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Re: Analysis of Legal Issues Related to Application No. 24430 –
Valero Refining Company–California Application for Emissions Banking

Dear David:

On behalf of the Bay Area Air Quality Management District ("District"), I am writing to respond to your August 8, 2013, letter to Jim Karas regarding the application submitted by Valero Refining Company–California ("Valero") seeking to bank certain emission reductions at Valero's Benicia refinery. The District has designated this application as Application No. 24430. As discussed in the Engineering Evaluation and related materials being transmitted to Valero under separate cover, the District is proposing to grant Application No. 24430 and issue Valero 2433.37 tpy worth of SO_2 banking certificates, pending consideration of any comments received.

In reviewing this application, the District considered the points you raised in your August 8 letter regarding the appropriate emissions "baseline" period to use in determining the amount of bankable emission reductions that can be credited to the application. I am writing on behalf of the District to provide a response to that letter and an explanation of the District's position on the issues you raised.

I. Introduction and Summary

The District's rules for calculating the amount of emission reductions that can be credited in a banking application such as Application No. 24430 are clear. The amount of emissions that an applicant can bank is based on the emissions from the source that has been shut down during the three-year period before the complete banking application is submitted—what is referred to as the "baseline" period under the District's regulations. Application No. 24430 was complete as of May 15, 2012. The baseline period for Application No. 24430 is therefore May 15, 2009 through May 14, 2012. This is the baseline period that the District has used in processing Valero's application.

Your August 8 letter requests that the District use a different baseline period. Your letter requests that the District use a baseline period of May 2005 through May 2008. This period is the 3-year period preceding a different permit application, Application No. 16937. Application No. 16937 was an application for an authority to construct regarding the Valero Improvement Project, which was a modernization project at the refinery that included the replacement and upgrade of certain older equipment. The sources that generated the emission reductions that Valero seeks to bank under Application No. 24430 (Sources S-3 and S-4) were among those that were shut down and/or replaced as part of the Valero Improvement Project, and as a result they have a connection to the authority to construct application for the project. Your letter stated that because the shutdown of these sources was related to that authority to construct application, the baseline period for banking the emission reductions under its *banking application* (Application No. 24430) must be determined using the date of the *authority to construct* application (Application No. 16937).

But that is not how the District's rules for calculating the amount of bankable emission reductions that can be credited to a banking application work. The District's rules are clear that the baseline period for calculating the amount of emission reductions that can be credited to a banking application is based on the date that that banking application. The amount of emission reductions that can be credited to Application No. 24430 is therefore based on the date of Application No. 24430—and not the date of Application No. 16937 or any other application that may be related to the sources at issue.

In light of your August 8 letter, the District has conducted a thorough review of its interpretation of the baseline calculation procedures set forth in Regulation 2-2-605 with regard to Application No. 24430. This analysis has shown that, based on all of the relevant principles of regulatory interpretation, the District's application of the baseline rule in this case is the correct one. These principles include the following:

- The plain language of the relevant regulation establishing the baseline period – Reg. 2-2-605.1 – indicates that the baseline period applicable to Application No. 24430 is the date that Application No. 24430 was complete.
- The regulatory context in which this provision arises indicates that references to "application" in the baseline calculation rules mean the *banking* application when they are applied in the *banking* context.
- The regulatory history of the provision is clear that the District always intended that the baseline calculation should be applied this way, and that the District clearly communicated this intention to the regulated community in connection with the adoption of the current baseline rules.

For all of these reasons, the District's review has confirmed that Section 2-2-605 requires that the baseline period for an emissions banking application must be based on the date of that application, not the date of any other application.

The balance of this letter provides a detailed explanation of how the District's regulations apply to Application No. 24430, and why the regulations require the District to base the baseline period for this application on the date that the application was complete. The letter starts with a brief summary of the pertinent facts surrounding Application No. 24430. It then provides an overview of the relevant regulatory provisions that determine how to calculate the amount of emission reduction credits available for banking under this application, including the relevant history of how these regulations were developed. The letter then goes through a detailed regulatory interpretation analysis of the applicable regulations that govern a banking application such as this one. This analysis demonstrates that, as a matter of law, the regulations require that the baseline period must be based on the date that the application was complete. The letter then concludes with a point-by-point response to the issues you raised in your August 8 letter.[1]

II. Overview of Facts Related To Application No. 24430

Application No. 24430 was submitted by Valero on May 15, 2012.[2] The Application requested that the District grant Valero banking certificates to bank certain emission reductions that Valero had achieved at the refinery. These emission reductions had been achieved by the earlier shutdown of two furnaces, Sources S-3 and S-4, on December 31, 2010. Application No. 24430 sought banking credits for these emission reductions under the District's emissions banking program.

