COALITION FOR SUSTAINABLE CEMENT MANUFACTURING & ENVIRONMENT
1029 J Street, Suite 300, Sacramento, CA 95814

January 11, 2009

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

Subject: California Cement Industry's Comments on the Preliminary Draft Regulation for a California Cap-and-Trade Program

Dear Ms. Nichols,

The Coalition for Sustainable Cement Manufacturing and Environment ("CSCME"), a coalition of all of the six cement manufacturers operating the 10 cement plants in California,[1] hereby submits the following comments to the California Air Resources Board ("CARB") November 24, 2009 Preliminary Draft Regulation for a California Cap-and-Trade Program ("PDR") for the implementation of the Global Warming Solutions Act of 2006 ("AB 32").

(1) In order to provide meaningful comments, CSCME requires additional details about how CARB plans to address the significant risk of leakage in the cement industry.

CSCME's prior submissions to CARB present the unique position of the California cement industry and its significant exposure to leakage. The PDR at page 9 expressly states that CARB staff is continuing to evaluate the treatment of the cement industry and "will provide more detail in the Spring 2010 draft regulation." As of this date, CSCME's ability to provide substantive comments on specific provisions of the PDR that will directly impact the cement industry, including key definitions (*e.g.*, "cement"), the appropriate point of regulation, the surrender requirements for covered entities, the distribution of allowance value, and changes that may be needed to the mandatory reporting requirements is limited due to the status of the PDR.

CSCME looks forward to working closely with CARB in the coming months to ensure that its views are fully considered in this phase of the rulemaking. CSCME intends to continue to work with CARB to identify and develop details well in advance of the April draft regulation about how the cement industry will be regulated under AB 32.

While CSCME has submitted a proposed regulatory framework for the industry and is actively engaged in discussions with CARB, we are concerned that we are getting very close to the Spring 2010 release date for detailed regulations without knowing how the cement industry will be regulated.

(2) A "one-size-fits all" approach is insufficient to address the unique situation of the cement industry.

As CARB awaits the final recommendations from the Economic and Allocation Advisory Committee ("EAAC"), we would like to emphasize that the threat of leakage faced by the California cement industry cannot be addressed by a "one-size-fits all" regulatory approach. The California cement industry faces

[1] The Coalition includes CalPortland Company, Cemex, Inc., Lehigh Southwest Cement Company, Mitsubishi Cement Corporation, National Cement Company of California Inc., and Texas Industries, Inc.

significant competition from both cement producers in unregulated jurisdictions outside of the United States and from producers of other substitutable products with higher lifecycle greenhouse gas ("GHG") emissions. Because cement is a fungible commodity and cost increases cannot be passed through to end users, failure to address the significant risk of cross-border leakage through an effective border measure and failure to address the significant risk of cross-sectoral leakage through cost mitigation measures will lead to detrimental consequences for both the California cement industry and the state's climate change objectives (all of which have been addressed in previous submissions to CARB as part of the public record in the development of the Scoping Plan and following its adoption). CSCME is concerned that the EAAC's recommendations with respect to reducing leakage in energy-intensive and trade-exposed industries in general, such as the use of allowance value and the application of a border adjustment mechanism, may not adequately reflect the specific challenges and unique circumstances of the California cement industry in particular.

(3) Allowance value should be used to reduce the risk of emissions leakage in energy-intensive and trade-exposed industries.

In the PDR, CARB discusses the auctioning of allowances, noting that it is awaiting final recommendations from the EAAC on this subject.[2] In its December 14, 2009 draft report, the EAAC found that the allocation of allowance value was advisable for energy-intensive, trade-exposed industries that face a threat of emissions leakage.[3] CSCME agrees with this assessment and believes that the administrative allocation of allowance value to energy-intensive, trade-exposed industries is a critical component of an effective and robust leakage prevention policy.

The EAAC report also notes the potential value of applying a border adjustment to imports of products in these sensitive sectors. CSCME supports such an approach, but does not agree with the Committee's draft recommendations that border adjustments are a mutually-exclusive "alternative" to the administrative allocation of allowance value, that emissions leakage would be substantially reduced by the enactment of regional or national emissions reduction programs, or that border adjustments should be "of short duration."[4] Attached are the detailed comments that CSCME has submitted to EAAC on these issues.

