#### 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 for several important Oregon initiatives 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.  |
| **DEQ recommendation and EQC motion** | DEQ recommends that the Oregon Environmental Quality Commission adopt the proposed rules for the Oregon Clean Fuels Program, as seen 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. The goal of this rulemaking is to reduce the greenhouse gases emitted by transportation fuels through the adoption of the Oregon Clean Fuels Program. |
| **Effect of rule** | If adopted, the rules would create the Oregon Clean Fuels Program that would be implemented in two phases: an initial reporting phase and a later greenhouse gas reduction phase.Phase 1 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. Phase 1 is intended to provide DEQ and regulated parties time to fully develop recordkeeping and reporting protocols and systems. It would also 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. Phase 2 would require regulated parties to reduce the average carbon intensity of fuels they provide in Oregon each year. Phase 2 is deferred indefinitely and can only be implemented if the Oregon Legislature adopts a bill to remove the statutory 2015 sunset that is currently in effect and if the Oregon Environmental Quality Commission adopts rules to remove the regulatory deferral of Phase 2. |
| **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** | * 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. The LCFS is a groundbreaking policy and some affected stakeholders have challenged the legality of it. 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 recently 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.

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, Oregon doesn’t have to wait to begin its program until the lawsuit is concluded because it can proceed with Phase 1 of the program without confronting the legal issues that gave rise to the California lawsuits.* Overlap with other fuels programs – Federal and state renewable fuel standards complement the Oregon Clean Fuels Program. If Oregon is going to achieve its fair share of greenhouse gas reductions, lower carbon fuels must be supplied and consumed here.

The federal Renewable Fuels Standard mandates that a minimum amount of renewable fuels be produced in any given year on a national level. However, nothing in the federal requirements mandates that Oregon receives its proportional share of fuel to be consumed and it is possible that none of the fuel will be used in Oregon. The Oregon Renewable Fuel Standard mandates a 10 percent ethanol blend for gasoline and a five percent biodiesel blend for diesel fuel used in Oregon for transportation purposes. However, the carbon intensity of ethanol and biodiesel can range from one tenth of petroleum fuels to the same or even more than petroleum fuels depending on a variety of factors so additional requirements are needed to ensure a reduction in greenhouse gases.* 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 begin implementing Phase 2 at this time and potentially have it end in 2015. Therefore, DEQ has proposed to defer implementation of Phase 2 until after the sunset is removed by the Legislature. An additional rulemaking will be needed to remove the deferral of Phase 2 to trigger its implementation.
* Fee authority and the ability of DEQ to adequately implement the program - There is no permanent funding source to implement the program; the development of the Oregon Clean Fuels 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 Phase 1 and develop Phase 2 of the program, including funds to hire outside expertise to assist the agency.
* Scope of the fiscal and economic analysis - DEQ’s proposed rule is divided into Phase 1 and Phase 2 of the program, with Phase 2 requirements deferred pending future EQC and legislative action.

DEQ convened a fiscal advisory committee to provide input on the Statement of Need and Fiscal and Economic Impact developed for this proposed rule. In it, costs for regulated parties to comply with Phase 1were estimated for both initial start-up and ongoing maintenance. Since Phase 2 is deferred, no requirements are imposed at this time; therefore, its fiscal and economic impact is zero. If DEQ proposes Phase 2 in a future rulemaking, a Statement of Need and Fiscal and Economic Impact for Phase 2 will be prepared at that time.* Higher fuel prices - Fuel prices fluctuate for a lot of different reasons that are beyond our control, but it will not be because of the Oregon Clean Fuels Program. On a per-gallon basis, the cost of ethanol, biodiesel, natural gas, propane and electricity used as a transportation fuel all cost less than petroleum-based gasoline and diesel at this time; so using more of these alternatives should reduce the amount you are spending on fuel. Since DEQ knows that businesses and the driving public are very sensitive to price increases, we will monitor the price of fuels closely; if prices do go up because of this program, we will suspend the requirements.
* Inadequate supply of lower carbon fuels – During Phase 1 of the program, there are no requirements to change the types of fuels that are currently supplied in Oregon. As DEQ studies whether Phase 2 of the program is feasible or not, we will conduct a fuels availability assessment to determine whether achieving the standard of a 10 percent reduction over a 10 year period is feasible or not. This information, in addition to that collected during Phase 1, will help determine whether to proceed forward with Phase 2, where more lower carbon fuels would be required.
* New fuels are incompatible with existing engines – Fuel quality specifications are established by the federal government, fuel producers, and vehicle manufacturers to ensure they meet a consistent standard of fuel economy, engine performance and emissions. Many studies have been conducted to ensure the compatibility of blending biofuels with conventional gasoline and diesel. In addition, many newer engines are designed specifically to accommodate blending higher percentages of biofuels, like flex fuel cars that can take up to 85% ethanol in gasoline. You should always consult your driver's manual to determine what types of fuels and blends are compatible with your vehicle's engine.
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| **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 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. Phase 1 is proposed to begin Jan. 1, 2013, and would require Oregon fuel producers and importers to register with DEQ the producers and carbon intensities of the fuel types they provide in Oregon. Beginning on July 1, 2013, Oregon fuel producers and importers are required to begin keeping records of the volumes and carbon intensities of fuels they provide in Oregon for each fuel transaction.DEQ intends to develop a web-based registration form and a web-based reporting tool for regulated parties to use in Phase 1 of the program. California’s web-based registration and reporting tools will be adapted and customized for use in Oregon.DEQ intends to submit a legislative concept to the 2013 Oregon Legislature to request that the sunset be removed from HB 2186. DEQ also intends to submit 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)Summary of Public Comment and Agency ResponsePresiding Officer’s ReportRelationship to Federal RequirementsStatement of Need and Fiscal and Economic ImpactLand Use Evaluation Statement |
| **Available upon request** | HB 2186Oregon Low Carbon Fuel Standards Advisory Committee Process and Program DesignEconomic Impact Analysis of the Low-Carbon Fuel Standard Rule for the State of Oregon |
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 Approved:

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