The shutdown of these sources was undertaken in connection with a project at the refinery known as the "Valero Improvement Project", or "VIP". Valero was required to undertake the VIP project to address a number of air quality violations, including illegal NOx and SO_2 emissions, among others. EPA filed a complaint against Valero Refining Company in federal District Court to address these violations in 2005, and the parties entered into a Consent Decree under which Valero agreed to implement certain measures to reduce SO_2 emissions (among other things).[3] Valero undertook the VIP project to satisfy its obligations under the Consent Decree, as well as to achieve certain other benefits for the refinery.

The VIP project involved the installation of new equipment subject to District permitting requirements, and so Valero applied for a District authority to construct for the project in accordance with District Regulation 2-1-301. Valero submitted its original

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[1] In addition, I will also follow up by email and send you copies of some of the relevant documents cited in the letter that you may not already have.

[2] This is the date that the District has used as the date on which the application was complete, and the date on which the baseline calculations discussed in this letter are based, and so the letter will refer to this date as the date of Valero's application.

[3] *See* Consent Decree, *United States of America et al. v. Valero Refining Co. et al.*, Case No. SA05CA0569 (W. Dist. Tex.), filed June 16, 2005.

application, Application No. 5864, in 2002, and the District issued an authority to construct for the project on July 31, 2003.[4] Valero subsequently commenced construction, but several years into the project it changed its plans somewhat. These project changes were called the "VIP Amendments", and they required a further authority to construct for the installation of additional and different equipment that was not included in the original authority to construct. Among other changes, the VIP Amendments changed the type of SO_2 scrubber technology that was used in the project, and this new technology required replacement of the two furnaces that generated the emission reductions at issue here (S-3 and S-4).

Valero submitted its authority to construct application for the VIP Amendments, Application No. 16937, on May 16, 2008.[5] The VIP Amendments involved air emissions from the new equipment being installed, and these new emissions had to be offset by emission reductions elsewhere as required by District Regulation 2-2-302 and 2-2-303 to ensure an overall "no net increase" in emissions as a result of the project. The bulk of the offsetting emission reductions came from Sources S-3 and S-4, which were shut down and replaced as part of the project, and the District allowed Valero to rely on these reductions in determining that the project satisfied the offset requirements in Regulations 2-2-302 and 2-2-303.[6] Based on these offsetting emission reductions, and Valero's satisfaction of all other District requirements for the project, the District issued an authority to Construct for the VIP Amendments on December 12, 2008. (Valero also submitted a subsequent application—Application No. 15606—to provide a more precise count of the number of fugitive emissions components that were actually installed after construction was complete. The District issued a revised authority to construct, based on the exact count of such components and a more precise statement of the emissions involved, on May 15, 2009.)

It was apparent at the time that Valero filed its application for the VIP Amendments that the emission reductions generated by shutting down the equipment would exceed the amount required to offset the new emissions from the project. There are several ways that a facility can handle such extra emission reductions under District regulations. One option is to use them to offset new emissions from additional projects the facility may undertake in the future, as "contemporaneous emission reduction credits". The facility does not need to do anything to preserve these extra emission reductions for such future use, as long as the facility plans to use them within the 5-year

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[4] See May 1, 2009, Engineering Evaluation, App. Nos. 16937 & 15606 (hereinafter, "Engineering Evaluation"), at p. 3.

[5] Application for Authority to Construct and Permit to Operate, Valero Improvement Project Amendments, Doc. No. 06993-023-400 (ENSR Corp., April 2008) (hereinafter, "April 2008 Application"). Valero initially submitted an application in November of 2007, but the District determined in December of 2007 that it was incomplete. Valero provided this further submittal, dated April 2008, and the District determined the application to be complete as of May 16, 2008 (per the District's permit application tracking database).

[6] See Engineering Evaluation, *supra* note 4, at Section IV.1.-IV.3., pp. 15-23.

"contemporaneous" period defined by District Regulation 2-2-242. Another option, if the facility desires to use them beyond this 5-year "contemporaneous" period and/or to sell them for use at another facility, is to bank them under the District's emission banking program. The facility needs to submit a banking application under District regulation 2-4-401 if it wants to pursue this second option.

When Valero submitted its application for the VIP Amendments, Application No. 16937, in 2008, the company indicated that it was interested in pursuing the second option—banking the credits. Valero thus expressed an intention in its application to submit a banking application at a future, unspecified date. Specifically, the application stated in two separate places that "Valero will submit an application to bank ERCs from these reductions under separate cover."[7] In response, the District recognized in its Engineering Evaluation for the application that Valero could submit such a banking application if it so desired. The District stated that "Valero may bank any allowable excess of emission reductions, in accordance with Regulation 2, Rule 4, after the project is built and the actual equipment has shut down."[8] It was thus apparent that in 2008, both parties understood clearly that Valero could request to bank such additional emission reductions if it wanted to, and that to do so Valero would have to submit a banking application under the provisions of the District's banking program in Regulation 2, Rule 4.