(4) The PDR's 4 percent limit on offsets does not sufficiently mitigate compliance costs and will lead to additional carbon leakage.

CSCME believes that the use of offsets as a compliance mechanism for a climate change regulatory program is essential to adapting to the new regulations in an economically-sustainable manner. AB 32 requires that CARB design regulations in a manner that "seeks to minimize costs."[5] Offsets not only lower compliance costs, but they also provide California industries with additional time to invest in new research and to develop cleaner technologies, while simultaneously spurring immediate innovation and technology development by offset suppliers.

For the cement industry in particular, the use of offsets will help to minimize the threat of leakage. Although a robust offset program is not a substitute for other effective anti-leakage measures (such as the administrative allocation of allowance value and the application of compliance requirements to imported products), offset programs that reduce the cement industry's compliance costs could play an important role in an effective and robust approach to minimizing leakage in the California cement sector.

[2] PDR at 8, 34, 47.
[3] EAAC report at 57.
[4] EAAC report at 57-58.
[5] AB 32 at § 38562(b)(1).

For instance, by partially mitigating compliance costs and, therefore, the competitive cost disadvantage experienced by California cement producers as a result of the policy, offsets will reduce shifts in demand from California-made cement to foreign cement, which typically has a higher emissions profile due to both higher-emission production processes as well as the additional emissions associated with the transportation of the product to the California market.

The PDR includes strict requirements for the qualification of offset programs to ensure that they are associated with real, verifiable, and permanent reductions in GHG emissions. CSCME believes that such requirements are essential to ensuring the quality of offsets. With these strict requirements in place, however, there is no compelling environmental or economic rationale for imposing quantitative or geographic restrictions on the use of offsets. Indeed, California's proposed limit on the use of offsets is substantially more restrictive than those proposed in leading federal legislative proposals. CSCME recommends that CARB reevaluate the proposed limit on the use of offsets and the extent to which a more robust approach would advance the objectives of AB 32, including cost effectiveness and leakage minimization.

(5) Appropriately designed sector-based crediting systems can play an important role in reducing the risk of emissions leakage in the California cement industry.

In the PDR, CARB discussed the possible use of a sector-based crediting mechanism to achieve emissions reductions in the developing world.[6] CARB notes that the international community is currently discussing such programs, which would increase participation in international efforts to address climate change. CSCME appreciates the role that sector-based initiatives can play in reducing global GHGs, as different sectors face distinct challenges and specific considerations in adapting to emissions reduction requirements. CSCME cautions, however, that the integration of such sector-based crediting programs into a California regulatory program must be designed carefully to avoid unintended economic and environmental impacts, including significant leakage, distortions to the global cement market, and disguised subsidization of foreign cement producers. CSCME generally supports the development of international sector-based crediting systems and looks forward to more detailed discussions with CARB on the most appropriate design for such systems and on how the California cement industry can play a productive role in their successful implementation.

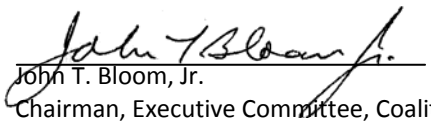
(6) The definition of "lifecycle greenhouse gas emissions" should be broadened to reflect its potential application in other contexts.

The concept of lifecycle GHG emissions is critical to the proper functioning of a cap-and-trade system. To the extent that a product's embodied emissions differ significantly from its lifecycle emissions, carbon prices may result in distorted market signals and perverse environmental outcomes. Thus, CARB should expand its definition of lifecycle emissions, improve its consideration of products other than transportation fuels, and enhance its applicability to other products in which embodied emissions may not accurately reflect true environmental costs.

CSCME recognizes that CARB is awaiting the EAAC final report before completing its proposal for inclusion of the cement industry under the final regulation. We hope that EAAC takes our comments into account in their final report and look forward to working with CARB in designing a regulation that is most appropriate to address the unique characteristics of the California cement industry.

