July 31, 2008

VIA ELECTRONIC AND U.S. MAIL

Mary Nichols, Chairperson
California Air Resources Board
1001 I Street
P O Box 2815
Sacramento, CA 95812

Re: Comments from El Paso Corporation
Climate Change Draft Scoping Plan, a framework for change, June 2008 Discussion Draft

Dear Ms. Nichols:

El Paso Corporation (El Paso) respectfully submits the attached comments on the *Climate Change Draft Scoping Plan a framework for change* (Scoping Plan) released on June 26, 2008.

El Paso Corporation (NYSE: EP) provides natural gas and related energy products in a safe, efficient, and dependable manner. We are organized around two core businesses — pipelines and exploration and production. We own North America's largest natural gas pipeline system, transporting approximately one quarter of the natural gas consumed in the U.S. each day. In fact, El Paso delivers over 30% of the natural gas consumed in California. In addition, our planned Ruby Pipeline will deliver well over an additional billion cubic feet per day of natural gas to meet California's immediate clean energy needs. Our exploration and production company ranks among the top 10 domestic independent natural gas producers operating in key onshore and offshore basins.

As an industry leader, we share the concerns being expressed by public and governmental stakeholders over the issue of greenhouse gases (GHGs). El Paso has been actively participating in national policy discussions and has instituted internal guiding principles on the issue of addressing climate change[1]. We have announced it is our goal that our multi-billion dollar Ruby pipeline be a carbon-neutral project, to be achieved through a number of GHG reduction/mitigation measures. To El Paso's knowledge, the Ruby project represents the first effort by a major natural gas pipeline to incorporate such GHG mitigation efforts into its plans. We are also members of the California Climate Action Registry (CCAR), and have the honor of being the first natural gas transmission company to certify our California GHG emissions. Being an industry leader, we understand the regulatory, technical and the commercial complexities associated with natural gas-related GHG emissions. We have participated in and communicated our experiences and recommendations under both the AB 32[2] and Western Climate Initiative (WCI) rule development. Additional leadership credentials are included in Attachment 1.

Our comments are summarized as follows. Detailed comments are included in Attachment 2.

[1] http://elpaso.com/CSR/neighbortohave.html

[2] Multiple comments filed with California Public Utility Commission, California Energy Commission and California Air Resources Board

1. ***California Cap-and-Trade Program Linked to Western Climate Initiative***:

   a. El Paso supports a single, consistent national cap-and-trade program. In the absence of a federal program, California and others in the WCI have proceeded to develop a regional cap-and-trade program. For efficient administration and meaningful reduction, the California and the WCI programs must be consistent and linked. However, it should be recognized that some aspects of the draft recommendations[3] of the WCI are inconsistent with recommendations of the California Public Utilities Commission (CPUC) with respect to regulating the natural gas sector. The California Air Resources Board (CARB) should adopt the well-reasoned position of the CPUC on this issue and reject that of the WCI in these specific areas.

   b. El Paso strongly recommends that CARB develop the cap-and-trade program based on "downstream" regulatory designs consistent with the recommendations of the majority opinion of the Market Advisory Committee (MAC)[4] and recommendations of the CPUC[5]. El Paso supports the recommendations of the CPUC with respect to the regulation of the residential and commercial sectors, and recommends its adoption by the CARB. A downstream design focuses on actual emissions and holding the actual emitter liable for compliance. It is a proven mechanism - the emitting entity is forced to take ownership of its actions and emissions and look for the lowest marginal cost of compliance via appropriate emissions management strategies. Whereas, an upstream design is a fuel proxy method and focuses on fuel throughput for the entire economy at a point along the natural value chain. It puts the compliance burden on select sectors of the gas economy for the purchase of emission allowances, without regard to actual existing regulatory or contractual limitation considerations.

