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President

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http://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=capandtrade2012&comm_period=A

Mr. Steve Cliff
Air Resources Board
1101 I Street,
Sacramento, CA

RE: Comments on the May 9, 2012 Amendments for Linking California's and Quebec's Cap-and-Trade (C/T) Programs

Dear Mr. Cliff:

The Western States Petroleum Association (WSPA) represents 27 companies that explore for, develop, refine, market and transport petroleum and petroleum products in the Western United States. Many of our members operate extensively in California and have been following all the proposed regulations governing the Cap and Trade(C/T) Program.

Our interest reflects the importance with which the regulations, provisions and other requirements directly affect the effectiveness of the C/T program and, in particular, how the California program could link with other regions, including those of Quebec and WCI. We see this program as one of many elements in the California Air Resources Board's (ARB's) plan to achieve AB 32 targets using market-based mechanisms.

We are concerned, however, that many comments we made, particularly in our March 29, 2012 and April 12, 2012 letters, remain unaddressed. In fact, the concerns we cite below relating to the May 9, 2012 amendments reflect lack of progress in addressing issues that we identified in our earlier comment letters. We encourage ARB to address these issues and recommendations so that California's cap and trade rule helps achieve the GHG reduction goals while minimizing cost and creating a business environment that encourages continued investments in CA.

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In order to facilitate ARB response, we include comments from our earlier letter as well as those specific to the proposed Draft Amendments.

LINKAGE ISSUES

ARB's Current Proposal to Link with Quebec using a Combined Market Goes Beyond Simple Linkage

ARB's original concept of linking California's CTR in a combined, multi-state market would have furthered the goals identified through WCI. At the time, a number of US states were actively contemplating adopting cap-and-trade regulations and, if they had continued on that path, the potential regional market would have been much larger. However, as of today, that opportunity is limited to Quebec as the only remaining member of WCI with a C/T regulation.

ARB's proposal to link with the Canadian Province of Quebec would create a combined carbon market relying only on a highly specialized market infrastructure reflecting the two jurisdictions. This specialized market structure may well adversely impact linkage to other markets in the future if they also require specialized requirements.

> Recommendation: Linkage is premature until ARB defines a broader, simpler and more cost effective program. WSPA has always supported linkage to a broad market with consistent and flexible requirements for all participants.

Contingency plan

Issues and uncertainties relating to the proposed C/T program continue to cloud the near-term (and perhaps longer-term) future. Until such time as policies, procedures, and requirements etc., become finalized, uncertainties about how the C/T program will function will continue to grow. For example, questions such as what happens to allowance values if either program is delayed/changed/stopped due to legal issues continue to remain unresolved.

Additionally, Quebec's proposed linkage regulation is still uncertain and is not anticipated to be adopted until fall of 2012. The Initial Statement of Reasons (ISOR) identifies several differences between the California and Quebec programs, such as the offset programs, GHG measurement accuracy and missing data substitution procedures.

In light of these regulatory uncertainties, it is vital for ARB to provide assurance and certainty for businesses to encourage the establishment of a working market.

> Recommendation: WSPA recommends that ARB's linkage program should clearly define contingency plans to address stranded costs if linkage with the C/T program in other regions is unsuccessful.

Economic impacts

The ISOR states that "the analysis indicates that the impact of linking with Quebec could cause the allowance price in California to remain unchanged or increase slightly". It further states that the "economic dynamics that will arise if linking with Quebec results in an increase to the California allowance price", is that it could "result in California facilities making more on-site emissions reductions. These reductions would be financed by sales of allowances to Quebec." It assumes that "whenever the allowance price rises above the cost of making additional emissions reductions on-site, businesses will choose to make those reductions. WSPA believes that

such assumptions may not be valid where the cap and trade program has not ensured that its features minimize leakage.

> Recommendation: WSPA recommends that ARB re-evaluate the 90% "of average" benchmarking policy and the trade exposure analysis for the refining sector to ensure that leakage is minimized. As demonstrated by the analysis in the BCG Study, we believe that the refining industry should be designated as highly trade-exposed.

The Combined Market will Propagate Flawed Market Policies

Quebec has followed the WCI design and California regulations closely in preparing its own program. As a result, the Quebec program contains a number of market design flaws that are identical to those of California. A prime example is the holding limit which will remove from the California market a quantity of allowances in excess of the entire amount of GHG allowances contained in the Quebec program.

> Recommendation: WSPA recommends simpler linkage approaches that would not require detailed market harmonization and that would facilitate linkage with Quebec and other programs as well.

Priority should be given to getting the California program up and running

California (both the ARB and possible market participants) needs to "learn to walk before they run". There are great benefits in gaining experience with California Cap and Trade Program prior to taking on tasks associated with linkage with other programs. We should take the time to understand what is going well and not going well before expanding the universe of trading further.

