



Via E-mail

Bob Fletcher
Division Chief
Stationary Source Division
California Air Resources Board
1001 I Street
Sacramento, CA 95812
rflatche@arb.ca.gov

Re: *Valero Energy Corporation Comments for Draft Low Carbon Fuel Standard (LCFS) Regulations*

Dear Mr. Fletcher:

Valero Energy Corporation (Valero) is providing to the California Air Resources Board (CARB) its comments relative to CARB's Draft LCFS Regulations (released October 10, 2008). Valero owns and operates through its subsidiaries the Valero Benicia and Valero Wilmington Refineries. The Benicia Refinery produces approximately 25% of the clean-burning transportation fuels for the Bay Area market and the Wilmington Refinery produces approximately 14% of the clean-burning transportation fuels for the Southern California market. Statewide Valero produces approximately 17% of the clean-burning transportation fuels for California.

Through the many public workshops, expert groups, and individual stakeholder meetings both before and after the adoption of AB 32, Valero has worked cooperatively both individually and through the Western States Petroleum Association ("WSPA") with CARB staff to identify and address its many concerns with AB 32, Low Carbon Fuel Standard ("LCFS"), and the AB 32 Scoping Plan. It is Valero's view that if we are to succeed in meeting the very ambitious AB 32 goals, we will need to remain focused on some core principles. For Valero, those principles include:

- Ensuring California's program is in harmony with whatever new federal climate program is ultimately adopted as well as with current federal and California legal requirements;
- Regulations and required technologies are technologically feasible and well-supported in the record;
- Programs are well-evaluated in the record and demonstrated to be cost effective;
- Programs promote innovation;
- Utilizing the best available science, economics and technical analysis in designing the program, as required by AB 32 and other applicable California and federal laws;
- Market mechanisms, such as a well designed cap and trade strategy are a significant part of the ultimate program; and

- Safeguards to ensure that as the Scoping Plan and LCFS Regulations are developed and implemented such that California will have adequate, reliable and affordable supplies of energy, including electricity, heat and transportation fuels.

Specifically, as to the Draft LCFS Regulations, Valero provides the following comments, which fall into the following categories:

- In Attachment 1, we have made specific comments (in italics) to clarify the regulations and make them more workable based on the principles enumerated above. We have also provided comments to issues raised by CARB staff that were solicited in the draft regulations.
- As provided below, we have some general comments concerning the Draft LCFS Regulations.

General Comments

Concerning Section 95421. Standards: Valero reserves comment on the standards compliance schedules and the feasibility of such schedules until CARB has completed its Life Cycle Analysis (LCA) of alternative fuels.

Concerning Section 95423. Compliance: Valero is supportive of the current form of the Draft LCFS regulations concerning the transfer of gasoline and diesel fuel compliance obligation. Unlike other CARB fuels regulations, the Draft LCFS regulations are not about changing the transportation fuels before leaving the refinery but about changing what renewable fuel is added at the rack and providing alternative fuels at the rack. The party that has title to transportation fuel at the rack level has control over what renewable fuel is added. By placing the LCFS obligation on the party that has title to the transportation fuel at the rack, the LCFS regulations will create a level playing field among obligated parties and provide an incentive for all transportation fuel providers to provide advanced renewable fuels and alternative fuels and will help ensure that the goals of the LCFS are met. This approach is workable from both a California fuels distribution standpoint and would not be in conflict with meeting, simultaneously, the U.S. EPA federal Renewable Fuel Standard (RFS) regulations.

To make the LCFS regulations consistent with the U.S. EPA RFS regulations, Valero recommends that CARB not cap the allowable deficit that an obligated party can incur, but instead limit to 20% of the current year's total obligation the amount of prior year credits that an obligated party can use. Valero also recommends that the restriction on consecutive year deficits not take effect until the 2013 compliance year due to the anticipated tightness in the LCFS credit market in the early years.

