



Western States Petroleum Association
Credible Solutions • Responsive Service • Since 1907

Catherine H. Reheis-Boyd
President

September 27, 2011

Via web: <http://www.arb.ca.gov/lispub/comm/bclist.php>

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, California 95814

Re: Comments on 2nd 15-day Proposed Regulations: California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Dear Clerk of the Board:

The Western States Petroleum Association (WSPA) is a trade association representing twenty-seven companies that explore for, produce, refine, transport, and market petroleum and petroleum products and natural gas in California, Arizona, Nevada, Hawaii, Oregon and Washington. Most of our companies have operations within California and are significantly affected by regulations proposed by the California Air Resources Board (ARB).

Because of the substantial impact on WSPA members, the economy, and likely potential impact on energy supplies, WSPA has been an active participant in the public policy discussions about the implementation of AB 32. We have previously commented on issues affecting the Cap and Trade program and benchmarking regulations to ARB (December 15, 2010) and on the first 15-day Proposed Regulations (August 21, 2011).

In addition, WSPA has made comments on many aspects of AB 32 implementation addressing key aspects such as leakage, trade exposure, cost containment, linkage, offsets, and most recently on the Supplement to the AB 32 Functionally Equivalent Document (SFED) and on the first 15-day comment period for Mandatory Reporting and Recordkeeping (MRR) (August 21, 2011).

ARB has made progress in its efforts to develop its cap-and-trade program and we appreciate the positive amendments made in the most recent 15-day proposed regulations. ARB's efforts to

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

understand the concerns of stakeholders have resulted in an improved understanding of the details surrounding the initiation of a market-based approach. However, the proposed Cap and Trade program still requires additional clarification prior to its initiation. We identify improvements and unresolved issues below.

Support for Market-based Approach

As in the past, WSPA reiterates its support for a market-based approach to *industrial emissions* in the implementation of AB 32. We continue to believe that a well designed market based approach will be the most effective means to meet the Greenhouse Gas (GHG) reductions mandated by AB32.

Concern with 10% reduction in free allowances

WSPA is very concerned, and joins others in opposing, ARB's imposition of a 10% reduction in allowances at the start of the cap and trade program. Rather than encouraging a "soft start" to the program and improve the chances of the program's success, the 10% reduction works to frustrate that effort by increasing costs and uncertainties to participants at a time when the economy cannot support additional costs. The reduction also poses a unique, additional hurdle for trade-exposed industries such as the oil and gas production and refining industries by imposing costs to operations in California that are not imposed on those operating outside the State.

In fact, the proposed reduction in free allowances is a policy decision that is in direct conflict with ARB's recognition, and stated intent, to mitigate the impacts of the C/T program on trade-exposed industries. Again, this is so because the proposed reduction exacerbates the impact of trade exposure to facilities within California because it imposes immediate and obvious costs to California operators that are not imposed on those operations outside the State. Because importers are not affected by allowance costs, this inequity can lead to leakage of goods and/or services to operators outside the State – again an outcome that ARB indicated it wished to avoid.

Finally, the immediate reduction in free allowances, in reality, simply represents an abrupt transfer of millions if not billions of dollars of revenue whose justification and ultimate use is both undefined and undocumented. While, we have been told that the 10% reduction is to provide incentive to be more GHG efficient, it seems obvious that the cap and trade program itself provides the necessary incentives. This additional 10% "incentive" is an unnecessary "add-on" that may cause a sudden unnecessary disruption that could negate a soft start to this program. The reduction has no impact to air quality nor will it contribute to emission reductions. Rather, it will generate literally hundreds of millions of dollars from participants for undefined and unidentified uses. In fact, up to this time, ARB has simply not been transparent in developing the requirements of the 10% reduction nor has the agency fulfilled the requirements to clearly document the need for that element within the Cap and Trade Program.

Recommendation: ARB should remove the 10% reduction in allocations from its program. Should it wish to pursue it in the future, the Agency should document: 1) the need for this element; 2) the anticipated environmental benefit; and 3) that the supply of allowances and offsets will be sufficient to ensure companies can comply with AB 32 limits.

