Court, Lubbock County, Texas), a suit alleging that AF had failed to pay $189,353.94 owed to Rowena Milling Company for cottonseed oil invoiced in December 2009 and

January 2010. The suit stated that AF had entered into a contract with Rowena for the purchase of 1,246,600 pounds of crude cottonseed oil at $0.23 per pound; AF accepted the crude cottonseed oil between November 30, 2009, and December 21, 2009; but subsequently breached the contracted agreement through its failure to pay Rowena the total contract fee. AF defaulted in the suit, and the court granted a judgment in favor of Rowena.

21. Based on the investigation in this case, including information provided by and through a variety of sources, it has been determined that in August 2010, Gunselman, through Absolute Milling, LLC, purchased Greenlight Bio-Diesel, an existing bio-diesel production facility near Anton, Texas. Johnny Porras, the AF Manager in charge of producing bio-diesel, made several attempts to produce bio-diesel at Anton, but the attempts to produce bio-diesel fuel were unsuccessful. Porras had acquired equipment to test bio-diesel samples in the office, and tests of the batch samples of the bio-diesel produced showed that it was not usable. Porras vented his frustration by stating, "I don't know how to make bio-diesel!" Before Porras was hired as Manager of AF, he was a diesel mechanic at the Lubbock Peterbilt truck dealer.

22. Based on the investigation in this case, including information provided by and through a variety of sources, it has been determined that in or about September 2010, Gunselman registered his Anton facility with the EPA. The facility was approved, and Gunselman was given an EMTS account, giving him authority to generate and sell RINs. Gunselman conducted all his EMTS activity through a Central Data Exchange (CDX)

account.

23. Based on the investigation in this case, including information provided by and through a variety of sources, the following was determined:

a. In November 2010, a RINs broker (RINs Broker) was attempting to buy RINS from Gunselman, and became suspicious when he saw the quantity of RINS that were being sold. He then challenged Gunselman as to the validity of the RINs. The RINs Broker asked Gunselman how AF was able to produce the volume of bio-diesel in order to be able to generate such a large quantity of RINs. The RINs Broker was not satisfied with Gunselman's answers, and cancelled the sale.

b. In December 2010, the broker sent an e-mail to an EPA employee, stating: "I . . . recently concluded a RIN transaction through EMTS with AF. The RINs appeared to be fine on paper but our vetting process for the RINs uncovered some inconsistencies on the plant and raised doubt on the validity of the RINs." The EPA Employee subsequently spoke by telephone with the RINs Broker, who said that he believed that the production quantities claimed by AF were not possible with the current economics of the bio-diesel industry. The RINs Broker said he called Absolute's bio-diesel testing lab, and was told the lab only receives sporadic samples of bio-diesel.

This did not make sense for a large producer. AF would not sell the RINs Broker any actual bio-diesel and was selling RINs at about half the market price.

c. The broker was going to send the questioned RINs back to AF, because he was not going to pay for them. It appears that he did not do so; the RINs are still in the Broker's account on the EMTS. The RINS Broker has not paid for the RINs, and Gunselman has never complained of non-payment or demanded return of the RINs.

24. Based on the investigation of this case, including discussion with the aforementioned EPA employee and review of EPA records, EPA CID S/A Mike Morrow learned the following:

a. AF was scheduled for a records audit and inspection to be conducted by employees of EPA contractor Bionetics Corporation, as required by EPA. On or about January 10, 2011, Gunselman was informed by letter of the scheduled EPA inspection and the business records that were to be produced for review. On February 3 and 4, 2011, Inspectors conducted a records audit and facility inspection of AF. On March 7, 2011, an Inspection Report was completed and forwarded to EPA.

b. The Inspection Report stated that Inspectors had requested to see various records required by EPA regulations to be maintained and

provided to EPA upon request. Despite having three weeks advance notice of the inspection, the Inspectors were not provided the records and were repeatedly rebuffed by Gunselman, with excuses such as "need time to assemble" the records, "need additional time to assemble the records," and "need more time to assemble the remaining records." The Inspection Report also stated that Gunselman claimed that he had been extremely busy and was unable to assemble the requested documentation before the Inspectors arrived.

c. The Inspectors presented Gunselman a letter dated February 4, 2011, requesting the production of records required to complete the audit. Gunselman agreed to provide requested records by March 18, 2011. As of the date of this Affidavit, no records had been provided by AF to EPA.

d. The Inspection Report noted the Inspectors' observation of "floors immaculately clean for a bio-diesel production facility." The report also stated, "It appears that the facility is not producing or producing less bio-diesel fuel than what was reported to the EMTS."

e. The Inspection Report stated that during the inspection of the production facility, Gunselman and Porras told the Inspectors that the bio-diesel fuel tanks contained "finished diesel product."

