Western States Petroleum Association
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Catherine H. Reheis-Boyd
President

June 19, 2015

Clerk of the Board, Air Resources Board
1001 I St., Sacramento, CA 95814
Via electronic mail to http://www.arb.ca.gov/lispub/comm/bclist.php

Dear Clerk of the Board,

Re. Proposed Re-Adoption of the Low Carbon Fuel Standard
Notice of Public Availability of Modified Text and Availability of Additional Documents and Information

The Western States Petroleum Association (WSPA) is a non-profit trade association representing twenty-five companies that explore for, produce, refine, transport and market petroleum, petroleum products, natural gas and other energy supplies in California and 5 western states.

Attached is a set of comments – both general and specific – that continue to concern WSPA. We support the inclusion of an additional Periodic Review of the LCFS in 2017. We are prepared to engage again next year, in advance of the 2017 review, in updating the data relative to the projected feasibility and health of the program.

If there are any questions or a need for additional clarification of our comments, please contact Gina Grey of my staff (ggrey@wspa.org) to arrange for further dialogue with WSPA.

Sincerely,

c.c. S. Wade – ARB

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
cathy@wspa.org ▪ www.wspa.org

Western States Petroleum Association's Comments on ARB's 15-day Notice of Public Availability of Modified Text and Availability of Additional Documents for the Amendments to the Low Carbon Fuel Standard Regulation.

General

WSPA believes that regulations should be based on sound science and free market principles, including a level playing field for all parties. Regulations should also include cost/benefit considerations and provide a clear and reasonable regulatory framework. Several elements of the amendments in the ARB's LCFS 15 day package do not satisfy these criteria; thus we respectfully request ARB revise this package to include these considerations.

Some of our core comments are presented below, with more detailed comments included in the following pages:

- WSPA continues to strongly object to the extremely limited accountability placed on electricity providers in generating LCFS credits. This is in dramatic contrast to the extremely rigorous application process and detailed record-keeping and reporting required on the part of liquid fuel suppliers and does not support the notion of a "fuel neutral" program as the LCFS is purported to be.

- ARB proposes several new and modified methods of credit generation, but with arbitrary and disparate effective dates. This seems to serve no purpose other than to favor one credit generation methodology over another. Staff should move immediately to align the effective dates of all applicable segments of the regulation (e.g., electricity, refinery investments, and innovative crude pathways) to ensure fairness in the treatment of compliance options.

- Credit accounting continues to be exceedingly complex, and the amendments in this 15-day package exacerbate these issues. With over 250 pathways approved by ARB, the lack of ARB oversight as to the validity of those credits and pathways, and a changing regulatory environment in which all fuel pathways must be recalculated using new model criteria, ARB cannot reasonably expect fuel suppliers to verify those credits with such an overly complex accounting system.

- Credit generation from light and heavy duty rail use is inconsistent with both the intent and the ISOR for the LCFS, and should be removed from the program.
  - The use of light and heavy duty rail existed prior to the implementation of the LCFS; as such, its use is not further reducing GHGs from the transport sector.
  - If ARB chooses not to remove these provisions, then ARB must account for such credits distinctly in ARB's quarterly summaries from other electricity credits so stakeholders can understand the contribution from these pre-existing sources.

- The Credit Clearance Market, in which deficit holders must participate, exacerbates an infeasible target, is not market-based, and does not provide the opportunity for fuel suppliers to evaluate the validity of credits. In addition, the publication of a list of Credit Clearance Market

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participants and each party's outstanding deficit obligation violates confidential business information practices. The inappropriate disclosure of this information has the distinct possibility of harming a given participant's competitive position in the market.

- It is critical that staff clarify the language in §95488 apparently prohibiting the sale of credits or fuel with obligation associated with new fuel pathway applications for up to two years. Staff has acknowledged that the currently proposed draft language does not represent what was intended and a very clear message must be issued to allow fuel producers some certainty.

- WSPA does not believe credits generated from the refinery investment credit provisions (as written) will contribute substantially to meeting fuel suppliers' compliance obligation. Despite some positive changes in the 15 day package, the characterization of these provisions as "pilot programs" and the significant barriers that still exist in the draft language substantively impede valid credit generation in apparent conflict with what ARB hopes to incentivize with the measure.

- ARB should not delete the multimedia evaluation provisions from the proposed regulations; to the contrary, ARB should be undertaking a multimedia evaluation for the LCFS as required by California Health & Safety Code. Multimedia evaluations are necessary in order to obtain a full and independent assessment of the range of potential environmental impacts of any newly proposed fuel regulations across all media. ARB's ADF multimedia evaluation and failure to undertake the required multimedia evaluation for the LCFS have not addressed the significant water demands associated with the production and use of biofuels under the LCFS, which may potentially exacerbate the severe drought California currently faces.

