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DCMN HERZFELD

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, D.C.

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.

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

Staff Present: Nick Abraham, Legislative Clerk; Charlotte Baker, Press Secretary; Andy Duerstein, Deputy Press Secretary; Todd

Harrison, Chief Counsel, Oversight/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.

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 standards. 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 regulation 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, and 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:]

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

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.

[The prepared statement of Ms. DeGette follows:]

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

Dr. Burgess. I can filibuster until he gets here.

Mr. Stearns. You can filibuster. We have two others, Mrs. Blackburn and --

Dr. Burgess. I will be brief.

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.

[The prepared statement of Dr. Burgess follows:]

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Mr. Stearns. Mr. Terry, the gentleman from 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.

[The prepared statement of Mr. Terry follows:]

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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.

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:]

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Mr. Stearns. The gentleman yields back.

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

The gentleman from California Mr. Bilbray.

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.

[The prepared statement of Mr. Bilbray follows:]

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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. Okay. 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 a subject of 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.

TESTIMONY OF JENNIFER CASE, COFOUNDER AND CEO, NEW LEAF BIOFUEL; GEORGE ANDREW SPRAGUE, OWNER AND OPERATOR, UNION COUNTY BIODIESEL CORPORATION; THOMAS PAQUIN, MANAGING MEMBER, 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

TESTIMONY 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 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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Mr. Stearns. Mr. Sprague.

TESTIMONY OF GEORGE ANDREW SPRAGUE

Mr. Sprague. Thank you, Chairman Stearns, Ranking Member DeGette and other members, 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 funds 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:]

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Mr. Stearns. Mr. Paquin.

TESTIMONY 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 participate 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 produces 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 targets. 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 the 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:]

******** INSERT 1-3 ********

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

TESTIMONY 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 standards. 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 a biodiesel at 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 on-road 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:]

******** INSERT 1-4 ********

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

TESTIMONY 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 standards 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:]

******** INSERT 1-5 ********

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

TESTIMONY 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.

RPTS DEAN

DCMN HERZFELD

[11 a.m.]

Mr. Drevna. 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:]

******** INSERT 2-1 ********

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 the 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 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. Okay, 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. Okay. 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.

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?

Okay, 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. Okay. Let me ask Mr. Fjeld-Hansen. Musket Company, 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. Okay. 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 faced 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. Okay. 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. Okay. 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. Okay. 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. Okay. 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 follows:]

******** COMMITTEE INSERT ********

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:]

******** COMMITTEE INSERT ********

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. Okay, 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 that through our due diligence 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 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 an 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 only 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, okay, 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. Yeah, 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 okay 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.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. Burgess. Yeah, 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.

Dr. Burgess. Yeah, 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.

Dr. 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.

Dr. Burgess. So you're the one having to provide the discount in order to salvage the program.

Ms. Case. Absolutely.

Dr. 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 we can come up with solutions in order to move forward.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. Burgess. Okay, 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 representing -- 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 go 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 fakes 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. Okay.

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 [inaudible] with prosecuting people. I think the next guy who is going to make 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, okay? 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 okay.

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, okay, it's okay 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.

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[12 p.m.]

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. Okay. 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. Okay. 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. 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. Okay. 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. Okay. 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. Okay.

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?

Dr. 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 --

Dr. 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.

Dr. 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. Okay. 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. Okay. 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:]

******** COMMITTEE INSERT ********

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.

TESTIMONY OF BYRON BUNKER, ACTING DIRECTOR, COMPLIANCE DIVISION, OFFICE OF TRANSPORTATION AND AIR QUALITY, OFFICE OF AIR RADIATION, ACCOMPANIED BY PHILLIP BROOKS, DIRECTOR, AIR ENFORCEMENT DIVISION, OFFICE OF ENFORCEMENT AND COMPLIANCE ASSURANCE, U.S. ENVIRONMENTAL PROTECTION ADMINISTRATION

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 diligent 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 take 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:]

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Mr. Terry. And at this time the chair recognizes the gentleman from Texas Mr. Burgess for 5 minutes.

Dr. 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 and some issues that remain to be seen, I think.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. 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.

Dr. Burgess. Will you transmit that request?

Mr. Bunker. Yes, I will.

Dr. 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 okay, 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. Okay. 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. Okay. 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. Okay. 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 certification 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 towards.

Mr. Green. Okay. 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. Okay. 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. Okay. 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 it.

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 hew 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 I 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 follows:]

******** COMMITTEE INSERT ********

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.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. Terry. All right. Thank you. The subcommittee is now adjourned.

[Whereupon, at 12:51 p.m., the subcommittee was adjourned.]