However, when the Inspectors asked for bio-diesel fuel samples from the tanks, they were then told that one tank was being used to store bio-diesel feedstock (the vegetable oil used in the process) and that the other tank contained unfinished bio-diesel requiring additional processing and retesting.

25. Based on the investigation of this case, including discussion with the EPA employee and review of EPA records, EPA CID S/A Mike Morrow learned the following:

a. Between January 26, 2010, and April 25, 2011, the AF CDX account was accessed 177 times. Of the 177 Internet Protocol (IP) addresses from which the Absolute CDX account was accessed, most were from a single IP address in the Lubbock, Texas, geographic area.

b. The AF CDX account was accessed on October 30, 2010, from an Internet Protocol (IP) address in Wichita, Kansas belonging to Starwood Hotels.

c. The AF CDX account was accessed December 24, 2010, from an Internet Protocol (IP) address in Alexandria, Virginia; Gunselman's parents reside in Alexandria, Virginia.

d. The AF CDX account was accessed at 11:21 a.m. on February 24, 2011, from an Internet Protocol (IP) address in San Antonio, Texas.

e. The EMTS is hosted on a mainframe computer located at Research Triangle Park, Durham, North Carolina. As previously set forth, all IP addresses from which RIN transactions were conducted on the AF EMTS account were located in the areas of Lubbock, Wichita (Kansas), San Antonio, and Alexandria (Virginia). Therefore, the transactions were conducted in interstate commerce.

f. EMTS data shows that between September 10, 2010, and September 30, 2011, AF sold over 46 million RINs for more than $40,000,000.00. This represents a purported production of over 36 million gallons of bio-diesel.

26. Based on the investigation of this case, including discussion with a Cooperating Witness (CW-1) who had specific and personal knowledge regarding AF, S/A Morrow learned the following:

a. AF produced no bio-diesel after January 2010. Attempts to produce bio-diesel at the Anton facility were unsuccessful; samples failed quality tests.

b. AF never sold any bio-diesel produced at its Anton facility. AF's Compliance Officer Verna Kell was suspicious of Gunselman's business activity and asked, "Where is all this money coming from?"

c. In April or May 2010, Gunselman instructed an employee to sell a specific quantity of RINs; however, the employee declined, because

AF had no RINs to sell. Gunselman took the employee out of earshot of the other employees and repeated his instruction to find someone to buy that quantity of RINs, stating, "This is in the pioneering stages and no one will ever know - we'll make the fuel later."

27. In or about April 2011, Gunselman purchased a second renewable fuels production facility in Gonzales County, Texas. On or about September 2011, Gunselman registered the Gonzalez facility with the EPA. The facility was approved and assigned a facility number, but no bio-diesel fuel production from this facility has been reported to EPA as of the date of this Affidavit.

RIN Sales by AF and Purchases of Assets by Gunselman

28. Based on the investigation of this case, including information provided by and through a variety of sources and database queries, it appears Gunselman acquired ten vehicles and an airplane valued at over $3,000,000.00, while AF was involved in the activities described in the previous paragraphs of this Affidavit.

a. As previously mentioned, in January 2010, AF records depicted a loss of approximately $500,000.00 after production costs. AF ended all bio-diesel production at the Dimmitt facility in January 2010.

b. According to interviews with CW-1, Gunselman was selling RINs prior to the enactment of the requirements set out in 40 C.F.R. 80.1454 (see Paragraph 15); AF was not registered with the Central

Data Exchange (CDX) account at this time, but Gunselman was trading RINs via unknown methods.

c. On August 11, 2010, Absolute Milling, LLC purchased the Anton production facility (see Paragraph 21).

