

State of California
AIR RESOURCES BOARD

Final Statement of Reasons for Rulemaking
Including Summary of Comments and Agency Responses

**PUBLIC HEARING TO CONSIDER AMENDING THE VARIANCE PROVISIONS
OF THE CALIFORNIA REFORMULATED GASOLINE REGULATIONS**

Public Hearing Date: January 25, 1996
Agenda Item No.: 96-1-5

I. GENERAL

On January 25, 1996 the Air Resources Board (ARB) conducted a public hearing to consider amendments to the variance provisions of the California Reformulated Gasoline (CaRFG) regulations (section 2271, Title 13, California Code of Regulations (CCR)). At the conclusion of the hearing, the Board adopted Resolution 96-3, in which the Board approved the regulatory amendments. As approved by the Board, the amendments included a number of modifications to the originally proposed text, reflecting suggestions made by the staff at the January 25, 1996 hearing. In Resolution 96-3 the Board directed the Executive Officer to adopt the approved amendments as emergency regulations, with such other modifications as may be appropriate, and submit them to the Office of Administrative Law (OAL) pursuant to Government Code section 11346.1. (Initial adoption as emergency regulations is required by Health and Safety Code section 43013.2.) Accordingly, on January 26, 1996 the Executive Officer issued Executive Order G-96-012, adopting the amendments as emergency regulations. The amendments were submitted to OAL on February 5, 1996 and were approved as emergency regulations on February 15, 1996.

In Resolution 96-3 the Board also directed the Executive Officer, during the 120-day period that the emergency regulations are effective, to complete all administrative requirements specified in the Administrative Procedure Act and resubmit the amendments as a non-emergency submission, to replace the emergency regulations. The Board therefore directed the Executive Officer to make the approved amendments, with such other conforming modifications as may be appropriate, available to the public for a written comment period of 15 days in accordance with section 11346.8 of the Government Code. He was then directed either to adopt the amendments with such additional modifications as may be appropriate in light of the comments received, or to present the regulations to the Board for further consideration if warranted in light of the comments.

The modified text of the amendments was made available for a 15-day comment period by issuance of a "Notice of Public Availability of Modified Text" which, together with a copy of the full text of regulations with the modifications clearly indicated, was mailed on February 8, 1996, to each of the individuals described in subsections (a)(1) through (4) of section 44,

Title 1, CCR. It should be noted that the modified text made available for the 15-day comment period was identical to the text of the emergency regulations submitted to and approved by OAL (with one minor exception--as approved by OAL, two nonsubstantive numbering changes were made to section 2271(e)(1)(B); (i) and (ii) were changed to (1.) and (2.) in this subsection). The comment period began on February 8, 1996 and ended on February 23, 1996. One written comment was received during the 15-day comment period. The Executive Officer then issued an Executive Order adopting the amendments with no additional changes from the text made available for 15-day comments (except for the nonsubstantive numbering changes to section 2271(e)(1)(B) mentioned above).

An Initial Statement of Reasons (Staff Report) was prepared for the proposed rulemaking. The Staff Report was released to the public on December 8, 1995, and is incorporated by reference herein. This Final Statement of Reasons (FSOR) updates the Staff Report by identifying and explaining the modifications that were made to the originally proposed text. The FSOR also contains a summary of comments received during the rulemaking process and the ARB's responses to these comments.

The Board has determined that the proposed regulatory action will not create costs or savings, as defined in Government Code section 11346.5(a)(6), to any state agency or in federal funding to the state; costs or mandate to any local agency or school district whether or not reimbursable by the state pursuant to Part 7 (commencing with section 17500), Division 4, Title 2 of the Government Code, or other non-discretionary savings to local agencies. The Board has also determined that there will be no, or an insignificant, potential cost impact, as defined in Government Code section 11346.5(a)(9), on private persons or businesses directly affected resulting from the proposed action.