Valero failed to follow up and submit a timely banking application, however. Valero shut down furnaces S-3 and S-4 on December 31, 2010, as implementation of the project progressed. But for reasons known only to Valero, the company did not request banking credit for the resulting NOx and PM_{10} emission reductions for another 15 months, until May 15, 2012. Valero has not provided an explanation as to why it failed to apply to bank these emission reduction credits for such a long time after it shut down the equipment and realized the emission reductions.

The District reviewed Valero's banking application, Application 24430, under the applicable rules in District Regulation 2 (Permits), which are outlined in the next section. As detailed there, the amount of emission reductions that can be credited in a banking application is based on the emissions of the source being shut down during a specified "baseline period." This baseline period is the 3-year period immediately preceding the date on which the application was complete. Application 24430 was complete on May 15, 2012, and so the baseline period for this application is May 15, 2009 through May 14, 2012. The District used the emissions from S-3 and S-4 during this baseline period as the baseline emissions, and therefore calculated the amount of bankable emission reductions

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[7] April 2008 Application, *supra* note 5, at p. 4-5, p.7-1. The Application made these statements in two places: (1) in the discussion of how the project will comply with the District's permit requirements in Section 4, under the heading "Emission Reduction Credits" (which discussed compliance with the offset requirements of District Regulations 2-2-302 and 2-2-303); and (2) in Section 7.0, in a discussion entitled "Banking Credits."

[8] Engineering Evaluation, *supra* note 4, at p. 4.

as 2433.37 tpy worth of SO_2 credits. This determination is reflected in Engineering Evaluation being transmitted to Valero under separate cover.

III. Summary of District Regulations Governing Application No. 24430

As you recognize in your letter, the District's emissions banking program is governed by District Regulation 2, Rule 4, and the provisions for determining the eligibility of emission reductions for banking and the amount of reductions that can be credited in a banking application are set forth in the relevant provisions of District Regulation 2, Rule 2. Specifically, Regulation 2-2-201 requires that emission reductions must be real, permanent, quantifiable, enforceable, and surplus in order to be banked as emission reduction credits. For reductions that satisfy these requirements, the quantity of reductions that can be banked is determined by the emission reduction calculation procedures in Regulation 2-2-605.[9]

Regulation 2-2-605 provides that the amount of emission reductions that can be banked is based on the "baseline" emissions of the source that was shut down to achieve the reductions, adjusted to reflect current regulatory standards. The baseline emissions are the source's average emissions during a 3-year baseline period, which is defined in subsection 605.1 as "the 3-year period immediately preceding the date that the application is complete . . . ." The amount of emission reductions from the source that can be credited in a banking application such as Application No. 24430 is therefore the source's average emissions over the 3-year period immediately preceding the date that the application was complete, less any adjustment necessary to account for current regulatory requirements.[10] The key date for purposes of an emissions banking application is thus the application date—not the date that the source was shut down or any other date related to the source.

Notably, an important practical effect of this baseline rule is to encourage applicants to submit banking applications as soon as possible after a source is shut down.

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[9] Various provisions of Regulation 2, Rule 4 establish that Section 2-2-605 provides the applicable calculation procedures for banking applications, as you note in your letter. Section 2-4-601, governing "Emission Calculation Procedures" for banking under Regulation 2, Rule 4, provides that "[t]he emission calculation procedures contained in Regulation 2-2-600 shall be applicable to this Rule [i.e., Regulation 2, Rule 4]." Section 2-4-201, the definition of "emission reduction credits" in Regulation 2, Rule 4, incorporates by reference the definition in Regulation 2-2-201, which provides that an "emission reduction credit" is "an emission reduction[] calculated in accordance with Section 2-2-605 . . . ." And Section 2-4-301, which establishes the substantive standards for banking emission reductions under Regulation 2, Rule 4, provides that bankable emission reduction credits are "emission reduction credits as defined in Section 2-4-201," which incorporates the Section 2-2-201 definition and the emission calculation procedure in Section 2-2-605 as noted in the previous sentence.

[10] The intent that the baseline period for banking applications is the three years before the *banking* application is complete is clear from the plain meaning of subsection 605.1 when it is applied to banking applications; from the regulatory context in which Section 2-2-605 arises; and from the District's clearly expressed intent in the administrative record when it adopted the current baseline rules for banking. These points are discussed in detail in Section IV below.

If an applicant waits to submit the banking application, periods after the source is shut down—when emissions from the source are by definition zero—get included in the baseline period, which reduces the overall baseline emissions and thus the amount of emission reductions available for banking credit.

