



Western States Petroleum Association
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Catherine H. Reheis-Boyd
President

October 19, 2011

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 Chairwoman Nichols and Board members:

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. 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 draft 15-day packages for the Mandatory Reporting Regulation and the Cap and Trade Regulations (September 26, 2011).

WSPA recognizes the programmatic targets required by AB 32. We note that the statute already includes a declining cap in GHG emissions and that the proposed regulations incorporate that programmatic reduction. While WSPA acknowledges that these targets must be met, we are concerned however, that each succeeding version of the proposed regulations appears to make the task of compliance harder rather than easier.

It would seem logical for ARB, given the complexity inherent in an unprecedented GHG program, to facilitate compliance by developing policies and regulations that are transparent. Instead, for every positive step forward, there are additional steps that remain opaque, undefined, or vague.

For example, WSPA continues to be concerned that provisions in the proposed regulations will have significant adverse impacts to participants of the Cap and Trade Program and, perhaps even more importantly, will result in real economic impacts to the State, which is already suffering 12% unemployment. In particular, we will continue to question ARB's intent to limit initial allowances to cap and trade participants and, in particular, to our industry (refining and oil & gas production sectors) which ARB has already concluded as energy-intensive and trade-exposed (EITE) sectors.

In December 2010, the Cap and Trade Program was adopted with the clear direction from the Board that staff was to evaluate the appropriate benchmark for the petroleum industry. For refining, ARB was to evaluate three options – Simple Barrel (a product based option), the WSPA proposed Energy Efficiency Index (EII) and the EU Complexity Weighted option. *Appendix J (December, 2010 Rulemaking package) included an option for a product-based benchmark with a 90% allocation as one method to minimize the potential for over allocation. However, the currently proposed benchmark, as defined in the September, 2011 Rulemaking package, is the EII option that caps the best performer at 100% - ensuring that there can be no over-allocation.*¹

For upstream oil and gas production, ARB was considering creation of separate benchmarks based on distinct production processes. While work is still needed to verify data and procedures and validate calculations, ARB appears to be settling on two separate benchmarks – one for thermal oil recovery and another for non-thermal recovery. *While WSPA, in general, supports this technical approach, both of these benchmarks for oil & gas production also inexplicably include a 10% allocation trimming.*

WSPA is truly disappointed with the curious and poorly-substantiated decision to limit initial allocations of allowances to certain cap and trade participants despite ARB's own insistence that doing so would endanger California's trade-exposed industry sectors and expose businesses in those sectors to out-of-state competition from companies not burdened with the costs that arise from the Cap and Trade program.

ARB's proposed approach to allocating allowances is even less logical in light of the Agency's and Chair's intent to have a "soft start." While there is room for interpretation as to what exactly constitutes a soft-start, for entities that are trade-exposed and suffering through a prolonged recession, and because of the need to devote limited capital to projects that reduce GHG emissions in the future, any reduction in the initial allowances represents a threat to continued operation at current levels.

In fact, while ARB may opt to look at the oil & gas production or refining sectors as a whole when evaluating the program's impacts, WSPA believes that the impacts of the 10% reduction are better evaluated when looking at the sources that are immediately challenged at the start of the Cap and Trade program. For those sources in particular, a soft and efficient start must involve allowing them

¹ The system proposed by WSPA was also designed to achieve the cap reductions in manner that tempers the impact to individual facilities while achieving the overall cap reductions required of the sector.

to optimize their resources towards future GHG reductions and not on purchasing of allowances – especially during the early years.

It is even more disturbing that instead of developing policies that encourage existing facilities to plan for the future and implement GHG emission reduction measures, ARB's proposed 10% reduction in allowances does exactly the opposite. It appears to force companies to choose between continuing to operate at current levels or investing in required technology in the years ahead.

We believe that limiting allowances at the outset of the program will lead to leakage of goods and/or services to operators outside the State and increase the costs of those goods and services. All of these are outcomes that ARB indicated it wished to avoid. This approach is not needed and is detrimental to launching a successful Cap and Trade program which WSPA supports doing. (See attached report: Analysis Group, 2011)

Recommendation: WSPA believes that all trade exposed sources should be given their full allocation and that the 10% reduction be deleted from the Cap and Trade Regulation.

We ask that the ARB Board include in their resolution a requirement to re-evaluate the merits and impacts of a 10% reduction on trade-exposed sources in early 2012 and bring the results before the Board to determine if a regulatory amendment is appropriate.

WSPA also continues to have serious implementation and compliance issues with the Mandatory Reporting Regulation (MRR) and with potential impacts on the Cap and Trade program. The MRR, as currently drafted, proposes to implement new facility calibration and accuracy requirements, including elements of the federal GHG reporting program that are still under development.

Given the uncertainty in how new ARB regulations will be finalized and when that action will occur, WSPA companies will likely not be able to meet the mandates as described in the MRR. This can, in turn, lead to problems with verification, and thus enforcement and penalty issues which ultimately can affect allocation of allowances from ARB.

In addition, the recent modification of MRR to incorporate federal Subpart W equipment categories has directly impacted the Cap and Trade benchmark determination as these Subpart W equipment categories were not accounted for in the oil & gas production sector benchmark values. Further, it is unknown how portable equipment, used in the oil & gas production sector and currently subject to an existing ARB program, is addressed in benchmark values.