d. On June 21, 2010, a 1972 Chevrolet Chevelle, Texas license plate BTV847, VIN 1D37F2B681366, was registered with the Texas Department of Motor Vehicles (DMV) showing Gunselman as the owner. It appears Gunselman acquired the Crevalle in May 2010. The Chevelle has been regularly seen at Gunselman's residence at 8106 Toledo Avenue, Lubbock, Texas. **[seizure item g.]**

e. On July 12, 2010, a 2011 Ford Super Duty F250, Texas license plate AJ59499, VIN 1FT7W2BT7BEA35253, was registered with the DMV showing Gunselman as the owner. It appears Gunselman acquired the Ford in June 2010. The 2011 Ford F250 has been regularly seen at Gunselman's Toledo Avenue residence. **[seizure item f.]**

f. Additionally, in July 2010, a 1999 Chevrolet G3500 Van, Texas license plate AN15479, VIN 1GCHG35R8X1133200, and a 2000 Dodge 2500 Ram Van, Texas license plate BZ3Y101, VIN 2B4JB25Y5YK149598, were registered with the DMV showing Gunselman as the owner. It appears the two vans were acquired in

early July 2010. **[seizure items h. and j.]**

g. In September 2010, AF registered with the EPA's CDX through identification number 3498, in order to conduct online RIN sales pursuant to the regulations set out in 40 C.F.R. 80.1454. Subsequently, in September 2010, AF completed the following CDX sales: On September 10, 2010, 500,000 RINs to Biouria Trading LLC for $0.48 per RIN, grossing $240,000.00; on September 14, 2010, 500,000 RINs to Biouria Trading LLC for $0.48 per RIN, grossing another $240,000.00; and on September 27, 2010, 500,000 RINs to Biouria Trading LLC for $0.48 per RIN, again grossing $240,000.00.

h. On September 27, 2010, a 2006 Ford F250, Texas license plate AN83175, VIN 1FTSW21P66ED39517, was registered with the DMV showing Gunselman as the owner. It appears Gunselman acquired the Ford in early September 2010. **[seizure item I.]**

I. On September 29, 2010, AF completed two CDX sales, one involving 1,000,000 RINs to Musket Corporation for $0.56 per RIN, grossing $560,000.00, and another involving 1,150,000 RINs to Marathon Petroleum Company for $0.52 per RIN, grossing $598,000.00.

j. In October 2010, AF completed the following CDX sales: On

October 4, 2010, 1,000,000 RINs to Biouria Trading LLC for $0.27 per RIN, grossing $270,000; on October 6, 2010, 500,000 RINs to National COOP Refinery Association for $0.56 per RIN, grossing $280,000.00; on October 8, 2010, 500,000 RINs to Marathon Petroleum Company for $0.55 per RIN, grossing $275,000.00; and on October 14, 2010, 500,000 RINs to Tesoro Corporation for $0.58 per RIN, grossing $290,000.00.

k. On October 19, 2010, a 2010 Mercedes Benz S65 AM, Texas license plate CD8J088, VIN WDDNG7KBXAA345501, was registered with the DMV showing Gunselman as the owner. It appears Gunselman acquired the Mercedes in mid-September 2010. The 2010 Mercedes Benz has been regularly seen at Gunselman's Toldeo Avenue residence, as well as at AF. The value of this vehicle is approximately $200,000.00. **[seizure item e.]**

l. In October 2010, AF completed the following additional CDX sales: On October 20, 2010, 1,000,000 RINs to Houston Refining LP for $0.58 per RIN, grossing $580,000.00; on October 25, 2010, 1,000,000 RINs to Sunoco Incorporated for $0.57 per RIN, grossing $570,000.00; on October 26, 2010, 1,000,000 RINs to Biouria Trading LLC for $0.50 per RIN, grossing $500,000.00; and on October 30, 2010, 750,000 RINs to Citgo Petroleum Corporation for

$0.57 per RIN, grossing $427,500.00.

m. On November 4, 2010, AF submitted an online CDX sale for 500,000 RINs to Trafigura AG for $0.56 per RIN. A Trafigura RINs broker questioned the legitimacy of the RINs to be sold, asking how AF could be capable of producing the volume of bio-diesel to generate such a large quantity of RINs. The broker was unsatisfied with Gunselman's answers and cancelled the sale; AF was required to pay a $50,000.00 cancellation fee.