Specific

Revised Compliance Schedule

WSPA received confirmation from ARB staff that new compliance information will be provided to the ARB Board at the July 23rd hearing, and we'd like ARB to once again confirm that this information will be provided prior to the July hearing. Additionally, the revised compliance schedule is missing from the staff package. WSPA requests it be re-included.

Arbitrary Dates for Credit Generation

The LCFS reauthorization regulations contain multiple internal inconsistencies with respect to measuring CI reductions and the generation of credits. For example, even though the base year for measuring CI reductions under the regulations is 2010, the regulation as proposed uses refinery energy consumption data from 2011 through 2013 as the basis for estimating the petroleum refining process CI, rather than 2010 data.

Further, credit generation for fixed guideway systems and electric forklifts is permitted without regard to when these projects began operation. Yet, energy efficiency improvements implemented in petroleum refineries between 2010 and 2016 cannot generate credits, despite the fact that they have reduced the CI of the products.

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Innovative crude production credits are available for solar steam and carbon capture and sequestration (CCS) projects that became operational as early as 2010, but are not available until January 1, 2015 for all other innovative crude production projects. There appears to be no consistency in the regulation's various segments as to a common date threshold of eligibility for credit generation.

The following chart illustrates this observation:

Element	***Proposed Code Section***	***Effective Date After Which Credits Can Be Generated***
Fixed guideway systems	95483(e)(6)	No threshold for eligibility—credits can be generated regardless of when operation began
Electric forklifts	95483(e)(7)	No threshold for eligibility—credits can be generated regardless of when operation began
Solar steam and CCS projects	95489(d)(1)(B)	2010
All non-solar steam and carbon capture and sequestration innovative crude projects	95489(d)(1)(B)	2015
Low-energy intense refineries	95489(e)(4)(B)	2015
Refinery investment credits	95489(f)	2017 (Permits received by 1-1-2016 –projects take at least 1 year to construct)

It is well-settled under California law that "logic and reason demand that [an] agency explain the basis for its decision." *McBail & Co. v. Solano County Local Agency Formation Com'n* (1998) 62 Cal.App.4th 1223. During the rulemaking process, an agency must provide a rationale for the elements of the proposed regulations; to be valid, regulations must be consistent. *Harris Transportation Co. v. Air Resources Board* (1995) 32 Cal.App.4th 1472, 1479; *see also Voss v. Superior Court* (1996) 46 Cal.App.4th 900, 916.

Federal courts agree that "an internally inconsistent analysis is arbitrary and capricious." *National Parks Conservation Association v. EPA*, Case No. 12-73757 (9th Cir. June 9, 2015), *see also Gen. Chem. Corp. v. United States*, 817 F.2d 844, 857 (D.C. Cir. 1987). An agency cannot simply mandate key elements or formulas within a regulation without an explanation of the basis for that decision. *National Parks Conservation Association, at *15-16*. Instead, an agency must explain the basis for exercising its discretion to craft a regulation in a particular manner; failure to do so will render the regulation invalid as arbitrary and capricious. *Id. at *17*.

But here, ARB proposes an internally inconsistent regulation with no explanation regarding the selection of incongruous dates to serve as the bases for credit generation for certain elements of the

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regulation. WSPA objects to this level of inconsistency between elements and proposes that ARB adopt consistent dates for credit generation across the board. At the very least, ARB must offer its basis for the existing inconsistency between dates.

California Reformulated Gasoline and Ethanol Denaturant Calculator Spreadsheet
WSPA understands staff has made changes to the California Reformulated Gasoline and Ethanol Denaturant Calculator Spreadsheet since it was last posted. Since this spreadsheet is used not only to calculate the new baseline CaRFG values but also the new ethanol CI values, WSPA requests that the final version of this spreadsheet be posted for public review.

§ 95481.(a) Definitions
(9) "Biodiesel Blend" - The term "biodiesel blend" is not used anywhere in the LCFS regulation outside this section. The definition should be deleted.

(63) "Petroleum Product" - It is inappropriate to include co-processed biomass in the definition for "petroleum product." Staff should consider a broader term like "refinery product" to avoid confusion.

(67) "Product Transfer Document" - We continue to object to the redefining of "product transfer document" as a single document consolidating information from existing documents. This term should follow the traditional definition to allow flexibility for regulated parties.

(71) "Renewable Hydrocarbon Diesel" – we would prefer the definition include a reference to "elemental composition primarily of hydrogen and carbon". We also have concerns with the definition indicating that a fuel additive may be defined as "Renewable Hydrocarbon Diesel" as currently written.

Suggested language:

(71) "Renewable hydrocarbon diesel" means a diesel fuel that is produced from nonpetroleum renewable resources but is not a mono-alkyl ester, with an elemental composition primarily of hydrogen and carbon, and which is registered as a motor vehicle fuel under 40 Code of Federal Regulations Part 79.

§95483 (a)(2)(A-D). Regulated Parties
We are opposed to the deletion of this section and the associated edits in this section.

