#### State of Oregon

Department of Environmental Quality Memorandum

**Date:** November 2, 2012

**To:** Environmental Quality Commission

**From:** Dick Pedersen, Director

**Subject:** Agenda item xx, Rulemaking: Oregon Clean Fuels Program

December 6-7, 2012, EQC meeting

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| **Why this is important** | The Oregon Clean Fuels Program is a component of several important Oregon initiatives to reduce greenhouse gas pollution, including Oregon's energy, transportation, and climate protection action plans. Approximately one-third of Oregon’s greenhouse gases come from transportation sources, and providing cleaner fuels will help reduce these emissions. This rulemaking provides the initial framework for fuels reporting that is foundational to an eventual low carbon standard. This rule will allow DEQ to gather data about Oregon’s transportation fuels to help inform DEQ and decision makers about the feasibility of moving ahead with a declining carbon intensity standard. |
| **DEQ recommendation and EQC motion** | DEQ recommends that the Oregon Environmental Quality Commission adopt the proposed rules for the Oregon Clean Fuels Program, as provided in attachment A of this staff report. |
| **Background and need for rulemaking** | The 2009 Oregon Legislature authorized the Environmental Quality Commission to adopt a low carbon fuel standard, with the goal to reduce greenhouse gas emissions from Oregon’s transportation fuels. DEQ worked with stakeholders to develop the framework to implement the standard. In April 2012, Governor Kitzhaber asked DEQ to begin the rulemaking process to adopt the Oregon Clean Fuels Program. |
| **Effect of rule** | If adopted, the rules would create the first phase of the Oregon Clean Fuels Program which are fuels reporting requirements.  The rules would require Oregon fuel producers and importers to register, keep records and report to DEQ the volumes and carbon intensities of the fuels they provide in Oregon. It would allow DEQ to gather valuable data about Oregon’s transportation fuels that will help inform DEQ and decision makers about the feasibility of moving ahead with the next phase of the program. It is also intended to provide DEQ and regulated parties time to fully develop recordkeeping and reporting protocols and systems.  The next phase would require regulated parties to reduce the average carbon intensity of fuels they provide in Oregon each year, with the ultimate goal of reducing greenhouse gas emissions by 10 percent from the 2010 levels. Implementing this part of the program would require a second public rulemaking and EQC action as some point in the future. For the next phase to be developed the Oregon Legislature will need to remove the statutory December 31, 2015 sunset that is currently in effect and the Oregon Environmental Quality Commission will need to adopt additional implementation rules. |
| **Commission authority** | The commission has authority to take this action under Oregon Laws 2009, chapter 754, also referred to as House Bill 2186 (2009). |
| **Key issues** | * **Changes made in response to public comment**: DEQ’s initial rule proposal included language implementing the fuels reporting requirements for the Clean Fuels program, and additional language describing the actual low carbon fuel standards and associated features of the program needed to implement the low carbon fuels statute. – As initially proposed, implementation of this second phase (i.e. the low carbon standards and associated rules) was differed until future action by the EQC; however, in light of concerns expresses during public comment, DEQ now proposed to proceed only with the initial fuels reporting requirements.   During the comment period, several stakeholders cited their concern that implementing the Clean Fuels Program would put Oregon businesses at a competitive disadvantage compared to businesses operating in other states without a similar program. Specifically, they cited unresolved legal issues in California, inadequate resources to implement the program on DEQ’s part, the continuing economic recession and the legislative sunset date as reasons not to move forward with the program.  These are all important concerns that will be discussed in the 2013 Oregon legislature. In the interim, and in response to these comments, DEQ has chosen to modify the rule language initially proposed to remove references to the second phase of the program including those that require compliance with the annual average carbon intensity standard, the generation of credits and deficits, and the deferral mechanisms for fuel shortages and fuel cost increases. This change in rule language clarifies the intent and ability of DEQ to implement only the registration, recordkeeping and reporting parts of the program at this time.  In addition to the registration, recordkeeping and reporting requirements, DEQ proposed to adopt several other core concepts of the program framework including:   * the designations of the regulated parties for the various fuels, * the administrative mechanism by which a compliance obligation is treated between the transferor and the recipient of the fuels, * the process to propose and gain approval for a carbon intensity value, * the methodology to determine the amount of carbon surpluses and shortfalls (previously credits and deficits) generated with the current supply of fuels, and * the requirement to for regulated parties to conduct net carbon balance calculations for the fuels they currently provide in Oregon. * Legal status of California’s program – Oregon’s program is modeled after California's Low Carbon Fuel Standard (LCFS) but contains several customizations for Oregon, many required by statute. The LCFS is a groundbreaking policy and some affected stakeholders have challenged the legality of California’s program. In December 2011, a federal district court ruled that the California LCFS impermissibly regulates interstate commerce. California appealed this ruling to the United States Circuit Court of Appeals for the Ninth Circuit, and the Ninth Circuit stayed the district court’s ruling. This allows California to implement its LCFS while the Ninth Circuit considers whether to uphold or reverse the district court’s ruling. A final ruling is expected in 2013.   