



December 10, 2008

VIA E-MAIL

Ms. Mary Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95814
E-mail:

http://www.arb.ca.gov/lispub/comm/bcsubform.php?listname=scopingpln08&comm_period=A

Re: Proposed AB 32 Scoping Plan

Dear Ms. Nichols,

Valero Energy Corporation ("Valero") is providing to the California Air Resources Board ("CARB") its comments relative to CARB's Proposed AB 32 Scoping Plan. Valero owns and operates through its subsidiaries the Valero Benicia and Valero Wilmington Refineries. The Benicia Refinery produces approximately 25% of the clean-burning transportation fuels for the Bay Area market and the Wilmington Refinery produces approximately 14% of the clean-burning transportation fuels for the Southern California market. Statewide Valero produces approximately 17% of the clean-burning transportation fuels for California.

Through the many public workshops, expert groups, and individual stakeholder meetings both before and after the adoption of AB 32, Valero has worked cooperatively both individually and through the Western States Petroleum Association ("WSPA") with CARB staff to identify and address its many concerns with AB 32, the Low Carbon Fuel Standard ("LCFS"), and the AB 32 Scoping Plan. Throughout the AB 32 Scoping Plan development process, Valero also has consistently stated that successful implementation of AB 32 requires embracing several key program principles. For Valero, those principles include:

- Ensuring California's program is in harmony with whatever new federal climate program is ultimately adopted as well as with current federal and California legal requirements;
- Regulations and required technologies are technologically feasible and well-supported in the record;
- Programs are well-evaluated in the record and demonstrated to be cost effective;
- Programs promote innovation;
- Utilizing the best available science, economics and technical analysis in designing the program, as required by AB 32 and other applicable California and federal laws;
- Market mechanisms, such as a well designed cap and trade strategy are a significant part of the ultimate program; and

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- Safeguards to ensure that as the Scoping Plan is developed and implemented that California will have adequate, reliable and affordable supplies of energy, including electricity, heat and transportation fuels.

It is Valero's view that if we are to succeed in meeting the very ambitious AB 32 goals, we will need to remain focused on these core principles and urges CARB to embrace them in the Final AB 32 Scoping Plan.

Unfortunately, because the Proposed AB 32 Scoping Plan is currently in essence only a proposed policy and legal framework for a California program that potentially links to regional and national efforts and lacks specificity, particularly for the currently proposed measures directed at the petroleum industry, Valero finds it difficult to comment in detail on the Plan at this time. However, some of the concerns it has with some of the Proposed AB 32 Scoping Plan's underpinnings and currently proposed program constructs are briefly discussed below.

Economic Analysis / Cost Effectiveness

Measures in the Proposed AB 32 Scoping Plan need to be evaluated based upon their cost-effectiveness. Now more than ever, it is important for CARB to avoid policies that will unnecessarily increase costs to California citizens, consumers, and business. Opting for the most practical and lowest cost emission reduction strategies is essential. On this point, Valero is in complete agreement with the AB 32 Implementation Group on the need for a more comprehensive economic analysis on how the Proposed AB 32 Scoping Plan impacts the competitiveness of California businesses including the near and long-term cumulative costs. The Legislative Analyst Office and other respected economists have reached the inescapable conclusion that the CARB's Economic Analysis Supplement for the Proposed AB 32 Scoping Plan is terribly deficient in critical ways and should not be used by the state government or the public for the purpose of assessing the likely costs of CARB's plans. Given this recent harsh criticism, Valero believes it is incumbent on CARB to not give the appearance of justifying the chosen package of regulatory measures in the Plan at the expense of evaluating or looking at more cost-effective measures.

Valero believes based on these criticisms and concerns it is highly advisable that CARB withdraw and republish its Economic Analysis Supplement after it has reconsidered and adjusted its base case assumptions and is properly peer reviewed. Valero further believes that a range of possible outcomes which recognize that there may be net costs to the economy is the realistic and advisable conclusion. Valero believes this is critical to demonstrate CARB's credibility that it is focused on both environmental and economic factors mandated in AB 32.

Accordingly, Valero respectfully urges the CARB Board to not adopt the Proposed AB 32 Scoping Plan until the appropriate peer-reviewed Economic Analysis is done consistent the intent of AB 32.