> Recommendation: WSPA believes certainty is critically important, we urge ARB to not divert vital resources that are needed to ensure compliance tools and guidance are delivered to compliance entities in a timely manner. The details to link the two programs could distract from the overall need to establish a sound and reliable trading program within California.

ISSUES WITH OTHER REGULATORY AMENDMENTS

Holding limits

The holding limits have been increased to account for the increase in combined allowance budgets. Changing the holding limit to account for the increased combined allowance budget does not mitigate the underlying problem. WSPA has opposed the "one size fits all" holding limit applied regardless of an entity's compliance obligation because it (1) it restricts liquidity in the market, (2) it creates opportunities for financial intermediaries to exercise market power, (3) it is without factual basis and is thus arbitrary, and (4) it does not take into account the need for different limits for larger compliance entities and does not provide a level playing field between market participants. Some entities that have corporate associations in Quebec may find the holding limit restriction even tighter, relative to their compliance obligations. The California Legislative Analyst Office in their February 9, 2012 report recommends eliminating holding limits to improve the way the carbon market functions.

> Recommendation: WSPA recommends eliminating the holding limits or at a minimum, consider increasing the holding limits for covered entities with compliance obligation so that these entities are

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allowed the currently proposed limit plus 50% of the difference between the entity's compliance obligation and the currently proposed limit.
If, notwithstanding these comments, ARB elects to continue to place holding limits, WSPA further recommends that the holding limits for future vintage year allowances be applied to all vintages within that compliance period rather than for each year. We believe that applying the holding limit to each vintage year places an unnecessary restriction.

"Know Your Customer" (KYC) requirements should minimize collection of individual's confidential information

WSPA recognizes the need to ensure the identity of individuals accessing the tracking system. However we believe that KYC should (1) recognize the differences between a representative of a covered entity and a representative for a non-covered entity and, (2) minimize collection of individuals confidential information only to the extent required to ensure the identity of the individuals. Requiring information beyond what is required solely to determine identity is unnecessarily intrusive.

As an example, assume that a covered entity has assets which include one or more processes or other operations in California. In this situation, ARB holds those covered entities responsible for complying with numerous C/T requirements, including significant compliance obligations. If these covered entities have the capacity to manage these operational and compliance activities, then they should be assumed to also have the capacity to ensure the identity of their employees who the entities authorize and attest are acting on their behalf. Therefore documentations, such as an open bank account in the US and/or Canada, addresses of permanent residents, and passport numbers which are particularly intrusive, should not be necessary for an authorized representative for a covered entity.

Recommendation: Add an additional paragraph to Section 95834(b) as (10) below:

95834(b) The individual must provide documentation of the following:
(1) Name;
(2) The address of the primary residence of the applicant, which may be shown by any of the following:
(A) A valid identity card issued by a state with an expiration date;
(B) Any other government-issued identity document containing an individual's primary address; or
(C) Any other document that is customarily accepted by the State of California as evidence of the primary residence of the individual;
(3) Date of birth;
(4) Employer name, contact information, and address;
(5) Either a passport number or driver's license number, if one is issued;
(6) An open bank account in the United States;
(7) Employment or other relationship to an entity that has registered or has applied to register with the California Cap-and-Trade Program if the individual is listed by an entity registering pursuant to section 95830;

(8) A government-issued document providing photographic evidence of identity of the applicant which may include:

(A) A valid identity card or driver's license issued by a state with an expiration date and date of birth; or
(B) A passport; and
(9) Any criminal conviction during the previous five years constituting a felony in the United States. This disclosure must include the type of violation, jurisdiction, and year.
(10) An individual representing a covered entity is required to provide documentation only as required in Section 95834(b)(1), (4), (8), and (9).

Push, push, pull is unnecessarily burdensome

WSPA believes that the requirement for "push, push, pull" to register a transfer of compliance instruments between two entities is unnecessarily burdensome. Specifically, two authorizations from the same entity requesting the transfer are unnecessary. Internal corporate controls, in addition to ARB notifications to multiple entity representatives of the transfer requests, should provide sufficient oversight to prevent unintended or deceptive transfer requests. A "push, pull" process would provide sufficient safeguard while significantly reducing unnecessary burden.

Recommendation: WSPA recommends that the process for transferring compliance instruments be revised to a "push, pull" process.

Consequences of push, push, pull timing requirements should only be rejection of the transfer request; it should not be consider a violation

Section 95921(a)(1)(B) specifies that a second account representative of the entity submitting a request for transfer of compliance instruments must confirm the request within and the receiving entity must confirm the transfer request within the remaining three days following the initial submission of transfer request. We believe that the consequence of missing these time limits should be only the cancellation of the transfer request. Missing these time limits will not result in any harm to the market or cause environmental harm. Conversely, the limits will unnecessarily increase exposures to potential violations. We see no compelling reason to classify missing these specified time intervals as a violation of the regulations.