DEQ is watching these developments closely and continues to analyze how it might affect Oregon’s program. In order to achieve the benefits of the program as soon as possible, DEQ is proposing to move forward with the reporting aspects of the Oregon program prior to the conclusion of the lawsuit since this first reporting phase of its program does not involve the legal issues that gave rise to the California lawsuits.   * Fee authority and the ability of DEQ to adequately implement the program – DEQ received public comment concerned that there are inadequate resources for DEQ to implement the Clean Fuels Program. At this time, there is no permanent funding source to implement the Oregon Clean Fuels Program, Development of the program to date has been covered by existing DEQ staff and funding. DEQ is proposing to introduce a legislative concept and policy option package (for up to $475,000 for the 2013 – 2015 biennium) to request authority to charge a fee on regulated parties that will be used to hire 1.3 fte of additional staff to implement the first phase of the program and assess the feasibility of moving to the next phase, including funds to hire outside expertise to assist the agency.   Scope of the fiscal and economic analysis – DEQ’s fiscal assessment included the proposed reporting requirements and The Oregon Department of Justice confirmed that sof the program by this rulemakingcurrently  Since the current proposal is to include only the first phase of the program, the assumptions made in the initial Statement of Need and Fiscal and Economic Impact remain the same. If DEQ proposes rules for the next phase of the program in a future rulemaking, a Statement of Need and Fiscal and Economic Impact will be prepared at that time.   * Sunset date in HB 2186 - HB 2186 contains a sunset date of December 31, 2015; and unless the sunset is removed, the Clean Fuels Program cannot be implemented beyond that date. For practical purposes, it does not make sense to establish and require compliance with the declining average carbon intensity standards and potentially have it end in 2015. Therefore, DEQ proposes to move forward with only the first reporting phase of the program until after the sunset is removed by the Legislature. If the sunset is lifted, an additional rulemaking by the EQC will be needed to adopt and implement the standard. |
| **Public outreach** | DEQ developed the rules based on discussions and recommendations from a 29-member advisory committee that helped DEQ explore technical issues and policy choices for designing the Oregon Clean Fuels Program. The committee included representatives of many areas of expertise, including petroleum fuel, low carbon fuel, environment, labor, farm, construction, trucking and rail.  DEQ also convened an advisory committee to gather input on the fiscal impact of complying with the requirements of the proposed reporting rules. Eleven people from the business and environmental communities were invited to participate on the committee and, with members of the public, were provided an opportunity to comment on the draft Statement of Need and Fiscal Impact.  Comments on the proposed rules were accepted from the public from July 20, 2012 through Aug. 31, 2012. A public hearing was hosted by the Oregon Environmental Quality Commission on Aug. 24, 2012. The hearing was held at 811 SW 6th Avenue in Portland. For that hearing, members of the public could also visit a DEQ regional office in Eugene, Medford, Bend or Pendleton for the opportunity to provide oral testimony via conference phone.  102 comments were received from the public, including 16 individuals who provided oral testimony at the public hearing. Oral and written comments are summarized in the attached Summary of Public Comment and Agency Response. |
| **Next steps** | If the rules are adopted, DEQ will file the rule record with the Oregon Secretary of State.  Oregon fuel producers and importers will be required to register with DEQ beginning on January 1, 2013 but no later than June 30, 2013. They must submit documents showing, among other things, the volumes and carbon intensities of the fuels they plan to provide in Oregon after July 1, 2013. Beginning on July 1, 2013, Oregon fuel producers and importers are required to begin keeping records for each fuel transaction. The first annual report, for the period of July 1, 2013 – December 31, 2013, will be due on April 30, 2014. The first quarterly report, for the period of January 1, 2014 – March 31, 2014, will be due on May 31, 2014.  DEQ intends to develop an electronic registration form and a web-based reporting tool for regulated parties to use in the first phase of the program. Since many of the regulated parties in Oregon also supply fuel in California, DEQ chose to collaborate with California to adapt and customize their registration and reporting tools for use in Oregon in order to streamline the recordkeeping and reporting processes.  DEQ intends to propose a legislative concept to the 2013 Oregon Legislature to request that the sunset be removed from HB 2186. DEQ also intends to propose a legislative concept to the 2013 Oregon Legislature to request fee authority and a policy package to spend up to $475,000 for the 2013-2015 biennium. |
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| **Attachments** | Proposed rules (redline)  Proposed rules (clean)  Summary of Public Comment and Agency Response  Presiding Officer’s Report  Relationship to Federal Requirements  Statement of Need and Fiscal and Economic Impact  Land Use Evaluation Statement |
| **Available upon request** | HB 2186  Oregon Low Carbon Fuel Standards Advisory Committee Process and Program Design  Economic Impact Analysis of the Low-Carbon Fuel Standard Rule for the State of Oregon |
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Approved:

Division: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Section: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Report prepared by: Cory-Ann Wind

Phone: 503-229-5388