January 11, 2009

Ms. Mary Nichols
Chair, California Air Resources Board
1001 "I" Street
Post Office Box 2815
Sacramento, CA 95812

Subject: Air Liquide comments regarding Preliminary Draft for California Cap & Trade Regulation

Dear Ms. Nichols;

Thank you for the opportunity to comment on the Preliminary Draft Regulation for a California Cap and Trade Program, in particular to the proposed Allocation of Allowances under the Cap and Trade System being developed by the California Air Resources Board (CARB).

As mutually supported by our industry colleagues and the Compressed Gas Association, Air Liquide believes the industrial gas industry can and should play an instrumental role in meeting the goals of AB-32 through the application of existing technologies and the development and adoption of new technologies to ensure the competitiveness of industries as we transition to a carbon constrained world. Simply stated, industrial gases help manufacturers improve productivity and efficiency in clean and environmentally sound ways, thereby strengthening overall competitiveness.

Air Liquide is the world's leading manufacturer of industrial and medical gases, such as oxygen, nitrogen and hydrogen, and has a significant presence in California. Air Liquide has directly invested over $0.5 billion in the State and operates more than 20 facilities that employ over 550 Californians with high paying industrial and professional jobs. Air Liquide supplies nearly all industrial sectors, from refining and chemicals to metals and manufacturing to food processing and pharmaceuticals. We also serve nearly 400 medical facilities in California with medical gases and provide approximately one quarter of the State's medical oxygen supply.

While there is no question that the industrial gas industry is itself energy intensive (around 70% of the variable cost of producing industrial gases is energy), the gases themselves are of a relatively low price and as such can not be economically distributed long distances. As such, industrial gases are generally produced locally and are not typically considered trade intensive, which could prevent the industry from sharing in any competitive benefits that may ultimately be granted by that distinction.

The business model of industrial gas companies is based on the use of gases in a wide range of applications and industries combined with the efficient aggregation of demand and the out-sourcing of production by the end user. Many industrial gas production facilities are physically located at the

customer site and integrated with the industrial processes that they serve. Air Liquide and its competitors operate many such on-site facilities within the State of California.

Potential for Market Distortions

Large consumers of industrial gases have the alternative to manufacture the products themselves or purchase them from an industrial gas supplier. This creates a unique situation in which the industrial gas producer is competing with the economics of self production by its own customers in addition to competition from other industrial gas suppliers. Often, customers operate industrial gas production facilities and purchase from third parties at the same facility. Currently, through a model of aggregation and efficiency, industrial gas producers are able to provide more competitive options as compared to less efficient customer operated industrial gas production.

A distortion in the marketplace would occur between an industrial gas company and those of its customers deemed exposed to "carbon leakage" if the former alone were required to bear higher costs related to direct or indirect CO2 emissions. Indeed, such customers would experience a perverse financial incentive to "in-source" or "internalize" the production of the gases needed in their industrial processes. The consequences would be to:

(a) Significantly increase carbon emissions from the production of industrial gas in the State of California[1],
(b) Disproportionally penalize the industrial gases sector by significantly increasing the cost of industrial gases above and beyond the additional cost of electricity given the loss of scale available through the disaggregation of demand,
(c) Reduce the adoption and use of gas applications technologies that have a significant positive benefit on the energy efficiency and carbon emissions of manufacturers throughout the State by increasing the cost of adopting such technologies,
(d) Increase the cost of industrial and medical gases to other sectors of industry that currently benefit from aggregation of their industrial gases requirements, including hospitals, home respiratory patients, as well as manufacturers.

To protect California consumers and jobs, it is imperative that industrial gases manufacturing be included in the Allocation of Allowances to Energy Intensive and Trade Exposed Industries.

Respectfully submitted by:

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[1] The European Industrial Gases Association (EIGA) commissioned Deloitte to undertake a study of the environmental and economic impacts of market distortions created by proposed European climate change legislation that excluded the industrial gas industry from government allowances of credits. In Deloitte's study, the internalization of industrial gas production resulted in a carbon emission increase of up to 25% for the production of oxygen and 31% for the production of hydrogen.