The District adopted this 3-year baseline rule for calculating emission reduction credits in 2000. Before that time, the source's baseline emissions were based on any representative 12-month period out of the 5 years immediately preceding the application date. This was the rule both for contemporaneous onsite emission reduction credits and for emissions banking, which prior to 2000 were governed by different sections. (At that time, the baseline rule for contemporaneous onsite emission reduction credits was set forth in Section 2-2-605.1, which provided that the baseline period was a representative 12-month period within the 5 years "immediately preceding the application date." The baseline rule for emissions banking was set forth in Section 2-4-202, a provision entitled "Banking Credit Period" that has since been deleted, which similarly provided that the baseline period was a representative 12-month period within the 5 years "immediately preceding the application date."[11])

The banking rules prior to 2000 also included a provision requiring that a banking application must be submitted within 18 months after the shutdown or other change at the source that generated the emission reductions.[12] A facility could therefore request banking credit at any time up to 18 months after the shutdown of a source, and it could use the source's emissions during a previous 12-month period while it was still in operation as the baseline emissions for purposes of calculating the amount of banking credit available. The old rules prior to 2000 therefore did not generate the same urgency to submit a banking application immediately after a source was shut down, because periods of zero emissions after the shutdown did not necessarily have to be included in the baseline.

In 2000, the District decided to switch to a 3-year baseline, for both contemporaneous onsite emission reduction credits and emissions banking purposes. The District cited various reasons for this change, including concerns raised by EPA staff that the use of any 12-month window within a 5-year period provided too much flexibility and discretion. (A full discussion of the reasons for the change was provided in the Staff Report the District prepared for the rule changes.[13]) The District effected this change by adopting the current language in Section 2-2-605, with the 3-year baseline provision in subsection 605.1, and by consolidating the calculation rules for both contemporaneous onsite emission reduction credits and emissions banking in that Section. The separate calculation rule for banking applications in Section 2-4-204 was eliminated, with the new

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[11] *See* Regulation 2-4-202, "Banking Credit Period" (Oct. 7, 1998 version).

[12] *See* Regulation 2-4-402.1 (Oct. 7, 1998 version).

[13] *See* Staff Report, Proposed Amendments to BAAQMD Regulation 1 (General Provisions) and Regulation 2 (Permits) Rule 1 (General Requirements), Rule 2 (New Source Review), and Rule 4 (Emissions Banking) (May 2000) (hereinafter, "2000 Staff Report"), p. 32.

rules in Section 2-2-605 providing the calculation procedures for emissions banking as well as for contemporaneous onsite emission reduction credits.

One practical impact of this change was to eliminate the ability of applicants to wait up to 18 months to submit a banking application without impacting their emissions baseline. Instead, the change required applicants to submit their banking applications immediately or have the amount of credits available for banking eroded by the passage of time. Given the importance of this change, the District discussed it in the Staff Report and several commenters asked for clarification on how the revised rules were intended to work. As the District explained in the Staff Report, "[t]he net effect of this change is to encourage applicants to complete their application in a timely manner . . . ."[14] The Western States Petroleum Association ("WSPA"), a trade association representing petroleum refiners, sought clarification on this proposed change, expressing its concerns as follows:

> The proposed amendments eliminate the ability to protect a quantity of potential emission reduction credits for 18 months, following the date of modification, by starting ***an immediate devaluation of the credits until an application is deemed complete.***[15]

District Staff responded to these concerns by clarifying that the baseline period does in fact run from the date of the banking application as WSPA noted. As Staff's response stated:

> [A]fter the rule change, [a delay in the submission of a complete application] will ***reduce the available credits.*** Very few of the banking applications we have received are for anything other than shutdowns. The rule change will require complete banking applications before reductions occur; ***a delay in application will result in a reduction in credit.***[16]

As these passages show, the District was clear and explicit from the very beginning in how the 3-year baseline rule was to be applied for emissions banking application. Moreover, members of the regulated community also clearly understood how the rule would work.

More recently, in a subsequent rulemaking in 2012 designed to clarify the District's permitting rules even more, the District revised the language used in the baseline calculation procedures to make it even clearer how these rules work. The revised language on establishing baseline emissions, which was renumbered from Section 2-2-605 into a new Section 2-2-603, spells out in detail how exactly the baseline period is calculated for each different type of application for which a baseline period needs to be

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[14] *Ibid.*

[15] *Id.*, Response to Comments on Workshop Draft (Apr. 12, 2000), p. Comment-9, Comment No. 25 (emphasis added).

[16] *Ibid.* (emphasis added).

established. For emissions banking applications, the revised language states explicitly that the 3-year baseline period is based on "the date on which the banking application is complete."[17] As the District explained in adopting this clarifying language for the baseline period for emissions banking:

> For emissions banking applications under Regulation 2, Rule 4, the baseline period is the period immediately preceding the date of the banking application. . . . This is the District's current procedure for handling banking applications under Regulation 2, Rule 4, and it will be codified in subsection 603.1.4.[18]

Notably, Valero submitted comments on this recent rulemaking. In particular, Valero commented on certain other aspects of the District's emission reduction credit calculation procedures other than the baseline period provision, and noted that "[t]he Staff Report discussion parallels the current practice."[19] Valero did not object that specifying more explicitly that the baseline period for a banking application runs from the date of the complete banking application was inconsistent with the way the baseline rules had historically been interpreted, or that clarifying this rule constituted a substantive change in the District's regulations. That is, Valero raised no objection that the clarification that the baseline period for a banking application is the 3-year period preceding the *banking* application did not also "parallel current practice."

