



Western States Petroleum Association
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Vice President

September 22, 2016

Mr. Sam Wade
Branch Chief
California Air Resources Board
1001 I Street
Sacramento, California 95814

sent via email: samuel.wade@arb.ca.gov

Re: WSPA Comments on ARB July 29, 2106 LCFS Workshop Presentation

Dear Sam,

The Western States Petroleum Association (WSPA) is a non-profit trade association representing companies that explore for, produce, refine, transport and market petroleum, petroleum products, natural gas and other energy supplies in California and four other western states. WSPA appreciates the opportunity to provide feedback on the California Air Resources Board (ARB) proposed Low Carbon Fuel Standard (LCFS) pre-regulatory concepts presented at the July 29, 2016 ARB Workshop in Sacramento, CA.

WSPA is providing these comments as part of a continuous effort to provide feedback on the LCFS-related items presented by ARB. WSPA reserves the right to provide formal comments during the notice and comment period once ARB initiates the formal rulemaking process.

Addressing Buyer Liability

WSPA has consistently expressed concern with the “buyer beware” approach that has been taken in the LCFS regulations. WSPA continues to urge ARB to look to certain aspects of the Quality Assurance Program (QAP) implemented by USEPA under the Renewable Fuel Standard (RFS) as a useful template for its proposed third-party verification program. The QAP program provides a structured process under which independent third parties audit renewable fuel producers and the generation of associated RINs. The QAP program acts as a supplement to the existing “buyer beware” liability provision of the RFS by allowing regulated parties to purchase RINs audited under this program and providing an affirmative defense against liability for civil violations involving the use or transfer of invalid RINs that have been verified under an approved QAP.

The QAP serves a number of useful purposes, including adding regulatory stability and thereby promoting market transparency and liquidity, as well as shielding the innocent end purchaser from civil penalties for invalidated RINs. However, WSPA believes the QAP program does not go far enough in protecting innocent end purchasers as it utilizes a shifting liability scheme for replacement of invalidated RINs; in most cases thus far, the end purchaser has ultimately been responsible for replacing the invalidated RINs despite usually being several parties removed from the bad actor and having limited vetting ability.

WSPA believes that renewable fuel producers or importers that initially generate the credits are in a better position to verify the carbon intensity (CI) than end purchasers. WSPA appreciates ARB’s stated position that the low CI fuel producers or importers should be the initial parties responsible for invalidated LCFS credit

replacement. However if the renewable fuel producer or importer is insolvent (e.g., cases of fraud, which have constituted almost all RFS cases thus far), WSPA continues to urge ARB to include a provision for auditor liability. Further, to the extent LCFS credit replacement is required, the obligation to replace credits should be subject to a de minimis threshold similar to the 2% threshold provided in the federal Renewable Fuel Standard rules. Finally, in light of ARB staff's recent assertions that they intend to increase enforcement of the program, including for technical violations by renewable fuel producers, WSPA urges ARB to implement regulatory language to protect innocent purchasers of verified LCFS credits from being penalized for other parties' errors or malfeasance. . WSPA proposes that regulatory language be added immediately after § 95494 concerning affirmative defenses along the following lines:

§ 95494.5 Affirmative defenses.

(a) Asserting an affirmative defense for invalid LCFS credit: To establish an affirmative defense to a violation of the provisions of this subarticle involving invalid LCFS credits, the party must demonstrate all of the following:

(1) The LCFS credit in question was verified through a quality assurance audit pursuant to §XXXX using a CARB-approved verification protocol as defined in §XXXX.

(2) The party did not know or have reason to know that the LCFS credits were invalid at the time of generation, import transfer or use for compliance, unless the LCFS credit generator or importer replaced the LCFS credit pursuant to §XXXX.

(3) The party did not cause the LCFS credit invalidation.

WSPA also reiterates our previously stated position that any third-party verification should be mandatory to avoid creating a tiered credit market and the resulting pricing disparity that has been observed with the QAP program.