   c. CARB, as part of the mandatory reporting regulatory development for AB 32, has concluded that a threshold of 25,000 tonnes per year of CO2 is an appropriate threshold for regulating stationary combustion sources. This threshold accounts for 94 % of industrial and commercial point source emissions in California. After careful review, CARB chose to use this threshold and not employ the carbon dioxide equivalent[6] (CO_{2e}) as the applicability threshold. CARB did not include the process and fugitive emissions in the industrial sectors, mainly due to uncertainty with the emission estimates and lack of technical protocols. However, the WCI has employed a CO_2e applicability standard, overlooking several years of technical analysis by the CARB. CARB should ensure that the 25,000 tonnes per year of CO_2 (and not CO_2e) threshold be preserved and maintained in linking the California cap-and-trade program with that of the WCI.

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[3] http://www.westernclimateinitiative.org/ewebeditpro/items/O104F17390.PDF and http://www.westernclimateinitiative.org/ewebeditpro/items/O104F18808.PDF

[4] "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California", Recommendations of the Market Advisory Committee to the California Air Resources Board, June 20, 2007; Pages 38-39.

[5] http://docs.cpuc.ca.gov/PUBLISHED/AGENDA_DECISION/80074.htm, March 13, 2008

[6] Per AB 32 §38505(c), "Carbon dioxide equivalent" means the amount of carbon dioxide by weight that would produce the same global warming impact as a given weight of another greenhouse gas, based on the best available science, including from the Intergovernmental Panel on Climate Change.

d. The production and processing sectors should not be included in either the California cap-and-trade program or the WCI cap-and-trade programs as covered sectors. This is mainly since the integrity of a cap-and-trade program is dependent on several factors, including measurement of emissions with sufficient accuracy and consistency. In exempting the agriculture and forest and land use sectors, the WCI cites that "emissions cannot be calculated or measured precisely and cost-effectively" for inclusion in a cap-and-trade program. This statement is also very true also for the natural gas sector, which faces similar issues with methane related emissions that account for approximately 35% of the emissions profile. Further, methane emissions from this sector are already targeted for reduction as an early action measure. The industry has contributed to significant reduction in national methane emission levels through participation in the EPA Natural Gas Star program.

e. While CARB has recommended multiple measures, several proposed mandatory reduction measures on the "capped sectors" have significant uncertainty related to its technical and legal implementation. In our opinion, over 88 $MMTCO_2e$ from the recommended mandatory measures are either uncertain or undefined. Therefore, the "capped sectors" face significant uncertainty with respect to the reduction targets, though CARB indicates very clearly that it expects the capped sectors to fully comply with these reduction targets and participation in the cap-and-trade program will not be an excuse for not meeting the reduction targets.

f. Layering additional reduction measures on the capped sectors with significant technical and/or legal uncertainty related to their effectiveness will likely create undue burden on the integrity of the cap-and-trade program and its impacted sectors.

2. Renewable Portfolio Standard:

The CARB proposal of a Renewable Portfolio Standard (RPS) goal of 33% by 2020 is extremely ambitious. Such a substantial increase in the renewable requirement would make it more essential than ever that there exist a natural gas "backstop" system during times when renewables are not available, such as a requirement that the California gas utilities hold "firm" interstate natural gas pipeline capacity. This would provide cost-effective "insurance" against potentially significant gas and electric price swings and supply disruptions that would be detrimental to all California consumers.

3. Energy Efficiency and Co-Benefits Audits for Large Industrial Sources:

A well-designed cap-and-trade program aims to achieve reductions in the most efficient manner, with the lowest marginal cost at the same facilities where CARB is considering energy audits. As such, we recommend these energy efficiency audits be voluntary, not mandatory, and that CARB rely on the cap-and-trade program to regulate such facilities.

