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Catherine H. Reheis-Boyd
President

August 13, 2012

Via email: http://www.arb.ca.gov/cc/capandtrade/comments.htm

Mr. James Goldstene (jgoldste@arb.ca.gov)
Mr. Steve Cliff (scliff@arb.ca.gov)
Air Resources Board
1001 I Street,
Sacramento, CA

RE: Leakage and Implementation of AB 32

Dear Mr. Goldstene and Mr. Cliff:

The Western States Petroleum Association (WSPA) represents 27 companies that explore for, develop, refine, market and transport petroleum, petroleum products and natural gas in the Western U.S. WSPA has been an active participant in the discussions involving strategies to implement AB 32 emission reduction goals.

WSPA attended the July 30 Leakage Workshop at which your staff invited comments on the methods proposed to study the risk of leakage. We will submit detailed technical comments by the August 31 deadline set by your staff, but wanted to take this opportunity to submit comments on key policy issues that can, and should, be addressed immediately.

Leakage is Occurring and Must be Addressed

WSPA appreciates that ARB has contracted with Resources for the Future and UC Berkeley as an indication of its intention to address leakage. While longer term policy approaches should be made with a clear understanding of the magnitude of the problem, leakage is an urgent matter that is already affecting investment in California. Unfortunately the timeline for the consultant studies extends well into 2013, but economic sectors impacted by leakage cannot afford to wait more than a year before a reasonable policy solution is offered.

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AB 32 requires that measures adopted to achieve the GHG reduction goals minimize leakage. The studies that the California Air Resources Board (ARB) has initiated may "evaluate how much is occurring" but they do not address leakage that has already occurred. Moreover, establishing policies or modifying the proposed program to address leakage is an urgent matter that must be a priority for ARB as it launches California's Cap & Trade (C/T) program. If not minimized, leakage will not only lead to a reduction in economic activity within the state, it will also reduce the environmental integrity of the C/T program. Emission reductions achieved from California industry will be offset by emission increases outside the state.

When AB 32 was passed and during the development of the regulations, it was assumed that at a minimum, California's neighboring western states would be joining a region wide program, helping to create a broad market and creating equity in the pricing of carbon emissions in the West. Unfortunately this has not occurred, leaving California businesses to confront yet another additional burden above the current disparities that already exist in costs of energy, fees, taxes and regulatory compliance with neighboring states.

Petroleum industry is Highly Trade Exposed

In 2011, ARB concluded that the upstream oil and gas industry was highly trade exposed[1]. WSPA agrees with that assessment. However, at the same time, ARB concluded that the refining industry is only moderately trade exposed. WSPA disagrees with ARB's characterization and instead believes that the refining industry is also highly trade exposed. This is defined best by ARB's slide #5 of the July 30 presentation that characterizes leakage risk as, "those industries in which production is highly emissions intensive, leading to high compliance costs, [and] industries for which competition is strong from out-of-state or international producers." The definition clearly applies to the refining and oil and gas industry.

The impact of leakage was evaluated in a report prepared by the Boston Consulting Group (BCG) which states, "AB 32, specifically the LCFS, is expected to fundamentally change the outlook for the refining industry in California….As a result, California will lose 20-30% of its refining capacity. … By the end of the 3rd compliance period, an additional 5-10% of refined fuels production capacity is lost, resulting in a cumulative loss of 25-30% during all compliance periods."[2] The report concludes that this can translate to a loss by 2020, of 5 to 7 of the state's 14 currently operating refineries producing CARB compliant gasoline and diesel fuel[3].

Address Leakage Now: Provide Greater Assistance for California's Industries

AB 32 directs the ARB to "minimize leakage."[4] This statutory directive should be followed at the onset of the program. The staff's proposal to study the leakage risk at the conclusion of the first compliance period is inconsistent with the statute's requirement and will result in diminished in-state

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[1] See October 2011 Final statement of Reasons – page 207 and Table 8-1 of the Cap and Trade Final Regulation Order)
[2] Understanding the Impact of AB 32, Report prepared by BCG, June 19, 2012: P. 29
[3] Ibid
[4] California Health & Safety Code Section 38562(b)

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economic activity while increasing emissions outside of the state. ARB has the authority and the obligation to minimize leakage and immediately address leakage impacts.

ARB must allocate 100% of the allowances (less the mandated declining cap reduction) to industries and businesses that are trade exposed. Full allowances will not adversely affect the stated objective of achieving the AB 32 emission reduction target or delay implementation. What such an action will do, is reward companies for working to implement AB 32 by not subsidizing their out-of-state competitors. Awarding the full amount of allowances will allow companies in the State to use funds that would have been used to purchase allowances to instead, install new and improved GHG emission reduction technologies. In fact, awarding full allowances to affected industry will help ensure that the GHG emission reductions that are expected in ARB's AB 32 plan come to fruition by not moving emissions out-of-state where they are left unmonitored and uncontrolled.

Continuing Need to Study Leakage

WSPA supports the study of leakage because it is important to understand how much leakage is occurring and how much more leakage may exist in the future. Hence, the studies outlined in the Workshop, while still at the preliminary stage, if correctly designed are valuable. It was clear from the workshop that ARB and its contractors are still determining the coordination and management of the various investigations. In particular, additional work is needed to better understand how the studies results will represent the long term impacts of climate change policy on California's industry and jobs absent other similar policies in other states and jurisdictions. We also need to learn more about how these studies will address sectors which may not be responsive to cost changes in historical electricity and freight costs. Study of leakage factors which have competitive impacts within a sector are also needed.

Specifically, ARB's consultant noted in answer to a question that WSPA raised, that some contractor results could be ready by the end of 2013. However, this timing ensures that the findings of these studies cannot be implemented in time to address allowance allocation for sectors found to have a risk of leakage in 2012 or 2013. This problem persists, and perhaps worsens in ensuing years; because the allowances for the second compliance period that begins in 2015 are to be awarded in 2014 (some will be sold at auction beginning in November 2012). In addition, completion of the consultant reports in 2013 provides virtually no time for public review of the reports, subsequent ARB action and company compliance planning. In short, even if the reports are completed in 2013, completing the extensive amount of work to rectify issues that were identified within, at most a 12-month period is unreasonable and unrealistic.

ARB's lack of a final schedule for the leakage study, and the potential for the study's likely impact on facilities in the second and third compliance period, are additional strong reasons for giving all affected trade-exposed facilities their full allowances in the second compliance period program. Again, such an action would allow the results of the studies to be fully vetted and then provide ARB sufficient time to implement them in adjustments to policies and program requirements, while not altering the goal of achieving the emission reduction goals of AB 32.

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As we indicated earlier, we appreciate the opportunity to provide these comments and will provide more detailed comments by the 31st.

Should you have any questions, I would be happy to address them.

Best Regards,

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