Refining Benchmarking: Inclusion of Solomon Energy Intensity Index (EII)

ARB's inclusion of the Solomon EII index within the allocation process is an important improvement in ARB's efforts to define an equitable allocation methodology. WSPA supports its inclusion in the allocation process because it rewards early action and energy efficiency without punishing California's more complex refining configurations, which are necessary to produce California's unique and cleaner fuels. Use of the EII is beneficial because the index recognizes the many products including many specialty chemicals and gases that are involved in the efficient transformation of crude oil into valuable products. Use of the EII is critical to the appropriate allocation of allowances in an emerging cap and trade program.¹

Recommendation: If ARB proceeds with the additional 10% cut in allowances, ARB should agree to work with WSPA to further refine the EII-based methodology and address new concerns that place California refiners at an unfair disadvantage.

Refinery Benchmarking: EII Data Year

The proposed regulations require that ARB choose the EII data from information submitted by refineries. This poses uncertainty as refiners are already in the process of developing their compliance strategy based on EII data already developed for their facilities. In addition, the proposed language also requires EII data for years that are not part of the biennial program. For example, while EII data for 2008 and 2010 data have been developed, data for 2009 and 2011 have not.²

The rule also requests EII data for years after the benchmark is set in the first compliance period. There is no basis for requiring this data after the EII benchmark is set.

Recommendation: Use 2008-year EII data validated and reviewed by Solomon unless that year is not representative of normal facility operations. If data for 2008 are not representative of normal facility operations, then 2010 data can be used. Alternatively, companies may choose to submit 2009 EII information for use by ARB.

Refinery Benchmarking: Protection and Handling of Confidential EII data

In what is probably an inadvertent omission in the provision describing use of the EII index, ARB has not described a process for protecting EII information as competitively sensitive Confidential Business Information (CBI). ARB should develop provisions governing handling of facility-specific EII information so that such data are not used inappropriately or released outside of the agency.

¹ While WSPA strongly supports the use of the EII-based model, ARB should note that the method proposed by WSPA never assumed an allowance purchase obligation of more than 4% for the refining sector in the first compliance period. In fact, the additional 10% cut in free allowances negates the tempering approach promoted by WSPA that is inherent in a "soft start" to a cap and trade program. The 10% reduction in allowances can impose significant and unanticipated inequities between California refineries and competing non-California refineries and importers.

² While individual facilities can request that Solomon prepare EII data for an "off" year, this data is not based on as comprehensive data set.

Recommendation: ARB should develop language to protect EII data as confidential business information.

Refinery Benchmarking Baseline Quantity

ARB has made no provision for allowances for power provided to the refining industry by industrial cogeneration plants. Emissions from these plants related to sales of steam and power to refineries should be included in baseline quantities and allowances.

Recommendation: Revise the equation as follows:

To BE_Y , purchased electricity from third party cogens should be added as follows::

$$BE_Y = GHG + (S_{Purchased} - S_{Sold}) * 0.0663 + (E_{PurchasedCogen} - e_{Sold}) * 0.431$$

where:

" $E_{PurchasedCogen}$ " is the annual arithmetic mean amount of electricity purchased from third party cogens by the refinery in MWh. This assumes that these cogens do not receive any allowances on their own

Availability of Offsets

ARB has not provided documentation that demonstrates how offsets are going to be made available in quantities sufficient to facilitate cost-effective compliance. For example, in the August, 2011 presentation, ARB staff (slide #17) asserts that the maximum offsets demand for the first compliance period (2012-2014) is 26 million metric tons. Yet, in June of 2010, the Staff asserted (Slide #27) that only 3 million metric tons will be available from sources in California.

In fact, only when offsets from Ozone Depleting Substances (ODS) from sources outside California are included, does ARB predict that 30 Million MT of offsets will be available. In other words, only by using virtually all the offsets from outside the state, can ARB assert that the offset supply is adequate during the first compliance period. This is inconsistent with ARB's historic reliance on in-state emission reductions subject to verification by ARB. Indeed, it is not apparent to WSPA members at this time how the very large volume of offsets would be available to all companies for all years as is suggested in the most recent proposal.