[6] PDR at 77-80.

Sincerely yours,



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COALITION FOR SUSTAINABLE CEMENT MANUFACTURING & ENVIRONMENT
1029 J Street, Suite 300, Sacramento, CA 95814

January 9, 2010

Professor Larry Goulder
Chair, Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Subject: California Cement Industry's Comments on the Economic and Allocation Advisory Committee's ("EAAC") January 2 and 7, 2010 Draft Reports

Dear Professor Goulder and Members of the EAAC:

The Coalition for Sustainable Cement Manufacturing and Environment ("CSCME"), a coalition of all six cement manufacturers operating the 10 cement plants in California,[1] would like to take this opportunity to comment on EAAC's January 2 and 7, 2010 draft reports entitled "Allocating Emissions Allowances Under California's Cap-and-Trade Program." CSCME is pleased to find that the prior versions of the report were amended to better characterize the risk of leakage in energy-intensive, trade-exposed ("EITE") industries, the policy options for minimizing that risk, and the important role that leakage minimization plays in achieving AB 32's environmental objectives.

Despite these revisions, CSCME still has several significant concerns regarding the report. In particular, we note that much of the analysis and many of the recommendations are general in nature. In contrast, the challenges associated with minimizing emissions leakage in the California cement industry are unique, especially in comparison to the electric power and transportation fuel sectors, which appear to be the primary reference point of the report. Consequently, we believe it is appropriate for the EAAC to acknowledge both the generality of its recommendations and areas in which more detailed industry-specific analysis is still required to confidently make conclusions about the optimal approach for minimizing leakage in specific industries.

The following comments represent CSCME's specific observations and suggested revisions.

- **CSCME disagrees with the Committee's view that the use of allowance value and the implementation of a border adjustment are "alternative" approaches.**

In section 6(2) of its report, the Committee recommends that CARB use free allocation to address leakage "only in circumstances where the alternative of some form of border adjustment is not practical." As stated in previous submissions, CSCME would like to emphasize that these two approaches should not be considered mutually exclusive and, within certain policy design parameters, are complementary. In the unique circumstances of the California cement industry, both types of measures are critical to address the significant risk of leakage. The use of allowance value is necessary to lower compliance costs within the state of California in order to reduce leakage to cement imports

[1] The Coalition includes Cemex, Inc., National Cement Company of California Inc., California Portland Cement Company, Mitsubishi Cement Corporation, Texas Industries, Inc. and Lehigh Southwest Cement Company.

and minimize the risk of cross-sectoral leakage. However, the use of allowance value alone may not be sufficient to create a level playing field with imports. Consequently, an effective border adjustment measure is a critical complementary measure to minimizing the risk of leakage to imported cement that does not face an equivalent incremental cost burden. The Committee's recommendations should not preclude the use of both measures where necessary to address the unique circumstances of the cement industry.

CSCME suggests the following minor revision to ensure that the EAAC's recommendations do not pre-judge the most appropriate regulatory approach for the California cement industry:

> 2. The EAAC [sic] recommends that the ARB employ free allocation only for the purpose of addressing emissions leakage associated with energy-intensive trade-exposed industries, and only in circumstances where the alternative of some form of border adjustment is not practical **or is insufficient alone to address emissions leakage for a particular industry**.

- **CSCME reiterates its strong objection to EAAC's proposal that "border adjustments or other leakage-oriented measures should be of short duration (though renewable)" because such an approach would result in disinvestment and leakage.**

In section 6(3) of its recommendations, the Committee states that any leakage-oriented measures should be "of short duration (though renewable), thereby allowing more adaptability." CSCME strongly opposes this recommendation because it intentionally and necessarily introduces uncertainty and unpredictability into the regulatory regime. Like other energy-intensive industries, the cement industry is highly capital intense with long-lived assets, and investment decisions require certainty and predictability over the long-term. The introduction of leakage-oriented measures that require periodic "renewal" undermines the ability to make sound present and future investment decisions in the California cement industry, including high cost facility alterations as well as the development and implementation of major new technologies such as carbon capture and sequestration ("CCS").