Striking a significant block of language related to the identification of regulated parties under the LCFS as part of a 15-day package, with no prior discussion of the change in the many workshops on the LCFS re-adoption, is arbitrary and capricious. Furthermore, this change does not add value to the program and does not address any issues with current compliance. What it does do is introduce an element of risk into compliance by removing the automatic transfer of obligation between regulated parties as product moves through the distribution system upstream of the terminal rack. Summarily removing this language increases the risk of discrepancies between the reports of regulated parties and unnecessarily complicates the nature of transactions between regulated parties. While staff characterizes this as "an unnecessary and complicated provision" in their explanation of the proposed change, the time to address such an issue would have been at the establishment of the program, not several years after the regulated community has developed business processes based upon the provision.

§95483. (e)(2), (e)(3)(A), (e)(3)(B), (e)(4), (e)(5)

As WSPA has stated numerous times in the past, we strongly oppose ARB's electricity provisions, and continue to propose that electricity NOT be part of the LCFS program. ARB should account for the GHGs from electricity separately and reduce the compliance obligation within the LCFS proportionally based on ARB's anticipated success of the roll-out of electric vehicles (EVs).

In addition, we have new concerns specifically related to changes in the 15-day proposed rulemaking package. In general, WSPA feels these changes:

- Are substantive and should not be included in a 15-day regulatory package,
- Are not explained or justified in the Notice of Public Availability,
- Exasperate the un-level playing field for electricity providers, by further reducing their public accountability, recordkeeping, and metering requirements.
- Increase concern regarding validity of credits generated from the electricity sector, and the decreasing amounts of due-diligence and reporting required by providers of electricity as a "transportation fuel".
- Are not clear in regards to whether anyone will make sure there is a true accounting of credits generated from electric vehicle charging.
    - If electricity providers are generating credits from residential charging from registration records and average electricity demand, will ARB subtract credits generated from private / workplace charging?
    - From fleet charging?
    - From public charging?

WSPA strongly opposes the following 15-day changes related to §95483(e) provisions:

1. ***Removal*** of the requirement that Electrical Distribution Utilities to "Use all credits proceeds to benefit current or future EV customers" (§95483(e)(1)(A)) from credits generated from public access charging, EV Fleets, or private EV charging (§95483(e)(2 - 4)). We urge ARB to correct the following reference in all parts of §95483(e) from:
   "must meet the requirements set forth in section 95483(e)(1)(B) through (D)."

   To:

   "must meet the requirements set forth in section 95483(e)(1)(A) through (D)."
2. Under §95483(e), ARB's modifications make the electric distribution utility the default credit generator in essentially all EV charging cases. This approach could have the consequence of the utilities using their power to restrict innovation and experimentation within the electric vehicle charging industry. Instead, ARB should allow the market and customer choice to guide development by allowing companies installing electric vehicle charging stations to generate credits by default.
3. Removal of the list of efforts that may be used to educate the public in 95483(e)(1)(B).
4. Removal of the requirement that ARB post supplemental information for public review each year.

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5. The modification to allow investor owned utilities to use Public Utility Commission reporting in lieu of LCFS specific supplemental information.

Furthermore, technology exists to directly measure residential EV electricity use and therefore should be required, consistent with recordkeeping required for other LCFS pathways. We incorporate by reference our February 2015 comments on the electricity provisions in our response to comments for the 45-day rulemaking package.

Combined, these proposed modifications further reduce the standards that electricity providers are held to, as compared to liquid fuel providers. As WSPA has stated in the past, there is also a fairness issue. Liquid fuel providers are expected to submit extremely detailed records for reporting and comply with extensive application processes for obtaining a CI pathway (and the record-keeping requirements for some pathways). The proposed reduction in accountability and reporting requirements for electricity providers, combined with the "estimates" of electricity used for residential charging, does not support the notion of a "fuel neutral" program, and provides inconsistent treatment at best.

In addition, it is not clear from the proposal whether a proper accounting of total credits from electric vehicle charging will be performed by ARB.

§95485. Demonstrating Compliance (Cost Containment Mechanism)

WSPA's concerns regarding the Cost Containment Mechanism (CCM) contained in the LCFS re-adoption package remain, as the proposed 15-day package revisions do not implement any substantial modifications to address the previously-raised concerns regarding this tool's ability to accommodate systemic and prolonged LCFS credit shortages. WSPA remains opposed to the inclusion of the CCM in the LCFS because we do not believe that it will accomplish its stated objective (contain prices) and will instead have a number of undesirable (and unintended) consequences. More specifically, the Credit Clearance Market (CCM):

Offers no certain path to retire carryover deficits

The CCM provisions in the LCFS re-adoption package (post the proposed 15-day package revisions) continue to obligate parties to participate in the year-end credit clearance market at prices as high as the pre-determined "cap" price and parties have no recourse but to carry over any remaining deficit into the following year with interest. The CCM provisions stipulate a five-year maximum deficit carryover period but no specific pathway to retire deficits if shortages persist year to year. Instead, obligated parties face the prospect of an ever-increasing accrued financial liability that is essentially outside their control. In a market that is consistently short credits year after year, the ability to defer unsatisfied obligations (with interest) offers little comfort to the regulated community who remained concerned with the possibility of ever-increasing deficits with no method to retire part of the obligation generated by an infeasible standard.

