VIA E-MAIL July 28, 2011

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

Electronic submittal: http://www.arb.ca.gov/lispub/comm/bclist.php

Re: **Supplement to the AB32 Scoping Plan Functional Equivalent Document**

Dear Sir/Madam:

Valero Refining Company – California and Ultramar Inc (collectively "Valero") appreciate this opportunity to provide comments regarding the California Air Resources Board ("ARB") Supplement to the AB32 Scoping Plan Functional Equivalent Document (FED), as posted for public comment on June 13, 2011. Valero owns and operates two refineries in the state of California, with a combined throughput capacity of over 305,000 barrels per day. Valero refines and markets products on a retail and wholesale basis through an extensive bulk storage and pipeline distribution system. Additionally, Valero's affiliates own and operate one of the nation's largest retail operations, which have a significant presence in California, as well as 37 other states. Valero, on behalf of itself and its affiliates, is providing comments to relay the significant deficiencies in the FED and the impact this will have not only on our California operations, but the people and economy of California as well as other States.

1. **The alternatives discussed in the FED, combined with the revisions to the Scoping Plan, highlight continued shortcomings in meeting the stated goals and objectives of AB32**.
   From a general perspective, we find that the FED is a hastily prepared document lacking in critical details that draws upon a foregone conclusion that California must have a cap-and-trade regulation to meet the goals of AB32. When considered beside the significant changes to the underlying basis of the Scoping Plan, Valero contends that the FED fails to meet both CEQA criteria and ARB goals and objectives on numerous issues:
   - Piecemeal approach to regulation: The economic impacts of the measures outlined under the Scoping Plan must be viewed in totality. Isolated economic impacts of the regulations, or regulations conceived in a vacuum without addressing the collateral effect of other regulations, lead to a disjointed and deceptively-simple picture of the impact of AB32 as a whole on the State of California. CEQA requires that ARB provide a comprehensive and holistic analysis of all aspects of implementation of AB32 in order for both citizens and industry to understand the costs and impacts associated with this initiative.

- Incomplete Rulemaking: ARB has multiple initiatives under AB32 which as of mid-year are still not final. Lacking in a set of clear requirements, it is difficult to understand how ARB can provide a satisfactory analysis under CEQA wherein the lack of rule provisions hinder understanding of the cumulative impacts of AB32. Given the revisions to the Scoping Plan foundation, the basis of the implementing regulations are further called into question, demanding a much more detailed review and analysis than ARB has provided in the FED.
- Balance: ARB fails to take a "balanced" review of the GHG reductions measures in the Scoping Plan in light of the significant changes to the underlying reductions targets and baseline. It is in the interest of all parties for ARB to review all the measures under consideration such that the legal obligations for reductions are redistributed and balanced among the regulated community. ARB's lack of assessment in this capacity calls into question the legitimacy of the FED and ARB's CEQA analysis of the Scoping Plan.
- Leakage: The issue of leakage continues to be of significance for multiple industrial sectors, including the petroleum refining sector. However, when ARB discusses this issue it does so in only highly generalized and subjective terms. ARB repeatedly makes statements regarding the "minimization of leakage," or how leakage is a greater possibility under one alternative than another, but fails to adequately describe in quantitative terms the actual risk and degree of leakage to industry in each of the scenarios. Furthermore, rather than fully considering alternatives to Cap and Trade to minimize the leakage issue, ARB has cited additional potential regulatory policy options to complement cap and trade that have not been evaluated under the FED and whose impacts have not been considered. This information is critical to any reasonable assessment under CEQA.
- No legal mandate for 2050 Goals: We note that throughout the FED there are references to Executive Order S-03-05, which targets an 80% reduction below 1990 level by 2050. We also note to ARB that there is no enabling legislation driving, requiring, or otherwise forcing ARB to consider this goal when crafting GHG regulations. Consequently it is premature and improper to consider this 2050 goal under the Scoping Plan.