Recommendation: amend section 95921(a) (3):

Section 95921(a)(3) ~~The parties to a transfer will be in violation and penalties may apply if the above process is completed:~~
~~(A) More than three days after the initial submission of the transfer request; or~~
~~(B) More than three days after the settlement day of the transaction for which the transfer request is submitted.~~

If the above transfer process is not completed within three days of the initial submission of the transfer request, the transfer request shall be considered as withdrawn. If the entity wishes the transfer to be executed, a new transfer request must be submitted.

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Parties should not be required to agree to submit documentations on the transaction (contracts)

Section 95921(b)(7) requires parties of the transfer request to, upon request of the Executive Officer, provide documentation on the transaction for which the transfer request was submitted. As currently proposed, ARB will already have access to transaction information regarding the parties involved, the date of the transaction and price. Access to the contract documents is unnecessary for market oversight. Such contracts are confidential business information that should not be subject to ARB oversight.

> Recommendation: delete Section 95921(b)(7):
> ~~(7) Parties to the transfer request agree to provide documentation on the transaction for which the transfer request was submitted upon the request of the Executive Officer.~~

Reporting the date of the transaction agreement and price of a particular transfer would provide limited value for ARB and should be deleted

Sections 95921(b) (4)&(6) require reporting of the date of the transaction agreement for which the transfer request is submitted and the price of the compliance instrument. However, we can envision numerous situations where arrangements may be made during a particular year for delivery at a later time in the year (i.e., a contract between parties may be agreed upon in March for execution or delivery in December). The dates and prices of the transaction agreement would not be contemporaneous with the transfer request date. Therefore this information would not provide current relevant data that we believe ARB is seeking and would have limited value.

ARB should be able to more effectively gather current price and quantity data from exchanges and brokers and, if desired, publish them the next year in an aggregated and useful format. In addition, due to the netting of delivery obligations under different contracts with the same counterparty, it would not be possible to report an actual transaction date and price for that (net) transfer. This issue is particularly problematic for exchange-traded contracts. Therefore, Sections 95921(b) (4) & (6) provide little or no useful information.

> Recommendation: Delete Section 95921(b) (4) & (6)

Minimize list of names and addresses of key responsible parties of an entity

Section 95830(c)(1)(B) should be amended so that it requires listing of 2 or 3 of the entity's officers who are: i) responsible for the conduct of the authorized account representatives, ii) alternate account representatives, and iii) account viewing agents. Listing of all the directors and officers of a large entity may be a very long list, which will be difficult to keep current, and is unnecessary to ARB's program oversight.

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Moreover, it is unclear why a list of persons controlling over 10% of the voting rights is necessary.

> Recommendation: Revise section 95830(c)(1) as follows:
>
> (A) Name, physical and mailing addresses, and contact information, and type of organization, date and place of incorporation;
> (B) Names and addresses ~~of the entity's directors and officers~~ of at least three of the entity's directors and officers who are responsible for the conduct of the authorized account representatives, alternate account representatives and account viewing agents.
> (C) Names and contact information for persons controlling over 10 percent of the voting rights attached to all the outstanding voting securities of the entity;
> (D) A business number, if one has been assigned to the entity by a California state agency; California Air Resources Board; E) A U.S. federal tax Employer Identification Number, if assigned;
> (F) Data Universal Numbering System number, if assigned;
> (G) Statement of basis for qualifying for registration pursuant to sections 95811, 95813, or 95814;
> (H) Identification of all other entities registered pursuant to this article with whom the entity has a corporate association, direct corporate association, direct or indirect corporate association pursuant to section 95833, and a brief description of the association; and
> (I) Identification of all entities registered pursuant to this article for whose benefit the entity holds compliance instruments pursuant to section 95834; and Applicants may be denied registration: (I) based on information provided; or (ii) if the Executive Officer determines the applicant has provided false or misleading information; or (iii) if the Executive Officer determines the applicant has withheld information material to its application.

Relationship of CEQA to Cap-and-Trade

WSPA continues to have significant concerns regarding the interplay between the requirements of CEQA and the AB32 C/T program. For example, one could envision emission reductions from a C/T program as mitigation for project-related impacts if the reductions exceed project emissions. In other words, allowances purchased under the C/T program that are in excess of project-related emissions should be considered as valid mitigation under CEQA.

Yet, ARB staff stated during the presentation that actions under the C/T program are not intended to address CEQA requirements. ARB has provided no explanation for its unwillingness to address this obvious and important issue. It would be very useful to know from the outset that GHG reductions under the C/T program count for CEQA mitigation.

> Recommendation: We strongly urge ARB to address the potential of GHG reductions under the CTR as mitigation for CEQA to industries working within the AB32 Cap-and-Trade market-based mechanism.

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Thank you for reviewing and acting on these comments. Should you have any questions, feel free to contact me or Mike Wang (mike@wspa.org; 626-590-4905).

Best Regards,

Attachments: BCG Report (June, 2012)

cc: Edie Chang, ARB
Richard Corey, ARB
James Goldstein, ARB

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