4. ***Other Measures:***

a. ***Carbon Fees:***

CARB is considering the implementation of carbon fees on interstate natural gas pipelines and processing plants. If interstate pipelines are held legally responsible to pay significant carbon fees/taxes for the CO_2 potential of their gas throughput into the State, they would be forced to mount legal challenges to the state regulations. The resolution of those challenges could take years. The CARB should reject further consideration of this concept due to legal, technical and policy reasons:

1. Technical and Policy:

    a. California should focus on regulating sectors that can provide the greatest emission reductions, most reliably, at the lowest cost. CARB should not support the use of a proxy method for actual emissions (whereby the cap is defined in terms of the carbon content of the fuel and allows a cap to be placed upstream on fuel producers and transporters) nor a carbon tax policy that does not provide any assurance as to compliance with AB 32's goals.

    b. The theory that upstream natural gas entities could attach billions of dollars of allowance cost to their cost of business and transmit the price signal through the economy is flawed unless explicit regulatory provisions are included to allow "pass through" of all costs and taxes.

    c. The CPUC has concluded that natural gas demand is "relatively inelastic" and "switching to other fuel sources (e.g., fuel oil) in response to high natural gas prices or shortages is less prevalent in recent years due to more stringent air quality standards". Thus, carbon fees are unlikely to have significant effect on gas-related emissions in the residential/commercial sectors.

    d. Therefore, if efficient pass-through of the carbon taxes or allowances can be established, adding a carbon tax on interstate pipelines with facilities already subject to the cap-and-trade program would likely result in a natural gas price increase of over $5/MMBtu, or over 50% of the current pricing for deliveries of natural gas carried by the interstate pipelines into California, while producing very little reduction in emissions.

    e. In our opinion, an additional carbon fee or tax structure operating in conjunction with a cap-and-trade program, would significantly hurt natural gas consumers and also have tremendous impacts on the California economy, with little benefit.

    f. There has been no practical application of an upstream emission fee/tax scheme in the US. A recent paper[7] explored the practical effectiveness of a carbon tax in Scandinavia, and

[7] Taxation as a Regulatory Tool: Lessons from Environmental Taxes in Europe, Monica Prasad, Northwestern University, March 2008

concluded the availability of "product" substitution is a dominant factor in achieving reductions. Due to lack of immediate substitution of natural gas and demand in elasticity, it is very conceivable that the imposition of such carbon fees/taxes would potentially raise energy prices in the State without tangible environmental benefits.

2. Interstate Commerce Legal Issues:

   a. *CARB has limited authority to impose administrative fees under AB 32:*
   The scope of CARB's authority to levy fees under AB 32 is specified in Health and Safety Code Section 38597. The analysis for the Assembly and Senate both describe this fee provision as providing authorization to CARB, "to adopt a schedule of fees to pay for the costs of implementing the program established pursuant to the bill's provisions." In other words, CARB's fee authority under AB 32 is limited to funding the administrative functions of implementing AB 32. However, statements made in the Scoping Plan regarding the imposition of carbon "fees" appear to go well beyond funding CARB's administrative costs associated with implementing AB 32. The Scoping Plan states that fees "can be used as a powerful tool to incent emission reductions by affecting the relative prices within the economy … carbon fees can affect consumption and investment within the economy and reduce GHG emissions." These and other statements in the Scoping Plan go well beyond CARB's fee authority under AB 32 to impose fees to cover the direct administrative costs of implementing AB 32. The Legislature simply has not granted CARB the type of broad fee-making authority that would be required to implement the carbon "fee" recommendations contained in the Scoping Plan.

   b. *CARB can impose administrative fees, but not taxes:*
   Health and Safety Code Section 38597 only grants fee authority to CARB. Further, AB 32 passed with less then the two-thirds super-majority required in order to impose a new tax. Therefore, any "fee" imposed by CARB pursuant to AB 32 must ensure that it does not constitute a tax under California law. and must satisfy the "nexus" requirements articulated in the California Supreme Court's Sinclair Paint decision. Sinclair Paint Company v. State Board of Equalization, *et al.* (1997) 15 Cal.4th 886

   c. *CARB cannot adopt "fees" or taxes that will violate the Commerce Clause:*
   The Scoping Plan states, "fees would be levied on all natural gas processing plants, the state's seven interstate natural gas pipelines, and pipelines from Mexico". However, a proposed carbon "fee" or levy on pipelines delivering natural gas into California, if adopted, would run afoul of the dormant Commerce Clause and would be actionable as such. *See Dennis v. Higgins*, 498 U.S. 439 (1991) (holding that dormant Commerce Clause suits against states may be brought under the Civil Rights Act of 1871, 42 U.S.C. § 1983).

