

ConocoPhillips Comments

September 25, 2009

**Submitted Electronically**

EPA Docket Center (Air Docket)

Attention: Docket ID No. EPA-HQ-OAR-2005-0161

ConocoPhillips appreciates the opportunity to submit comments on the Environmental Protection Agency's Notice of Proposed Rulemaking (NPRM) on Regulation of Fuels and Fuel Additives: Changes to Renewable Fuel Standard Program (74 FR 24903 May 26, 2009). As an importer, manufacturer, blender, distributor, and marketer of transportation fuels, with operations located in all regions of the U.S., ConocoPhillips is directly impacted by this rulemaking.

The following comments provided are arranged in topical format, with some comments being general in nature and others very specific to a proposed provision or section language. ConocoPhillips is a member of the American Petroleum Institute and the National Petrochemical and Refiner's Association and generally support the comments submitted by both associations. The following comments identify where ConocoPhillips suggests variants to the associations comments or provide supplemental details of support.

There are several areas of primary concern to ConocoPhillips that we want to bring to the Agency's attention. These include the following:

**Designation of obligated party** – ConocoPhillips strongly believes a change is necessary to help prevent market distortion and to equitably place the obligation where refiner parity is retained – with those parties in control of providing finished transportation fuels.

**RIN carryover cap** - the rollover cap should be maintained or removed to ensure more RIN liquidity. This concern becomes less important should the definition of obligated party be changed to the provider of finished transportation fuels.

**Effective date for new requirements** – the effective date should be January 1, 2011 to provide adequate lead time for implementation.

**Biomass-based diesel standard** – there should be no separate biomass-based diesel standard until the effective date of the regulation. The 2011 biomass-based diesel standard should be for 2011 biomass-based diesel volumes only.

**Equivalence values** – we are supportive of maintaining the energy content approach for EVs and additionally, some approach that recognizes GHG emission reduction levels above threshold requirements.

There is a separate section of comments addressing the life cycle analysis methodology and outcomes.

Should the EPA have any questions regarding the comments submitted, please contact me at the following address or phone number.

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## **General Comments**

### **1. Designation of Obligated Party Should Be Changed to the Provider of Finished Transportation Fuels**

ConocoPhillips believes that a change in the obligated party designation is imperative to the workability of the RFS2 program and parity amongst market participants. We strongly support shifting the obligation to the provider of finished transportation fuels as discussed in the following. The current structure was developed for RFS1; however, the circumstances have radically changed with RFS2 which render the existing system unworkable. Under the initial RFS program, renewable volumes were being blended in excess of the requirements. This was projected to continue through most of the RFS1 time period and resulted in credits being readily available and inexpensive to obtain. In this situation, having the obligated party be the refiner or importer was the simplest and worked relatively well, given the low complexity of the program (single standard based on ethanol).

The RIN market volatility has significantly increased over the last year with the substantially increased volume requirements (11.1 billion gallons in 2009 which far exceeds the 6.1 billion gallons called for under RFS1). The industry is already facing challenges even before the vastly more complex four-tier mandate program is implemented. The much higher volume requirements, the approaching blend wall and increased number of compliance categories make access to RINs far more critical for RFS2 compliance and RIN market distortion far more likely.

The current designation of obligated party as only the refiner or importer creates winners and losers and potentially puts some in a position to take draconian steps to be in compliance. This is particularly true for merchant refiners or partial merchant refiners (i.e. refiners who are not wholly integrated where direct marketing sales are far short of refinery production making them a partial merchant refiner). Renewable fuels, with few exceptions, are not blended at the refinery. This will be the case for many years to come and well past a breaching of the blend wall (10% saturation of current gasoline markets) for ethanol. Some refiners who have fully integrated terminal and marketing operations may be able to adequately control the amount and type of renewable fuel blended downstream of their refinery production to be able to comply with the RFS2 requirements under the RFS1 architecture. However, for others it may be impossible to comply especially as the blend wall is approached and given the RIN carryover provisions.

Here is a simple example using two parties under RFS1 type architecture for illustrative purposes. It assumes a standard of 10% for ease of illustration.

- Refiner A produces 100 gallons of transportation fuel (RVO = 10) but markets 150 gallons.
- Refiner B produced 100 gallons of transportation fuel (RVO = 10) but markets 50 gallons
- Refiner A purchases renewable fuel, and blends 10% so receives 15 gallon RIN.
- Refiner B purchases renewable fuel, and blends 10% so receives 5 gallon RIN.
- In year one, Refiner A is long 5 RIN. Assuming their RVO remains at 10 for the following year, they can hold over 2 RIN to use for next years compliance. In year two, they continue to purchase renewable for their marketing volumes (15 RIN) plus their 2 RIN carryover, which puts them long 7 RIN for year two, however, they can again carryover 2 RIN. This leaves them 3 RIN in year one and 5 RIN in year two for potential sale or retirement.