Given this history, the District was under the impression that Valero understood how the 3-year baseline period works for emissions banking, along with the rest of the regulated community. Your August 8 letter indicates that this was apparently not the case. One important purpose of this letter is to explain for Valero exactly how and why the District's baseline rules work this way. The next section of the letter will help achieve this goal by providing a regulatory interpretation analysis for the emissions banking baseline rules.

IV. Under District Regulations, the Baseline Period for Application No. 24430 is the 3-Year Period from May 15, 2009, through May 14, 2012.

In light of the points you raised in your August 8 letter, the District has gone back and undertaken a detailed regulatory interpretation analysis of the rules governing the baseline period for Application No. 24430. In particular, the District has considered whether the baseline period for this banking application should be based on the April

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[17] *See* Section 2-2-603.1.4 (adopted Dec. 19, 2012). Note that the revised regulations have not taken effect yet pending final approval by EPA.

[18] Final Staff Report, *Updates to BAAQMD New Source Review and Title V Permitting Programs* (Sept. 26, 2012), at pp. 95-96 (underlining in original text omitted).

[19] *See* Letter from S. Gustofson, Valero, to C. Lee, BAAQMD, Oct. 26, 2012, re: *Comments on Proposed Amendments to Regulations 2-1, 2-2, 2-4, and 2-6, etc.*, (hereinafter, "Gustofson Letter"), p. 3, Comment # 3 (Emissions Reduction Credit Calculation Procedures (2-2-605)).

2008 date when Valero submitted its application for an authority to construct for the VIP Amendments—approximately 4 years before Valero submitted the banking application, Application No. 24430, in May of 2012.

The District's analysis shows that the meaning and intent of the provisions for calculating banking credits are clear: The baseline period for determining the amount of bankable credits is based on the date of the application to bank the credits, not on the date of any other application that may have been submitted regarding a particular source. The details of the regulatory interpretation analysis are set forth in the discussion below, which first goes through the relevant legal principles for interpreting regulations and then addresses the specific points you raised in your August 8 letter.

A. District Regulation 2-2-605.1 is Clear that the Baseline Period for Application No. 24430 is "the 3-year period immediately preceding the date that the application is complete," which was May 15, 2012.

All relevant principles of regulatory interpretation—including the plain language of the baseline provision, the broader context in which the provision exists within the District's permitting regulations, and the District's express statements of the intended meaning of the provision in the regulatory history—demonstrate that the baseline period for a banking application is the 3-year period immediately prior to the date of the banking application. None of the relevant principles of regulatory interpretation supports Valero's position that the baseline date should be based on some other date such as the date of a prior application for an authority to construct. In light of this regulatory analysis, the only reasonable conclusion is that the date that establishes the baseline period for Application No. 24430 is the date of Application No. 24430—i.e., May 15, 2012. At the very least, the District's reasonable interpretation of its own regulations on this issue is entitled to substantial deference, and would therefore prevail over Valero's contrary view in the eyes of any reviewing tribunal. (*See, e.g., Environmental Protection Information Center v. California Dept. of Forestry & Fire Protection* (2008) 44 Cal. 4th 459, 490 & 505 ("[W]e defer to an agency's interpretation of its own regulations, particularly when the interpretation implicates areas of the agency's expertise.").)

1. The Plainest and Most Natural Reading of the Term "Application" is that it Refers to the Application Under Review.

The starting point for any regulatory interpretation analysis is the plain language of the regulation. (*Garcia v. McCutchen* (1997) 16 Cal.4th 469, 476 ("[O]ur first step is to scrutinize the actual words of the statute, giving them a plain and commonsense meaning.") (internal quotation marks & citations omitted).) Here, the plainest and most natural reading of the term "application" in the baseline provision in subsection 605.1 is that it is referring to the application to which baseline provision is being applied. That is, when subsection 605.1 is being applied to determine the baseline period for *Application No. 24430*, the plain language regarding "the date that the application is complete" means the date that *Application No. 24430* is complete. To interpret it as referring to any other

application—such as a prior application for an authority to construct that was submitted four years earlier—requires a strained reading that departs from the plain and obvious meaning of the text.