   In reference to enacting a carbon "fee" for interstate pipelines, it is unclear whether the Scoping Plan intends to also apply to natural gas that is merely being transported through California for use in another state or location. Further, the Scoping Plan specifically mentions interstate

pipelines, and does not reference intrastate pipelines. If the proposed law only taxes interstate pipelines, it is discriminatory and is therefore, "virtually *per se* invalid."

Interstate gas pipelines are regulated by the Federal Energy Regulatory Commission (FERC). First, an interstate pipeline does not have a substantial nexus to any specific State and certainly no "substantial nexus" to a State in which they deliver gas. Second, the proposed "fee" would bear no relationship to a pipeline's investment within the State, but merely to the amount of carbon transported through the State. Third, the proposed "fee" discriminates against interstate carriers if it only applies to interstate pipelines. Fourth, the proposed "fee" would not be related to any services provided by the State. The Constitution simply does not permit local interests to unduly burden interstate commerce. Yet, that is what the California proposal seeks to do.

d. Even if the Commerce Clause is overcome, the CARB proposal on "fees" or taxes will need significant revisions requiring FERC approval, and could result in an unintended shift of natural gas to other states without carbon constraints

California or other State's attempts to regulate GHGs from the natural gas sector at the interstate pipeline level would cause regulatory complications that, at best, will slow the implementation of and limit the effectiveness of the program. The FERC would need to accommodate cost recovery and pass-through of the carbon fees. At the same time, the interstate pipeline business is generally very competitive, and pipelines cannot simply increase their rates without risking losing business to competitors.

If interstate pipelines become legally responsible to pay a significant carbon fees/tax for the CO_2 potential of their gas throughput, they would be forced to mount legal challenges to the State regulations. The resolution of those challenges could take years, and the pipelines would seek recovery of those costs in their rates. Moreover, it would create a disincentive for shippers to select that State's delivery points for their gas. This outcome, or even the risk of such an outcome, could further result in pipeline companies choosing not to develop new pipeline capacity to the regulating State and instead spend their capital developing projects in other regions.

b. <u>Emission Offsets:</u>

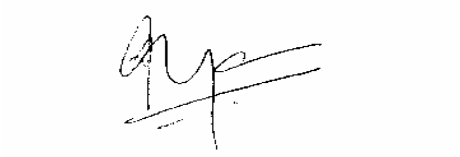
We support the inclusion of emission offsets in any cap-and-trade program. Offsets are an excellent means of achieving GHG reductions from sources not easily covered under a cap-and-trade program due to difficulties in accurately measuring their emissions (i.e., fugitive methane emissions from natural gas pipelines). Additionally, offsets are an important means of keeping compliance costs down, and give covered entities the time necessary to develop and deploy new technologies to mitigate other sources of emissions.

c. Use of Possible Revenues

Transparency related to the use and disbursement of revenue is critical. We recommend that a significant portion of revenues generated by the cap-and-trade program be employed to fund new research and development (R&D) for new green technologies (e.g. carbon capture and sequestration), and for other direct environmental reduction programs.

Our commitment related to environmental issues carries out our core value of stewardship as we strive always to be good stewards of the environment and within our communities. We hope you find these comments useful in your important work. As the CARB deliberates the contours and content of a world class cap-and-trade program in California and the WCI region, please feel free to contact me at (713) 420-7913 or fiji.george@elpaso.com, with questions or for further information.