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- In year one, Refiner B needs an additional 5 RIN to be in compliance. They are able to secure the 3 excess RIN from Refiner A, leaving them short or deficit 2 RIN. In year 2 they again need an additional 5 RIN plus the carryover deficit of 2 from the previous year for a total of 7 RIN required for compliance. They can secure 5 from Refiner A putting them deficit two years in a row, resulting in a non-compliance situation not allowed in the program.

This reflects a noncompliance situation for Refiner B, placing them in sole dependence of Refiner A or facing draconian measures of shutdown, export, or other untenable business approaches. This situation is accelerated with the increasing volumes and types of renewable fuels mandated in RFS2 and the greater number of market players than utilized in the example. It is no wonder that we have already seen extreme market volatility of RIN market prices (over 4x in the last 5 months) for the short period that RFS1 architecture has been applied to RFS2 obligations.

A change in the obligated party designation is definitely needed to alleviate this inequitable situation and allow those that supply the final products and that are in control of the renewable blending determine the pedigree of renewable they need to be in compliance with the 4-tier standard. Absent the change, some refiners will find that market conditions cannot provide compliance levels of RIN at any reasonable price long before others (i.e. those who are long on marketing sales) are impacted by the blend wall limitations.

Currently, there are marketers who blend renewable fuels but have no obligation. This results in them blending only when the market economics are favorable which leads to RIN market shortfalls and acceleration of the blend wall dynamics. In addition, unbranded marketers may demand either by contract or state law that non-blended products be provided. Today, up to 1/3 of market volume sales are by non-obligated parties (brands without refinery operations). Current RFS1 obligated parties find it difficult to compete in these markets when they are forced to blend, no matter what the economics suggest, in order to comply with the obligated volumes while others participants in the liquid market are not exposed to the renewable fuel obligation. This is further exasperated when one considers the low cost of corn-ethanol in comparison to projected advanced or cellulosic based ethanol. There is nothing a refinery can do to RBOB to force the blending of the high cost, advanced ethanols to facilitate a market generation of RIN absent an extreme overbidding for RIN that is inefficient and ultimately costly to consumers.

Some of the non-obligated marketers would appear to have a small market share when looked at on a national basis. However, many of them operate in regional markets where their market share may be as large as 20 percent or more. Changing the obligated party to the finished fuel provider would pull these entities into the program, creating a level playing field for all market participants.

Additionally, we find the current construct of RFS1 as inconsistent with other fuel specification requirements. Other mandates like ULSD or low sulfur gasoline have refinery gate specifications but have corresponding downstream mandated provisions. The downstream provisions, like vehicle fueling requirements for lead or sulfur controls and marketplace standards for octane, drive compliance responses throughout the system. A refinery structure obligated to standards with no market place motivation is inefficient and volatile.

Shifting the obligation to the provider of finished fuels will require all market participants to share the burden and be exposed to blend wall limitations in nearly a similar timeframe.

In addition to the concept of moving the point of obligation to finished fuel provider, the Agency has suggested two additional potential variants to the RFS1 architecture. Both are helpful but fall short of enabling a dynamic and effective market;

1. **Direct Sales Option:** The Agency has suggested that renewable fuel producers may be allowed to separate RIN from their production and sell directly to obligated parties. While this would facilitate access to RIN by obligated parties, it does nothing to encourage all parties in the markets to utilize the renewable fuel in the products offered for consumption. In addition, it increases the potential for market manipulation by those parties producing the renewable fuels, a concern that the Agency has certainly acknowledged for even the RFS1 architecture. Should the Agency adopt the direct sales approach for either the obsolete RFS1 or our recommended RFS2 architecture there must be safeguards included such as only obligated parties may secure RIN, renewable fuel producers must not retire RIN, and such producers must clear inventory of RIN on a quarterly basis as posed by the Agency.
2. **RBOB/CBOB Option:** The Agency has suggested that perhaps one approach would be to have refiners exclude RBOB/CBOB volumes from their obligation volumes as this is not finished product. Downstream blenders would be subject to including these BOB type materials in their obligation determination as they are finished with renewable fuels. We believe this is the minimum approach that should be adopted. Fundamentally, it is not feasible that a refinery could place on product transfer documentation (PTD's) suitable language that would bring about cellulosic ethanol vs. corn-based or advance ethanol blending in markets where the other ethanols have no ability to compete on a cost basis with corn-ethanol. Thus, it is imperative that the final blender in these instances be identified as an obligated party. Likewise, should some unforeseen future distillate blending result in distillate BOBs for downstream blending, the application should be paralleled to the gasoline RBOB/CBOB provisions.

