

## **An Introduction To Cellulosic Biofuel Waiver Credits**

*Law360, New York (June 02, 2010)* -- On Feb. 3, 2010, the U.S. Environmental Protection Agency issued its long-awaited amendments to the National Renewable Fuel Standard program ("RFS2"), which increased mandated quotas of ethanol, biodiesel and other biofuels in the U.S. transportation fuel supply.

The National Renewable Fuel Standard program was originally created in the 2005 federal energy bill and was substantially modified by the Energy Independence and Security Act of 2007 ("EISA").

The RFS2 program sets quotas for biofuels in the U.S. fuel supply starting at 12.95 billion gallons in 2010 with an ultimate goal of 36 billion gallons of renewable fuel by 2022. The RFS2 includes nested subquotas for advanced biofuels, cellulosic biofuels and biomass-based diesel, with the goal for cellulosic fuels at 21 billion gallons by 2022.

The policy goals of the RFS2 include energy independence through displacing imported petroleum and increased domestic energy supplies. Generally, any refiner or importer of gasoline or diesel fuel in the U.S. mainland or Hawaii is an obligated party ("Obligated Party") under the RFS2 and must comply with its quotas.

This guest column describes the cellulosic biofuel credits the EPA has named "Cellulosic Biofuel Waiver Credits" ("Waiver Credits") that will be issued to Obligated Parties under the circumstances described below.

### **Cellulosic Biofuel Standard**

EISA requires the EPA to set the cellulosic biofuel standard for each calendar year based on the lesser of (1) the volume specified in EISA or (2) the projected volume of biofuel production based on EPA estimates for that calendar year.

Under the RFS2, the EPA has determined that projected volume for cellulosic biofuels production for 2010 would be 6.5 million gallons, well below the 100 million gallon mandate in EISA and the EPA's proposed rule issued in May 2009. When the projected volume is less than the mandate required by EISA ("Short Years"), the EPA is required to make Waiver Credits available for sale to Obligated Parties in order to allow Obligated Parties to meet the renewable volume obligations under EISA.

### **Waiver Credits Pricing**

EISA requires the EPA to sell the Waiver Credits for an inflation-adjusted price that is the higher of (1) \$0.25 per gallon or (2) the amount by which \$3.00 per gallon exceeds the average wholesale price of a gallon of gasoline in the United States.[1]

Based on this formula, EPA stated it will make these Waiver Credits available for a price of \$1.58 per gallon-RIN for compliance year 2010. Generally speaking, this means that an Obligated Party should be indifferent between buying a gallon of gasoline plus a Waiver Credit versus buying a gallon of cellulosic biofuel for a price equal to or less than the price of the gallon of gasoline plus the cost of the Waiver Credit.

For example, if a gallon of gasoline costs \$1.50 in 2010, an obligated party would pay \$3.08 (\$1.50 (the price of the gasoline) + \$1.58 (the price of the Waiver Credit)) to sell a gallon of fuel and comply with its renewable volume obligation.

Alternatively, the obligated party could buy a gallon of cellulosic biofuel for some price equal to or less than \$3.08 (most likely a cellulosic biofuels producer would offer a discount to make the decision easy for the obligated party) in order to meet its renewable volume obligation under the RFS2.

Thus, the renewable volume obligations combined with the Waiver Credits can operate as a floor and make the economics work better for producers of the cellulosic biofuels during Short Years because ultimately cellulosic biofuels must compete with gasoline on price.[2]

At the same time, producers of cellulosic biofuels cannot charge exorbitant prices to Obligated Parties because the foregoing pricing structure will functionally operate as a cap on the amount that Obligated Parties would be willing to pay for a gallon of cellulosic biofuel.

Indeed, without the Waiver Credits, Obligated Parties would be in a very bad negotiating position relative to producers of cellulosic biofuels during Short Years because there would be very little supply available to allow Obligated Parties to meet the renewable volume obligations under RFS2. In years other than Short Years, presumably market forces will dictate the price of cellulosic biofuels.

### **Use and Limitations of Waiver Credits**

The EPA has created a number of limitations on the use of Waiver Credits in order to prevent abuse of the Waiver Credits. To that end, Waiver Credits:

- will only be available for the compliance year for which the EPA has waived some portion of the cellulosic biofuel standard;
- will only be available to Obligated Parties;
- will be nontransferable and nonrefundable;
- may only be purchased by Obligated Parties up to the level of their cellulosic biofuel renewable volume obligations, less the number of cellulosic biofuel RINs that they own;
- may not be used by Obligated Parties to meet a prior year deficit obligation;
- may not be carried over by Obligated Parties to the next calendar year;
- may only be used for an Obligated Party's compliance with its cellulosic biofuel renewable volume obligation and not the advanced biofuel or renewable biofuel standards; and
- may only be purchased by an Obligated Party to the extent it establishes with the EPA that it does not have sufficient cellulosic biofuel RINs to meet its cellulosic biofuel renewable volume obligation.

## **Mechanics of Purchasing Waiver Credits**

Waiver Credits will be sold in a generic format rather than the serialized format used for RINs. The EPA and the U.S. Treasury plan to define the procedures for purchasing Waiver Credits later this year. The EPA stated that it will publish these procedures with the Obligated Party annual compliance report template and will provide the forms necessary to purchase the Waiver Credits.

An Obligated Party will be allowed to purchase Waiver Credits at the time that it submits its annual compliance demonstration to the EPA and demonstrates that it does not have sufficient cellulosic biofuel RINs to meet its cellulosic biofuel renewable volume obligation.

## **Conclusion**

The EISA provisions relating to cellulosic biofuels and the EPA's new rules implementing RFS2 are intended to encourage the fledgling cellulosic biofuel industry while also preventing cellulosic biofuel producers and Obligated Parties from gaming the system put in place.

Since this is the first year Waiver Credits will be introduced, and none of the Waiver Credits will be sold until much later in the year or early next year, it remains to be seen whether the structure and limitations put in place will accomplish these objectives or whether market forces will overwhelm these rules and result in unintended consequences.

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*The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.*

[1] The EPA will use the average monthly bulk (refinery gate) price of gasoline based on the most recent 12 months of data from the Energy Information Administration at the time it develops the cellulosic biofuel standard when determining the average wholesale price of gasoline for the purposes of pricing Waiver credits.

[2] For simplicity the foregoing analysis ignores the fact that obligated parties may have to incur capital and increased operational expenditures to deal with the storage, blending and transportation of cellulosic biofuels. Capital and operational expenditures to deal with these issues could affect the price that an obligated party is willing to pay for cellulosic biofuels.