Sincerely,



Fiji George
Manager, Corporate Development

ATTACHMENT 1

EL PASO'S GHG LEADERSHIP CREDENTIALS

- El Paso is sponsoring the Ruby pipeline[8] project to provide increased access to abundant Rocky Mountain gas to California. Ruby is the first major interstate pipeline to incorporate GHG mitigation measures in its construction and design, with a goal of offsetting 100% of its carbon footprint.

- El Paso has been a member of the California Climate Action Registry (CCAR) since 2006. In June 2007, El Paso became the first natural gas transmission company to file an emissions inventory covering all applicable GHGs, including methane, N_2O and CO_2. On July 16th of 2007 El Paso became the first natural gas company to certify its emissions and earn the status of Climate Action Leader. We were also the first CCAR member to report and certify an emissions inventory for 2006.[9] On December 31, 2007, El Paso registered its 2006 GHG emission estimates under DOE 1605(b) requirements.

- El Paso is a member of The Climate Registry's (TCR) Advisory Committee.[10] As such, El Paso provides input on technical elements associated with TCR's design and implementation, and feedback on broader policy issues that could affect the organization's support of state and provincial climate programs.

- El Paso has participated and reported into the Carbon Disclosure Project (CDP) V and VI. In June 2008, El Paso released its first Corporate Social Responsibility (CSR) report[11].

- El Paso is part of the Natural Gas Protocol Workgroup facilitated by the CCAR and the World Resources Institute (WRI), with the goal to produce a guidance document and protocol for estimating GHG emissions from natural gas transmission, storage and distribution sectors. The protocol and calculation tool(s), to be developed through a stakeholder workgroup process, will supplement the CCAR's General Reporting Protocol[12] and the WRI/World Business Council for Sustainable Development Greenhouse Gas Protocol - A Corporate Reporting and Accounting Standard.[13]

- The El Paso Pipeline Group's GHG emission reductions from participation in the EPA Natural Gas Star Program total over 55 billion cubic feet, or approximately 20 million tons of CO_2e, since 1993. These and many other internal initiatives within El Paso have ensured that the El Paso Pipeline Group's lost and unaccounted for (LAUF) gas was less than 0.15% for 2006.

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[8] http://www.rubypipeline.com/

[9] El Paso's 2006 entity-level emissions report is available at http://www.climateregistry.org/CARROT/public/reports.aspx.

[10] El Paso was nominated for this position by California Environmental Protection Agency

[11] http://elpaso.com/CSR/index.html

[12] http://www.climateregistry.org/docs/PROTOCOLS/GRP%20V2-March2007_web.pdf

[13] http://www.ghgprotocol.org/templates/GHG5/layout.asp?type=p&MenuId=ODg4&doOpen=1&ClickMenu=No.

- El Paso is part of the Coalition for Emission Reduction Projects (CERP), which aims to educate policy-makers about the key role that offsets can play in a U.S. cap-and-trade program. The CERP is a unique group, which brings together leading companies in the energy, financial and offset provider sectors.

- El Paso maintains leadership positions in the Interstate Natural Gas Association of America (INGAA) on GHG and in the development of the INGAA Greenhouse Gas Emissions Estimation Guideline for Natural Gas Transmission and Storage.

- El Paso is part of the LNG Protocol Workgroup facilitated by the Cleaner Fossil Energy Task Force of the Asia Pacific Partnership and led by the American Petroleum Institute.

- El Paso was recognized for its technical, regulatory and policy leadership on GHG issues by Southern Gas Association (SGA) and became a recipient of SGA's 2007 Environmental Stewardship Excellence Award.

ATTACHMENT 2

EL PASO'S COMMENTS ON THE "CLIMATE CHANGE DRAFT SCOPING PLAN A FRAMEWORK FOR CHANGE"

El Paso Corporation is the largest natural gas pipeline company in North America and one of the top ten independent exploration and production companies in the United States. We are also recognized leaders in the area of GHG issues for our sector and are members of the California Climate Action Registry (CCAR). Two of our subsidiaries are The Climate Registry (TCR) "Founding Reporters".