There is potentially another variant approach that would mirror the adopted California Low Carbon Fuel Standard regulation. This approach transfers obligation when title to bulk transportation fuel is transferred to another obligated party. For example, if Refiner A sold bulk barrels from their refinery to Refiner B (pipeline, barge, ship, etc.) then Refiner B would assume obligation for those volumes. Although this approach helps to level the playing field among obligated refiners, and would be preferred over the current construct, it does not level the playing field for all market participants.

ConocoPhillips urges EPA to redefine the obligated party to the provider of finished transportation fuels.

## **2. RIN Carryover Cap**

Should EPA revise the definition of obligated party as discussed above, the RIN carryover cap could remain in place or even increased some to account for the time lag in moving RINs through the system. However, the current RIN carryover cap exacerbates the problem when put in combination with the existing obligation structure. This is particularly true when the blend wall nears or is met. The RIN carryover cap allows entities who are long on RINs to hold them back each year. This results in increased market volatility at the best and other parties being deficit at the worst. Even if those parties with excess RINs eventually sell them, it may not be until end of year compliance demonstrations are due and will lead to short term extreme RIN

market fluctuations. However, if the obligated party is moved to the provider of finished fuels, this phenomena will be dampened and the current carryover cap, with expansion to account for time lag, could likely remain without problem.

### **3. Effective date for new requirements**

A transition to the new requirements would be most effective at the beginning of a calendar year, so that the new requirements were in effect for the whole year. There is not sufficient time to accomplish implementation by January 1, 2010. It is possible the Agency will not even have the rule finalized and issued by January 1, 2010. A mid-year implementation would be fraught with numerous problems especially on the recordkeeping and reporting side tied to changes in RIN types, etc. The only feasible option is an implementation date of January 1, 2011. This timeframe would allow the necessary time for the renewable fuel producers to register and verify their processes and associated "D" codes for RIN generation. It would also provide alignment with the projected availability of the EMTS, a significant tool that will aid in facilitating the implementation of the program.

### **4. Biomass-based diesel standard**

ConocoPhillips does not support the potential averaging approaches outlined by EPA as a means to qualify biodiesel as biomass-based diesel. EPA's current life cycle analysis results indicate that biodiesel produced from vegetable oils does not meet the 50% GHG emission reduction threshold requirement as mandated by the Energy Independence and Security Act of 2007. Although EPA has the authority to lower that threshold to as low as 40%, vegetable oil based biodiesel would still not meet that threshold. Based on projected availability of qualifying fuel, EPA should immediately reduce the biomass-based diesel standard to reflect what qualifying volumes will be available.

Given the above discussion and normal or legal relationships of regulated entities and final regulatory provisions, there can be no retroactive standard. EPA has proposed combining the 2009 biomass-based diesel standard (retroactively) with the 2010 requirement for a combined total volume requirement of 1.15 billion gallons. Regardless of when the rule is effective (see comment above supporting a 1/1/11 date), there should be no retroactive standard. Therefore, should the standard be effective starting in 2011, the biomass-based diesel standard should be no more than 0.8 billion gallons, the legislated target for 2011 volume. Given EPA's analysis of fuel availability meeting the 50% GHG emission reduction threshold, it's apparent that 0.8 billion gallons remains unachievable and needs to be modified by the Agency using their general and/or biomass-based diesel waiver authorities.

### **5. Equivalence values**

ConocoPhillips supports retaining the current energy based equivalence values. An energy density-based approach helps provide a level playing field for all existing and future potential renewable fuels. In general, it costs more to produce renewable fuels with higher energy content, putting them at a disadvantage. Transportation demand projections show increasing demand for distillate fuels relative to gasoline fuels. Continuation of an energy density-based RIN system would provide some additional incentive for production of these higher energy content renewable fuels suitable for use in distillate fuels or as a replacement for distillate fuels.

The simplest approach to accomplish this and recognize contributions of higher energy renewable fuels to the transportation sector is to provide weighting factors with the factored RIN

volumes used to meet the standards (i.e., the biomass-based diesel standard). EPA has indicated that even under an energy density-based approach, compliance calculations for biomass-based diesel would be treated unique as straight volume-based requirements. This approach would still allow the additional weighted RIN volume to be used toward meeting the Advanced or Total standard. This approach, although not our first choice, is preferable to the option of no energy density-based approach at all.