WSPA continues to believe that if all of these criteria are met, then buyers should be free from penalties for subsequently using invalid credits. We also suggest that ARB clarify in the regulation their intention to require that the entity whose error or intentional act created the credit shortfall be responsible for replacing the invalid credits. Explicit mention and clarity on this subject may encourage entities to act in a way to prevent these errors in the first place.

Reporting Reconciliation Differences

During the July 29, 2016 Workshop, the ARB staff presentation identified a focus on reporting reconciliation differences versus credit validation (termed as "misalignment"). WSPA believes that quarterly reconciliation gaps are more about disagreements about how the obligation has passed or whether a particular counterparty needed to report or not. These types of issues should be addressed through reconciliations and significant progress has already been made in that area.

Credit validity is a different issue and goes to whether the fuel was produced in a manner consistent with the parameters that yielded the approved carbon intensity value. Credits could be perfectly aligned in the reports, but still be invalid or inaccurate. In the ARB staff presentation, it was made clear that reconciliation differences account for a very small percentage of the overall volumes in the program. The focus of this rulemaking should be on CI verification. The necessary tools for resolving reconciliation differences are already in place.

Credit Transactions and Reporting

In Slides 55 and 56 in the ARB staff presentation at the Workshop, an extensive, rather complex explanation was made to clarify the credit reporting deadline which WSPA feels is a straightforward item. WSPA recommends that ARB clarify their initial credit reporting deadline recommendation by defining the deadline as simply business days (excluding weekends and holidays). Perhaps the term business day deserves a definition in the regulation for clarity.

Even if ARB streamlines their proposal as indicated above, WSPA continues to believe that even a well-defined three (3) business days (excluding weekends and holidays) is still too tight of a schedule. The current regulation gives the seller 10 calendar days to initiate transaction reporting. While we would prefer the clarity of establishing the deadline in terms of business days rather than calendar days, WSPA does not agree there is a compelling need to drastically shorten the time frame for reporting transactions. When the delivery date is prompt (i.e., not in the future), it takes the seller at least 5 business days to draft a confirmation, which confirms the terms of the deal (commercial terms plus other terms, like force majeure, invalidation, adequate assurance). WSPA prefers that the current transaction reporting regulatory language be retained without change. However, if ARB desires a change, WSPA recommends that ARB consider setting the credit reporting deadline at five (5) business days (excluding weekends and holidays).

We believe that transaction reporting and credit transfer initiation should be separate processes within the LRT-CBTS. Currently there is no valid way to manage future credit delivery in the LRT-CBTS. ARB had previously indicated that this functionality would be built into the LRT-CBTS, but until such time, the only way to comply with § 95487 of the regulation would be on a spot transaction basis.

WSPA proposes that, within the regulation's reporting deadline requirement, the seller should be obligated to report the transaction within the LRT-CBTS, yet the timing for the initiation of transfer of credits, whether prompt or for future delivery should be at the discretion of the buyer and seller.

Reporting Variation Threshold

WSPA supports a reporting variance threshold of 5% as a reasonable number which is consistent with MRR. It is further suggested that some minimum allowed CI delta be incorporated as well for fuels that are already very low in carbon intensity. WSPA recommends the following additional language: *"...5% or an allowance of 1-2 CI, whichever is greater."*

Critical Path Parameters

In general, critical parameters of the CI pathway should not be left at the discretion of the verifier working with the pathway holder. All new pathway approvals should include definition of the critical path parameters at the time of approval. For existing pathways, ARB should set a timetable for adding critical parameters to the pathway approval to help guide the verifiers in their task. Within the regulation, language should address the development of a monitoring plan that would include the critical parameters as part of verification.

Unique Credit IDs (UIDs) or Tracking Numbers

WSPA is supportive of the use of UIDs or tracking numbers in concept but in order for the program to work effectively the UIDs need to be visible in all scenarios. Our understanding is that under certain alternate proposals it is ARB's desire to keep UID's "invisible" in order to prevent certain credit types from being discriminated against. However, consideration is needed as to the wider effects of failing to provide UID visibility. Without UID visibility, the inability to trace, monitor, and perform appropriate due diligence and attendant risk of purchasing fraudulent credits, may increase transaction costs that could ultimately lead to the

market mechanism breaking down, which may in-turn leave compliance entities extremely reluctant to transact.