In fact, absent predictability in the duration of leakage-oriented measures and in the conditions for renewal, adoption of the Committee's approach would result in substantial disinvestment in the California cement industry. Investment will shift to other jurisdictions where there is greater regulatory certainty and where production (and associated transportation) may generate higher GHG emissions, thus generating the leakage that the relevant measures were intended to address.

The Committee does not provide a rationale to support its implied view that the significant risk of leakage, particularly in the cement industry, will decrease over an unspecified "short duration" or the circumstances that would lead to such reduction. The EAAC does not suggest logical and transparent criteria to govern the decision to renew such a policy. In the absence of logical and transparent criteria, decisions to renew the policy are likely to be arbitrary and subject to political manipulation. This would result in a substantially less predictable investment environment -- thereby increasing rather than decreasing the risk of leakage.

Moreover, although referencing the issue of international leakage -- the major concern for the California cement industry -- the Committee only refers to leakage-oriented measures being "conditional on the

absence of regional or national climate change efforts." The Committee's only justification for short duration is to allow for more adaptability but the Committee does not explain what such adaptability would consist of. One would have to understand the unique circumstances of an industry to determine if measures can be taken to effectively adapt to climate change regulations and remain competitive with imports. California cement producers compete in a globally competitive commodity industry and can not pass thru higher climate change compliance costs without losing sales to foreign cement producers that do not have such costs. California cement producers are already highly energy efficient compared to foreign cement producers and approximately half of the emissions are process emissions which are unavoidable until an economically feasible CCS technology becomes available. And, even if such a CCS technology becomes available, leakage protections will be necessary to insure its deployment since it will be a cost that foreign cement producers without comparable climate change regulations would not have.

Prematurely phasing out leakage protections before equally stringent climate change regulations are adopted throughout the world will result in leakage and would likely result in an increase in global emissions due to the high transportation related emissions associated with imports. The California Air Resources Board (CARB) is the entity that should determine what is the most environmentally effective framework to minimize leakage based on each industry's unique circumstances and the Committee should appropriately qualify its recommendation in deference to CARB.

CSCME suggests the following minor revision to address its concerns:

> 3. The EAAC advises the ARB to adopt policy instruments that can be substantially modified or eliminated as leakage problems change with the emergence of regional**,** ~~or~~ federal**, or international** policies. The ARB should avoid policies that create property rights or other entitlements that cannot be changed should regional**,** ~~or~~ federal**, or international** policies be adopted. The ARB's commitments to border adjustments or other leakage-oriented measures should be **based on the unique circumstances of each industry and should generally be** of short duration (though renewable), thereby allowing more adaptability**, with the duration and applicable conditions for renewal set forth clearly to maximize predictability for future investment decisions**.
>
> > The prospect of these changing circumstances implies that the ARB's commitments should be easily adaptable to changing circumstances and conditional on the absence of regional**,** ~~or~~ national**, or international** climate efforts.

- **The Committee's comments do not reflect a sufficiently detailed analysis of the relative competitive advantage of domestic versus imported products, particularly in relation to the unique circumstances facing the cement industry.**

In footnote 22 and section 5.1.4 of the January 7, 2010 draft report, EAAC states that local producers can have a cost advantage over imports "due to transportation or other costs" and that, as a result, increased costs of climate change regulation may only lower profits and not result in a shift in consumption to imports. CSCME has several concerns about this statement.

First, the statement certainly does not reflect conditions within the California cement industry, and it is doubtful that it reflects conditions for in California manufacturing industries in general. California producers face enormous federal and state regulatory compliance costs, energy, labor, materials, insurance, and other costs and conditions that not only may equalize, but in most instances exceed any absolute competitive advantage based solely on transportation costs borne by imports. Furthermore, as explained in earlier comments, the California cement industry's potential cost disadvantage under AB 32 is staggering, with a carbon price of $30 per ton, for example, resulting in excess of a 30% increase in the price of cement. Thus, even with a price of carbon at the low end of current estimates, the impact on the price of cement is likely to be significant, will substantially outweigh any absolute advantage associated with the avoidance of transportation costs faced by imports, and will adversely affect the relative competitive conditions between California-produced cement and imported cement.[2] Accordingly, the Committee should avoid such general, hypothetical, and undocumented statements in the absence of detailed industry analysis that supports these claims.

