HB 2186: Oregon Clean Fuels Program Update

**Submitted to:**

**Governor John Kitzhaber**

**Oregon Legislative Assembly**

**Oregon Environmental Quality Commission**

**By: Dick Pedersen, Director**

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DEQ is a leader in restoring, maintaining and enhancing the quality of Oregon’s air, land and water.

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# Executive Summary

[House Bill 2186](http://www.leg.state.or.us/09reg/measpdf/hb2100.dir/hb2186.en.pdf) (2009) authorized the Oregon Environmental Quality Commission to adopt a low carbon fuel standards program for Oregon and specified certain features, such as regulatory flexibility and consumer protection, to be included in the program design. This report summarizes DEQ’s efforts to adopt the phase 2 rules for the program. The full report can be accessed on the [DEQ website](http://www.deq.state.or.us/pubs/legislativepubs/index.htm).

Key highlights of DEQ’s report include: 1) Governor John Kitzhaber’s February 2014 letter directing DEQ to fully implement the Clean Fuels Program; 2) the staff report to the commission for the formal rulemaking; and 3) the phase 2 rules adopted by the commission.

### Oregon Clean Fuels Program

The goal of the Clean Fuels Program is to reduce the average lifecycle emissions of greenhouse gases from Oregon’s transportation fuels by 10 percent over a 10-year period. The program will provide Oregonians with greater access to cleaner, lower carbon fuels such as electricity, natural gas, propane, biogas and biofuels. The program provides consumers with more fuel choices and creates an opportunity for businesses to save money on their fuel bills, while improving air quality and increasing energy security in the state.

### Development of Phase 1 Rules

In April 2012, [Gov. Kitzhaber directed DEQ](http://www.deq.state.or.us/aq/cleanFuel/docs/LowCarbonStandards041712.pdf) to move forward with rulemaking and to implement the program in two separate phases. The first phase required Oregon producers and importers of fuels to register with DEQ, keep records and submit reports about the fuels they currently supply. The second phase requires the same parties to meet the clean fuel standards by supplying cleaner, lower carbon fuels in Oregon or purchasing credits from clean fuel providers. In December 2012, the EQC adopted the phase 1 rules. DEQ’s efforts to adopt the phase 1 rules for the program can be found in the 2013 report to the Oregon Legislature and is on the [DEQ website](http://www.deq.state.or.us/pubs/legislativepubs/2013/HB2186LegRpt2013.pdf). Since 2013, DEQ has collected information about the fuels being imported into Oregon.from fuel distributors.

### Development of Phase 2 Rules

In February 2014 Gov. Kitzhaber directed DEQ to fully implement the Clean Fuels Program by drafting the phase 2 rules. DEQ developed rules based on discussions and recommendations from a 21-member advisory committee that included representatives from large and small fuel distributors, Oregon producers of biofuels, providers of lower carbon fuel such as electricity, propane, natural gas and biogas, local governments, and business and environmental interests. The committee’s purpose was to gather expert input on policy and technical issues related to several program design options and the fiscal and economic impact of the proposed rules. Since the advisory committee for the phase 1 rules discussed many of the basic design issues, the advisory committee for the phase 2 rulemaking focused on how new information could affect the original program design choices.

DEQ placed the draft phase 2 rules on public notice from Oct. 1 through Nov. 25, 2014. DEQ received 742 written and oral comments during the public comment period. In general, those opposed to the program were concerned that businesses in Oregon would be at a competitive disadvantage due to uncertainty about access to clean fuel supplies and infrastructure, as well as possible fuel price increases that might be caused by the program. Supporters of the program expressed concern that further delay in implementing the rules would delay the program’s environmental and economic benefits.

### Environmental Quality Commission Involvement

DEQ provided the EQC with briefings throughout Phase 2 rule development. DEQ Director Dick Pedersen provided an update as part of his Director’s Report at EQC meetings held on March 20, 2014, June 19, 2014 and Aug. 27, 2014.