If such an approach is not acceptable to CARB, Valero respectfully urges, as an alternative, that CARB create an ongoing process that assesses the annual economic impact of its AB 32 regulations. This will enable CARB to adjust those regulations that may result in onerous economic impact, consistent with the requirements and intent of AB 32.

Use of Market Mechanisms

Valero applauds CARB for the beginnings of a Cap and Trade program in its Proposed AB 32 Scoping Plan. Aligning market forces has the greatest potential for global warming reductions success. However, without a broader market, there is real potential for economic harm, particularly if California's program starts without WCI or national linkage. A "cap and control" program, as some have labeled it, restricts the trading market that the state's stationary sources need to meet by the 2020 target.

As drafted, most of the major GHG reductions relied on by other jurisdictions such as the UN, EU, and RGGI will not be available to California sources. Stationary sources responsible for the additional 35 MMT reduction will, therefore, be much more vulnerable and dependent on access to offsets, than sources subject to other regional GHG programs. California's proposed offset restrictions (10% reduction use limitation and restriction to California sources) are too stringent given the likely shortage of offsets and high demand due to lack of reduction opportunities for California's sources under CARB's proposed program.

Moreover, the Proposed AB 32 Scoping Plan also includes a number of measures that would apply to petroleum industry facilities, including an energy efficiency assessment requirement. The Plan proposes that these facilities be under the cap and trade program, hence they will have a strong market incentive to improve energy efficiency. Valero, therefore, recommends that as CARB moves forward with the Plan, those measures be re-evaluated as part of, and in light of, the cap and trade regulation.

Revenues and Fees

The Proposed AB 32 Scoping Plan includes a significant discussion on fees and use of revenues from those fees. However, AB 32 does not provide CARB with the authority to impose "carbon fees" beyond those necessary to cover the administrative costs of the program. Therefore, use of a carbon fee as discussed in the Proposed AB 32 Scoping Plan requires additional legislative authority for ARB to assess and for ARB to allocate/distribute funds generated by such fees.

The Proposed AB 32 Scoping Plan envisions the LCFS as a major contributor to achieving the AB 32 emission reduction goal. CARB is also evaluating inclusion of transportation fuels in the cap and trade scheme by 2020. The LCFS alone will be a major undertaking requiring the use of breakthrough innovations that have not yet been developed. Valero urges CARB to carefully

assess the pros and cons of including transportation fuels under the cap and trade instrument. The Final AB 32 Scoping Plan must not inhibit industry's ability to provide adequate, reliable and affordable supplies of energy.

Tracking Mechanisms

There is nothing in the Proposed AB 32 Scoping Plan regarding tracking mechanisms or early indicators that will identify and disclose the effect of the plan on energy supply and its impact on the economy. Valero urges that the Final AB 32 Scoping Plan incorporate such tracking mechanisms or early indicators that will allow for CARB to identify needed course corrections on an ongoing basis - the five year review is the minimum required by AB 32.

Carbon Capture and Storage

The Proposed AB 32 Scoping Plan does not include a discussion of carbon capture and storage ("CCS"). We believe CCS is critical to the success of this program. Valero urges CARB to include in the Final AB 32 Scoping Plan a regulatory framework for a workable CCS program (as is required by AB 32 – H&SC §38561(f)). Further, we urge that the Final AB 32 Scoping Plan promote research, development and demonstration of CCS in California.

Co-Benefits / Co-Pollutants

As the AB 32 Scoping Plan rulemaking process moves forward, Valero strongly opposes the inclusion of "co-benefits/co-pollutants" analyses. As a GHG control strategy, AB-32 cannot be viable unless it is implemented to be self-sustaining on these grounds alone. This will not be possible if CARB seeks to obtain justification from other pollutant reductions that are already well regulated under a myriad of federal, state, and local regulations.

CEQA / Multimedia Analysis

AB 32 has created major new uncertainties regarding the inner workings of the CEQA process as it relates to energy, development, and infrastructure projects. With the overlap of AB 32 and CEQA's "universal access" to the courts for third parties, a real risk exists that California's ability to continue to modernize, which is essential to achieve our AB 32 goals, is at risk of abuse and stagnation. No guidelines or consistency exist today to address either quantitative or qualitative options to address and mitigate AB 32 impacts. Critically needed energy and infrastructure projects (i.e., CARB RFG Phase III Amendments, LCFS, etc.) may not be able to move through mandated permitting processes in a timely manner necessary to meet regulatory deadlines.