Second, the statement implies that leakage is not a concern unless the absolute costs of domestic products exceed that of imports. It ignores the fact that export decisions are driven by marginal costs and an asymmetric increase in marginal costs for California cement producers would put them at a competitive disadvantage. This would reduce or potentially eliminate profits, which would precipitate plant closures and a shift in capital investment toward less stringently regulated jurisdictions -- thereby increasing leakage.

Accordingly, CSCME strongly recommends that the following two portions of the text be deleted.

Footnote 22:

> 22 In a market that imports products, local producers can enjoy a cost advantage due to transportation or other costs. In these circumstances, increasing CO2 regulation may raise local costs, but not enough to make imports cheaper than local production. In this case, local producers will experience lower profits but still maintain their local production as imports would still be a more expensive source.

Section 5.1.4:

> For several of the remaining industries, the additional cost of putting a price on CO2 emissions may not exceed the additional cost of importing competing products.

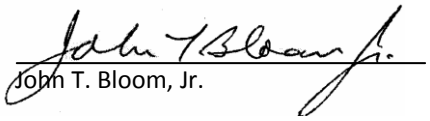
- **The Committee's comments should more explicitly recognize that increased electricity costs for EITE industries can substantially increase the risk of leakage, and that any anti-leakage measures for such industries should offset these indirect emissions costs through the administrative allocation of allowance value.**

[2] Depending on the country, foreign producers may also benefit from substantial subsidies or other state intervention that significantly distorts the conditions of competition in favor of imports.

Electricity costs can represent as much as 25-30% of total manufacturing costs for a cement producer, and the adoption of a cap-and-trade program has the potential to increase these costs substantially. Furthermore, due to the existing high electric power costs within the state, California cement producers have already invested heavily in measures to improve electricity efficiency -- making it one of the most electricity efficient cement industries in the world. To the extent that electric power cost increases are not offset upstream, any anti-leakage measure for the cement industry (or other EITE industries) should offset these indirect emissions costs through the administrative allocation of allowance value.

CSCME appreciates the Committee's efforts in drafting its recommendations and looks forward to maintaining an open dialogue regarding how to achieve California's climate change goals through carefully designed policy measures that minimize the potential for emissions leakage.

Sincerely yours,



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December 14, 2009

Professor Larry Goulder
Chair, Economic and Allocation Advisory Committee
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Subject: California Cement Industry's Comments on the Economic and Allocation Advisory Committee's ("EAAC") December 9, 2009 Report

Dear Professor Goulder and Members of the EAAC:

The Coalition for Sustainable Cement Manufacturing and Environment ("CSCME"), a coalition of all six cement manufacturers operating the 11 cement plants in California,[1] would like to take this opportunity to comment on EAAC's December 9, 2009 and December 14, 2009[2] draft reports entitled "Allocating Emissions Allowances Under California's Cap-and-Trade Program." The following comments represent CSCME's specific observations about certain elements of EAAC's recommendations.

- **CSCME strongly agrees with the Committee's finding that it is advisable to use allowance value to "address emissions leakage problems associated with energy-intensive, trade-exposed industries."[3]**

The Committee notes that the risk of emissions leakage is greatest for "industries where two conditions hold: they use relatively more energy in production ('energy intensive') and they are exposed to unregulated competition in their export or import markets ('trade exposed')."[4] A variety of factors indicate that California cement producers are a textbook example of an energy-intensive, trade-exposed ("EITE") industry:

- Cement production is an energy-intensive process that requires the heating of limestone at extreme temperatures of 2,700-2,800 Fahrenheit. In principle, various fuels can be used in

[1] The Coalition includes Cemex, Inc., National Cement Company of California Inc., California Portland Cement Company, Mitsubishi Cement Corporation, Texas Industries, Inc. and Lehigh Southwest Cement Company.