May drive credit costs up

The CCM provisions in the LCFS re-adoption package (after the proposed 15-day package revisions) may not keep credit prices in check during periods of rising prices (i.e., credit shortages in the open market). The CCM to clear the market at the end of the year is meaningless during a credit-short environment as there will not be any remaining credits to be brought to the table by sellers. The

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compounding of interest on the carryover/deferred balances will make it likely that credit buyers will soak up the available pool of real LCFS credits in the market during the year and not wait for the CCM. The pool of real LCFS credits available is fixed – it is only their price that remains in question. Staff's setting of the price cap at $200/ton will likely serve as the benchmark for credit prices in that environment.

Conversely, during periods of stable or declining prices (i.e., credit surplus in the open market), the CCM cap price creates an artificial "floor" value below which sellers may be hesitant to offer real LCFS credits for sale to the regulated community at substantially lower prices. This may artificially increase compliance costs – as credit prices could be artificially raised to (or near) the ARB cap with the likely result of fewer transactions taking place before the end-of-year sale. Credit trading could be seriously impaired as the open market may not be allowed to function as it should.

Provides no liability protection against invalid credits

The LCFS re-adoption package (after the proposed 15-day package revisions) continues to lack an acceptable liability defense provision or protocol to protect obligated parties from potentially fraudulent credit sellers. The only protection buyers of credits have is to perform due diligence and carefully screen the parties they choose to engage as partners in LCFS credit-buying transactions. It appears that buyers will not be afforded this luxury in the credits they are obligated to purchase (pro-rata share) through the CCM. Moreover, the timetable being put in place by ARB to organize and complete the CCM does not give parties comfort that the agency will be doing any such screening of the credits that are pledged by sellers for the CCM. WSPA objects to the fact that parties may potentially wind up in a position of non-compliance through no fault of their own simply because there is a credit shortage and buyers need to participate in the CCM where they have no control over what credits they buy and from whom.

Offers no connection to LCFS program sustainability

LCFS credit market liquidity (measurable potentially through a number of different indicators) is not only essential to the program's success but, also, the absence of such liquidity (as evidenced through the CCM) should be viewed as a clear signal that the program's CI reduction targets are overly aggressive and that the regulated community is finding it difficult to meet its obligations and remain in compliance. There is no connection in the CCM provisions of the
LCFS re-adoption package (after the proposed 15-day package revisions) to bring about a comprehensive program review should the potential trend of systematic credit shortages materialize and persist.

Does not clarify the mechanics of deficit carryover

The CCM provisions of the LCFS re-adoption package (after the proposed 15-day package revisions), while improved over the initial ISOR version, remain lacking in the execution/implementation details that would allow parties to understand exactly how the CCM would work. We recognize that staff has added some clarification to indicate that parties cannot retire accrued previous years' obligations until they have satisfied (met) their obligation for the immediately previous year. Staff has also included clarification of when the interest on accumulated carryover obligations will occur (i.e., in May each year prior to the start of the CCM in June).

1415 L Street, Suite 600, Sacramento, California 95814
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While this seems to be pointing to a Last-In-First-Out (LIFO) accounting method, it does not explicitly indicate how older obligations are to be addressed. For example: Can parties retire (through blending or purchases) obligation carryover from four years ago before they retire corresponding deficits carried over from two years ago? Moreover, the application of a LIFO method (if indeed that is staff's intent) appears punitive in that it would maximize the accrued interest on obligation deficits carried over from previous years. We emphasize that such obligation carryovers could occur through no fault of the parties (i.e., even after they have made every best faith effort to cover their annual obligation) and find it objectionable that, not only will there be an interest penalty levied for carryovers through the CCM, but that this penalty will be maximized by not allowing the oldest obligations to be retired first.

Furthermore, while we understand at what point during the year the interest will be levied (i.e., in May), we are uncertain as to whether the immediately preceding year's unmet obligation will also be included in the calculated interest. We do not believe that should be the case as parties should be given the opportunity to cover an additional part of any such remaining obligation from the immediately preceding year through the CCM. We believe this to be staff's intent but request clarification that interest will be applied the May following the Credit Clearance Market or one year after the initial annual report is submitted. We propose the following language for section 95485. (c)(5)(A):

(A) Compound Interest on Accumulated Deficits. Regulated Parties with an Accumulated Deficit will be charged interest to be applied annually to all deficits in a regulated party's Accumulated Deficit account. Interest will be applied in terms of additional deficits that must be retired pursuant to section 95485(c)(1)(B), above, at a rate of 5 percent annually, applied May 1, 20XX, where 20XX = compliance year +2.

