Comments of the National Biodiesel Board
on the Proposed Consent Decree in *In re PES Holdings, LLC*

The National Biodiesel Board ("NBB") urges the Department of Justice to reconsider its proposed Consent Decree and Environmental Settlement Agreement in *In re PES Holdings LLC*, No. 18-10122 (Bankr. D. Del.) ("the Proposed Settlement"). The Proposed Settlement allows PES Holdings LLC and the other debtors (collectively, "PES") to escape the vast majority of their 2016–2017 obligations under the Renewable Fuel Standard ("RFS"). It also gives PES an unwarranted head start towards 2018 RFS compliance. If finalized, the Proposed Settlement would both harm the renewable fuel industry and frustrate the goals Congress sought to achieve through the RFS.

The Government does not need to enter into a settlement that rewards the deliberate decision of PES and its parent companies to ignore the requirements of the RFS. Instead, the Government should hold PES to the same renewable volume obligation as all other refiners. There are two key reasons why PES should be required to meet its obligation in full:

- First, the RFS holds parent companies liable for the compliance obligations of their subsidiaries. Thus, PES's corporate parents Carlyle and Sunoco can be required to comply with the RFS obligations incurred by PES. EPA has not explained why it is abandoning that avenue for ensuring complete fulfillment of PES's obligations.

- Second, the renewable volume obligations ("RVOs") under the RFS cannot be discharged in bankruptcy. The RFS creates an affirmative duty for obligated parties to blend or use biofuels or to buy credits from others who have done so. Such a duty persists through the bankruptcy because it cannot be resolved by a payment to the Government.

At the very least, a finalized settlement should require PES or its parent companies to comply with a far greater share of its RVOs. While NBB recognizes the value of resolving liabilities of a bankrupt entity through settlement, the terms of Proposed Settlement are an unnecessary concession to PES that sets a dangerous precedent. The settlement excuses more than 70 percent of PES's RFS compliance obligations for 2016–2017 and also gives PES a complete break from compliance for January through April of 2018. Moreover, it allows PES to gain an *advantage* in its future compliance during the remainder of 2018 by allowing it to use over 64 million RINs that it should have retired towards its 2016–2017 obligations. As a result, it will encourage other refiners to neglect their RFS obligations and then seek to reduce them through a settlement.

NBB represents the biomass-based diesel industry in the United States. NBB's members include biomass-based diesel producers and feedstock producers that utilize a diverse array of inputs, including vegetable oils, waste oils, and animal fats. If the Government finalizes the Proposed Settlement in its current form, it would severely injure NBB's members, along with producers of other advanced biofuels and producers of corn ethanol alike. It would also hurt farmers across the country and everyone who is employed in the renewable fuel supply chain. And it would

hinder the RFS's goals of enhancing energy security, protecting the environment, and building our nation's rural economy.

I. Background

Throughout its filings in the bankruptcy court, PES has repeatedly claimed that its bankruptcy was a result of the RFS. That claim is demonstrably false. PES's bankruptcy is the result of decisions that placed it in a poor position to deal with changes in the U.S. oil market. To the extent PES cannot meet its current RFS obligations, it is because it deliberately chose not to invest in blending equipment and then ensured through dividends and other expenditures that it lacked the funds to purchase RFS credits (referred to as renewable identifications numbers or "RINs"). Indeed, the obligation to blend biofuels or purchase RINs does not even place a net burden on PES because refiners can recoup such costs.

A. The PES Bankruptcy was the result of management decisions, not the RFS.

If it had been managed properly, PES could have ensured that it was able to meet its RFS compliance obligations. To begin with, PES could have invested in the blending infrastructure necessary to blend biofuels in its own products without the need to purchase RINs. Other merchant refiners, including Tesoro and Western Refining have done so successfully. *See* Memorandum to Senator Grassley, Grassley Energy Policy Staff (Feb. 5, 2018), *available at* https://www.grassley.senate.gov/sites/default/files/MEMO%20Grassley%20Analysis%20Finds%20RFS%20Has%20Minimal%20Impact%20on%20Success%20of%20Refineries.pdf ("Grassley Memo").