Concerning Section 5424. LCFS Credits, Deficits, and Incremental Obligation: Valero supports not allowing 3rd parties to take title to LCFS credits. As has been discussed at length in the various working group meetings, there are numerous examples of U.S. EPA fuel credit programs that worked extremely well that did not allow 3rd parties to own credits. Valero has previously articulated, there is no reason to allow 3rd parties to own or have title to LCFS credits. Doing so only opens the market to potential speculators that could raise the price of LCFS credits, which in turn would ultimately raise the price of fuels to California consumers. A market where a non-

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obligated party is a seller to an obligated party is not a level playing field. Under such a regulatory scheme, the non-obligated party has an unfair advantage in that they do not have to sell credits, while the obligated party has a legal requirement to buy credits.

* * *

In conclusion, Valero would like to thank CARB for the opportunity to provide these comments and looks forward to working productively and cooperatively with CARB and other stakeholders in developing LCFS Regulations that meets the principles outlined above. It is important for CARB to realize as it continues through its rulemaking process, that failure to develop LCFS regulations that are consistent with the principles above and incorporate Valero's comments could result in a substantial disruption in fuel production with a corresponding increase in fuel prices and reduce the availability of clean burning fuels for California.

In submitting these comments, Valero incorporates by reference all of its previous correspondences and comments to CARB, verbal and written, concerning AB 32, LCFS, and the AB 32 Scoping Plan. In addition, Valero supports and adopts as its own the written correspondences and comments submitted by WSPA to CARB. Valero reserves the right to supplement these comments, its previous comments, as well as provide future comments during the AB 32 Scoping Plan and LCFS rulemaking processes.

If you have any questions or wish to discuss this further, please contact me at (210) 345-2922 or by E-mail at John.Braeutigam@Valero.com.

Sincerely,



John R. Braeutigam
Director Strategic and Regulatory Development
Valero Energy Corporation
One Valero Way
San Antonio, Texas 78249-1112
(210) 345-2922
john.braeutigam@valero.com

Attachment (1)

Mr. Bob Fletcher, *Re: Valero Draft LCFS Regulations Comments & Recommendations*

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cc:

Mary D. Nichols
Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95812
Via E-mail: mnichols@arb.ca.gov

Dean Simeroth
Chief Criteria Pollutants Branch
Stationary Source Division
California Air Resources Board
1001 I Street
Sacramento, CA 95812
Phone: (916) 322-6020
Via E-mail: dsimerot@arb.ca.gov

Renee Littau
Fuels Section Manager
Stationary Source Division
California Air Resources Board
1001 I Street
Sacramento, CA 95812
Phone: (916) 322-6019
Via E-mail: rlittau@arb.ca.gov

Dickman Lum
Air Pollution Specialist
Enforcement Division
California Air Resources Board
1001 I Street
Sacramento, CA 95812
Phone: (916) 327-1520
Via E-mail: dlum@arb.ca.gov

Christina Zhang-Tillman
Stationary Source Division
California Air Resources Board
1001 I Street
Sacramento, CA 95812
Via E-mail: czhangti@arb.ca.gov

Attachment 1
Valero's Specific Comments on the Draft LCFS Regulations

Section 95420. Applicability of the Standard

(b) Exemption for Alternative Fuels Distributed in Low Volumes for Transportation Uses.

(1) The ... at an aggregated volume of less than 420 million MJ (3.6 million gasoline gallon equivalent) per year.

Valero recommends the above language be changed to: “at an aggregated volume of less than 42.6 MJ (365,000 gasoline gallon equivalent) per year.”

Valero believes that parties providing 1,000 gasoline gallon equivalents per day of alternative fuel should be included in the LCFS regulations.

Section 95421. Standards

(a)

(1) Standards for gasoline and fuels used to substitute for Gasoline.

Table 1. LCFS compliance schedule for 2010 to 2020 for gasoline or fuels used to substitute for gasoline.