[2] CSCME will be reviewing the December 14, 2009 draft report released today in greater detail and may provide additional comments on this draft.

[3] EAAC, pg. 54.

[4] EAAC, pg. 12. Although CSCME strongly agrees with the spirit of this statement, we believe that a more precise characterization is warranted. Specifically, the risk of leakage is primarily determined by an industry's *GHG intensity* (*i.e.*, GHG emissions per dollar of output or value added) rather than its energy intensity *per se*. Furthermore, the risk of leakage is a function of exposure to *less stringently regulated* competition in general rather than unregulated competition in particular.

the pyroprocessing stage, but coal and petroleum coke have been the predominant fuels due to costs, availability, and superior performance characteristics.

- Cement production is inherently an emissions-intensive process. Common to all cement manufacturing is the chemical reaction that occurs when the calcium carbonate ("$CaCO_3$") in limestone is heated and breaks down into lime ("CaO") and carbon dioxide ("CO_2") — a process known as "calcination." These irreducible process emissions are fundamental to the manufacturing process and account for approximately 57% of CO_2 emissions in the California cement industry.[5]

- Cement is a fungible commodity that is actively traded in internationally competitive markets and competes almost exclusively on the basis of price. As a result, even seemingly small cost differentials between domestically-produced and imported cement can result in a substantial loss of competitiveness, reduction in market share, and disinvestment.

- California's location on the Pacific Ocean makes it easily accessible to imports of all products, including those that are typically expensive to transport by land, such as cement. The California cement industry's extreme exposure to imports was demonstrated as recently as 2006, when imports represented approximately 40% of California's total cement consumption.

This unique combination of energy intensity, emissions intensity, product fungibility, and exposure to international competition demonstrates that the California cement industry faces an extreme risk of emissions leakage.

- **The cement industry's status as an EITE industry has received widespread confirmation in a variety of policy venues and analyses.**

As noted by the Committee, various efforts are currently underway to identify those industries at risk of emissions leakage. The EITE frameworks embedded in leading national proposals, including the Waxman-Markey and Kerry-Boxer bills being considered by the U.S. Congress, apply a logical set of objective criteria (energy intensity, emissions intensity, trade intensity) to identify "presumptively eligible" industries. Using these criteria, numerous analyses -- including a preliminary assessment conducted by the U.S. Environmental Protection Agency -- have confirmed the cement industry's EITE status.[6]

Likewise, the EU's Emissions Trading System ("ETS") included a quantitative approach to identifying those sectors at risk of emissions leakage. The ETS methodology is based on the estimated cost

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[5] Lime is the key ingredient in cement, and CO_2 is released in a fixed ratio with the production of lime. In short, the majority of CO_2 emissions are a direct and unalterable consequence of the chemical reaction that is fundamental to the cement manufacturing process. These immutable "process emissions" distinguish the cement industry from many other carbon-intensive sectors, such as electric power or transportation.

[6] *See* U.S. EPA (June 2009). Comparison of FTI and EPA Analysis of H.R. 2454 Title IV. Memorandum Prepared for the House Energy & Commerce Committee Staff.

increases and trade exposure experienced by an industry. Again, based on an objective quantitative assessment, the European Commission confirmed the cement industry's EITE status.[7]

- **In the absence of effective anti-leakage measures, implementation of AB 32 is likely to result in a substantial cost differential between domestic and imported cement.**

The California cement industry's potential cost disadvantage under AB 32 is staggering. As a general rule of thumb, the production of one ton of cement results in one ton of CO_2 emissions and sells for approximately $100. Consequently, a carbon price of $30 per ton would result in a 30% increase in the price of cement. In the absence of measures that either relieve the initial cost pressure or impose equivalent costs of imports, such a substantial price increase will render the California cement industry economically unviable, will result in a massive shift in market share toward imports in the short run, and will precipitate sustained disinvestment in the California cement industry in the long run.