Indeed, industry experts estimate that PES could have built the blending infrastructure necessary to meet its RFS obligations for around $40 million. *Id.* But instead, PES has spent over $900 million on other projects since 2012, including $130 million to build a new railway terminal. Gregory Meyer, *Carlyle loses control of bankrupt US oil refinery*, Financial Times (Jan. 22, 2018). And PES has issued hundreds of millions in dividends and payouts to the Carlyle Group and other investors, including $260 million in 2015 alone. *See* Jarrett Renshaw and Jessica Resnick-Ault, *Four years after rescue, U.S. refiner reels as investors profit*, Reuters (Nov. 7, 2018) (also noting that in 2013, Carlyle took out a $550 million loan, $121 million of which was paid as distributions to Carlyle and other investors).

Though it decided not to invest in blending infrastructure, PES could have met its RFS obligations by purchasing RINs from other companies who have blended or used biofuels. Other refiners in the industry that rely on purchasing RINs to meet their compliance obligations remain highly profitable. For example, while Valero had $311 million of RIN costs in the fourth quarter of 2017 alone, it also invested $2.4 *billion* in various projects and still had a quarterly profit of $509 million. Tom Kloza, *Verleger: PES Bankruptcy Judge Could Inflict Lehman-Like Moment*, Oil Price Information Service (Feb. 6, 2018). And for number of years, PES itself experienced strong profits while meeting its RFS obligations. *Id.*

The current struggles of PES are due in large part to its business strategy that depended on cheap domestic crude oil from the Bakken region. *Id.* Instead of making investments to improve its

refining processes or the specifications of its products, PES maximized its ability to transport and process Bakken crude oil that was artificially cheap as a result of the U.S. oil export ban. *Id.* That strategy worked for several years but backfired when the export ban was lifted and the price of U.S. crude jumped. Without cheap inputs, PES was at a disadvantage compared to other refiners that had diversified, improved their refining processes, and developed superior products. *Id.*; Grassley Memo.

Yet, even after PES began to experience financial difficulties, it still could have purchased enough RINs to meet its 2016–2017 compliance obligations. But rather than accumulating a sufficient RIN stockpile, PES did the opposite—it *dumped over 40 million RINs back into the market*. Grassley Memo. PES may have done so in an attempt to short the market in the hopes that RIN prices would fall, or it may have done so simply to increase its short-term cash. Either way, PES did not make a good-faith attempt to comply with its obligations under the RFS.

B. Refiners Can Pass On the Cost of RINs.

That the RFS did not cause the PES bankruptcy is further evident from the fact that refiners can pass on the cost of RINs. Multiple studies have demonstrated that refiners are not harmed by purchasing RINs because they can recoup the entirety of those costs.

Indeed, EPA itself has concluded that RINs are not a net cost to refiners. In a 2015 study, EPA found that "merchant refiners, who largely purchase separated RINs to meet their RFS obligations" are not disadvantaged by RIN costs, "as they are recovering these costs in the sale price of their products." Dallas Burkholder, EPA, *A Preliminary Assessment of RIN Market Dynamics, RIN Prices, and their Effects* (May 14, 2015) (Dkt No. EPA-HQ-OAR-2015-0111-0062). EPA reiterated that finding in conjunction with its most recent annual rulemaking under the RFS, explaining that "EPA has concluded that refiners are generally able to recover the cost of RINs in the prices they receive for their refined products, and therefore high RIN prices do not cause significant harm to refiners." EPA, Renewable Fuel Standard Program—Standards for 2018 and Biomass-Based Diesel Volume for 2019: Response to Comments (Dec. 2017); *See also* David Korotney, EPA Office of Transportation and Air Quality, *Memorandum: Assessment of waivers for severe economic harm or BBD prices for 2018* (Nov. 30, 2017) (Dkt No. EPA-HQ-OAR-2017-0091).