2. Crafting the FED to meet the requirements of CEQA i.e., *Association of Irritated Residents, et al. v. California Air Resources Board (CARB)*, is insufficient given the scope of revisions.

ARB has ostensibly prepared the FED in order to satisfy the court's finding that an appropriate CEQA analysis for cap-and-trade alternatives must be prepared. However ARB uses this revision to the FED to introduce significant revisions to the GHG emissions baseline, targets, and necessary reduction measures under the overall Scoping Plan. These additional revisions are highly significant to the overall strategy for complying with AB32 and require a much deeper analysis and discussion than that offered by ARB: all revisions need to be fully vetted to allow stakeholders an opportunity to understand and comment on the basis for these significant revisions. The

ARB must expand the focus of the FED to address the broader issues and impact presented by the significant revisions therein.

3. **ARB does not provide a sufficiently unbiased and quantitative discussion to justify the alternatives presented.**

The expanded discussion of cap-and-trade alternatives in the FED is largely qualitative in nature and not quantitative. The generalized statements employed throughout the analysis makes an impartial and scientifically-sound review of the alternatives impossible.

For instance:

- Alternative 2 Impact Discussion (pg 51): *"Leakage would be minimized by the market-driven pricing of carbon and the availability of lower cost offsets for a portion of the reductions to help manage allowance prices. The allocation strategy would also include free allowances for trade-exposed industries. Many co-benefits would occur with an effective market-driven GHG reduction program, such as energy conservation and efficiency, reduced fossil fuels use, reduction of regional co-pollutants, and job-forming economic opportunities related to facility modifications and development of energy efficiency technologies."* There is no support for this conclusory statement.
- *"Although localized air quality impacts resulting from compliance responses by covered entities and the development of offset credits related to Alternative 2 are highly unlikely, they cannot be entirely ruled out."* (pg 53). This conclusory statement is not supported or justified. Many of the measures ARB is considering for GHG reductions, including Carbon Capture and Sequestration (CCS) and Cogeneration, will have local criteria pollutant impacts due to the energy penalty involved in the process to recover CO_2.
- *"To address the possibility of unanticipated localized air impacts caused by the cap-and-trade program, ARB would incorporate an adaptive management program into the alternative. This means that ARB would be committed to monitoring the data on localized air quality impacts and to adjusting the program, if warranted*." (pg 53). ARB has provided no details or insights into how such an "adaptive management program" will be crafted or deployed. This is a new development under AB32 that has not been vetted by the regulated community and consequently cannot be accurately assessed as an alternative.
- The discussion of Compliance and Enforcement in Alternative 2 lacks sufficient substance to fully evaluate. The evaluation only states that "ARB staff could consult with legal and enforcement staffs from state and federal agencies to gain insight in this area", which does not provide the ability to fully evaluate the impact on the regulated community or resources needed by the State to administer a program. This means the full cost of implementation cannot be estimated which does not allow the State to consider the broad range of public benefits (as stated in the objectives) or cost

effectiveness of the program since the administration costs will be passed onto the regulated community and/or the public.

- ARB states in Alternative 3 that Carbon Capture and Storage (CCS) is developing as a technology, but has yet to be proven as a cost-effective and viable GHG reduction technology. We agree with this assertion. However, the command and control approach of Alternative 3 will target stationary sources, requiring industry to cover the 22 $MMTCO_2e$ reductions needed, *with the expectation that the regulatory limit will drive technology*. This position, that the regulations will drive the necessary technology to meet imposed limits, is unproven and consequently fails to meet the criteria of this CEQA analysis. There is no basis for ARB's assertion that previously-unproven technology can suddenly become viable simply by imposing sufficiently stringent limits. Further, the discussions in Alternative 3 fail to address the impact of federal regulations on reductions in GHGs (See Transportation and the lack of discussion regarding the federal regulation of fuel efficiency of new vehicles).
- ARB's discussion of Alternative 4 (Carbon Tax) provides an unsupported, unfair and biased analysis of this market mechanism. Unqualified positions such as: the limited ability of a tax to control emissions, or the need to limit the affected sources to a small industrial subset for administrative purposes, belies the position that ARB has performed a sufficiently detailed review of the carbon tax market mechanism to eliminate further consideration. We note that ARB's own analysis lists 15 different instances where a carbon tax is being applied – yet ARB concludes that this is not the best approach. We find this conclusion ill-informed given the comparative number of cap-and-trade systems enacted, as well as ARB's statement that none of the listed programs can assessed for successful implementation.
- Finally, we note the quotation from the July 8 FED Workshop Presentation, Slide 4, bullet 3, that the CEQA analysis:

  > "Must describe anticipated adverse and beneficial environmental impacts associated with proposed action".

  The impacts discussed must therefore include all detrimental and beneficial impacts that may result from climate change. In implementing its endangerment finding the U.S. Environmental Protection Agency acknowledged that there were beneficial environmental impacts from climate change likely to occur in many geographic regions, including the United States[1]. ARB has failed to appropriately describe these beneficial impacts in California, making a balanced assessment of the alternatives, including the "no further action" option, impossible. Unless and until ARB provides a more detailed, thorough, and fact-driven analysis of all benefits, we contend the FED does not present an adequate analysis of the alternative to cap-and-trade and consequently does not meet the requirements of CEQA.

[1] Federal Register, Vol. 74 No. 239, Tuesday December 15, 2009, Pg 66531
Federal Register, Vol. 74 No. 239, Tuesday December 15, 2009, Pg 66532

4. **ARB does not provide sufficient economic analysis of the alternatives in light of the revisions to the Scoping Plan Baseline and Reduction Targets**

   Given the significant changes to the Scoping Plan Baseline, the targeted reduction strategy, and the apparent changes in effectiveness of various emission reduction strategies, ARB has changed the "playing field" to such an extent that a re-evaluation of the compliance strategy and economic consequences under the Scoping Plan is necessary in order to satisfy CEQA objectives. This evaluation should include the alternatives discussed in the FED. Prior economic analyses were based specifically on the roadmap outlined by the Scoping Plan in order to meet the established baseline and reductions. With this foundation now changed, the impacts of the measures considered, or not considered, must be revisited to ensure a compliance path is chosen that will not cripple the California economy and send industry and jobs out of state.

5. **ARB does not provide sufficient discussion or documentation to quantify the changes in the scoping plan targets and baseline.**

   With regards to the changes in the updated BAU projections, emission baseline, and overall reduction targets, ARB has not provided sufficient information for stakeholders to understand the origin and context of these changes and consequences thereof. Multiple emission reduction measures now have tonnage-reductions assigned to them that differ from the original Scoping Plan. Some measures appear to be omitted without explanation or combined with others. The structure of the FED is such that a direct comparison to the reduction measures and estimated reductions in the original Scoping Plan is not possible. Even to the extent that some discussion is provided, further analysis to understand the attendant impacts is not provided. For instance:

   "The 2008 Scoping Plan also included a measure to reduce GHG emissions from high global warming potential (GWP) gases via a fee. However, staff's evaluation of this measure since the 2008 Scoping Plan was initially developed, indicates that at this time a regulation to levy a fee to reduce emissions from high GWP gases would not be feasible. Therefore, this measure will no longer be pursued as part of the Proposed Scoping Plan (see discussion under Alternative 3)." (pg 11)

   The discussion under Alternative 3 provides little insight as to the underlying cause to abandon this measure. Greater details are necessary to justify positions such as this, considering that this measure would have offset over 22% of the reductions now targeted under the proposed cap-and-trade system. This "decision" has a market value consequence of approximately $40 million/yr to the California economy, based on proposed market floor price of $10/MT.