In addition to the EV value used for RFS1, ConocoPhillips believes it appropriate to provide additional equivalency value relative to the GHG value of the utilized renewable fuels. The current approach provides very broad threshold values that do not value a renewable fuel for its potential contribution to GHG emission reductions. We support further weighting through added RIN production of advance-low GHG renewable fuels in a manner similar to the EV value in RFS1.

## **6. Recordkeeping and Reporting**

ConocoPhillips supports EPA's development of the EMTS. This system, when implemented, will help alleviate the burden of tracking RIN transactions and hopefully reduce complication of non-legitimate RINs in the marketplace. However, it is imperative that the EMTS, along with recordkeeping and reporting requirements that are promulgated, recognize the time requirements to verify data and transactions. Further, we believe the EMTS tool can reduce the perceived complications of placing the obligation with final fuel providers. EPA should be designing the EMTS to accommodate this approach.

As one of the largest RIN transactional parties under the RFS1 structure, ConocoPhillips offers the following specific comments regarding the proposed recordkeeping and reporting requirements and the propose EMTS

- **The EPA should not require reporting of RIN prices**  
We consider this information to be Business Confidential and object to its inclusion in the RIN reporting requirements. EPA should eliminate this when promulgating the final rule.
- **EPA should apply any expired RINs to reducing the next year's total volume obligation**  
RF credits today have a fixed life prior to expiration but should be counted. Expiring credits due to market inefficiencies, intentional hold back, negligence, or other means places extreme stress on credit markets, particularly during periods of tightness due to supply or blend wall conditions. This stress disproportionately impacts those merchant suppliers/importers under the current program architecture that need credits to fulfill obligations under the RFS program. The Agency has the information and capacity to identify expiring credits and to apply such credits to the national "obligation" standard for the ensuing year. Such application would not limit the amount of RF that could be blended but would assure that the RF credits created are fully accounted for in meeting national targets.
- **Three days to enter RIN transactional information into EMTS is not feasible**  
We recognize that timely input of information into the EMTS is essential for the system to operate smoothly. However, there are numbers of situations where the information may not be readily available in its entirety within 3 days. We think a more reasonable approach would be to require sellers to enter data within 7 days and provide purchasers an additional 7 days (for a total of 14 days following the activity). Given the complexity of the 4 tiers of renewable fuels and establishment of the new D code, this additional

time will be particularly important at the start of the program. The seller is the party that initiates the transfer of transactional information (i.e. product transfer documents including an invoice). The purchaser will want to await receipt of these official documents before entering or confirming their side of the transaction. Changes can and do occur after a sale/purchase agreement is made. An example would be where a company agrees to purchase 1000 gallon RIN from another company. However, the seller may actually only have 995 gallon RINs in inventory and that is what they invoice to the purchaser. Absent the provision of additional time, we could be in a position of having to enter data that was not quality assured leading to correcting entries later. This would cause problems throughout the system and could be potentially avoided by the allowance of additional time.

- **Monthly Reporting for RIN owners**

EPA proposes requiring monthly reporting in 2010. We do not support implementation of the rule in 2010. Aligning the start date of the regulation with the implementation of the EMTS (January 1, 2011) should alleviate EPA's concerns over data accessibility. Even if there ends up a timing disconnect between the implementation of the rule requirements and the initiation of the EMTS, monthly reporting is not warranted. At a minimum, monthly reporting should only apply to renewable producers as the accuracy of the RIN information is critical to the system.

- **The EMTS should simplify or eliminate the need for some provisions**

There should be no need for the entire 38 digit RIN to be on the PTD. This information is captured and memorialized in EMTS. Also, the attestation requirements should be simplified due to the presence of EMTS. These transactions will be verified within the system eliminating the need for such a rigorous attestation process.

## **7. Treatment of E85**

E85 is currently not produced in large volumes due in part to the limited market for the product and the difficulty in producing E85 that consistently meets ASTM specification, the performance standard. E85 is an alternative fuel that is suitable for use only in Flex Fuel Vehicles designed specifically to utilize E85. EPA makes the statement in the preamble that "The RFG and anti-dumping regulations currently require certified gasoline to be blended with denatured ethanol to produce E85. The gasoline must meet all applicable RFG and anti-dumping standards for the time and place where it is sold." EPA needs to expand upon that statement as we cannot discover the RFG and anti-dumping regulatory sections EPA implies are applicable to E85. The ASTM specification does not require use of certified gasoline to produce E85 meeting the specification.