EPA's finding that RIN costs are no detriment to refiners is corroborated by third-party studies, including studies by Wells Fargo and the Center for Agricultural and Rural Development (CARD) at Iowa State University. *See* Bruce A. Babcock *et al.*, CARD, *Impact on Merchant Refiners and Blenders from Changing the RFS Point of Obligation* (Dec. 2010); Todd Neeley, *Wells Fargo: Most Independent Refiners Benefit from RIN* (Jan. 27, 2017), https://www.dtnpf.com/agriculture/web/ag/perspectives/blogs/ethanol-blog/blog-post/2017/11/27/wells-fargo-independent-refiners-rin. Even some of those in the oil and gas industry have made the same point. For example, Marathon Petroleum has noted in comments to EPA that "the cost of complying with the renewable volume obligation is embedded in the refinery gate price of the regulated transportation fuel." Marathon Petroleum, Comments on the

Proposed Denial of Petitions for Rulemaking to Change the RFS Point of Obligation (Feb. 21, 2017) (Dkt No. EPA-HQ-OAR-2016-0544).

In light of the abundant research demonstrating that RIN compliance places no net burden on refiners, PES's claim that its financial woes are a result of the RFS rings hollow. The RFS is merely a convenient scapegoat for the decisions of PES that led to the bankruptcy.

II. The Government Should Hold PES and Its Parent Companies to Their Full Obligations Under the RFS.

The Government does not need to settle with PES in a manner that excuses the vast majority of the debtor's RFS obligations. EPA could and should require PES or its corporate parents to comply in full. To begin with, EPA could enforce PES's RFS obligations against PES's corporate parents the Carlyle Group, LLC ("Carlyle") and Sunoco, Inc. ("Sunoco"). Moreover, because RFS obligations are not dischargeable in bankruptcy, EPA did not need to settle PES's RVO liabilities in this bankruptcy proceeding.

A. Carlyle and Sunoco are liable for PES's RFS obligations.

EPA's RFS regulations explicitly hold parent corporations liable for RVOs. 40 C.F.R. § 80.1461(c). Likewise, each partner to a joint venture is jointly and severally liable for obligations of the venture. *Id.* § 80.1461(d). Thus, because PES is a joint venture owned by Carlyle and Sunoco, either or both of Carlyle and Sunoco are liable for PES's obligations under the RFS.

This obligation of parent companies to meet the RVOs of their subsidiaries does not depend on piercing the corporate veil. Instead, EPA's regulations establish that "*any* parent corporation is liable for *any* violation" by a subsidiary, regardless of whether corporate formalities are observed. *Id.* § 80.1461(c) (emphasis added). Thus, there does not need to be evidence that any of the PES debtor entities was an alter ego of Carlyle or Sunoco or evidence that corporate assets were comingled in order for EPA to enforce PES's RFS obligations against Carlyle and Sunoco.

It is likewise immaterial that Carlyle and Sunoco own holding companies that in turn own the PES debtor entities. Corporate "grandparents" such as Carlyle and PES must be held liable for the obligations of their subsidiaries if EPA's RFS regulations are to have any effect. Otherwise, companies could escape the obligations of their subsidiaries simply by creating a shell company to nominally own any subsidiary that incurs an RVO through refining activities. Indeed, EPA has explained in the context of an analogous fuel program that the actions of entities in all levels of a corporate structure must be "taken into consideration when evaluating compliance" because "[i]n many cases, there are likely to be multiple layers of parent companies, with the ultimate parent being the one for which no one else has controlling interest." Control of Hazardous Air Pollutants from Mobile Sources Proposed Rule, 71 Fed. Reg. 15,804, 15,878 (Mar. 29, 2006).

There is no doubt that Carlyle and Sunoco are the "ultimate parents" of the PES debtors. The SEC filings of both Carlyle and Sunoco make clear that PES is a joint venture owned by Carlyle and Sunoco. *See* Energy Transfer Partners, L.P. Form 10-K For the fiscal year ended Dec. 31, 2017, SEC File Number 1-31219 ("Sunoco, Inc., owns an approximate 33% non-operating interest in PES, a refining joint venture with The Carlyle Group, L.P., which owns a refinery in

Philadelphia."); Philadelphia Energy Solutions Inc. Amendment No. 7 to Form S-1, July 27, 2015, Registration No. 333-202119 ("PES LLC is a joint venture originally formed among Carlyle, PES Equity (as successor-in-interest to Sunoco) and members of our management to own and operate the Philadelphia refining complex and the North Yard terminal.").