   As a further example, the information presented in tables such as 1.2-3 and 2.7-1 is not adequately discussed such that it is clear what measures ARB is proposing or their effectiveness. Appendix F fails to provide sufficient backup documentation to understand the derivation of the compliance pathways to account for the recession in the revised BAU/target reduction case. Unless and until ARB can provide stakeholders with

this information, and in a form that is comparable and commensurate with the original Scoping Plan, a reasonable analysis of the FED is untenable.

6. <u>ARB's analysis of the Cap-and-Trade alternative fails to acknowledge the economic impact to the State of California</u>

The revised BAU case, baseline, and overall reduction targets that ARB presents here call into question ARB's reliance on a cap-and-trade program to address the "shortfall" that remains after all other measures are implemented. The revised BAU case for 2020 reduces emission levels from 596 $MMTCO_2e$ to 507 $MMTCO_2e$. The emission reductions necessary to meet target have accordingly been reduced from 174 $MMTCO_2e$ to 80 $MMTCO_2e$ – a reduction of over 54%. A reduction of this magnitude in the regulatory burden of the state should drive ARB to reassess all programs under the Scoping Plan to determine how this burden can be equitably applied across the reduction measures identified. However, despite this huge reduction in the GHG burden that California industry must bear, ARB claims that a further 18 $MMTCO_2e$ must still come from cap-and-trade. The magnitude of these reductions is not commensurate with the tremendous costs associated with this program.

- Cap-and-trade (including complementary measures), continues to be slated as a program that will cover 85% of the GHG emissions in the California economy. This amounts to 399 $MMTCO_2e$ (based on the 2002-2004 data used in the Scoping Plan). The market value of these emissions at the minimum floor price of the proposed regulation ($10/MT) is $3.9 billion. The market value of the reductions that ARB claims the cap-and-trade system will produce amount to $180 million. This means that the cap-and-trade system will cost the people of California $3.9 billion to reduce $180 million-worth of CO_2 emissions. For perspective, <u>California will pay over 20 times the market value of these emission reductions</u>. This is the very definition of "cost-ineffective" and belies the agency's position that cap-and-trade is positive for the economy and the necessary solution to address the "shortfall".
- Given these market implications, it will be critical for ARB to review the suite of measures available for GHG reductions, regardless of whether currently promulgated or otherwise, and make an equitable assessment and adjustment to find a reduction of 80 $MMTCO_2e$ without burdening the CA economy in such an extreme fashion. Significantly, the inclusion of fuels under the cap-and-trade program will be one of the primary reasons this approach will impact consumers in such a negative financial way. ARB must include discussion of these impacts in the CEQA analysis for there to be educated dialogue on the best approach for California. We call upon ARB to re-evaluate the Scoping Plan and delay implementation of AB32 until a scientifically-sound and equitable suite of reduction measures can be found.
- Finally, we note that in the "Scoping Plan Objectives" discussion (Pg 4), ARB has omitted as an objective HSC38562 (b)(5), which requires ARB to "Consider cost-effectiveness of these regulations". While ARB frequently references "cost effective reductions", this is not the same as "cost effective regulation", as the above discussion illustrates. ARB is required by Statute to include this requirement in the Scoping Plan Objectives, and we formally request ARB to include discussion,

analysis, and detailed documentation regarding the execution of this goal to ensure the Scoping Plan comports with Statute.

Valero strongly urges ARB to not only reconsider the CEQA analysis in the FED, but to reassess the Scoping Plan and associated regulatory development process so that the totality of the impacts can be meaningfully reviewed by the regulated parties. Valero believes that, if crafted consistent with our recommendations, ARB would be minimizing the impact of AB32. We look forward to working with ARB on the Scoping Plan and the FED in a manner that is reasonable, technically feasible, cost effective, and considers the practical impact of AB32 on jobs, the economy, and the consumer. On behalf of Valero and its affiliates, please contact me at (210) 345-4620 should you have any questions or need clarifications concerning our comments.

Sincerely,

Matthew H. Hodges
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Corporate Environmental
Valero Companies