In preparing this regulatory proposal, the staff evaluated the potential economic impacts on California businesses enterprises and individuals. The Board has determined that adoption of the proposed amendments will not have a significant adverse economic impact on businesses, including the ability of California businesses to compete with businesses in other states. In accordance with Government Code section 11346.3, the Board has also determined that the proposed regulatory action will not affect the creation or elimination of jobs within the State of California, the creation of new businesses or elimination of existing businesses within California, or the expansion of businesses currently doing business within California. An assessment of the economic impacts of this regulatory action can be found in the Staff Report.

As explained in the Staff Report, it is possible that some individual businesses may be adversely affected by this regulatory action, even though overall there should be no significant adverse economic impact on businesses as a whole. Therefore, the Board has determined that the adoption of this regulatory action may have a significant adverse impact on some businesses. The Board has also determined, pursuant to Government Code section 11346.5(a)(3)(B), that the regulation will affect small business.

Finally, the Board has determined that no alternative considered by the agency would be more effective in carrying out the purpose for which the regulatory action was proposed or would be as effective and less burdensome to affected private persons than the action taken by the Board.

II. SUMMARY OF MODIFICATIONS

As discussed above, the Board approved the originally proposed amendments to section 2271 with various modifications suggested by the staff. This section summarizes the modifications made to the originally proposed regulatory text, and explains the rationale for the modifications.

- Section 2271(b)(2) was modified to expedite the process of making confidentiality determinations for variance applications. For information submitted by variance applicants and claimed as confidential, a shorter time period (10 days) is set than the time period otherwise specified in the Board's confidentiality regulations (21 days). The 10-day time period applies when the Executive Officer has determined that submitted information is not entitled to confidential treatment. The information is then released to the public after 10 days, unless during this time period the submitter obtains a court order restraining the Board from releasing the information. The shortened time period is necessary because situations in which a variance is needed often arise on relatively short notice. The 10-day period will allow a interested parties to gain access to all nonconfidential information as soon as possible, while still providing an applicant who disagrees with the ARB's confidentiality determination with an adequate opportunity for court review.
- Section 2271(f)(1)(D) was modified to set a maximum limit on the amount of variance gasoline that may be sold or supplied from an applicant's production facility during a variance period. The limit cannot exceed the applicant's capacity to produce complying gasoline, and must be set after considering available data on the applicant's gasoline production. This provision was added to ensure that a refiner will not be able to use a variance to gain an unfair market advantage by selling more gasoline than it would normally be able to produce.
- Various modifications were made to the emergency variance provisions of section 2271(h). The most notable modification clarifies that all the provisions of section 2271(f) (i.e., conditions and fees in variance orders) apply to emergency variances, with the exception that an emergency variance order is not required to specify a final compliance date by which the requirements of the applicable sections will be achieved. This exception is necessary because, for some types of emergencies, insufficient information may be available at time of the variance hearing to specify a final compliance date. It is also specified that telephone notice of an emergency variance hearing shall be provided to interested parties as soon as practicable, considering the nature of the emergency. This provision was added to reassure

interested parties that the ARB will act expeditiously to provide advance notice for emergency variance hearings.

- Several minor section numbering and punctuation changes were also made to section 2271 to improve clarity and conform with the numbering conventions used in Barclay's Official California Code of Regulations.

III. SUMMARY OF COMMENTS AND AGENCY RESPONSES

Written comments were received from Texaco Refining and Marketing Inc. (Texaco), Mobil Oil Corporation (Mobil), Chevron USA Products Company (Chevron), 76 Products Company (Unocal), and Ultramar, Inc. (Ultramar). Chevron and Unocal also presented oral testimony at the hearing. During the 15-day comment period, one comment letter was also received from Texaco.

