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President

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

Re: Comments on Supplement to AB 32 Functionally Equivalent Document (FED) Dated June 13, 2011 regarding the Scoping Plan

Dear Clerk of the Board:

The Western States Petroleum Association (WSPA) is a trade group representing twenty-seven companies that explore for, develop, refine, market, and transport 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 ARB.

Because of the possible impact of AB32 on WSPA members as well as its possible impact on energy supplies and the economy, WSPA has been an active participant in the public policy discussions about the implementation of AB 32. We have reviewed the Supplement to the AB 32 Functionally Equivalent Document (SFED) and recognize that the document prepared by ARB is comprehensive and addressed the issues concerning comprehensiveness of the previously-prepared FED. [1]

Support for Market-Based Approaches Including Cap and Trade (C/T)

After reviewing the SFED, our position remains unchanged. WSPA strongly believes that use of a well-designed market-based program is essential in order to implement AB 32 in an efficient and cost-effective manner. If ARB feels that a cap and trade (C/T) program is the most appropriate approach to

[1] WSPA will concentrate our comments on issues of concern to our industry and where we have special knowledge. We are leaving comments on aesthetics, land use, water use, etc to others, but have an interest in ARB's responses to all comments.

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implement the objectives of AB 32, then we will continue to engage in efforts to initiate that program efficiently and cost-effectively. We note that ARB, in the FED, has identified the C/T program as the option most viable in the short-term and, given the challenges facing the ARB and the State, we agree with that assessment.

We note that other alternatives have been suggested as options to consider in the future. We support looking at market-based options to buttress the initial approach identified by ARB as efforts to implement AB 32 progress.

Source-Specific Regulations Are Not Appropriate

We continue to believe that source-specific regulations to achieve the goals of AB32 are not appropriate given the State's need to move quickly. If source-specific regulations are to be developed correctly, control technologies have to be identified that recognize unique operating requirements and performance of various facilities within the State. As ARB and local agencies have seen in the past, this is a time-consuming effort if it is to be done correctly under AB32 and applicable California law.

Moreover, we believe that source-specific regulations are not appropriate for California as it strives to lead the country and the world to address GHG reductions. California acting alone does nothing to address the need for significant global GHG reductions nor would source-specific regulations promote linkage with other programs which is a key tenet, and indeed a necessary and enacted goal, if AB 32 is to be successfully implemented.

Need for Detailed Environmental Analyses

Implementation of the AB 32 Scoping Plan can have varying and significant environmental impacts and can be anticipated to generate varying economic impacts. For example, the Low Carbon Fuel Standard (LCFS) included within Alternative 1 can be expected to have a significant impact on the manufacture and distribution of transportation fuels and their environmental and economic impacts. This impact may be exacerbated by the impact of the High Carbon Intensity Crude Oil (HCICO) alternative being explored by ARB. We remain convinced the current HCICO policy will lead to crude shuffling and in most cases an increase in GHG emissions. The ARB should conduct a peer-reviewed study of the potential increase in emissions and provide the results in the SFED.

We offer some detailed comments on each of the SFED Alternatives in the Attachment.

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Thank you for considering these comments. We look forward to working with ARB in the future as efforts to implement AB 32 continue.

Best Regards,

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

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Comments on Individual Alternatives

Alternative #1: No project

It seems clear that ARB must develop a program, or programs, to implement AB 32. A key aspect that must be determined in conjunction with the many stakeholders is the timing, approach and environmental and economic impacts associated with strategies to ultimately achieve the goals of AB 32.

Projects (i.e., early actions, landfill methane, LCFS, building standards, refrigerant, RPS – see Table 2.3-1 P.22) included within the No Project Alternative are important and ARB should NOT minimize the significance of these projects under CEQA. Indeed, many of these projects – despite the misnomer of being included within the No-Project alternative– can pose a potentially huge environmental and economic impact to the State. Hence, both the anticipated environmental impacts AND their potential economic impact must be carefully considered.

With specific reference to the High Carbon Intensity Crude Oil (HCICO) alternative, WSPA is concerned that the approach will lead to a greater reliance on oil from foreign suppliers, many of whom are unfriendly to U.S. interests and/or located in parts of the world subject to political and social upheaval. In short, the current HCICO policy will likely result in Canada's crude oil being exported to China or other emerging economies while California refiners will be forced to purchase ever increasing amounts of oil from distant producers. Such an impact would clearly increase GHG and other emissions and frustrate the core objectives of AB 32 as well as other environmental programs within the State.

We continue to see that the current crude oil policy creates unnecessary risks of fuel supply disruptions. The ARB's approach to crude oil treatment could also lead to changes in the production of conventional fuels and in refinery operations, which in turn could have negative environmental and job impacts. ARB through its SFED should evaluate if either or both of these outcomes might directly or indirectly, increase GHG emissions.

> **Recommendation**. WSPA recommends that ARB prepare as part of the SFED an environmental and economic analysis of the impacts of the LCFS including the High Carbon Intensity Crude Oil Pathway (HCICO). At a minimum, the SFED should clearly present an evaluation of the emissions impacts associated with HCICO and the potential for crude-shuffling or on refinery operations and alternatives to the current HCICO policy.

Alternative #2: Adopt a Cap and Trade Program

As stated earlier, WSPA is supportive of well-designed market-based approaches to implement AB 32 targets. We support implementation of a Cap and Trade Program if that approach is ultimately chosen by ARB.