Moreover, this is the only meaning for the term "application" that makes logical sense in all banking situations. In many cases, banking applications are filed in situations where there is no other relevant "application" that has ever been submitted with respect to the source or equipment that is being shut down. This situation is explicitly contemplated by Regulation 2-2-201.2, which states that:

> All emission reduction credits shall be enforceable by permit conditions in the authority to construct and permit to operate, except that, ***in the case of source closures where no permit is required for the source being shut down***, the emission reduction credit shall be enforceable through appropriate contractual provisions in a legally binding and irrevocable written agreement in which provisions will be made expressly for the benefit of the District.

(District Reg. 2-2-201.2 (emphasis added).) In these cases, "the application" can only mean the banking application, as there is no other "application" that the term could possibly refer to. Any argument that the term "application" in the banking context means a prior authority to construct application breaks down because it becomes nonsensical in banking situations such as these. (*See People v. Shabazz* (2006) 38 Cal.4th 55, 67 ("[I]f a statute is amenable to two alternative interpretations, the one that leads to the more reasonable result will be followed.") (citing *Metropolitan Water Dist. v. Adams* (1948) 32 Cal.2d 620, 630-31).)

2. The Regulatory Context Surrounding Section 2-2-605 Establishes that "Application" Means the Banking Application When Applied in the Banking Context.

In addition to the plain language of subsection 205.1, the regulatory context in which Section 2-2-605's baseline calculation rules are situated also indicates that the term "application" means the banking application when it is being applied to a banking application.

The emission calculation procedures in Section 2-2-605 are used in multiple different contexts with the District's permitting regulations. They are used for measuring both emissions increases and decreases, and they are used both in the context of applications to authorize new increases in emissions from new sources and in the context of applications to bank emission reductions from the shutdown of existing sources. Any interpretation of the term "application" in Section 2-2-605.1 needs to recognize that the regulation is intended to apply in all of these different contexts—and therefore needs to be interpreted so that it will function in each of these different contexts. (*See Robert L. v. Superior Court* (2003) Cal.4th 894, 903 ("Statutory language should not be interpreted in isolation, but must be construed in the context of the entire statute of which it is a part, in

order to achieve harmony among the parts.") (quoting *People v. Morris* (1988) 46 Cal.3d 1, 16).) In order to do so, the term "application" needs to be read to refer to the particular application at issue in each of the different situations in which it is applied. Where it is being applied to determine the amount of an emissions increase associated with an authority to construct for a new or modified source, for example, the term "application" means the application for the authority to construct. By the same token, where it is being applied to determine the amount of emission reductions that can be credited in a banking application, the term "application" means the application to bank the reductions.

Any assertion that the term "application" needs to be read to refer to a single type of application for all purposes ignores the context of the regulation, which was intended to apply to multiple different types of "applications" in multiple different regulatory situations. The only way to make this term function properly in the context of the District's permitting regulations is to read "application" to mean the particular application under review to which the baseline calculation procedures are being applied. In the banking situation presented here, that "application" is Application No. 24430, the banking application currently under review to which Section 2-2-605 is being applied.

3. The District Clearly Stated When it Adopted the Current Banking Rules that the Baseline for Banking Applications is Calculated Using the Date of the Application to Bank the Emission Reduction Credits—Not Any Other Application Date.

Turning to the regulatory history of the baseline provision in Section 2-2-605, the record is clear that the District always intended that the baseline for emissions banking applications would be calculated based on the 3-year period immediately preceding the date of the banking application. When the District adopted this rule, District staff noted in the Staff Report that the practical effect of the rule will be to require the submission of banking applications "in a timely manner," given that the emissions baseline is calculated from the date of the banking application and will start to erode if the banking application is delayed.[20] Industry commenters recognized that the banking calculations would be based on the banking application date, and observed that doing so will result in "an immediate devaluation of the credits until an application is deemed complete."[21] And District staff replied to their comments by confirming that the new rules "will require complete banking applications before reductions occur; a delay in application will result in a reduction of credit."[22] In light of these statements in the rulemaking record, the District's intent behind the baseline provision could not be more clear: The baseline period for a banking application was always intended to run from the date of the complete *banking application*; and where an applicant delays in submitting its banking application until some time after the shutdown of the source for which banking credit is

[20] 2000 Staff Report, *supra* note 13, at p. 32.

[21] *Id.*, Response to Comments on Workshop Draft (Apr. 12, 2000), p. Comment-9, Response to Comment No. 25 (emphasis added).

[22] *Ibid.* (emphasis added).

sought—as Valero has done here—the amount of bankable reductions to be credited to the application was intended to decline based on the passage of time.

To the extent that there is any ambiguity about whether the term "application" in the context of a banking application refers to the banking application or some prior authority to construct application, this explicit discussion in the regulatory history clears it up. These passages make clear that the intent of the regulation was the former—that the baseline for banking purposes is calculated from the date of the banking application. The District interprets Section 2-2-605 this way because (in addition to the plain language and regulatory context) that is the way that the provision was always intended to be interpreted. (*See Brinker Restaurant Corp. v. Superior Court* (2012) 53 Cal. 4th 1004, 1049 fn. 28 ("[P]roof that statutory or regulatory language was adopted with a particular intent, and that the adopting body did not thereafter express a contrary intent, may suffice to show that the language should be interpreted today in line with that original intent.").)