Finally, we remind ARB that the intent of offsets is to provide options for emission reductions rather than to offset inequities or the effects of arbitrary benchmarks.

Recommendation: Remove the 10% reduction in free allowances so that the demand on supply matches anticipated availability.

Monitoring and Periodic Regulation Review

We understood that ARB expects to incorporate, into the regulation, specific requirements for a review of the program at least once every compliance period in the ISOR. However there are no references to

this proposal in the actual regulation. We also understand that ARB intends to use “adaptive management” as an element in review of the program to identify and mitigate adverse impacts of the program, and help develop any additional improvements or changes necessary to this regulation.

WSPA believes that in order to ensure that the changes can be made in a timely manner and that the obligated entities are provided certainty, ARB should identify leading indicators that should be monitored for the economic and energy health of California and criteria for changes to the program, before the program begins. Staff proposes to incorporate into the regulation specific requirements for a review of the program at least once every compliance period. The new regulatory text will include specific deadlines for completion of the review, a list of topics that must be addressed in the review, and minimum requirements for public input during the review process.

Recommendation: ARB should identify the leading indicators of California’s economic and energy health that should be monitored routinely and specify the criteria that will drive any changes to the program. Moreover, ARB should specify that any review of the cap and trade regulation shall occur at least once every compliance period. If revisions are needed, they should be completed no later than one year before the start of the next compliance period to allow sufficient time for compliance by program participants.

Carbon Weighted Approach

The proposed regulation cites the future use of a carbon-weighted index CWT. While WSPA agrees that some carbon-weighted index is appropriate, the use of the term CWT refers to a specific index used in Europe that may not be appropriate for use in the United States. ARB has indicated that they will review the various candidate carbon-weighted indexes in 2012.

Recommendation: Change references to a carbon-weighted index with the term (CW) to allow the full evaluation of all appropriate carbon-weighted indexes for use in the second compliance period and thereafter. WSPA will work with ARB to identify an appropriate approach.

Section 95890 (a) Allocations (Benchmarking)

WSPA supports the use of a well-designed benchmarking method that results in an equitable distribution of allocations for facilities in the upstream oil and gas extraction sector as well as the downstream refining sector. Characteristics of a well designed benchmark (i.e., one that yields equitable treatment of facilities and does not produce arbitrary windfalls or shortfalls) include:

- An accurate and reliable reflection of a facility’s GHG emissions considering the quantity of oil and gas produced, or the processing required,
- Inclusion of GHG emissions associated with use of electricity irrespective of generation location (i.e., on-site or off-site),
- Inclusion of GHG emissions associated with hydrogen production irrespective of location (i.e., on-site or off-site),
- Clarity and transparency in the calculation methodology,

- Fulfillment of ARB's objective of minimizing leakage and providing assistance during a transition period, and
- Specific to the upstream sector, segmentation of comparable facilities based on appropriate consideration of key operational parameters.

Section 95890 requires that an entity obtain a positive or qualified positive verification statement to be eligible for direct allocation.

WSPA believes that this section needs to recognize that there are circumstances where an entity cannot get a qualified positive product data verification – this is a new procedure that could have complications.

Recommendation: WSPA recommends that the regulation be amended to allow an EO decision or a method for direct allocation in case a decision is pending on a qualified positive verification or in case of an adverse verification opinion.

WSPA further recommends that the regulation be amended to allow an EO determination for a direct allocation in case a decision is pending on a qualified positive verification or in case of an adverse verification opinion.