n. On November 5, 2010, a 2010 Lexus RX450H, Texas license plate CF9N356, VIN JTJZB1BA3A2403387, was registered with the DMV showing Gunselman as the owner. It appears Gunselman acquired the Lexus in mid-October 2010. The Lexus has been regularly seen at Gunselman's residence. **[seizure item d.]**

o. In November 2010, AF completed the following CDX sales: On November 8, 2010, 500,000 RINs to Sunoco, Inc. for $0.59 per RIN, grossing $295,000.00; on November 10, 2010, 1,000,000 RINs to Biouria Trading LLC for $0.56 per RIN, grossing $560,000.00; on November 16, 2010, 500,000 RINs to Delek Refining LTD for $0.59 per RIN, grossing $295,000.00; and on November 16, 2010, 500,000 RINs to Houston Refining LP for $0.59 per RIN, grossing $295,000.00.

p. On December 20, 2010, a 2011 Toyota Sequoia, Texas license plate CG5J412, VIN 5TDDW5G11BS045265, was registered with the DMV showing Gunselman as the owner. It appears the Toyota was acquired in November 2010. **[seizure item c.]**

q. On November 30, 2010, AF completed the following CDX sales: 500,000 RINs to PetroDiamond Incorporated for $0.62 per RIN, grossing $310,000.00; 89,240 RINs to Marathon Petroleum Company LLC for $0.56 per RIN, grossing $49,974.40; 500,000 RINs to Kolmar Americas Incorporated for $0.61 per RIN, grossing $305,000.00; 500,000 RINs to BP Products, North America, for $0.68 per RIN, grossing $340,000.00; 500,000 RINs to Sunoco Incorporated for $0.60 per RIN, grossing $300,000.00; and 1,000,000 RINs to Citgo Petroleum Corporation for $0.59 per RIN, grossing $590,000.00.

r. In December 2010, AF completed the following CDX sales: On December 1, 2010, 500,000 RINs to Marathon Petroleum Company LLC for $0.60 per RIN, grossing $300,000.00; on December 7, 2010, 500,000 RINs to Sunoco Incorporated for $0.60 per RIN, grossing $300,000.00; on December 15, 2010, 500,000 RINs to Total Petrochemicals USA Incorporated for $0.80 per RIN, grossing $400,000.00; on December 16, 2010, 500,000 RINs to Tesoro

Corporation for $0.80 per RIN, grossing $400,000.00; on December 24, 2010, 500,000 RINs to Petrodiamond Incorporated for $0.78 per RIN, grossing $390,000.00; and on December 30, 2010, three sales to Tesoro Corporation, 500,000 RINs to Tesoro Corporation for $0.70 per RIN, grossing $350,000.00; 500,000 RINs to Tesoro Corporation for $0.74 per RIN, grossing $370,000.00; and 500,000 RINs to Tesoro Corporation for $0.65 per RIN, grossing $325,000.00.

s. On January 5, 2011, a Gulfstream G-1159A multi-engine turbojet was registered to AF LLC, 2517 74th Street, Lubbock, Texas, and the plane was assigned tail number N-431JG. The value of this aircraft is approximately $2,500,000.00. This aircraft is maintained in a hangar at Lubbock International Airport, Lubbock Aero Fuel Base Operations, 6304 North Cedar Ave, Lubbock, Texas. **[seizure item a.]**

t. On January 13, 2011, AF completed a CDX sale of 2,000,000 RINs to Tesoro Corporation for $0.60 per RIN, grossing $1,200,000.00.

u. In March 2011, AF completed a CDX sale of 2,000,000 RINs to Petrodiamond Incorporated for $0.50 per RIN, grossing $1,000,000.00; In March 2011, AF also completed the following CDX sales: On March 8, 2011, 1,000,000 RINs to Petrodiamond

Incorporated for $0.46 per RIN, grossing $460,000.00; on March 11, 2011, 1,000,000 RINs to Petrodiamond Incorporated for $0.50 per RIN, grossing $500,000.00; on March 14, 2011, 1,000,000 RINs to Petrodiamond Incorporated for $0.50 per RIN, grossing $500,000.00; on March 24, 2011, 2,000,000 RINs to Petrodiamond Incorporated for $0.70 per RIN, grossing $1,400,000.00; and on March 26, 2011, 192,081 RINs to Marathon Petroleum Company LP for $1.06 per RIN, grossing $203,605.86.