Carlyle and Sunoco can easily comply with the RIN obligations of PES—Carlyle alone has $195 billion in assets. The Carlyle Group, *Corporate Overview*, https://www.carlyle.com/corporate-overview (last visited Mar. 25, 2018). Neither is part of the bankruptcy proceeding and neither appears to be in financial distress. There is therefore no reason that Carlyle and Sunoco should be allowed to escape their obligation to meet the RVOs of their subsidiary. The Government's abdication of any enforcement against Carlyle and Sunoco through the Proposed Settlement effectively removes the incentive for corporate parents to ensure that their subsidiaries comply with the RFS.

B. RVOs are not dischargeable in bankruptcy.

There is a second reason why the Government should not settle PES's RFS compliance obligations: RVOs are not dischargeable in bankruptcy. Instead, they are the type of non-monetary environmental compliance obligations that can continue to be enforced despite bankruptcy proceedings.

A statutory obligation is a "claim" that may be discharged in bankruptcy only if, in lieu of the obligation being met, some creditor can be satisfied by "obtain[ing] a money judgment instead." *See United States v. Apex Oil Co.*, 579 F.3d 734, 736 (7th Cir. 2009). Liabilities that can be satisfied only through performance are not dischargeable. *Id.* And environmental compliance obligations are exactly the type of liabilities that courts have repeatedly recognized can be met only by performance. *See id.*; *In re Torwico Elecs., Inc.*, 8 F.3d 146, 150 (3d Cir. 1993). There are certain exceptions to that rule, such as when the Government takes it on itself to clean up contamination and then has a claim for monetary reimbursement from the bankrupt entity. *See In re Chateaugay Corp.*, 944 F.2d 997, 1008 (2d Cir. 1991). But where there is an environmental cleanup or other obligation that can be performed only by the debtor, the obligation to do so survives a bankruptcy in the interest of ensuring that the environment and the public is protected. *Apex Oil Co.*, 579 F.3d at 736; *Torwico Elecs., Inc.*, 8 F.3d at 150.

RFS obligations can be satisfied only through performance. There are two ways for a refiner to meet its RVOs: (1) blending or otherwise using biofuels or (2) purchasing RINs from another company that has blended or used biofuels. *See* 40 C.F.R. § 80.1400 *et seq*. While the latter method involves a payment of money, it does not involve a payment to the Government or any specific creditor. RINs can be purchased only from entities who have blended or used fuels and thus "separated" RINs that can be sold. Thus, the Government does not have a "claim" to enforce against PES in a bankruptcy proceeding because a payment to the Government would not satisfy PES's obligation. The Proposed Settlement itself appears to recognize this reality, as it requires PES to retire a certain amount of RINs rather than paying a fine. *See* Proposed Settlement at 1. Yet, it would allow PES to escape the majority of that obligation.

The structure of the RFS and its accompanying regulations further clarifies that Congress intended RFS obligations to be complied with rather than met through monetary payments. The Government is authorized under the statute to seek to enjoin any entity that fails to comply with the RFS. 42 U.S.C. § 7545(d)(2). While the Government may also seek monetary penalties for each day of delayed compliance, those penalties are in *addition to* its ability to require compliance. *Id.* § 7545(d)(1). There is no provision that allows obligated parties to escape RFS obligations by paying a fine. *See generally id.* Instead, the only mechanisms through which RVOs may be reduced or eliminated are EPA's waiver authorities, *Id.* § 7545(o)(7), and the small refinery exemption, *Id.* § 7545(o)(9). Neither of those conditions are present here. EPA's general waiver authority is triggered only when EPA makes a finding of widespread severe economic harm from the RFS or a lack of domestic supply, and the small refinery exemption is only available for certain refineries that process no more than 75,000 barrels per year. *Id.* §§ 7545(o)(7), (o)(9).

Because RVOs are not dischargeable in bankruptcy, there was no need for DOJ to even attempt to settle with PES on EPA's behalf. The Government could simply continue to enforce PES's RVOs against PES or its corporate parents, just as it does for every other refiner in the country that does not meet the criteria for a small refinery exemption.