Based on the proposed 15-day package revisions, the criteria and conditions for retiring deficit carryovers in paragraph 95485(c)(5)(C) appear confusing in that they could be interpreted to limit a regulated party's ability to retire older deficits through the CCM. While we disagree with staff's apparent selection of the LIFO credit accounting method as indicated above, we would like staff to explicitly indicate their intent that regulated parties can buy more credits from the CCM than their immediate prior year's obligation shortfall as long as: a) they have used up all their accumulated credits and still have a carryover balance from years other than the immediately preceding year, and b) they first retire their immediate prior year's obligation through the credits obtained through the CCM.

Additional comments on specific provisions under the CCM are as follows:

§95485. (c)(4)(B)

WSPA continues to strongly object to ARB publishing a list of Credit Clearance Market participants and each participating party's pro-rata share of pledged credits, and WSPA feels ARB's decision to list this information without any explanation or basis is arbitrary and capricious. LCFS credit and/or deficit balances and the individual entity names should be treated as highly confidential business information because the release of this information could adversely impact business operations. This proposal to make public the long and short credit positions of regulated parties violates the principles underlying protection of confidential business information. A regulated party's competitive position could be seriously compromised by the publication of this information. In addition, this information would give competitors both an understanding of a regulated party's compliance strategy and a view

into the regulated party's fuel and credit acquisition activity for the year. Using this information and average market pricing, one could estimate the financial impact of LCFS compliance on a regulated party. It is well-established that this information is protected from disclosure under California law, and ARB should treat it as the highly confidential information it is. *See, e.g,* Cal. Gov. Code § 6254; Cal. Evid. Code §1060.

§95485. (c)(5)(D)
WSPA understands ARB is proposing to prohibit entities that have a roll-over deficit under the credit clearance approach from transferring/selling credits to another party until the deficit is "paid back." WSPA understands this prohibition is only intended to apply to "separated" credit transactions and not to the transfer of obligation with physical fuel. We are requesting that ARB confirm this in writing. WSPA still requests clarification that the prohibition on credit transfers and sales does not include credits attached to biofuels that move by default in the transactions. This could be handled in a response to comment or guidance.

§95486. (a)(4)(B)(4)(b) Generating and Calculating Credits and Deficits
WSPA supports ARB allowing regulated parties to use Carryback Credits to minimize any compliance shortfalls.

Section 95486(c) - Credit Generation Frequency. Beginning 2011 and every year afterwards, a regulated party may generate credits quarterly after data are reconciled with its business partner.

WSPA believes the new proposed language is unworkable in its current form. WSPA supports the goals of staff of accurate reporting, and we support the new reporting provisions requiring an initial report followed by a 45 day reconciliation period. Section 95491 Reporting and Recordkeeping (a)(1)(A) calls for reporting parties to "work in good faith with their counter parties to resolve any fuel transaction discrepancies between the parties". WSPA supports this but notes this does not ensure there will not be any discrepancies between reporting parties. To be consistent with section 95491, WSPA believes the language of 95486(c) should be modified to state (proposed change in red):

> (c) Credit Generation Frequency. Beginning 2011 and every year afterwards, a regulated party may generate credits quarterly after ~~data are reconciled with its business partner.~~ the quarterly report has been submitted in the LRT. Regulated parties shall **make a good faith effort to** reconcile their data with their business partners before submission.

§95487. (c)(1)(B) Credit Transactions - Confidentiality
ARB proposes to remove the following language from the regulation:

> "Except as provided in section 95487(d) below, the Executive Officer will treat information submitted in the online Credit Transfer Forms as Confidential Business Information."

WSPA objects to ARB's removal of the language and requests that it be reinstated. Protection for such information is well-established under California law. Pursuant to the Government Code, such confidential business information is excluded from responses to Public Records Act requests. *See, e.g,* Cal. Gov. Code § 6254; Cal. Evid. Code §1060. This information has always been designated as Confidential Business Information under the LCFS, and ARB has provided no explanation as to why it

should be classified differently as part of this rulemaking. Removal of this language without explanation is arbitrary and capricious, and ARB must continue to fulfill its statutory obligation to protect such information from disclosure. Accordingly, WSPA requests that the stricken language be added back into section 95487(c)(1)(B).

§95488. (a)(3) Obtaining and Using Fuel Pathways.

During the original revisions to the LCFS re-adoption, released in December, 2014, there were apparently significant revisions to Section 95488 relating to Provisional Pathways. The 15-day package released in June of 2015 further revised this section by including Tier 1 pathways. While the regulation does say that "Based on timely reports, the applicant may generate provisional credits", it also says, "such credits may not be sold, transferred, or retired for compliance, nor may fuel with a provisional CI be transferred with obligation." The revised regulation also goes on to say that "The applicant may not sell credits generated under a provisionally-approved pathway, or transfer the provisional fuel with obligation, until the Executive Officer has adjusted the CI or informed the producer that the provisional CI has been successfully corroborated by operational records covering a full two years of commercial operation".