B. Valero Is Incorrect that the Baseline Period for Application No. 24430 Should Be Based on the Date of Application No. 16937.

The points outlined above demonstrate that the District's interpretation is correct and is supported by all applicable principles of regulatory interpretation. In addition to this regulatory interpretation exercise, the District also has the following responses to specific points you raised in your August 8 letter.

1. The "Plain Language" Reading of Section 2-2-605.1, as well as the Regulatory Context, Show that the Baseline Date for Application No. 24430 is the Date that *that* Application was Complete.

You claimed in your letter that the "plain language" of subsection 605.1 says that the term "application" means the prior application for the authority to construct for the VIP Amendments, not the banking application. Your "plain language" argument is that Section 2-2-605 is a provision in the District's NSR rules in Regulation 2, Rule 2, and so the term "application" must therefore "be understood within the context of those rules that refer to NSR permit applications." You also argued that the banking rules in Regulation 2, Rule 4 use "the specific terminology 'banking application' " where they refer to such banking applications, and that the term "application" in subsection 605.1 must therefore mean an authority to construct application. (Aug. 8 Letter p. 3.) In other words, your argument is that if the District had intended the term "application" in subsection 605.1 to mean the banking application, it would have specifically stated "banking application" in that subsection instead of using the more generic term "application".

These arguments are misplaced. You are correct that the term "application" in subsection 605.1 must be understood in the context of the rules in which it is used. But that context makes clear that the baseline rules in Section 2-2-605 are used for multiple

different purposes—including applications for authorities to construct for new and modified sources *and* applications to bank emission reductions. It is thus clear that they should not be interpreted as referring to authority to construct applications under all circumstances as you suggest. To the contrary, it is clear that they were intended to refer to authority to construct applications when they are applied to authority to construct applications, and banking applications when they are applied to banking applications. Indeed, "application" in Section 2-2-605.1 has to be interpreted to mean "banking application" in at least some circumstances, as there are many cases where there is no other "application" related to a source that has been shut down other than the banking application, as noted above (*see* discussion in Section IV.A.1.). The term cannot be read as having to mean a prior authority to construct application in all cases, as Valero has argued, because in many cases such a reading is nonsensical.

Moreover, you are incorrect that the District always uses the specific term "banking application", as opposed to the more simple shorthand reference "application", where it means banking application. It is common to refer to a banking application simply as the "application" where it is clear from the context which application is being referred to. The District does this in a number of places in Regulation 2, Rule 4,[23] and in fact Valero routinely does this itself in communications with the District.[24] You even did the same thing yourself in your August 8 letter, requesting that "the District promptly approve Valero's application" and that it "act on Valero's application within the next 30 days." There is simply no way that the use of the more general term "the application" in the District's baseline rules can be taken as an indication that the District intended to specifically exclude banking applications in situations where the baseline rules are being applied to banking applications. To the contrary, the term "application" (as opposed to the more specific "banking application") is actually necessary in this provision so that the language will be flexible enough to apply to both authority to construct applications and banking applications.

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[23] See, e.g., District Regulation 2-4-402 ("If the APCO determines that the application is not complete, the applicant shall be notified in writing of the decision, specifying the information that is required. . . . Upon a determination that the application is complete, the APCO shall notify the applicant in writing. Thereafter, only information to clarify, correct, or otherwise supplement the information submitted in the application, may be requested.") In each of these places where the Regulation says "application", it clearly means "banking application".

[24] Valero itself said it would submit an "application" to bank any excess emission reductions – not that it would submit a "banking application". *See* April 2008 Application, *supra* note 5, at p. 4-5, p.7-1. Obviously, the intention was clear that when it said "application", it meant "banking application". The same holds true for interpreting the term "application" in Section 2-2-605.1 as it applies to banking applications.

2. Using the Application Date Encourages Applicants to Submit Banking Applications Promptly After They Shut Down Their Sources, Which Fully Supports the Policy and Purpose Underlying Emissions Banking.

You also claimed that applying the baseline rule in this manner fails to "support[] the overall purpose of the rule" by not allowing Valero to preserve emission reductions from prior equipment shutdowns for banking at a later date under a subsequent banking application submitted several years later. (Aug. 8 Letter at pp. 3-4.) The District strongly disagrees that its application of the baseline rule fails to support the overall purpose of the rule. To the contrary, applying the rule this way serves the very important purpose of encouraging applicants to submit timely banking applications, as District staff explained in the Staff Report that accompanied the adoption of the current baseline rules.[25] The District does not want facilities to leave creditable emission reductions lingering in limbo without going through the banking process, if they do in fact intend to bank them. This has always been an inherent part of the District's banking program, and before the current banking rules were adopted the program had a hard 18-month deadline for submitting banking applications to further this purpose. The 2000 amendments changed this rule to remove the hard deadline, but retained the fundamental purpose of encouraging timely banking applications by replacing the hard deadline with what is effectively a gradual reduction in the amount of bankable credits over time. It is important that the District calculate the emissions baseline based on the date of the banking application in order to further this central purpose of the banking rule.