Valero reserves comment on this compliance schedule and the feasibility of such a schedule until CARB has completed its Life Cycle Analysis (LCA) of alternative fuels.

(2) Standards for diesel fuel and fuels used to substitute for diesel fuel.

Table 2. LCFS compliance schedule for 2010 to 2020 for diesel fuel or fuels used to substitute for diesel fuel.

Valero reserves comment on this compliance schedule and the feasibility of such a schedule until CARB has completed its LCA of alternative fuels.

Section 95423. Compliance

(a) Regulated Parties

(1) Gasoline and Gasoline Blends.

(B) Transfer of Gasoline and Compliance Obligation.

This ... on each occasion when any person transfers custody or title of gasoline ...

Valero recommends the above language be changed to: “on each occasion when any person transfers title of gasoline ...”

Different parties can have custody and title of the same gasoline. The reference to custody should be dropped or the regulation will not be workable. The obligation should move with title transfer as the person that has title to the gasoline at the rack level is in a position to control the renewable fuel that is added to the CARBOB.

Valero is supportive of the current form of the LCFS regulations. See expanded comment below.

(2) Diesel Fuel and Diesel Fuel Blends.

(B) Transfer of Diesel Fuel and Compliance Obligation.

This.... on each occasion when any person transfers custody or title of diesel fuel...

Valero recommends the above language be changed to: “on each occasion when any person transfers title of diesel fuel...”

Different parties can have custody and title of the same diesel fuel. The reference to custody should be dropped or the regulation will not be workable. The obligation should move with title transfer as the person that has title to the diesel fuel at the rack level is in a position to control the renewable fuel that is added to the diesel fuel.

Valero is supportive of the current form of the LCFS regulations concerning the transfer of gasoline and diesel fuel compliance obligation. Unlike other CARB fuels regulations, the Draft LCFS regulations are not about changing the transportation fuels before leaving the refinery but about changing what renewable fuel is added at the rack and providing alternative fuels at the rack. The party that has title to transportation fuel at the rack level has control over what renewable fuel is added. By placing the LCFS obligation on the party that has title to the transportation fuel at the rack, the LCFS regulations will create a level playing field among obligated parties and provide an incentive for all transportation fuel providers to provide advanced renewable fuels and alternative fuels and will help ensure that the goals of the LCFS are met. This approach is workable from both a California fuels distribution standpoint and would not be in conflict with meeting, simultaneously, the U.S. EPA federal Renewable Fuel Standard (RFS) regulations.

(b) Determining Compliance.

(2) Determination of Compliance.

(A)

(B)

(C) If compliance credits are less than zero, the regulated party is not compliant with the LCFS for the compliance period.

If running a deficit of up to 10% is allowed, then it should not be referred to as being noncompliant.

Valero recommends changing the above language to: “If compliance credits are less than zero, and the deficit is less than 10 percent of the regulated parties’ incremental compliance obligation INC^{TOT} as calculated under 95424(a)(3), then the regulated party is in deficit for that year’s LCFS.”

(D) If compliance credits are less than zero, and the deficit is greater than or equal to 10 percent of the regulated parties' incremental compliance obligation INC^{TOT} as calculated under 95424(a)(3), then the regulated party is in violation of the LCFS.

(E) If compliance credits are less than zero for two or more consecutive years, then the regulated party is in violation of the LCFS.

The EPA RFS regulations do not limit the size of the allowable deficit. Valero strongly recommends that CARB adopt EPA's position and not limit the size of the allowable deficit. Valero's comments above and below attempt to clarify this in the context of the regulatory language.

The proposed 2010 LCFS reduction is 0.0% from the baseline. It is likely that no or very few LCFS credits will be generated in 2010. It is also likely that obligated parties will hold on to any LCFS credits generated in 2011 until after all of the reports are filed and the final volumes are known. Assuming this occurs, the first year that there will be a meaningful amount of LCFS credits being offered for sale would be in 2012. Since 2012 will be the first typical year for the LCFS from a credit availability standpoint, the prohibition against running a deficit for two or more consecutive years should begin in 2013 (an obligated party could not run a deficit in 2013 if they had one in 2012). This will ensure that the beginning of the LCFS program is workable.