ConocoPhillips does not agree that production of E85 through the process of blending ethanol, gasoline, and blendstock or just ethanol and blendstock should result in the terminal being classified a refinery. The production of E85 does constitute production of a transportation fuel which should result in the non-ethanol volume establishing an obligation for the E85 producer. This is independent of the outcome of the obligated party definition but more naturally is consistent with our recommended approach of the obligation accruing to the finished fuel provider.

Given the myriad of issues connected with E85, it would be prudent for EPA to develop discussion and guidance on E85. However, the Agency should strive to maintain simplicity to allow the production of E85 without undo administrative burden.

## **8. Renewable Diesel Definition**

ConocoPhillips is supportive of EPA's proposed definition of co-processed renewable diesel. The proposed definition would allow producers of non-ester renewable diesel to categorize their product as biomass-based diesel by choosing to operate existing or modified equipment in a blocked out or sequential operation rather than processing the renewable feedstock simultaneously with petroleum feedstock. This provides needed additional flexibility to meet the biomass-based diesel requirement in the most cost effective manner.

## **9. Demonstration of feedstock classification**

The recordkeeping requirements concerning demonstration that feedstocks meet the definition of renewable biomass appear to be very onerous. The sheer volume of documentation that would have to be passed from feedstock producers to renewable fuel producers is staggering. EPA should give serious consideration to ways to simplify this requirement, particularly for domestic feedstocks. The vast majority of feedstocks that come from domestic agricultural lands would be renewable. There is very little land in the U.S. that was not previously cultivated that is in use or likely to be in use for the production of renewable fuel feedstocks. There would appear to be very limited ways that these domestic feedstocks would not meet the definition (i.e., someone converted forest land since December 17, 2007 and planted crops, etc.). The burden of having every farmer provide documentation that then must get passed along to the renewable fuel producer seems great when essentially all of certain types of crops would fall into the renewable biomass category. This would also seem to be true for feedstocks that come from animal sources (fats, etc.).

## **Comments on Life Cycle Analysis**

### **1. Inclusion of Indirect Land Use Change Impacts**

The Energy Independence and Security Act of 2007 directed that the greenhouse gas emission assessments must evaluate the full lifecycle emission impacts of fuel production including both direct and indirect emissions, including significant emissions from land use changes. EPA has determined through their current analysis that the indirect land use change (LUC) impacts are significant for certain fuels and have included these impacts in the total life cycle assessment. ConocoPhillips is supportive of including these factors, based on the best scientific data currently available. ConocoPhillips encourages the Agency to conduct periodic evaluations to be able to capture any improvements in the modeling and assessment technologies as they evolve.

### **2. Life Cycle Assessment Time Period and Discount Factors**

ConocoPhillips favors the use of 30 years for averaging and a zero discount rate which represents a more conservative and realistic approach than the 100 year, 2% discount factor approach proposed by EPA. The shorter time period gives more weight to the known, more immediate, effects of carbon release from clearing, burning and loss of soil sequestration while a zero discount rate values future impacts the same as current impacts. A 100 year timeline requires assumptions that are so far in the future they would seem to lack accuracy. Use of a 30 year averaging period would result in a reduction of qualifying biofuels (i.e. fuels meeting the

required emission reduction thresholds for classification as biomass-based diesel or advanced biofuels). EPA should use the general waiver authority provided to adjust the volume requirements to account for the lack of qualifying renewable fuels.

**3. Federal methodologies and approaches should be harmonized and take precedence over state efforts**

There are a number of states that have Low Carbon Fuel Standard initiatives. There are states that are implementing programs (California), states that have passed legislation requiring LCFS regulations be written (Oregon) and others that are studying the potential of an LCFS (Northeast states, Mid-West states, etc.). The industry cannot tolerate a patchwork of varying regulations that all use different approaches to life cycle analysis. ConocoPhillips urges EPA to pre-empt states from establishing unique state requirements that utilize differing life cycle analysis approaches than EPA. The EPA has spent countless hours doing exhaustive research concerning the best models, assumptions, data availability, economic impacts, etc. for life cycle assessments. The States generally do not have the staff needed to thoroughly evaluate and develop comprehensive GHG emissions modeling. California currently is the only state that has completed lifecycle analysis to establish emissions from various fuel pathways. The state of California chose to use 30 year averaging in their modeling efforts. Should EPA use a 30 year rather than a 100 year timeframe, it would help harmonize the California and EPA results (there would still be some differences due to remaining differences in models used and other assumptions). Any further proliferation of unique state requirements should be stopped through EPA direct action to pre-empt states from adopting their own programs utilizing life cycle analysis.