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Mr. Steve S. Cliff, Ph.D.
Cap and Trade Program Manager
California Environmental Protection Agency Air Resources Board
1001 I Street
Sacramento, CA 95812

RE: AB 32 CAP AND TRADE EMISSION ALLOWANCE CALCULATIONS

Dear Steve:

On behalf of California Steel Industries, Inc. (CSI), thank you for the opportunity to offer further comment on ARB's latest draft of its cap and trade rules.

In particular, our comments are directed at ARB's current methodology for determining the amount of allowances directly allocated to industrial sources, as codified at section §95891.

It is our sincere belief that the current methodology as described is not adequate in providing sufficient allowances for those sources that have invested in clean technology, energy efficiency and industrial growth in the state of California. This is particularly important in light of the state's precarious economic condition, and ARB's stated sensitivity to the financial impact of compliance, especially in the initial years of the program.

The insufficiency is related to the manner in which the compliance obligation is set and the allowances are allocated. Different production years are used to determine the compliance obligation and the allowance allocation.

The regulations base an industrial source's compliance obligation on their current year's level of emissions reported to the ARB under the Mandatory Reporting Program. Emissions are based on the source's current level of production in that same year. For example, the compliance obligation in the year 2015 is based on that source's emissions and level of production in the year 2015.

However, the allowances allocated to that source for the year 2015 would be based on its production level in the year 2013. A facility that may have experienced production growth between 2013 and 2015 could find itself with insufficient allowances because different years are used as baselines in determining emissions and allowances.

ARB intends to provide allowances prior to the beginning of the compliance year. Therefore, allowances for 2015 would be awarded at the end of 2014. As the 2015 production is not known until the end of the year, ARB has introduced a "true-up" calculation formula in an attempt to provide allowances to make up the difference between the estimated level of production and the actual level of production for 2015.

Unfortunately, the true-up calculation also uses production levels from previous years in estimating the true-up amount. As an example, for the 2015 true-up, the difference in production between the years 2011 and 2013 is used in estimating the true-up. If there was a decline in production between 2011 and 2013, the true-up could even have a negative value, regardless of what actually occurs in 2015.

A more equitable means of allocating allowances would be, as much as practicable, to use the level of production from the same year that is used in reporting emissions in the equation at §95891(b). An additional true-up during each production year, perhaps in the late third quarter of the year, might be explored as a solution. Such an approach would certainly reduce the uncertainty for companies and would represent a more accurate and timely coverage of their exposure for allowance needs.

This issue of proper true-up of allowance allocation is especially important in the weak economy which we face today. If struggling companies in the current recession are forced to buy allowances that they have counted on to be "free," it could push many of them over the edge. Under the currently proposed methodology, the need to buy allowances is likely to happen in many cases as companies' production levels gradually increase coming out of the recession.

An improper true-up mechanism is especially damaging for companies that have "taken the plunge" to invest in increased production capacity in recent years. CSI is one example. CSI spent more than $70 million during the recession to invest in a new, cleaner reheat furnace, representing state-of-the-art emissions control technology for its production of hot-rolled steel sheet. The new furnace reduces greenhouse gas emissions per ton of steel produced, and also allows about 50 percent greater production capacity, which helped justify this major expenditure. Now, as CSI seeks to obtain the expected payback on this investment, it will be seeking to grow its production and sales beyond the levels that existed prior to the recession. In a scenario of annual growth for several years, a company such as CSI will be constantly coming up "short" on allowances and having to go to market to buy them – even though the new production capacity produces fewer emissions per unit of production. This result is not fair or reasonable and is both damaging to the economy and punishing to companies willing to invest in growth in California.

We respectfully request that ARB revisit the allocation issue to more equitably address the reality that many companies who survive the recession will be raising their production annually for the next several years, and will be in a precarious position to absorb unexpected costs of buying emission allowances.

Very truly yours,

Brett Guge

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