*Valero recommends that paragraph (e) above, be changed to “**Beginning in the 2013 compliance year, if compliance credits are less than zero for two or more consecutive years, then the regulated party is in violation of the LCFS.**”*

(3) Significant Figures.

*Valero recommends that CARB state that ASTM rounding methods should be used. Valero recommends adding the following language to clarify this: “**ASTM E 29-02^{E1} Standard Practice for Using Significant Digits in Test Data to Determine Conformance with Specifications should be used for rounding in compliance and reporting calculations.**”*

(4) Deficit Reconciliation.

(A) If the regulated party is out of compliance, but not significantly out of compliance with the LCFS requirements, the regulated party has until December 31st of that year to fully reconcile the deficit without penalty; or

*Given Valero's recommended changes to the prior language for clarity, Valero also recommends changes to the above language to: “**If the regulated party is in deficit for a given year's LCFS as defined in 95423(b)(2)(c), the regulated party has until December 31st of the next year to fully reconcile the deficit without penalty; or**”*

(B) If the regulated party is not compliant with the LCFS requirements, they have until December 31st of that year to fully reconcile the deficit. In addition, the regulated party is subject to penalties to the extent permitted under state law and must implement any additional measures imposed by the Executive Officer.

The current language does not match up with the previous parts on a deficit. For clarity Valero recommends changing the language above to: “If the regulated party is in violation of the LCFS, the regulated party is subject to penalties to the extent permitted under state law.”

Penalties need to be specific and spelled out. Therefore, Valero recommends dropping the undefined penalty language of “any additional measures imposed by the Executive Officer.”

(c) Compliance and Progress Reporting Requirements.

(1) Reporting Frequency.

(A) Quarterly Progress Reports For All Regulated Parties and Credit Generators

(B) Annual Compliance Reports.

(1)

...

(8)

(9) Any additional information specified by the Executive Officer to be included in the report.

For clarity, the above item (9) needs to be specifically defined in the final LCFS regulations.

(2) How To Report.

(A)

(B)

(C)

...

The regulated...for a minimum of 3 years and must provide such records within 48 hours of a request by the Executive Officer or as otherwise mutually agreed to by the Executive Officer and the regulated party.

Valero recommends changing the above language “48 hours” to “7 business days”. Records 3 years old may be in records retention and will take time to locate and retrieve.

(3) Reporting Requirements for Quarterly Progress Reports. A regulated party must submit a quarterly progress report that meets, at minimum, the requirements outlined in Table 4.

Table 4. Checklist of reporting requirements for LCFS transportation fuels.

Obligated parties will know the volumes of CARB without ethanol, CARBOB, CARB Diesel without biodiesel, ethanol, and biodiesel that are blended into gasoline and diesel fuel and Blended and Pure Fuels (i.e., E85, B20, B100, E100). CARB needs to clarify that volumes for these “blendstocks” are required. CARB also needs to clarify that the data on the blendstocks that make up CARB without ethanol or CARBOB or CARB Diesel without biodiesel are not required.

In addition, the batch number requirement needs to be dropped as there are no batch numbers at the rack level.

[Commentary. ARB is seeking feedback on the feasibility of including a requirement for sustainability reporting and what that requirement should include.]

A reporting requirement for sustainability is not feasible at this time since sustainability has not been defined. In addition, any sustainability reporting requirement should be the obligation of the renewable fuel producer, not the blender or obligated party.

(d) Recordkeeping and Auditing.

(1)

(2) Evidence Of Physical Pathway. If a regulated party acquires pure ethanol or pure biomass-based diesel, the regulated party must demonstrate, through appropriate documentation such as a purchase contract, a physical pathway by which the Biofuel arrives in California.