Upstream Benchmarking. WSPA appreciates ARB's replacement of the heavy oil / light oil approach used in the prior 15-day change package with a thermal / non-thermal approach. However, several serious concerns still remain:

- The proposed oil and gas extraction sector benchmarks (0.0816 for thermal and 0.0082 for non-thermal) are derived from a process that remains undocumented by ARB and thus unsubstantiated to upstream producers. There has been no published protocol or methodology describing how the benchmarking calculations were performed. Further, no data, calculations or other information used to derive the benchmarks have been published. This lack of transparency has made it impossible for upstream oil and gas producers to examine the approach, to duplicate benchmark results or validate the ultimate conclusions.
- ARB has indicated that the benchmarks are based on data from MRR reports and a voluntary 2007 survey. However, the 2007 data has not been subject to any form of validation/verification, and would not meet verification protocols that are required for MRR data.
- EPA's 40 CFR Part 98, Subpart W language, which has been included into MRR, will require reporting emissions from equipment types that were not included in ARB's upstream oil & gas extraction sector benchmark calculations. ARB has not addressed this inequity.
- The data ARB used to determine the oil & gas production benchmarks failed to incorporate indirect GHG emissions, e.g., those emissions associated with electricity and heat used/produced in the production process. For California oil & gas producers, electricity and heat consumed in oil & gas production can vary widely, and for some facilities represents a significant portion of energy consumed. The lack of appropriate consideration in the calculated benchmarks represents a systemic error in ARB's approach. This error will likely have significant impact when allowances are allocated, which will likely create an

incentive for companies to favor purchasing power from the grid and/or outsourcing thermal purchases.

Recommendation: WSPA recommends that ARB work with industry to ensure the appropriateness and accuracy of the petroleum and natural gas sector benchmark values through confirmation of the reported and verified data and the calculation methodologies.

Baseline for Refining

The proposed regulation uses the period 2008-2010 to determine sector quantity. However, ARB proposes to use 2008 year emissions to determine the sector quantity for other sectors including utilities.

Recommendation: WSPA recommends that the 2008 year be used to determine sector quantity for all sectors in the cap and trade program.

Section 95920 (d) Holding Limits

We propose that ARB revisit the issue of holding limits as they create a number of market inequities created by the “one size fits all” holding limit, regardless of an entity’s compliance obligation. ARB reasons that large entities can hold the necessary allowances for compliance by placing allowances into their compliance account. However, once there, entities are precluded from later selling these allowances, which may be required to manage the cost exposure associated with a fluctuating carbon price.

Restricting the number of allowances an entity can *freely* hold to less than an entity’s annual compliance obligation is fundamentally discriminatory against entities with large compliance obligations, and does not create a level playing field between market participants. In fact, it punishes companies who have invested more in California and rewards competitors in the same sector who have invested less.

In addition, such a policy will exacerbate potential hoarding, as many entities that may want to sell their bank of allowances will be prevented from doing so. This will artificially drive up the cost of compliance.

Finally it will also reduce market activity and liquidity, another cost driver, by reducing the number of allowances available in the market because larger compliance entities will be required to comply earlier and retire allowances to avoid violating the arbitrary holding limits. This action, in turn could constrain the supply of allowances available in the market.

To our knowledge, no other cap and trade program imposes holding limits on market participants.

Recommendation: Allow holding limits up to compliance obligation levels for covered entities.

Section 95920(f) Holding limits

ARB has stated that the holding limits are required to ensure the market is not manipulated. WSPA believes that it is critical that controls be in place to prevent market manipulations but as stated above, we disagree with the one size fits all holding limit. We are additionally concerned with the deletion of the provision that excluded application of holding limit for associated entities that were prohibited by regulations from coordinating market activities. WSPA believes that this provision should be reinstated. We do not believe that there is any support for forecasting that disruptions in the allowance market are likely to occur between entities prohibited by regulations from coordinating market activities.

Recommendation: Reject the proposed deletion of the provision and return the original language.

Once again, thank you for the opportunity to comment on these proposed regulations. Should you have any questions, I will be happy to assist you or you may contact Mike Wang directly at (626) 590-4905 or via e-mail (mike@wspa.org).

Sincerely,

A handwritten signature in blue ink, reading "Cathryn A. Boyd". The signature is fluid and cursive, with the first name "Cathryn" and last name "Boyd" clearly legible.

Cc: CARB Board Members
CARB Executive Officer
CEC Commissioners
CalEPA Secretary