Valero understands that the Office of Planning and Research (OPR) has asked CARB to develop recommendations on thresholds. As explained by CARB staff during a recent October 27th Workshop, its Preliminary Draft Staff Proposal for a statewide GHG CEQA Significance

Threshold is being prepared as a recommendation to the Office of Planning and Research (OPR) to guide that office in formulating revisions to Title 14 Code of California Regulation, Section 15000 et seq. (CEQA Guidelines), as mandated by SB 97. SB 97, among other things, requires that on or before July 1, 2009, OPR shall prepare, develop, and transmit to the Resources Agency guidelines for the mitigation of greenhouse gas emissions or the effects of greenhouse gas emissions as required by this division, including, but not limited to, effects associated with transportation or energy consumption. The guidelines must be adopted by January 1, 2010.

Because of California's universal access to the courts under CEQA, state level guidelines are a critical component to avoid CEQA grid lock. Accordingly, Valero strongly supports the development of a uniform statewide approach to determining GHG Significance Thresholds as opposed to the ad hoc, patchwork of CEQA GHG significance determinations and mitigation schemes that is currently emerging throughout the state. Accordingly, because CARB was given primary authority under AB 32 to regulate GHGs in California, it is incumbent on CARB to develop a reasonable, balanced and equitable approach to harmonizing the requirements of CEQA, AB 32, and SB 375 which will ensure that businesses in California can continue to operate in an economically and environmentally sound manner.

However, CARB in developing a uniform statewide approach to determining a GHG Significance Threshold, should not make the mistake of recommending a numeric GHG threshold, combined with proposed regulatory performance standards, that will undermine the development of a reasonable, balanced and equitable approach to harmonizing the requirements of CEQA, AB 32, and SB 375. Doing otherwise will jeopardize projects moving forward prior to promulgation of the final AB 32 regulations, as currently being proposed by CARB staff. Valero believes that in the context of the Proposed AB 32 Scoping Plan, the CARB can send a strong signal, preferably in any Board Resolution that may be part of adopting the Plan, that for those projects that the lead agency anticipates will be subject to regulations promulgated by CARB under AB 32 for the reduction of GHG, the lead agency may evaluate whether the project will result in a net increase in energy efficiency or decrease in the carbon intensity of the underlying economic activity or the state's overall carbon footprint. If such a project results in a net improvement in energy efficiency or a net decrease in carbon intensity of the underlying economic activity or the state or region's overall carbon footprint, then a lead agency may determine that a project does not have a significant impact on the climate.

Also, as the AB 32 Scoping Plan rulemaking process moves forward, Valero believes that CARB must undertake a multimedia evaluation as part of its rulemaking and CEQA obligations for the entire Final Scoping Plan in order to access the totality of the potential environmental ramifications both positive and negative associated with the AB 32 Scoping Plan. Valero believes that it is legally impermissible for CARB to defer the multimedia and appropriate CEQA analyses and view impacts in isolation as it undertakes specific elements of the Final AB 32 Scoping Plan.

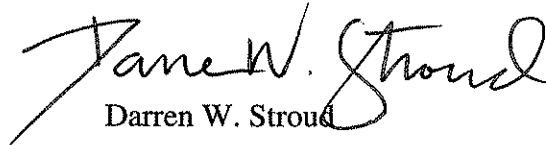
Conclusion

In conclusion, Valero would like to thank CARB for the opportunity to provide these comments and looks forward to working productively and cooperatively with CARB and other stakeholders in developing a Final Scoping Plan that meets the principles and addresses the concerns outlined above.

In submitting these comments, Valero incorporates by reference all of its previous correspondences and comments to CARB, verbal and written, concerning AB 32, LCFS, and the AB 32 Scoping Plan. In addition, Valero supports and adopts as its own the written correspondences and comments submitted by WSPA, AB 32 IG, and CMTA to CARB. Valero reserves the right to supplement its previous comments as well as provide future comments during the AB 32 Scoping Plan and LCFS rulemaking processes.

Please contact me at (210) 345-2871 or Scott Folwarkow at (916) 503-1639 if you should have any questions or need clarifications concerning Valero's comments.

Sincerely yours,



Darren W. Stroud

DWS:sf

cc: CARB Board Members
James Goldstene, California Air Resources Board
Chuck Shulock, California Air Resources Board
Mike Scheible, California Air Resources Board
Bob Fletcher, California Air Resources Board