Set forth below is a summary of each objection or recommendation made regarding the proposed amendments, followed by an explanation of the action taken to accommodate the objection or recommendation, or the reasons for making no change. A number of comments indicated general support for all or some of the proposed amendments, but did not suggest that the Board take any specific action. While these comments were considered by the Board, the comments are not separately addressed below because they are not objections or recommendations specifically directed at the proposed action or the procedures followed by the Board in proposing or adopting the proposed action.

1. Comment: The variance fee should be variable. The fee should be based on the extent to which the variance fuel exceeds ARB specifications; where the noncomplying fuel has greater environmental impact, the fee would be greater. Similarly, where a variance yields an economic benefit to the company, the fee would be correspondingly greater. The problem with a fixed fee is that it does not fit all situations, and will always be either too low or too high to offset the environmental and economic consequences of the variance. This does not seem fair to either refiners or the California public. (Unocal)

Agency Response: This issue of whether to specify a fixed or variable fee was carefully considered by the ARB. A fixed fee was ultimately chosen for the reasons discussed at length on page 13 of the Staff Report, at the Board hearing, and in the comment letters that supported a fixed fee. With regard to the issues raised by the commenter, we would also add that the commenter's analysis incorrectly assumes that the sole purpose of the variance fee is to offset the economic benefit of the variance to the applicant, and the environmental detriment to the public. However, one of the fundamental purposes of a fixed fee is to insure that a variance is used only as a last resort, after the applicant has first relied on the marketplace to correct the problem. A fixed fee will provide a strong incentive for refiners to exhaust every practicable marketplace alternative before applying for a variance and will better protect the investments of all refiners. Finally, a fixed fee is preferable in that it is much easier to administer.

and does not invite "gaming" and market speculation that could be driven by uncertainty about the size of the fee.

2. Comment: We endorse ARB's intent to exclude imported product from variances that is not from a source owned by the company and not part of their compliance plan. These outside sources have not demonstrated that they have made the investments and commitment to be secure suppliers of CaRFG and should not be eligible for a variance. (Mobil)

Agency Response: The commenter believes that the regulations are intended to prohibit all variances for gasoline imported from a source that has not submitted a compliance plan under section 2269, Title 13, CCR. This is not an accurate interpretation. The regulations establish certain criteria that must be met before a variance can be granted. As long as an applicant meets these criteria, a variance involving noncomplying imported gasoline could potentially be granted. For example, a California producer could conceivably be allowed to import noncomplying gasoline in appropriate cases, regardless of what was stated in their section 2269 compliance plans. These compliance plans relate to how a producer plans to comply with the March 1, 1996 standards, and may not be at all relevant to variance applications received after March 1.

It is also possible that a variance could be granted to an importer. The key issue is whether the variance criteria have been met. In practice, it may be very difficult for certain types of businesses (e.g., importers) to meet some of these criteria. But any applicant who does meet them is entitled to receive a variance, and it is not appropriate to automatically prohibit all variances involving imported gasoline. Further discussion of these issues can be found in Appendix 2 of the Staff Report (Draft Guidelines for Variances, Section 4.)

3. Comment: Before granting a variance, the ARB should be required to document that alternative supplies of complying gasoline are not available. (Mobil)

Agency Response: We believe that the regulation already incorporates the basic concept suggested by the commenter, although not in the exact form the commenter suggests. To demonstrate that requiring compliance would result in an "extraordinary economic hardship", section (e)(1)(B) requires an applicant to "make a substantial showing that no alternative to a variance would eliminate or mitigate the need for a variance." To make this showing, section (e)(1)(B) also specifically requires an applicant to address the alternative of "obtaining complying gasoline from outside sources."

It is likely that any such showing would include evidence that "documents" the unavailability of alternative supplies. However, it would not be particularly useful to include in the regulation a specific requirement that "documentation" must be provided, since this term is vague and it is possible that an applicant's testimony would rely on evidence that might not be considered "documentation" under some meanings of this term. If the applicant is able to adequately prove his case, we should not be arguing about the semantics of whether the case

has been "documented". Furthermore, the ARB should not be the party that is required to "document" anything, as the commenter may be suggesting. The regulations are structured to place the responsibility on the applicant to demonstrate the variance criteria have been met. It is appropriate that this responsibility remain firmly on the applicant, since the ARB cannot be expected to know the details of the applicant's actions or the market in which the applicant operates.