Upon becoming aware of this revision (with respect to the addition of Tier 1 pathways in the 15-day package as well as the original language apparently revised in December 2014), understandable concern was raised by fuel investors and compliance entities alike as this section could be interpreted to mean that start-up facilities and pathways cannot sell credits or sell fuels (with an obligation) until they have operated for 2 full years. Obviously if this interpretation were to hold, this section of the regulation would significantly undermine the innovation that the LCFS itself seeks to encourage. Few, if any, plants or new pathways would be economic if they were not able to sell credits – or sell fuel with obligation– within the first 2 years of operation – a critical time period in the lifetime of a new operation. An Argus article dated June 11 discussed the potential impact of these revisions on the market as follows:

> *The point of the program is to help commercialize new low-carbon fuels, but the provisional credit provision creates two years of uncertainty for affected producers unless they are comfortable with waiting up to two years before they can sell the credits and bank their cash value.*
>
> *The regulations could lock up significant amounts of credits or actual fuel supplies from new conventional low-carbon fuel producers, said Philip Sheehy, a technical specialist at consultant ICF. Credit prices could rise up to near the program's price cap of $200/t in 2018 or 2019, according to recent ICF forecasts that account for the provision credits system.*

In subsequent conversations, staff acknowledged that this section of the regulation was poorly drafted and that it is not the intent of the regulation to prohibit generation of credits or sale of fuels from start-up operations. It is crucial that staff <u>immediately</u> clarify the language of this section of the regulation by an appropriate mechanism. It is critical that both investors and regulated parties clearly understand the intent of this section of the regulation.

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
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§95489. Provisions for Petroleum-Based Fuels (Refinery Investment Credit and Hydrogen Co-processing)

WSPA's primary concern throughout the process of developing the specific provisions and eligibility criteria related to the refinery investment credit and hydrogen co-processing provisions has been that the stringency of the provisions and criteria not be so restrictive that no projects will be eligible to generate credits. Most of the changes WSPA recommended leading up to the February Board meeting and in subsequent discussions with staff on the 15-day package were aimed at preserving the ability to generate credits from eligible projects.

Staff has made some improvements in addressing our comments consistent with the idea that more projects will be eligible. Unfortunately, some provisions remain problematic despite the changes CARB has proposed; and CARB has added new provisions that go in the wrong direction with respect to enhancing opportunities for project eligibility.

Improvements in the Proposal

- We appreciate staff's revision to allow potential criteria pollutant and/or toxics increases associated with candidate projects to be offset as provided in the applicable project permitting requirements. This was one of the key changes WSPA had identified as necessary to make the proposal viable and equitable.

- WSPA is also in agreement with staff's decision to remove the proposed 50% discount for any credits generated by "less efficient refiners," as the methodology employed was rather arbitrary and had the potential to discriminate against complex refineries or penalize refineries that may have made prior investments in GHG reduction projects.

- WSPA also appreciates staff's decision to reduce the 10% bio-feedstock minimum in the Hydrogen Co-processing provision which should make it more likely for such projects to move forward.

Provisions that were not Sufficiently Addressed

- Staff did not act to avoid other arbitrary restrictions and thresholds to encourage innovative GHG reductions, most notably the 0.1 gCO2e/MJ minimum CI improvement for RIC project eligibility. This remains an inequitable provision as the standard will be much more difficult to meet for larger, fully integrated refineries. WSPA continues to maintain that supplementing this standard with an alternative flat 5,000 metric ton of CO_2e per year project impact threshold would allow more credit generation without unduly burdening staff with an overwhelming number of applications involving small projects.

- While we are well aware of staff's unwillingness to provide retroactive credit for projects that have already started up (even if the start date was after the start of the LCFS program), we are completely puzzled by staff's refusal to implement a simple, practical and equitable criterion for project eligibility pivoting off the project's start date, i.e., the date GHG reduction benefits

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cathy@wspa.org ▪ www.wspa.org

begin to accrue. We also highlight the potential unintended adverse impact that the current criterion (permit to construct issued after January 1, 2016) might have on projects currently underway in that it could provide an incentive to delay such projects and potentially withdraw/refile permit applications to ensure that the permit to construct is not issued before January 1, 2016 (rendering the project ineligible for RIC credits). We believe that this was not staff's intent. WSPA continues to maintain that staff's proposed RIC eligibility criteria penalizes early actors.

As stated above, WSPA feels the base year should be consistent across all elements of the LCFS. However, at a minimum we recommend that, if staff wants to utilize the permit to construct data issuance (instead of project startup date) as the eligibility threshold, at a minimum staff should utilize January 1, 2015 as the associated date and not January 1, 2016.

