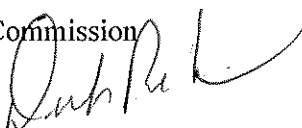


State of Oregon
Department of Environmental Quality

Memorandum

Date: Nov. 16, 2012
To: Environmental Quality Commission
From: Dick Pedersen, Director 
Subject: Agenda item N, Action item, Rule proposal: Oregon Clean Fuels Program
Dec. 6-7, 2012, EQC meeting

Why this is important The Oregon Clean Fuels Program is a component of several important Oregon initiatives to reduce greenhouse gas emissions 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 of the program that is foundational to eventual low carbon fuel standards.

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 low carbon fuel standards, with the goal to reduce greenhouse gas emissions from Oregon's transportation fuels. DEQ worked with stakeholders to develop the framework to implement the standards. 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.

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. This 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. This 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. The Oregon Legislature will need to remove the statutory Dec. 31, 2015 sunset date to develop the next phase of the program. Then DEQ would propose new rules covering the next phase for the EQC to consider.

**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

At a previous commission meeting, DEQ discussed a proposal that entailed adopting rules for a two-phased program, with Phase 1 registration, recordkeeping and reporting to be implemented now and Phase 2, compliance with the standards, to be implemented at a later date. As initially proposed, implementation of the Phase 2 rules was deferred pending further approval by the Oregon Legislature and EQC.

During the comment period, many stakeholders said that they were concerned that 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, resources to implement the program, the potential economic impact of the program, and the legislative sunset date as reasons not to move forward with the program.

To allow time for resolution of these issues while providing a clear regulatory framework for the entire program, DEQ proposed to adopt the program in its entirety but indefinitely defer Phase 2. However, many stakeholders disagreed with this deferral approach and suggested waiting to adopt Phase 2 of the rules until after further discussions with the Oregon Legislature.

In light of the comments received, DEQ is proposing to modify its initial rule language to remove references to the second phase of the program, including language describing:

- Compliance with the declining annual average carbon intensity standards,
- The generation, banking and transfer of credits and deficits, and
- The deferral mechanisms for fuel shortages and fuel cost increases.

The revised proposal now focuses exclusively on implementing the registration, recordkeeping and reporting requirements. While Phase 2 is not proposed for adoption at this time, the model rule language for

Phase 2 will remain available for reference on DEQ's website.

The revised proposal allows DEQ to work with regulated and opt-in parties to build the reporting framework necessary for the success of the next phase of the program, while allowing time for additional discussion about the Phase 2 program design with stakeholders and the Oregon Legislature. This approach reinforces the regulatory flexibility focus of the authorizing statute.

In order to implement the registration, recordkeeping and reporting requirements of the first phase, the proposed rules include several other core administration features including:

- The designations of the regulated and opt-in parties for various fuels,
- The transfer and receipt of the compliance obligation,
- The process to propose and gain approval for a carbon intensity value, and
- The methodology to determine the amount of surpluses and shortfalls, previously called credits and deficits, and calculate net carbon balances.

DEQ will use these reports and other information to make a recommendation to the Oregon Legislature and EQC about the next phase of the program. DEQ remains committed to working with stakeholders and elected officials to continue developing the Oregon Clean Fuels Program.

Legal status of California's program

DEQ received comments that stakeholders are concerned that DEQ's proposal is unconstitutional based on legal proceedings occurring in California. Oregon's program is modeled after California's Low Carbon Fuel Standards, but contains several customizations for Oregon, many of them required by statute. In December 2011, a federal district court ruled that the California Low Carbon Fuel Standards 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 standards 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. Because the first phase of its program does not raise the legal issues under contention in the

California lawsuit, Oregon may move forward with this phase prior to conclusion of the lawsuit. This allows Oregon to achieve the benefits of the program as soon as possible and to incorporate any program revisions required by the court in the design of the next phase.

Fee authority and the ability of DEQ to implement the program

DEQ received comments that stakeholders are concerned that DEQ lacks adequate resources to implement the program. At this time, there is no funding source to implement the Clean Fuels Program. DEQ has a small group of air quality planning staff that is funded to develop new air quality programs, including those to meet federal air quality standards, reduce risk from air toxics, reduce greenhouse gases and meet federal visibility protection requirements. DEQ was able to develop the Clean Fuels Program by temporarily assigning existing planning staff to this work and delaying other work. The planning staff must now turn to other challenges, such as addressing new National Ambient Air Quality Standards and reducing risk from air toxics exposures, and is not available to implement the Clean Fuels Program.

DEQ is proposing to introduce a legislative concept and policy option package for up to \$475,000 for the 2013–2015 biennium and to request authority to charge a fee to regulated parties. If approved by the Oregon Legislature, the fee will be used to hire 1.3 new full-time-equivalent staff positions 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 received comments that stakeholders are concerned that the scope of the fiscal and economic analysis conducted for this rulemaking was incorrect. As initially published for public comment, DEQ's proposal was 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 1 were estimated for both initial start-up and ongoing maintenance. Since Phase 2 was deferred, no requirements were imposed; therefore, its fiscal and economic impact was zero.

Since the revised 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, a Statement of Need and Fiscal and Economic Impact will be prepared at that time.

Sunset date in House Bill 2186

DEQ received comments that stakeholders feel that DEQ should not proceed with the program until the legislative sunset date is removed. House Bill 2186, approved in 2009, contains a sunset date of Dec. 31, 2015, and, unless the sunset is removed, the Clean Fuels Program cannot be implemented beyond that date. It would not be practical 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 phase of the program until after the sunset date is removed by the Oregon Legislature. If the sunset date is lifted, an additional rulemaking by EQC will be needed to adopt and implement the standards.

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, along 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, as part of the commission's meeting at DEQ's headquarters in downtown 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 attachment C.

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 Jan. 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 through Dec. 31, 2012, would be due to DEQ on April 30, 2014. The first quarterly report, for the period of Jan. 1 through March 31, 2014, would be due to DEQ 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 that state's registration and reporting tools for use in Oregon in order to streamline the recordkeeping and reporting processes.

DEQ intends to ask the 2013 Oregon Legislature to remove the sunset date from House Bill 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.

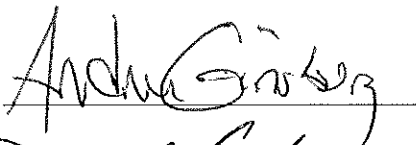
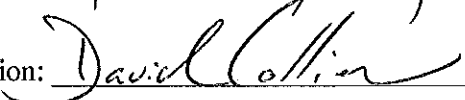
Attachments

- A. Proposed rules (redline)
- B. Proposed rules (clean)
- C. Summary of public comment and agency response
- D. Presiding Officer's Report
- E. Relationship to Federal Requirements questions
- F. Statement of Need and Fiscal and Economic Impact
- G. Land Use Evaluation Statement

Available upon request

- 1. House Bill 2186
- 2. Oregon Low Carbon Fuel Standards Advisory Committee Process and Program Design
- 3. Economic Impact Analysis of the Low-Carbon Fuel Standard Rule for the State of Oregon

Approved:

Division: 
Section: 

Report prepared by: Cory-Ann Wind