4. Comment: Any variance granted by the ARB should be subject to cancellation by the ARB if the CaRFG supply becomes sufficient to meet demand. (Mobil)

Agency Response: To receive a variance, one of these criteria that the applicant must demonstrate is that requiring compliance would result in an "extraordinary economic hardship". The commenter seems to be suggesting that a variance should be canceled in all cases where the supply meets the demand in the market as a whole, even if such cancellation would result in an "extraordinary economic hardship" to the applicant or the applicant's customers. We believe that such an approach is not appropriate. The relationship between supply and demand in the market as whole may have little relationship to the justification for a particular applicant's variance. Even if the overall supply is sufficient to meet demand, market forces may not allow either the applicant or its distributors to obtain an adequate source of supply for themselves.

It should also be noted that the existing section 2271(j) allows the ARB executive officer to modify or revoke a variance for "good cause", after holding a public hearing. This section already allows the flexibility to reconsider a variance decision if changed circumstances make it appropriate to do so. This flexibility allows all relevant circumstances to be considered at such a hearing, including a change in the supply and demand situation in the marketplace, without dictating a particular outcome based solely on such a market change.

5. Comment: Unocal is concerned that the regulation is written so rigidly that even when a variance is appropriate, the ARB may not be able to issue one. The current language may only allow variances for a few narrowly-defined situations. For example, section (e)(1)(A) seems to imply, if we are reading it correctly, that variance applications may only be considered for either initial compliance with the March 1, 1996 standards, or for equipment breakdowns. Additional language should be added to section (e)(1)(A) stating that other unexpected situations besides initial compliance and future breakdowns will be considered for variances. (Unocal)

Agency Response: The commenter first makes a general comment that the regulation is written too rigidly, and then provides one example. With regard to the general comment, we do not agree with the commenter and believe that the regulation is appropriately written. The only example provided by the commenter is the language of section (e)(1)(A). This first sentence of this section states the general rule that the applicant "must demonstrate that reasonably diligent and timely efforts to achieve compliance have been made" in order to show

that noncompliance is "beyond the reasonable control of the applicant". The next two sentences of section (e)(1)(A) then go on to identify the more specific elements that must be shown for two situations: where a variance is sought from initial compliance with the March 1, 1996 requirements, and where a variance is sought due to a breakdown. By identifying specific elements for these two situations, the language in no way implies that these are the only two situations in which a variance may be sought. Other situations are simply not addressed by this language. Such other situations would be governed by the first sentence of section (e)(1)(A), and a variance would be allowed if the applicant can "demonstrate that reasonably diligent and timely efforts to achieve compliance have been made" (and if the other variance criteria have also been met). In short, we believe that the existing language is sufficiently flexible and does not need to be modified as suggested by the commenter.

6. Comment: Section (e)(3) states that: "In the case of a proposed variance that would begin on March 1, 1996, the compliance plan shall identify and provide a date for each key step that remains to be accomplished for attaining compliance. As applicable, these steps shall include financing, engineering plans, ordering and contracts, receipt of major equipment, commencement and completion of construction, and testing." We feel that this language is far too permissive. By late January, refiners should have completed project financing, engineering plans, etc. Only completion of construction and testing should remain. Section (e)(3) should be clarified to not allow variances for refiners still in the early stages of financing, engineering, and construction. (Unocal)