Recommendation: WSPA requests that ARB incorporate into the adoption resolution for the Cap and Trade regulation, an action item for the EO and staff to continue to work with stakeholders to review, evaluate and identify needed updates to the MRR regulation to ensure a smooth implementation of both the MRR and the Cap and Trade program. This review would also include work with industry to ensure the appropriateness and accuracy of the oil & gas production sector benchmark values through confirmation of the reported and verified data and the calculation methodologies.

Further, we are very concerned with the potential adverse economic and jobs impacts of overall AB 32 implementation. We ask that the adopting resolution for the Cap and Trade regulation incorporate instructions to the EO and staff to work with CEC, finance experts and stakeholders on measures to

track and evaluate economic and jobs impacts of the Cap and Trade program. It is also of critical importance to identify economic indicators, such as changes in the consumer price index and energy (electricity, natural gas, and transportation fuels) supply and price volatility that will allow ARB and the state to evaluate and react to potential energy impacts of the program; and to evaluate and report on the impacts of the operation of the market from the sale of allowances from the reserve account and to ensure that cost containment mechanisms are robust.

In terms of the administrative process, the ARB informed the public that it does not intend to include “written responses to comments submitted in connection with the October 20, 2011, Board hearing” in its final statement of reasons (“FSOR”) for the regulation. This is a clear violation of the California Administrative Procedures Act (“APA”) which requires that the FSOR include “a summary of each objection or recommendation made regarding the specific adoption, amendment, or repeal proposed, together with an explanation of how the proposed action has been changed to accommodate each objection or recommendation, or the reasons for making no change.” *Gov. Code 11346.9(a)(3)*. This provision encompasses all comments submitted in response to the adoption of the regulation which clearly includes comments submitted in connection with the October 20 Board hearing. Thus, ARB is required under the APA to include responses to those comments in the FSOR.

We find ARB’s notice that it does not intend to include written responses as especially curious given that the Notice of Public Hearing states that “written and oral comments will be considered by the Board and will be part of the administrative record,” however, “the Board will not have the option of making changes to the regulation as part of [the] rulemaking action.”

It is unclear how the Board can meaningfully take comments into consideration when it “will not have the option” of amending the proposed cap and trade regulation. The APA requires that an agency explain “how the proposed action has been changed to accommodate each objection or recommendation, or the reasons for making no change.” *Gov. Code 11346.9(a)(3)*. As the Board feels that it does not have the option to change the proposed rule to accommodate comments, the comments are effectively worthless, negating the goal of public participation inherent in the APA.

Further, nothing in the APA suggests that it is appropriate for an agency to be limited to options to adopt or decline to adopt a regulation without the option to modify the regulation based on comments received.² This process is in direct conflict with the APA’s purpose to “establish basic minimum procedural requirements” which provide for transparent decision-making and allow the public to shape rulemaking. *Gov. Code 11346*.

² Moreover, ARB claims that the reason it cannot respond to comments in the FSOR or allow the Board to modify the regulation is that the “legal deadline” for submitting the regulation to OAL is October 28, 2011. However, this date is not a “deadline”. There is no statutory or regulatory requirement for ARB to submit the cap and trade regulation by this date. This date merely represents the date on which ARB’s one year period for completing action on its initial cap and trade rulemaking notice will have expired under the APA. Contrary to ARB’s suggestions, this is in no way a “legal deadline” for adopting the rule. ARB should not be permitted to use this self-imposed deadline as an excuse for failing to comply with the requirements of the APA in completing the cap-and-trade regulation rulemaking.

Even more curious, ARB also plans to consider approval of a “Proposed Adaptive Management Plan” at the October 20 hearing. ARB has not followed any APA procedures in adopting this plan and no version of the proposed plan was publicly available until the plan was posted on ARB’s website ten days before the hearing. ARB claims the plan is integral to the cap-and-trade scheme, but if this is the case, ARB should allow sufficient time for commenters to adequately analyze and comment on the plan before it is submitted to the Board for potential adoption. The 10-day period between when the Plan was released and its planned adoption by the Board on the 20th does not provide adequate notice and is not consistent with the deliberative process required by the APA.

Finally, ARB has not completed an array of public participation measures that it committed itself to completing in adopting the cap-and-trade regulations. ARB initially stated that it would hold multiple stakeholder meetings and intimately involve the public and affected parties in crafting the regulation because of the complex and novel issues at hand. Instead ARB is pushing through a regulation which is incomplete and highly controversial, and cutting procedural corners in violation of the APA, all in an apparent attempt to avoid having to re-notice the cap and trade rulemaking.

Recommendation:

In order to address these concerns, WSPA respectfully requests that ARB include in the FSOR responses to all comments submitted in response to the October 20 board hearing.

WSPA also requests that CARB defer action on the proposed Adaptive Management Plan (“AMP”). We further suggest that in the Board Resolution on the Cap and Trade rule, the Board direct staff to provide a meaningful opportunity for public review and comment on the proposed AMP followed by Board action at a duly noticed public hearing. We suggest that ARB conduct this process over a period of approximately 120 days.

WSPA further asks that the Board direct staff, within the same 120 day period, to engage with stakeholders and interested parties regarding potential amendments and revisions to the Cap and Trade regulation in order to fulfill ARB’s initial promise to intimately involve the public in crafting all its rules and regulations.

Thank you for the opportunity to comment on these proposed regulations.

Sincerely,

A handwritten signature in blue ink, appearing to read "Catherine A. Boyd". The signature is fluid and cursive, with the first name "Catherine" and last name "Boyd" being clearly legible.

Attachment: Analysis Group, 2011

Cc: CARB Board Members
CARB Executive Officer
CEC Commissioners
CalEPA Secretary
Cliff Rechtschaffen
Nancy McFadden