As the ARB well understands, there are a myriad of issues that must be resolved if the C/T program is to be implemented efficiently and cost-effectively. We have seen in the Discussion Draft (and anticipate in the upcoming 15-day packages) some clarification of the processes, procedures, and requirements in the C/T program. However, it is clear that even these documents will not provide all of the detail needed to evaluate specific environmental and economic impacts. Given this situation, the SFED should consider the broad policy impacts that could occur and not speculate on unproven or undocumented impacts.

WSPA has identified several broad policy issues that should be addressed:

- It seems clear that if a C/T program is to work effectively, it must start with an appropriate benchmark for all affected industries. The issue of how benchmarks will be developed is an on-going discussion that is extraordinarily important to all stakeholders and market participants and has significant environmental impacts.

  Recommendation. The SFED should review criteria for developing a benchmark that is equitable and results in a fair and competitive environment for all C/T participants. The SFED should also evaluate the environmental implications for choosing among various benchmarking alternatives.

- The C/T program should start with equitable initial allocations. ARB's proposed approach to reduce the initial allocations by 10% (more in some cases, less in others) puts many sources in compliance or economic jeopardy at the start of the program and promotes leakage. Initial allocations between and among industries and industry sectors must be equitably distributed.

  Recommendation: The SFED should consider the implications of the "10% haircut" in initial allocations as this may pose an unreasonable risk to the program and result in significant environmental impacts at the very onset of C/T activity. The SFED should pay particular attention to inequities or unintended consequences of various alternative benchmarking procedures as well as resource commitments that may result and the overall effectiveness of the program and its environmental impact.

- The Energy Efficiency Audit (EEA) Report regulation calls for an assessment of Energy Efficiency opportunities at facilities that would be used to inform ARB and the facilities on potential CO2 and co-pollutant reductions at facilities. Reports are due at the end of 2011. Implementation of opportunities or projects identified in the report is not mandated by the existing regulation.

  Recommendation. The SFED should consider the environmental and economic impacts of mandated implementation of projects based on the EEA audit – especially given the competitively sensitive data and project planning that is inherent in these evaluations. The SFED should particularly consider the possibly adverse impacts associated with the market should details of prospective project planning as well as project scheduling be divulged to competitors. The SFED should specifically address the risk of leakage.

- Processes, procedures, rules, registrations and details concerning compliance, enforcement and penalty (CEP) provisions must be adequately defined. As stated earlier, program details have not been finalized at this time. Yet, even with the one-year deferral in the start of the program, such details must be defined promptly if the C/T program is to begin on –time and in an efficient manner.

  Recommendation. The SFED should include progress made to date on this issue and evaluate progress made by the staff involved in Mandatory Monitoring Recordkeeping and Reporting (MRR), and enforcement. The SFED should quantify and discuss the risks of leakage from alternative CEP policies.

- Fuels should NOT be included within the Cap as there are simply too many details that need resolution and insufficient time remains for those issues to be resolved.

  Recommendation. The SFED should evaluate the alternative where fuels are NOT included within the Cap, and the environmental and economic impacts of this key alternative.

<u>Alternative #3: Source Specific Regulations</u>

Source-specific regulations are an inappropriate and inefficient approach to implement AB 32. It can preclude linkage with sources in other regions – a principle design assumption for AB 32. This is especially the case with respect to refineries as each is a unique entity with its own set of operating and design features that effect GHG emissions and energy efficiency. Moreover, source-specific controls can increase the risk of leakage to an already trade-exposed industry. This is especially true if the ARB suggests limits to production as a means to implement emission reductions.

WSPA agrees with the ARB where they state," However, it is uncertain that Alternative 3 would result in the most cost-effective GHG emissions approach, <u>because performance standards would be set administratively and not based on the market</u>. (Emphasis added). Most importantly, the effectiveness of the approach would likely be hindered by substantial leakage, which would not be consistent with AB 32 itself and the Scoping Plan objectives and may not *ultimately meet the environmental objectives or other substantive requirements of AB 32*." Later on, ARB adds:

> "*However, implementation of this Alternative could result in substantial leakage for industrial sources and electricity generation, because the performance standards placed on the covered sectors are not defined by market conditions. For example, replacing high carbon fuels (e.g., coal) with lower carbon fuels (e.g., natural gas) could result in out-of-state electricity now being used by California being sold in other markets."*
>
> *Source specific regulation would reduce in-state GHG and potentially co-pollutant emissions, but also increase out-of-state production and importation/transportation potentially resulting in increased out-of-state and transportation emissions. Consequently, implementation of this Alternative could result in adverse regional and local air quality impacts out-of-state*

associated with construction (e.g., use of heavy-duty equipment) and operational (e.g., higher facility production levels) increases in criteria air pollutants and TACs."

Recommendation: The SFED should more clearly highlight the environmental risks and dis-benefits of a source-specific approach to implementing AB 32.

Alternative #4: Combination of Strategies

This approach has raised some interest within WSPA. It seems clear that depending upon the mix of strategies chosen, this alternative has the potential for identifying efficient and flexible approaches to achieve goals set forth by AB 32.

Recommendation: The SFED should note the need for ongoing research and investigation to identify combinations of approaches or strategies that may be suitable for implementation in the long-term.