Agency Response: The criteria for granting a variance are set forth in section (d). Before a variance can be granted, the applicant must demonstrate that all of these criteria have been met. This includes a demonstration that noncompliance is "beyond the reasonable control of the applicant", which means that the applicant "must demonstrate that reasonably diligent and timely efforts to achieve compliance have been made." Section (e)(3) does not modify these criteria in any way. Section (e)(3) merely describes the information that must be included in an applicant's proposed compliance plan. This is what the language of this section plainly states. We agree that a company that has not completed financing, engineering plans, etc. would face a very difficult or impossible task in demonstrating that "reasonably diligent and timely efforts to achieve compliance have been made." But it is important to have complete information on what the applicant has not done, and how the applicant intends to address the situation, in order to make an informed decision on whether the variance criteria have been met. This is why section (e)(3) requires this information to be included in a proposed compliance plan.

7. Comment: The regulation should include explicit language to address how rolling 180-day average values for fuel properties will be handled under a variance that affects those properties. We suggest that the averaging "clock" for a gasoline property be temporarily stopped during a variance period when the variance includes that property. When the variance period ends, the 180-day averaging clock would resume. (Unocal)

Agency Response: The CaRFG regulations establish specifications for eight gasoline

properties. Except for the Reid vapor pressure and oxygen content specifications, the regulations provide two compliance options for meeting the limits applicable to gasoline being supplied from a production or import facility. One option is to elect to have the gasoline subject to a "flat limit," which must be met by every gallon of gasoline leaving the production or import facility. The other option is to elect an "averaging limit." The averaging limits established in the regulations for each of the six properties are more numerically stringent than the comparable flat limits. Under the averaging option, the producer may assign differing "designated alternative limits" (DALs) to different batches of gasoline being supplied from the production or import facility. Each batch of gasoline must meet the DAL for the batch. A producer or importer supplying a batch of gasoline with a DAL less stringent than the averaging limit must within 90 days before or after supply from the same facility sufficient quantities of gasoline subject to more stringent DALs to fully offset the exceedances of the averaging limit. The CaRFG regulations also contain a mechanism under which a producer or importer may use the "California predictive model" to identify alternative flat and averaging limits applicable when gasoline is supplied from the production or import facility. Producers and importers may use the predictive model to identify any combination of alternative flat and averaging limits as long as the emissions from the gasoline with the combination of limits are no greater than the emissions of gasoline meeting the comparable flat and average limits identified in the regulation.

As can be seen from the above description, the averaging provisions of the CaRFG regulations are quite complex. Hundreds of possible situations may arise for producers who are utilizing these averaging provisions and who are also applying for a variance. The approach suggested by the commenter may work for some situations but lead to unfair results in others. There are simply too many possible situations to create a rule, or a number of rules, which would effectively deal with every contingency. The current provisions in subsection (e)(1) provide the flexibility to include in a variance order whatever conditions are necessary. Such conditions can specify how averaging will be treated during and after the variance period, on a case-by-case basis.

8. Comment: Although Ultramar supports the requirement that a refiner produce the highest possible quality fuel, the regulation should specify that, at a minimum, the variance fuel must comply with U.S. EPA reformulated gasoline specifications. (Ultramar)

Agency Response: The 1990 amendments to the federal Clean Air Act (CAA) require the U.S. EPA to adopt regulations regarding reformulated gasoline (RFG; CAA section 211(k).) These regulations have been adopted as 40 C.F.R. sections 80.40 to 80.82. The U.S. EPA regulations establish certain federal RFG specifications that have applied in most of Southern California since December 1994. It is not necessary to specifically state in the regulation that California variance gasoline must meet federal RFG specifications, because under federal law a variance granted from the California requirements will not excuse the variance applicant from complying with applicable federal requirements.

9. Comment: The proposed regulations allow the ARB Executive Officer to consider confidential information in reaching a decision to grant or deny a variance (section 2271(b)(2)). This is not allowed under California law. Health and Safety Code section 43013.2(f), which was added by SB 709, states that variance determinations "... shall be based solely on substantial evidence in the record of the variance proceeding." In addition, Government Code section 11523 states that the 'complete record of the proceedings "... shall be delivered to petitioner [seeking review of an administrative decision] ... after a request by him or her..." This section places the entire record in the public domain and, as a result, limits the scope of the record of a variance proceeding to only those materials that are publicly available.

