State of Oregon Department of Environmental Quality

Written Comments

March 2017, Clean Fuels Program 2017 Rulemaking Advisory Committee Meeting

Commenters

Western States Petroleum Association

Oregon Fuels Association

Western States Petroleum Association
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Jessica Spiegel
NW Region

March 20, 2017

Via email at: OregonCleanFuels@deq.state.or.us

Ms. Cory-Ann Wind
Oregon Department of Environmental Quality
Clean Fuels Program
811 SW Sixth Ave
Portland, OR 97204

Re: WSPA Comments on the Oregon Clean Fuels Program

Dear Ms. Wind:

The Western States Petroleum Association (WSPA) appreciates the opportunity to provide the Oregon Department of Environmental Quality (DEQ) comments from recent DEQ materials and Agenda Item D from the last advisory committee meeting. Our member companies are key stakeholders in the Oregon Clean Fuels Program (CFP). WSPA is a non-profit trade association that represents companies that account for the bulk of petroleum exploration, production, refining, transportation and marketing in the five western states, including Oregon.

General

Based on information recently provided by DEQ, the overall GHG emissions reduction of the CFP is less than 1% of the total emissions in Oregon (2-3% reduction projected of 37% transportation emissions total). Yet, the CFP endeavors to substantially transform the transportation fuel mix, which touches all parts of the economy. The purpose of this rulemaking as directed by the legislature is to protect Oregon consumers from the overall cost of the program by developing cost containment strategies. WSPA members support strong cost containment provisions, given that there is substantive economic risk for so little emission reduction.

Agenda Item D: Proposed Cost Containment Mechanism

Short Term Mechanism

WSPA members appreciate that DEQ has acknowledged the need for transparency regarding short-term price spike protection for consumers. As stated in previous comments, for maximum transparency these measures should be based on credit price (not fuel price) as the most direct indicator of market health.

We agree that it is difficult to establish specific triggers and actions in an immature market. However, while the market is developing it is important that:

1. There is some guidance of what will happen when an unforeseen spike occurs and
2. That once a market is established there is a mechanism in place to measure what a spike looks like (a "trigger") and a corresponding action.

WSPA requests that DEQ put forward a specific short-term proposal as soon as possible for consideration.

During the Advisory Committee Meeting on March 3, the California credit market behavior from 2013-2016 was discussed for a 25% and 40% price spike trigger. WSPA members reviewed the market volatility of the example shown by the table provided in Agenda Item D at the last advisory committee meeting. Based on the data from California, other alternatives can still protect consumers. For example, in the first three years of the program, DEQ could pause the deficit accrual for one quarter if, in any 30-day period, credit prices spike by 100% or more or the cap is reached. DEQ would then investigate the cause of the spike. After the initial three-year period or if a mature market is realized before then, DEQ could pause the deficit accrual for one quarter if, in any 60-day period, credit prices spike by 40% or more or the cap is reached. DEQ will then investigate the cause of the spike. A dollar threshold instead of a credit threshold could also be used.

Long Term Mechanism

As discussed, some actions that DEQ can take to support a clear market mechanism are:

1. A credit clearance market (CCM) trigger with a $200 price cap consistent with California. A tiered mechanism as suggested by DEQ is confusing and risky as it may lead to unanticipated stressed responses from investors and other markets. Capital projects to create low carbon fuels require a sustainable long-term price signal. Varying the price over the short term does little to help justify a lender granting loans to a biofuels producer that will be paid back over a 15-year or longer time frame. The tiered pricing mechanism therefore complicates the forward view while delivering little, if any benefit.

2. A true relief valve should be included. WSPA recommends pausing deficit accrual without penalty if credits become scarce to allow the market to catch-up, before the standard continues to adjust.

   DEQ has suggested that a public process will be needed to adjust the standard. WSPA recognizes this DEQ position, but in order to create a true cost containment mechanism, an automatic "pause" should be an available mechanism to DEQ.

3. The small deficit carryover of 10% should be retained along with a CCM as this provides for needed flexibility in a tight market.