- Lastly, WSPA notes staff's reiteration in the LCFS 15-day package of the earlier attempt to differentiate RIC candidate projects based on whether they are capital projects or part of routine refinery turnarounds and/or maintenance. We remain uncomfortable with the lack of specificity of the proposed language that calls for identification of the primary purpose or intent of a candidate project. We continue to believe that non-capital projects that offer sustained GHG improvements should be included since many energy efficiency upgrades are considered non-capital and may be part of a multi-pronged refinery strategy to simultaneously upgrade equipment for improved reliability, reduced maintenance and enhanced energy efficiency. Such projects could include shutdowns (i.e., replacement of a fired heater with heat exchangers) and should not be excluded from generating a credit. Staff should clarify that projects whose primary intent is increased energy efficiency but involve equipment shutdowns are not excluded.

New Provisions or Changes that are Problematic

- Staff has removed entirely the ability to generate RIC credits from co-processing liquid bio-feed stocks at facilities, leaving Hydrogen co-processing as the only viable option available to some. While the opportunity to seek dedicated pathway approvals for such applications is still provided, staff's action eliminates substantial flexibility for parties' smaller scale projects/applications that may not warrant the dedication of time and resources to the rigors of the specified pathway approval processes.

- WSPA is disappointed with staff's apparent "change of heart" regarding the RIC as evidenced by staff's recasting of this provision (as well as the Hydrogen Co-processing provision) as "pilot programs" designed to allow staff "time to evaluate the credit potential from these provisions and prevent any unanticipated impacts, if the volumes outstrip current expectations."

  In WSPA's view, this is a fundamental change in staff's approach to what had been a significant part of the LCFS 45-day proposal– one that was discussed extensively during the nearly year-long workshop process leading to the February Board hearing and one that our industry had invested extensive time and resources to ensure it is a workable and practical provision. The implication of a pilot program designation is one of potentially temporary

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
cathy@wspa.org ▪ www.wspa.org

provisions that may be terminated in future program revisions. This leaves our industry with uncertainty as far as proceeding with the necessary investments to implement GHG reduction projects at facilities where projects may be consistent with what was perceived as the original intent of including the RIC provision in the LCFS.

- Further evidence of staff's concern in this regard can be found in the implementation of largely unsubstantiated "caps" on the potential contribution from the RIC (at 20% of a regulated party's annual credit obligation) and the Hydrogen Co-processing provision (at 10%) whose sole purpose appears to be to provide further "insurance" that our industry could not actually rely on these provisions for anything more than a small percentage of the overall compliance obligation. Such an approach is inconsistent with the concept of 'neutrality" that staff (and the Board) have reiterated upon numerous occasions involving the variety of LCFS compliance options available to regulated parties. .
- The RIC and Hydrogen Co-processing provision included in the LCFS 15-day package go even further in curtailing the practical utility of these provisions in limiting the ability of a party that generates such credits to do anything other than use them for their own compliance purposes, (i.e., prohibiting the sale of such credits in the marketplace).

  We understand that this may not be staff's intent and that this flexibility-limiting provision may be simply the result of limitations in staff's ability to bring about the necessary LRT revisions in a timetable consistent with the LCFS re-adoption schedule. Nevertheless, WSPA once again needs to point out the rather arbitrary application of "neutrality" in that other eligible credit generating mechanisms in the regulations (e.g., electricity) are not limited in the volume of credits that can be generated, or in their ability to participate in the credit markets.

Despite some improvements made by staff in the 15-day package, WSPA still believes that the current proposal substantively impedes valid credit generation in conflict with what ARB hopes to incentivize with the measure. These impediments not only manifest themselves as direct limitations to the quantity of credits that can be generated, but also by creating uncertainty that erodes credit generation prospects. As a result, few, if any, credits are likely to be generated from the provision as written – particularly while the provision remains a "pilot" program.

§95490. Multimedia Evaluation

WSPA strongly disagrees with ARB's decision to completely eliminate the multimedia evaluation provisions in section 95490, as well as the proposed elimination of the definition of "multimedia evaluation" from section 95481(a)(59) and the proposed deletion of the application requirements related to multimedia evaluations in section 95488(c)(4)(G)6.d.

WSPA also strongly disagrees with ARB's statement, in its Notice of Public Availability of Modified Text, that the LCFS "does not establish any fuel specifications." *Notice of Public Availability at 9.* As discussed in our February 17, 2015 comments on the proposed regulations, carbon intensity as established by the LCFS is a criterion or "specification" to which motor vehicle fuels must comply. The Health & Safety Code itself recognizes a fuel specification for light-duty vehicle exhaust emission standards—standards that, like the LCFS, are based on overall emissions from fuels as opposed to quantification of their particular components. Cal. Health & Safety Code § 43018(d)(1). Even the Ninth Circuit has already considered the LCFS to be a fuel control measure. *See Rocky Mountain*

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
cathy@wspa.org ▪ www.wspa.org

Farmers Union v. Corey, 730 F.3d 1070 (9th Cir. 2013) (recognizing that the LCFS is "a control respecting a fuel or fuel additive and was enacted for the purpose of emissions control").