v. In April 2010, AF completed the following CDX sales: On April 4, 2011, 500,000 RINs to Marathon Petroleum Company LP for $1.30 per RIN, grossing $650,000.00; on April 8, 2011, 1,000,000 RINs to Tesoro Corporation for $1.30 per RIN, grossing $1,300,000.00; on April 12, 2011, 1,000,000 RINs to Marathon Petroleum Company LP for $1.35 per RIN, grossing $1,350,000.00; and on April 25, 2011, 1,000,000 RINs to Marathon Petroleum Company LP for $1.21 per RIN, grossing $1,210,000.00.

w. On April 14, 2011, Gunselman, as AF LLC, registered the company as owner of a 2006 Ford F250, Texas license plate AW39071, VIN 1FTSX21P66EB28637. It appears the Ford title was assigned to Absolute Fuels in March 2011. **[seizure item b.]**

x. On May 3, 2011, Gunselman registered himself as the owner of a

2011 Bentley Continental, Texas license plate CP3D020, VIN SCBCU7ZA2BC067564. It appears he acquired the vehicle in mid-April 2011, from John Eagle European, a dealership in Austin, Texas. The value of this motor vehicle is approximately $267,000.00. **[seizure item k.]**

y. In May 2011, AF completed the following CDX sales: On May 10, 2011, 1,000,000 RINs to Conoco Phillips for $1.20 per RIN, grossing $1,200,000.00; and on May 26, 2011, 1,000,000 RINs to Conoco Phillips for $1.30 per RIN, grossing $1,300,000.00.

z. In June 2010, AF completed the following CDX sales: On June 2, 2011, 1,000,000 RINs to Citgo Petroleum Corporation for $1.31 per RIN, grossing $1,310,000.00; on June 10, 2011, 1,000,000 RINs to Tesoro Corporation for $1.36 per RIN, grossing $1,360,000.00; and on June 27, 2011, 1,000,000 RINs to Citgo Petroleum Corporation for $1.40 per RIN, grossing $1,400,000.00.

aa. In July 2011, AF completed the following CDX sales: On July 21, 2011, 1,125,000 RINs to G.P.&W., Inc. DBA Center Oil Company, for $1.33 per RIN, grossing $1,496,250.00; and on July 28, 2011, 1,000,000 RINs to G.P.&W., Inc. DBA Center Oil Company, for $1.32 per RIN, grossing $1,320,000.00.00.

bb. On August 5, 2011, AF completed a CDX sale of 1,000,000 RINs to

Citgo Petroleum Corporation for $1.34 per RIN, grossing $1,340,000.00.

cc. On September 19, 2011, a 2011 Cadillac Escalade, Texas license plate CY7R345, VIN 1GYS4DEF1BR37876, was registered with the DMV, showing Gunselman as the owner. The motor vehicle is worth $85,085.00. **[seizure item l.]**

Conclusion

29. Based on the information in the preceding Paragraphs of this Affidavit and my training and experience, I believe there is probable cause that the property described in Paragraph 4 of this Affidavit is subject to civil and criminal forfeiture to the United States under 18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) as property derived from proceeds traceable to violations of 18 U.S.C. § 1343.

30. Based on my training and experience, a protective order under 21 U.S.C. § 853(e) will not be sufficient to assure the availability of the property (vehicles and an airplane) due to their inherent mobility and "saleability." The items of property could easily be hidden/concealed or removed from the United States to a neighboring country such as Canada or Mexico, and thus made unavailable for forfeiture. Additionally, they could quickly be sold to an unsuspecting buyer or used as collateral for funds with unsuspecting lenders. For these reasons, I believe that an order under 21 U.S.C. § 853(e) will not be sufficient to assure the property's availability for forfeiture. I, therefore, request that seizure warrants be issued for the property pursuant to 18 U.S.C. § 981(b)

and 21 U.S.C. § 853(f).

MICHAEL J. FIVEASH
Special Agent
United States Secret Service

Reviewed and Approved:

SARAH R. SALDAÑA
UNITED STATES ATTORNEY

JOHN J. DE LA GARZA III
Assistant United States Attorney

Subscribed to and sworn to before me this 14th day of October, 2011.

NANCY M. KOENIG
UNITED STATES MAGISTRATE JUDGE
Northern District of Texas at Lubbock