- **In the absence of effective anti-leakage measures, implementation of AB 32 is likely to result in a substantial increase in the emissions associated with California cement consumption.**

The potential negative impact on the GHG emissions associated with California's cement consumption is also staggering. In addition to the inevitable shift of California's cement consumption to less stringently regulated and less carbon efficient sources, the higher emissions associated with the transportation of cement imports is particularly troublesome. For instance, even under the broad and unrealistic assumption that all other production emissions are equal to those of highly-regulated California producers, imports of cement from China still result in 25% more emissions than cement produced and consumed in California due to the transportation of the product across the Pacific Ocean.[8] Thus, any shift in the sourcing of California's cement consumption to China is virtually certain to result in a net increase in global GHG emissions.

- **In the absence of effective anti-leakage measures, implementation of AB 32 is likely to result in environmentally inefficient substitution in downstream product markets.**

Even if the differential in compliance costs between domestically-produced and imported cement is equalized through the use of a border adjustment mechanism, the California cement industry is likely to remain at risk of "cross-sectoral" leakage. To the extent that cost equalization allows all cement suppliers to pass through the cost of regulation, consumers in downstream markets (*i.e.*, concrete batch plants and concrete product manufacturers) will be placed at a cost disadvantage to alternative construction materials, such as asphalt, steel, and lumber, especially if the carbon content of these materials escapes regulation.

Moreover, even if competing construction materials (*i.e.*, concrete, asphalt, steel, and lumber) are subject to a uniform carbon price, the outcome is likely to be both economically and environmentally

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[7] European Commission, Draft Commission Decision of determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage, approved September 18, 2009, available at

http://ec.europa.eu/environment/climat/emission/pdf/draft_dec_carbon_leakage_list16sep.pdf.

[8] ENVIRON International Corporation, Greenhouse Gas Emissions from Cement Importing, prepared for certain California cement producers, October 23, 2007. *See also* CARB, Draft Scoping Plan (June 2008) at C-106.

inefficient. This perverse result arises because the cap-and-trade system imposes a carbon price at the point of production, which does not take into account the higher lifecycle emission savings of concrete (including its production, use, and disposal) relative to competing construction materials (asphalt, steel, lumber). As a result, the price signal for those who select construction materials will be distorted -- erroneously incentivizing them to use products with a higher lifecycle emissions profile.

- **CSCME shares the Committee's view that border adjustments can be an effective method for reducing the risk of emissions leakage.**

CSCME strongly believes that border adjustments would be an effective tool for reducing emissions leakage caused by increased regulatory costs within the state of California. By including products originating outside California that are sold in the California market, border adjustments are a necessary part of a comprehensive policy to target emissions associated with the consumption of products in California. Moreover, a border adjustment is particularly effective in relation to cement, because the unique attributes described above make cement especially susceptible to leakage to imports and because the emissions associated with imports can be effectively identified, unlike products with more complex supply chains.[9]

- **CSCME disagrees, however, with the Committee's implied view that the use of allowance value and the implementation of a border adjustment are supplementary approaches.**

The EAAC report describes border adjustments as an "alternative" to allowance allocation.[10] CSCME would like to emphasize that these two approaches should not be considered mutually exclusive. The use of allowance value is an important component of a comprehensive policy because it lowers compliance costs within the state of California, minimizing the risk of cross-sectoral leakage. Industries may still face incremental compliance costs over and above the allowance value received, however, and a well-designed and targeted border adjustment can impose an equivalent incremental cost on imported cement that has a similar GHG profile -- providing more robust and effective leakage prevention than allowance allocation alone.

- **CSCME also disagrees that a regional and/or national cap-and-trade system would absolve the need for anti-leakage measures.**

In its report, the EAAC notes that "the extent of emissions leakage depends directly on the presence or absence of a regional or national cap-and-trade program" and that leakage would be "substantially reduced with the arrival of a regional or national-level cap-and-trade policy."[11] Although CSCME agrees that the implementation of a regional and/or national cap-and-trade (or equivalent) program would help to reduce emissions leakage caused by imports into California of goods from other U.S. states, such programs would not address leakage caused by imports from other countries (unless these programs contained a border adjustment covering foreign products). As noted above, the

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[9] Implementation and enforcement of a border adjustment for imports of cement is less complex than for other products. Cement is a fungible, commodity-type product without "a supply chain that involves many inputs from various sources." EAAC, pg. 13. Moreover, unlike other energy-intensive sectors (steel, chemical, aluminum, glass, etc.), the downstream products of cement (*i.e.*, concrete products) are normally not imported or otherwise traded across borders.