On Nov. 6 and Nov. 20, 2014, the EQC hosted public hearings so that stakeholders could speak directly to the commission. Commissioners also had the opportunity to hear presentations from a panel of experts including representatives of the California Air Resources Board, Boston Consulting Group, Environmental Entrepeneurs and ICF International about the current state of low carbon fuel policy. In addition, 46 people provided oral testimony. After evaluating the comments received, DEQ proposed final rules to the EQC at its Jan. 7, 2015 meeting. The commission voted to 4 – 1 to approve the phase 2 rules, which go into effect on Feb. 1, 2015.

### Significant Policy Decisions

Key policy choices proposed by DEQ in rule and adopted by the EQC include:

* The Clean Fuel Standards: The clean fuel standards are the annual average carbon intensity values a regulated party must comply with, expressed in grams of carbon dioxide equivalents per megajoule of energy or gCO2e per MJ. There is a standard for gasoline and gasoline substitutes and a standard for diesel and diesel substitutes. The baseline year is 2015 and the baseline carbon intensity values represent the fuels that currently exist in Oregon: 10 percent ethanol blended with gasoline and 5 percent biodiesel blended with diesel fuel. The rules require a 10 percent reduction in average carbon intensity from 2015 to 2025, from 89.31 to 80.36 for gasoline and gasoline substitutes and 87.09 to 78.38 for diesel and diesel substitutes.
* Deficits and Credits: Deficits occur when the carbon intensity value of a specific fuel exceeds the clean fuel standard in a given year. Credits occur when the carbon intensity value of a specific fuel is lower than the clean fuel standard in a given year. To be in compliance with the standards in any given year, there must be enough credits available to balance out the amount of deficits generated. Excess credits can be banked for future compliance or sold to another party.

* Program, participants: Parties that import gasoline, diesel, ethanol and biodiesel for use in Oregon are the regulated parties. Parties that produce ethanol and biodiesel in Oregon are also regulated parties. An “importer” is the party that owns the transportation fuel at the time it is brought into the state of Oregon. Parties that provide clean fuels - fuels whose carbon intensity values are lower than the standard for the gasoline or diesel they substitute for - are eligible to be credit generators. Credit generators are not required to participate, but can choose to voluntarily participate if they want to generate credits for fuel they provide in Oregon. Brokers are parties that are not themselves a regulated party or a credit generator, but who are authorized by a regulated party or a credit generator to act on their behalf. Brokers can participate in the program to facilitate credit generation and credit trading.
* Administrative Requirements: Regulated parties, credit generators and brokers must register with DEQ before producing fuel in Oregon, importing fuel into Oregon or generating or transacting credits for fuels supplied in Oregon. Regulated parties, credit generators and brokers must keep records for each transaction of transportation fuel imported, sold or supplied for use in Oregon. Regulated parties, credit generators and brokers must submit quarterly progress reports and annual compliance reports to DEQ. All reporting must be done using the Clean Fuels Program online system.
* Establish cost-containment mechanisms: DEQ incporated three mechanisms to monitor and evaluate the supply of clean fuels and the price of fuels, and to allow the program to respond and adjust requirements if Oregon experiences fuel shortages or excessive fuel price increases.

1. Forecasted Deferral Due to Fuel Supply ensures an adequate supply of clean fuels to comply with the clean fuel standards in the next year. This deferral allows DEQ to defer requirements and prevent compliance problems before they occur, if there are fuel supply problems.
2. Emergency Deferral Due to Fuel Supply responds to an unanticipated shortage of lower carbon fuel supplies. This deferral allows DEQ to act rapidly to respond to an emergency related to the production or transportation of clean fuels.
3. Fuel Price Deferral ensures that fuel prices in Oregon remain competitive with neighboring states that do not have a low carbon fuel standard. This deferral requires DEQ to defer, amend or suspend program requirements if the Clean Fuels Program is the underlying cause of any significant fuel price increase.

### Effect of the 2015 Sunset

Under HB 2186, the EQC’s authority to implement the low carbon fuel standards sunsets on Dec. 31, 2015. As required by the legislation, DEQ and the advisory committee discussed the likely effects of a program sunset. In the final report, DEQ concluded that the existence of the sunset is a significant barrier to new investment in the infrastructure needed to support the low carbon fuels standards. Removal of the sunset would provide a clear market signal to companies wishing to construct new clean fuel production capacity, purchase alternative fuel vehicles or install infrastructure to distribute clean fuels.