In fact, the truth is that Valero's contrary position is the one that would fail to support the overall purpose of the rule. Valero's position would put no time limits whatsoever on submitting the banking application in situations like this one. Under Valero's position, a facility could shut down a source as part of a project that was subject to an authority to construct, and then come back many years – or indeed even decades – later and request banking certificates for any excess emission reductions that were not used in offsetting emissions from the prior project. Such an open-ended process would severely undermine the rule's purpose of ensuring that facilities submit timely banking applications. The District has never intended its banking program to work this way, and moving to such a system now would not make for good public policy.

3. The District Explicitly Informed Regulated Entities When it Adopted the Current Banking Rules that the Baseline Period for Emissions Banking Applications Would Be Based on the Date of the Application to Bank the Emission Reduction Credits.

Finally, you also stated that calculating the amount of creditable emission reductions for this banking application based on the date of the banking application would violate Valero's "due process" rights. This contention was based on an argument that the District failed to provide notice to the regulated community about how it would

[25] 2000 Staff Report, *supra* note 13, at p. 32.

apply the rule at the time of adoption. Specifically, you stated that the District has failed to provide notice because "there [was not] any suggestion during the relevant time frame that the value of the ERC's would be diminished if the ERC banking application was not filed concurrently with the shutdown of the sources at issue." (Aug. 8 Letter at p. 4.)

But this assertion is obviously not correct as a factual matter. To the contrary, the District explicitly addressed this point when the current baseline rule was adopted in a colloquy with the regulated community, as noted above, and it made clear that the amount of bankable credits *will* be diminished if the banking application is not filed concurrently with (or prior to) the shutdown of the sources. Specifically, District stated explicitly in the rulemaking record that the baseline rule "will require complete banking applications before reductions occur" and that "a delay in [submitting the banking] application will result in a reduction of credit." Moreover, a trade organization representing Bay Area petroleum refiners also explicitly recognized that the rule results in "an immediate devaluation of the credits until an application is deemed complete." Given these explicit statements in the rulemaking record, Valero simply cannot assert that the District failed to provide sufficient notice to the regulated community of how it intended to apply the baseline rules to banking applications such as this one. (*See Howmet Corp. v. EPA*, 614 F.3d 544, 553-54 (D.C. Cir. 2010).)

Moreover, since the current rules were adopted in 2000, the District has publicly explained how the baseline rule works for banking applications, and Valero has never voiced any objection. Specifically, as noted above (*see* Section III), the District recently amended its rules to clarify that in the context of emissions banking, the baseline period is calculated based on the date of the banking application—and it specifically discussed in the accompanying Staff Report that this has always been the District's practice under the current rules. Valero was clearly aware of this clarification and the accompanying discussion, because it noted in a related context regarding ERC calculation procedures that the Staff Report discussion "parallels the current practice."[26] And yet Valero never voiced any concern that establishing the baseline period for banking applications based on the banking application date could be a departure from current practice. This lack of concern at the time belies Valero's current assertion that the District is somehow changing the rules in the middle of the game. To the contrary, the District is simply applying the same rules that have been clear from the day the District adopted the current regulations.

V. Conclusion

For all of the foregoing reasons, the District disagrees with the arguments expressed in your August 8 letter that the District should use the date of Application No. 16937 to establish the baseline period for Application No. 24430. As explained herein,

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[26] *See* Gustofson Letter, *supra* note 19, p. 3, Comment # 3 (Emissions Reduction Credit Calculation Procedures (2-2-605)).

the District's regulations require that the baseline period for Application No. 24430 must be based on the date of Application No. 24430, not the date of any prior application.

The District has evaluated Application No. 24430 on this basis, and based on that evaluation the District is proposing to issue Valero 2433.37 tpy worth of SO_2 banking certificates, pending consideration of any comments received. The District invites Valero to submit comments on the proposal. In particular, the District invites Valero to submit comments on any of the issues discussed above, as the analysis set forth in this letter is a basis for, and incorporated by reference into, the Engineering Evaluation for Application No. 24430. The District will consider any and all comments received before making any final decision on its proposal.

Please also feel free to give me a call at (415) 749-4732 if you have any questions about any of the points raised in this letter, or if you would like to discuss them in a less formal setting than submitting a comment on the District's proposal.

Very truly yours,

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