[10] EAAC, pg. 12.

[11] EAAC, pg. 6, 55.

California cement industry faces significant competition from overseas, especially cement producers in Asia, and very few imports originate from other U.S. states. Thus, the implementation of a regional and/or national cap-and-trade system is unlikely to significantly reduce the risk of leakage in the California cement industry.

- **CSCME strongly objects to EAAC's proposal that "border adjustments or other leakage-oriented measures should be of short duration (though renewable)" because such an approach would severely undermine any new investments to meet California's future cement demand.**

In addition to the points discussed above about the adoption of a regional or national policy removing the need for anti-leakage measures, the December 14, 2009 EAAC draft report introduces a new recommendation that border adjustments or other leakage-oriented measures should be of short duration in order to facilitate "adaptability," although with the possibility that such measures could be renewed.[12] CSCME strongly opposes this recommendation because it intentionally and necessarily introduces uncertainty into the regulatory regime. Cement is a capital intensive industry in which investment decisions require certainty and predictability over the long-term. The introduction of leakage-oriented measures that require periodic "renewal" undermines the ability to make sound investment decisions in the California cement industry.

It is important to keep in mind that you cannot achieve growth and development objectives in California without cement. It takes concrete to build and repair schools, roads, and bridges, construct new buildings and factories, and improve transportation infrastructure. Importantly, you also cannot implement effective climate change solutions without cement. Concrete is critical for adaptation strategies (such as flood controls and irrigation systems) and for mitigation strategies (such as wind farms). Because climate change is a global problem, it is simply not realistic (or equitable) to expect that California's cement consumption, and the emissions associated with it, should be out-sourced to developing countries. Thus, we have the unusual situation where the preservation and growth of a healthy and secure California cement industry is both in the economic and climate change interests of California.

Accordingly, California's climate change regime must establish sufficient long-term certainty and predictability in the operation and effectiveness of measures to address the significant risk of leakage in the California cement industry. Without such a regime, California's cement consumption will not be met by new investments in California but by increased imports with a higher GHG emissions footprint, undermining both California's economic development and climate change objectives.

- **CSCME believes that it is both possible and desirable to design a policy framework that leverages the benefits of both allowance allocation and border adjustment mechanisms in a manner that minimizes the risk of leakage in a WTO consistent manner.**

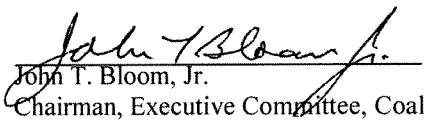
As the EAAC report notes, both the allocation of allowance values and the implementation of a border adjustment may be subject to challenge under the U.S. Constitution and the World Trade Organization ("WTO") agreements, which set rules for the trading of goods between U.S. states and Member countries of the WTO, respectively. CSCME believes that the design of these programs should take

[12] EAAC (December 14, 2009), pg. 58.

into account potential challenges under these legal regimes in an effort to minimize the risk of an unfavorable finding by a U.S. court or WTO dispute settlement panel. Importantly, CSCME considers that with the proper policy design these measures can indeed survive any future judicial or WTO challenge. For example, a successful policy design would not discriminate between in-state and out-of-state (including foreign-made) products or between one foreign country and another (*i.e.*, such design should generally apply the same requirements to products from all sources). It would also be tailored to problems that are specific to California's environment and population, rather than trying to regulate the effects of climate change outside of the state. CSCME has specific design proposals that would meet these criteria and looks forward to sharing these ideas with the EAAC in the near future.

CSCME appreciates the continuing work of the Committee in drafting its recommendations and looks forward to maintaining an open dialogue regarding how to achieve California's climate change goals through carefully designed policy measures that minimize the potential for emissions leakage.

Sincerely yours,



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