ARB should not delete the multimedia evaluation provisions from the proposed regulations; to the contrary, ARB should be undertaking a multimedia evaluation for the LCFS as required by California Health & Safety Code. Multimedia evaluations are necessary in order to obtain a full and independent assessment of the range of potential environmental impacts of any newly proposed fuel regulations across all media. ARB has enough information regarding the types and blends of fuels that will likely be used to meet the LCFS to conduct a multimedia evaluation for the regulation.

Given the severe drought conditions California currently faces, the multimedia evaluation must take into account the significant water demands associated with the use of biofuels, which are outlined in more detail in the peer-reviewed study by Julian Fulton of the Energy and Resources Group at U.C. Berkeley and Heather Cooley of the Pacific Institute. The multimedia evaluation for the ADF regulations fails to evaluate these potential impacts.

The LCFS' carbon intensity fuel specifications stand to promote the use of multiple types of fuels that have not been fully evaluated for potential water impacts. As Fulton and Cooley note:

> "California's Low Carbon Fuel Standard…has reinforced demand for bioethanol as a means to reduce the greenhouse gas intensity of transportation fuels. Although early LCFS policy assessments raised the issue of water demands and impacts from increased biofuel production, any subsequent efforts to track or address those impacts through policy have been lacking." Fulton and Cooley, The Water Footprint of California's Energy System, 1990-2012 (February 26, 2015) at 10.

The potential for significant impacts makes a multimedia evaluation for the LCFS all the more critical. The evaluation should be completed as soon as feasible to comply with the Health & Safety Code.

§95491. Reporting and Recordkeeping - Table 12

- WSPA recommends that the requirements for ARB in determining the annual average crude carbon intensity be included in Table 12.

§95491(a)(7) Reporting and Recordkeeping

We object to the removal of annual reports from the section related to Correcting a Previously Submitted Report. There may be instances in which an annual report may also need to be re-opened for corrective edits and resubmittal. The removal of annual reports from this section essentially dis-allows regulated parties to correct previously submitted annual reports.

§95494. Penalties

As discussed in WSPA's comments of February 17, 2015, WSPA opposes a per-day penalty, but does not oppose a maximum penalty of $1000 per tonne of deficit. While AB 32's enforcement provisions provide for per day penalties when a violation results in the emission of an air contaminant, where, as here, no actual emission of air contaminant is occurring on a per day basis, the imposition of such a penalty would be unjustifiably punitive, excessive and onerous. *See* Cal. Health & Safety Code §§

42400.1, 42400.3. A per deficit penalty approach is authorized by the Health & Safety Code. *See* Cal. Health & Safety Code § 38580(b)(3).

The proposed changes to section 95494(c) appear to embrace a per-deficit penalty, but the vague language needs to be clarified. The proposed language currently reads:

> "Each deficit that is not eliminated at the end of a compliance period or carried over as permitted by section 95485 constitutes a separate day of violation, subject to a penalty not to exceed $1000 per deficit."

The addition of the words "day of" essentially turns the per deficit penalty into a per-day penalty for each deficit, which WSPA strongly opposes as unduly onerous and unjustifiably excessive —all the more so because ARB has removed regulated parties' ability to request that their annual reports be re-opened for correction. WSPA suggests the following language be adopted:

> "Each deficit that is not eliminated at the end of a compliance period or carried over as permitted by section 95485 constitutes a separate ~~day of~~ violation, subject to a penalty not to exceed $1000 per deficit."

§95495. Defining "Material Information"

Including in the definition of "material Information" "information that would affect by any amount the Executive Officer's determination of a carbon intensity score…" potentially broadens ARB's authority to suspend, modify, or revoke credits. As discussed in WSPA's February 17, 2015 comments, the regulations penalize credit holders if they hold invalid credits, even if that occurs despite a regulated party's best efforts to hold valid credits. ARB may not require entities to participate in the credit scheme without providing some level of certainty that credits validly represent the reductions they purport to represent. *See* Cal. Health & Safety Code § 38562(d)(1) ["Any regulation adopted by the state board pursuant to this part or Part 5 [market-based compliance mechanisms] shall ensure all of the following: (1) The greenhouse gas emission reductions achieved are real, permanent, quantifiable, ***verifiable***, and enforceable by the state board …"] [emphasis added].

An appropriate definition of "material information" as used in the subsection would help to minimize the risk of arbitrary invalidation by limiting the bases for invalidation under proposed section 95495(b)(1). WSPA therefore requests that section 95495(b)(1)(G)1 be stricken from the regulation.

§95496. Regulation Review

Assuming continuation of the LCFS program, we support the addition of a 2017 Progress Report on the LCFS to the ARB Board and the inclusion of public review of the Progress Report findings.

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 ▪ Fax: (916) 444-5745 ▪ Cell: (916) 835-0450
cathy@wspa.org ▪ www.wspa.org