In addition to the broader UID visibility concerns, WSPA has questions at the operational level that need to be addressed to ensure an understanding of how UIDs work, including;

- How they are assigned and how they would move through the distribution system with the fuel?
- Are they at point of import rather than point of production?
- Will a tracking number be assigned to a "batch" or will each credit have a unique tracking number?

In summary, WSPA is concerned that absent UID visibility, the inability to trace, monitor and perform due diligence could significantly raise the overall costs of the program and may frustrate its ability to meet its planned objectives. Additionally, there is a need for more details at an operational level in order to fully understand how implementation would take place.

Know Your Customer

Consistent with the WSPA June 22, 2016 LCFS comment letter to ARB, WSPA continues to be opposed to the ARB "Know Your Customer" proposal. The regulated parties under the LCFS are not individuals, but companies. Determining the qualification of individual employees to act on behalf of the company is the job of the employer. Nevertheless, we appreciate ARB's efforts to provide an alternative means of complying (as presented in the July 29, 2016 Workshop) but believe further discussion needs to occur to address issues of privacy, confidentiality, and information beyond the needs of this regulation. ARB's proposed changes allowing for the information to be collected and housed by the individual's employer are an improvement but WSPA still considers the Know Your Customer provisions unnecessary and intrusive and opposes their inclusion.

Innovative Crude

WSPA supports the removal of the proposed ARB innovative crude change from consideration, at this time, in the regulation. We appreciate ARB staff's consideration of stakeholder input to this item and believe that the decision not to include the Innovative Crude amendment is appropriate.

Consistency with MRR Reporting and Verification

With regard to LCFS credit reporting and verification, WSPA believes that ARB should be as consistent as possible. We would like information to better understand exempted volumes under each approach (current LCFS and current MRR) to ensure that there are no significant differences. The requirements for third party verifiers (including training, availability, and conflict of interest) should be aligned between the two programs to the greatest extent possible as there should be no need to do things differently or to duplicate efforts.

Consideration of June 2nd ARB Proposal, 1st Alternative Proposal, and 2nd Alternative Proposal

In consideration of the three LCFS reporting and verification proposals presented in Slides 14 through 25 of the July 29, 2016 Workshop, WSPA has reviewed each of the three proposals and has the following comments, requests, and recommendations:

- While no proposal is without deficiencies, WSPA believes that a hybrid approach offers the best approach. Starting with the 2nd Alternative Proposal but building in quarterly volume reconciliation, annual credit verification, and the use of visible IDs is our preference.

- WSPA requests that ARB consider quarterly review of critical parameters for the initial credit generators (pathway holders) and importers. In evaluating this concept, ARB should provide some illustrative examples of what might be considered for inclusion in the critical parameter list of some existing pathways in order to allow participating parties to determine the time and possible cost required for this effort.
- WSPA is not recommending that LCFS credit release be delayed until the quarterly verification of critical parameters is performed. WSPA believes that the inclusion of this modification to the 2nd Alternative Proposal would significantly reduce concerns over the maximum length of time that may transpire before a potential issue requiring RIN invalidation is discovered and rectified (from a year to three months).
- WSPA suggested that Calendar Year 2018 be considered a "trial year" with verifications conducted but any "adjustments" or corrections in CI values for fuel pathways would be applied forward rather than backward. This should also provide ARB with sufficient time to complete the review of existing pathways for critical parameter inclusion into the quarterly verification plan

WSPA supports the intent to limit verification requirements for parties other than producers and importers to an annual basis. Annual verification for such parties should provide a reasonable level assurance – quarterly verification would have been excessively burdensome and substantially adds to compliance and transaction costs.

WSPA appreciates this opportunity to provide our input to this important regulation development. If you have any questions, please contact me at (805) 701-9142 or via e-mail at tom@wspa.org.

Sincerely,



cc: Jim Aguila - ARB (via e-mail: jim.aguila@arb.ca.gov)
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