III. At a Minimum, the Government Should Not Allow PES to Escape the Vast Majority of Its RIN Obligations.

NBB appreciates that there is always litigation risk and that there are benefits to resolving issues through settlement. But in no event should EPA have allowed PES to escape over 70 percent of its 2016–2017 RIN obligations and still have a head start in 2018. Given that EPA had a strong legal basis for holding PES to its *entire* obligation, the settlement is an unnecessary giveaway to PES. It has negative consequences for both the renewable fuel industry and the RFS.

A. The Proposed Settlement removes most of PES's 2016–2017 compliance obligation and gives it an advantage in 2018.

Under the Proposed Settlement, PES will comply with only about 29 percent of its 2016–2017 RVOs. *See* Settlement Agreement at 1. And the proposed settlement also resolves PES's compliance obligation from January through April of 2018, even though PES is continuing to generate RFS obligations. That additional four-month release is particularly unnecessary because PES will not need to demonstrate its compliance with the 2018 RVOs until 2019. When that additional release is factored in, PES is escaping around three quarters of its RFS obligations from 2016 through April 2018.

Making the proposed settlement even worse is the fact that PES gets to carry over more than 64 million RINs towards its 2018 compliance obligation *after* the release provided in the agreement. PES is currently in possession of those RINs, so they could easily have been used to meet more of its 2016–2017 obligation. But the Government is instead allowing PES to get a head start on 2018 RVO compliance compared to other refiners that have been complying with the law. In effect, the Government is rewarding PES for neglecting two years of RFS obligations by giving it a leg up on its competition going forward.

Additionally, while NBB generally supports the Proposed Settlement's inclusion of additional reporting requirements and stipulated penalties to ensure PES's compliance going forward, the penalties specified are far too low to be meaningful. In fact, the $10,000 stipulated penalty for the first five days of violations of the RIN retirement requirements in the Proposed Settlement is *lower* than the typical penalties imposed for RFS violations. *See* 42 U.S.C. § 7545(d). Thus, if anything, the stipulated penalties are giving PES an additional break. Moreover, the stipulated penalties are simply not high enough to account for the benefit that PES would receive from non-compliance. The lesson that PES will learn from this bankruptcy is that it can fail to comply with the RFS and then settle millions of dollars of RIN obligations at a more than 70 percent discount. To discourage such behavior in the future, EPA must impose penalties that would remove any economic benefit to PES from its failure to comply *and* impose substantial additional penalties to create a sufficient deterrent.

B. Allowing PES to escape its compliance obligations thwarts the goals of the RFS.

PES is a large refiner with a correspondingly large RVO. Erasing most of PES's 2016–2017 RVO and part of its 2018 RVO will thus have a significant effect on the market for RINs and the RFS program as a whole. For example, allowing PES to escape over 70 percent of its 467-million-RIN obligation for 2016–2017 will mean that 329 million fewer RINs are retired.

The precedent that the Proposed Settlement sets will have an even more detrimental impact. If PES is allowed to receive such a sizeable discount, even though it disregarded its obligations and even *sold* RINs prior to bankruptcy, other refiners will look to do the same. Refiners that are in financial distress for any reason can attempt to blame it on the RFS and significantly reduce their RFS compliance costs through a settlement with the Government in a bankruptcy proceeding. Refiners could even follow PES's model to *create* financial distress through poor management or excessive dividends if they can hope to receive the same treatment that PES does in the Proposed Settlement.

The Proposed Settlement would therefore significantly harm all of NBB's members, as well as producers of ethanol and other biofuels. And the harm wouldn't stop there. A reduction in the RIN market and corresponding reductions in renewable fuel production would harm the farmers who produce soybeans, corn, animal products, and other feedstocks, as well as all of the employees in the renewable fuel production supply chain. The Proposed Settlement also runs counter to congressional intent. Through the RFS, Congress sought to enhance our country's energy security, protect the environment, and promote our rural economy. Pub. L. No. 110–140, 121 Stat. 1492 (2007). Allowing PES to escape its RFS obligations and encouraging other refiners to do the same would frustrate each of those goals.