Ethanol and biodiesel markets use a fungible distribution system. Both ethanol and biodiesel will have U.S. EPA Renewable Identification Numbers (RINs) associated with them. The RINs are production facility specific. Therefore, in order to not disrupt the markets for these fuels, CARB should base its evidence of physical pathway on the facility number imbedded in the RINs of the alternative fuel. If CARB requires contracts, this will disrupt the market and prevent parties from transferring RINs to achieve compliance with the LCFS regulations.

Valero recommends changing “arrives” to “can arrive” in the above paragraph so it would read as follows: “Evidence Of Physical Pathway. If a regulated party acquires pure ethanol or pure biomass-based diesel, the regulated party must demonstrate, through appropriate documentation such as a RIN, a physical pathway by which the Biofuel can arrive in California.”

Section 95424. LCFS Credits, Deficits, and Incremental Obligation

(c) Credit acquisition, banking, borrowing, and trading.

(1) If credits are traded within the LCFS market, the credits can be banked without expiration.

Valero supports unlimited credit banking without expiration.

However, to facilitate the availability of LCFS credits for obligated parties that need LCFS credits for compliance, Valero recommends that CARB follow the U.S. EPA example of the RFS regulations and limit the percentage of prior year(s) LCFS credits that an obligated party can use in a given compliance year to 20% of that year's obligation.

[Commentary. There may be limits on the credits generated in the early years (2010-2014). Staff is conducting additional analyses on the impact of capping credits generated early in the LCFS implementation.]

There should be no cap on credit generation in any year or period. This would hinder credit trading among obligated parties. In addition, GHG reduction is a long term issue. If anything, earlier reductions should be rewarded, not penalized.

(2) A regulated party ... An external 3rd party entity that is not a regulated party or an exempted party, or acting on behalf of a regulated or an exempted party, may not purchase, sell, or trade LCFS credits.

Valero supports not allowing 3rd parties to take title to LCFS credits. As has been discussed at length in the various working group meetings, there are numerous examples of U.S. EPA fuel credit programs that worked extremely well that did not allow 3rd parties to own credits. As Valero has previously articulated, there is no reason to allow 3rd parties to own or have title to LCFS credits. Doing so only opens the market to potential speculators that could raise the price of LCFS credits, which in turn would ultimately raise the price of fuels to California consumers. A market where a non obligated party is a seller to an obligated party is not a level playing field. Under such a regulatory scheme, the non-obligated party has an unfair advantage in that they do not have to sell credits, while the obligated party has a legal requirement to buy credits.

Section 95425. Determination of Carbon Intensity Values

(b) Selection of Method.

(1) Method 1 – ARB Lookup Table.

(A)

(B)

(C) Conventional Fuels.

Valero supports CARB's selection of 10% of a crude's well to wheels Carbon Intensity (CI) hurdle for classifying crudes as conventional crudes and for approving individual crude values. The 10% should apply to the entire well to wheels analysis not just the crude production portion of the life cycle analysis. The 10% hurdle is appropriate due to the uncertainty in the life cycle analysis and as a mechanism to simplify the regulations.

(c) Scientific Defensibility, Burden of Proof, the "10-10" Substantially Requirement, and Data Submittal Procedures for Approval of Method 2.

(1)

(2) "10-10" Substantially Requirement.

Valero supports CARB's selection of 10% of a renewable fuel's well to wheels Carbon Intensity (CI) hurdle for approving individual renewable fuels, blendstocks, CARBOB and CARB diesel fuel values. The 10% should apply to the entire well to wheels analysis not just the production portion of the life cycle analysis. The 10% hurdle is appropriate due to the uncertainty in the life cycle analysis, the fungible nature of the transportation fuel distribution system, and as a mechanism to simplify the regulations. There will always be an economic incentive for producers to improve the energy efficiency of their processes. The 10% hurdle will not act as a disincentive.