4. While using the annual supply forecast is a good start in terms of assessing the long-term health of the program, this tool is still shortsighted in its one-year forecast design. In particular, the lack of consideration for other markets such as California LCFS and Canada LCFR. SB324 Section 6(1)(G)(c) directs DEQ to consider the carbon fuel standards of other states for the purposes of adopting standards. It is not clear to WSPA how DEQ has factored these other programs into the long term health and forecast of the Oregon CFP. This request has been made several times to DEQ and should be viewed as a required part of the rulemaking "analysis." How other markets will affect Oregon guides cost containment policy; without this analysis a clear and transparent long-term cost containment mechanism is even more important for Oregon consumers.

The current methodology used by ICF in the updated Illustrative Scenario work, meant to look at the longer term does not include consideration of other markets or the realities of the current program. As pointed out in the last advisory committee meeting, ICF also has not considered current data on credits generated in Oregon to date (approx. 150K through Q3) when suggesting 350K total credits are needed for banking**.**

Agenda Item D- Credit Basics:

As stated in past comments, obligated parties should not be held responsible for illegitimate credits passed on by a producer. The suggestion at the last advisory meeting to require additional banking of credits and therefore program costs to build a bank in case of fraudulent activities is unacceptable. This would force compliant parties to pay for bad actors ahead of time, and put more cost on the overall system.

WSPA members agree that DEQ should include stronger language around fraud, falsified records and market manipulation- as well as strengthening vetting of producers and the credit verification process- to minimize program exposure to bad actors. DEQ should be granted the authority to suspend, revoke and modify credit activity in the case of bad actions early on in the reporting tool. If credits are found to be fraudulent at a later date, the obligation should be forgiven, or deferred without penalty over the remainder of the program.

There should also be a statute of limitations of two years on finding credits invalid as to minimize the retroactive cost impact of the program to consumers.

WSPA further recommends that the regulations specify that any LCFS credit shortfall arising from an audit of the fuel producer's pathway CI be made up by the fuel producer and the credits previously generated and used by downstream parties remain valid. Please note, that unlike traditional fuel regulations, where downstream parties can confirm through independent testing that the fuel meets specific properties as represented by the seller (i.e., RVP, benzene, olefins, etc.), there is no way for the downstream parties to independently confirm a fuel's CI as represented. As a result, keeping credits valid after they have been used by downstream parties will go a long way toward stabilizing a LCFS credit market and improving its liquidity. In addition, it puts the onus on the party that generated the low CI fuel and obtained its low CI benefit in the market.

In light of our concerns, WSPA requests that DEQ consider several ideas to reduce fraudulent activity, and protect those not directly involved in fraudulent activity. The following are two suggestions for consideration:

- Affirmative Defense
  By providing a mechanism for purchasers of renewable fuel to receive an extra level of protection via the affirmative defense against civil liability, USEPA has added a degree of regulatory stability to the RFS program and thereby promoted market transparency and liquidity. WSPA urges DEQ to provide an affirmative defense for any civil/administrative penalties associated with LCFS credit invalidation to provide the same regulatory stability, market transparency, and liquidity for CFP.

- Third Party Verification System
  Similar to what California is proposing, we would like DEQ to consider third party verification for credits, fuel volumes and carbon intensity to mitigate the likelihood of fraud.

Agenda Item D- Effect of Low CI Fuels on Credit Prices:

WSPA strongly disagrees with the two specific points made in the DEQ CCM Cap slides:

1. That fuel blends containing low CI biofuels have a lower cost to the consumer, and
2. That this effect is amplified with higher LCFS credit prices.

To address the first point, different prices to consumers for a specific fuel blend (such as E10) containing different CI biofuels do not exist. Based on DEQs presentation, a consumer of these fuels would be willing to pay a higher price for the high CI fuel, and the seller of the blend containing the high CI would have to sell it at a higher price because it will cost more. However, this is exactly the opposite of what happens in the market and is contrary to DEQ's intention to create incentives for the production of low CI biofuels.

Consider what this would mean to producers and consumers of biofuels. A biofuels producer needs to spend considerable money to modify their processes to consume less carbon and perform the life cycle analyses to establish a low CI. The producer would not spend this money if he or she did not expect to be able to sell their low CI fuel at a higher price. So low CI fuels have to be sold by the producer at prices higher than high CI fuels. Conversely, a fuel supplier who purchases biofuels is willing to pay a higher price for low CI biofuels. CI is one of the key negotiating points between the biofuels producer and the fuel blender/supplier, and pricing agencies objectively report the differences in price between different CI biofuels. The fuel supplier/blender has a choice to buy a higher carbon biofuels and LCFS credits, or lower carbon biofuels and not buy LCFS credits. He or she is indifferent to either approach and will always choose the combination of high and low carbon biofuels that provides the number of credits needed at the lowest price.