Therefore, because variance determinations must be based solely on the record of the variance proceedings (which are comprised entirely of publicly available materials) California law mandates that the ARB must base its variance determinations solely upon publicly available materials. To comply with California law, subdivision (b)(2) of the regulation should instead provide that: "No decision to grant or deny a variance shall be based, in whole or in part, upon information that is claimed by the variance applicant to be confidential." (Texaco)

Agency Response: Regarding the commenter's legal argument, the commenter has incorrectly interpreted California law, and that there is no legal prohibition against considering confidential information in a variance proceeding. Health and Safety Code section 43013.2(f) merely requires that a variance decision be based solely on evidence contained "in the record of the variance proceeding." As explained in the response to the following comment, the administrative record in a variance proceeding may consist of both confidential and nonconfidential material. There is no violation of section 43013.2(f) simply because a decision may be based in part on confidential material that is in the record. There is also no violation of Government Code section 11523. This section applies only to judicial review of quasi-adjudicative proceedings under the Administrative Procedure Act (APA). However, state law does not require that APA procedures be used in ARB variance hearings, and Government Code section 11523 is therefore inapplicable. Staff are also unaware of any other statute or court decision that prohibits confidential information from being considered in administrative hearings. What law exists on the subject suggests that such information may properly be considered. (See *Superior Court v. Martin*, 259 Cal.App.2d 306, 66 Cal.Rptr. 183 (1968); and Evidence Code section 910, which makes Evidence Code provisions relating to privilege--including the trade secret privilege in Evidence Code section 1060--applicable to quasi-adjudicative proceedings of administrative agencies.)

As a policy matter, it is important to allow confidential information to be considered because to receive a variance an applicant must demonstrate that requiring compliance would result in an "extraordinary economic hardship". In many cases such a demonstration may require the applicant to reveal confidential trade secret information on

the applicant's financial situation, refinery operations, or customer relationships. An applicant should not be forced to choose between revealing confidential information and damaging its competitive situation, or withholding confidential information and being unable to adequately demonstrate "extraordinary economic hardship".

10. **Comment:** Texaco has the understanding that the ARB intends to implement the provisions of section 2271(b)(2) in the following manner: (1) The ARB will record any and all confidential information that it receives for the purpose of determining whether to grant a variance to the CaRFG regulations, and (2) the transcript of such communication will be delivered to a court of competent jurisdiction upon request by a petitioner for a record of the variance proceedings.

Agency Response: In response to fundamental due process considerations, it has been the practice of the ARB for many years to make either a written transcript or an electronic recording of all variance hearings. If an applicant wishes to present confidential testimony at a variance hearing, the only practical procedure is to briefly interrupt the proceedings to hold a closed session in which confidential information (either written or oral) is presented. Tape recordings or transcripts are made of both the public and closed sessions. The records of both sessions, including all nonconfidential and confidential written documents that may have been introduced, are part of the administrative record for the variance proceeding. This is the most common sense way to handle the situation. It is what the ARB has done in the past and will continue to do in the future.

Also, it is possible that a Public Records Act request to see the entire administrative record may be received by the ARB, but that the request would not be made in connection with a lawsuit. If there is no lawsuit there is no reason to involve the courts. Such a request would be treated as set forth in the ARB's existing confidentiality regulations (Title 17, CCR, section 91000 to 91022), with the two procedural modifications specified in section 2271(b)(2). In the event of a lawsuit challenging a variance in which confidential information is part of the record, the ARB would seek the guidance of the court. The entire administrative record would be forwarded to the court, which could then deal with the confidential material in an appropriate matter (e.g., holding an *in camera* session to review this material, allowing some or all of the material to be disclosed under a protective order, etc.).