In a market where all biofuels generate the same credits (such as RFS), the situation is different. In the RFS, since all conventional ethanol produced have the same credits attached with the same value, there is no basis to differentiate value of ethanol in the market. Accordingly, when these credits (known as RINS) increase in price, the producer does not see any of this value. Similarly, since all fuel suppliers/blenders who buy the ethanol receive the same value for the attached RIN, they all see the same reduction in their cost of goods sold for E10 blends. This does not happen in the LCFS market specifically because of the need to differentiate low and high CI biofuels.

The second point (that blends of lower CI biofuels have even lower prices with higher credit values), is moot if the first point is incorrect. However, consider what it would mean to the case described on slide 16 of the DEQ Item D presentation. This shows E10 with ethanol at a CI=55 g/mj priced at 7 cpg less than imported E10 with a credit price of $200 per ton. If the credit price is high enough, this analysis suggests that the ethanol blend with low CI would be free! Everyone who deals with the fuels markets regulated by low carbon fuel standards knows that this is not reasonable.

WSPA has members that can explain these points to the DEQ in greater detail, if desired.

Q4 2016 Reporting Guidance

Reporting Sales Without Obligation Below the Rack:

For sales below the rack without obligation, WSPA requests that DEQ waive the following record requirements in the Product Transfer Documentation under section 340-253-0600 (2) since this information is not relevant to the transferee:

- (d) Fuel pathway Code
- (e) Carbon Intensity
- (h) The EPA fuel production company ID and facility ID as registered with the RFS program

Thank you for your consideration of WSPA's comments. We welcome any questions or comments you might have. Please contact me at (360) 352-4512 or by email Jessica@wspa.org.

Sincerely,

cc: Tom Umenhofer, WSPA

To: Cory-Ann Wind & Bill Peters, Air Quality Program, Oregon Department of Environmental Quality (ODEQ)

Re: Comments to the ODEQ on Point of Obligation Rule Proposal

March 17, 2017

Dear Cory-Ann and Bill,

Thank you once again for your consideration of our comments. In response issues discussed at the March 3, 2017 Clean Fuels/Low Carbon Fuel Standard Advisory Committee meeting, the Oregon Fuels Association (OFA) submits the following for your consideration:

Cost Containment/Long-Term Credit Price Spikes Proposal

OFA advocates for keeping the existing 10% deficit that a regulated party is currently able carryover to the next compliance year if they cannot meet their compliance obligation in the current year. The carryover provision is a key cost compliance measure to ensure that regulated parties have the necessary time to meet their obligation.

Point of Obligation OFA Rule Proposal

OFA appreciates the support we received at the March 3, 2017 Advisory Committee on our Point of Obligation rule proposal. You asked us to put some thought to three questions regarding our proposal, which we have done below:

Question 1: Is the Clean Fuels/LCFS deficit/obligation being passed down from the producer/importer today?

Answer: Anecdotal information suggests that parties are being given the option today of buying "obligated" or "unobligated" fuel by some companies, but this is not consistent and may change over time as compliance becomes more difficult.

Question 2: How should the DEQ account for uses of fuel that are exempt from the Clean Fuels/LCFS program?

Answer: This is very difficult for OFA members to track. There is little linkage between the party delivering the fuel and knowledge about the intended end use of the fuel.

Question 3: Is there any situation where a party below a fuel importer in the chain of delivery would want to take the fuel deficit/obligation with the fuel?

Answer: In the interest of easing both the administration of the program on the DEQ's side and for Oregon's small businesses, OFA advocates for the simple rule that the LCFS/Clean Fuels deficit could not be passed below the rack/terminal.

Thank you,

Danelle Romain & Paul Romain, Representing the Oregon Fuels Association

Mark Gram, Jubitz Corporation

Jeff Rouse & Blake Woodbury, Carson Oil Company

Ralph Poole, Campo & Poole Distributing LLC