El Paso appreciates the opportunity to comment on the June 2008 Scoping Plan. Our comments are detailed below:

1. ***California Cap-and-Trade Program Linked to the Western Climate Initiative:***
   "*Implement a broad-based cap-and-trade program that links with other Western Climate Initiative Partner programs to create a regional market system. Ensure California's program meets all applicable AB 32 requirements for market-based mechanisms."*

   a) Scope and Coverage

   CARB has been working with other WCI partners in developing a regional cap-and-trade program; this model regional rule is expected by August 2008. Per the directives of AB 32, the California cap-and-trade program must be finalized by January 1, 2011. On May 16, 2008, the WCI released its "Draft Design Recommendations on Elements of the Cap-and-Trade Program" (WCI Draft) and on July 23, 2008, the WCI released its "Draft Design of the Regional Cap-and-Trade Program"[14], providing recommendations on a broad, regional cap and-trade program. Since the scoping plan is based on the May 16, 2008 WCI Draft, our comments are mainly tailored to the same WCI Draft.

   El Paso supports a single, consistent national cap-and-trade program. In the absence of a federal program, California and others in the WCI have proceeded to develop a regional cap-and-trade program. For efficient administration and meaningful reduction, the California and the WCI programs must be consistent and linked. El Paso's comments specifically focus on the treatment of the natural gas sector.

   Several governmental and non-governmental research and analysis projects have been performed on various aspects of a cap-and-trade design in the United States, including incorporating cap-and-trade experiences from the European Union Emissions Trading System (EUETS). However, in our opinion, there have been two seminal studies specifically related to California that reviewed its unique energy and emissions profile, which were commissioned as part of the AB 32 regulatory process. These include the recommendations of the MAC[15] and the CPUC[16]. The CPUC report released earlier this

[14] The CARB recommendations in the scoping plan are based on the May 16, 2008 WCI DRAFT.

[15] "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California", Recommendations of the Market Advisory Committee to the California Air Resources Board, June 30, 2007; Pages 38-39.

year reviewed various reports, including the MAC final report, against the development of a California specific cap- and-trade program. A summary of natural gas related cap-and-trade design issues is provided below.

CPUC Decision

Essentially, the CPUC concludes that the natural gas sector[17], should not be included in a cap-and-trade system at this time. The CPUC states that "it would be premature to include the natural gas sector in a cap-and-trade system because:

· Significantly fewer options exist to reduce GHG emissions in the natural gas sector compared to the electricity sector.

· There is currently very limited availability of low-carbon alternative sources of natural gas.

· Energy efficiency and other natural gas demand reduction programs are the best options for reducing GHG emissions in the natural gas sector.

· The incremental benefits from including the natural gas sector in a multi-sector cap-and-trade program are likely to be smaller than those for the electricity sector.

· Reporting protocols for GHG emissions for this sector are still under development.

· Relying on programmatic measures to achieve emissions allows additional time to develop reporting protocols."

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The MAC Final Report

The MAC outlined several coverage options to address cap-and-trade design schemes for the various fossil fuels within the California economy. A schematic developed by the MAC (Figure 4-1) is reproduced below.

In its final recommendations, the "sense" of the MAC (representing the majority opinion) is to prefer a cap-and-trade program design in which: (i) the program initially covers first sellers of electricity and large industrial emitters; and (ii) "the transportation and buildings sectors are added in subsequent phases as soon as CARB determines that emissions in those sectors can be monitored, and that the administrative costs of extending coverage to those sectors are not prohibitive."[18] In other words, referring to the MAC's Table 4-1 reproduced below, design a cap-and-trade program that regulates sources e1 and e2 first and then move to c2 and eventually to c3.

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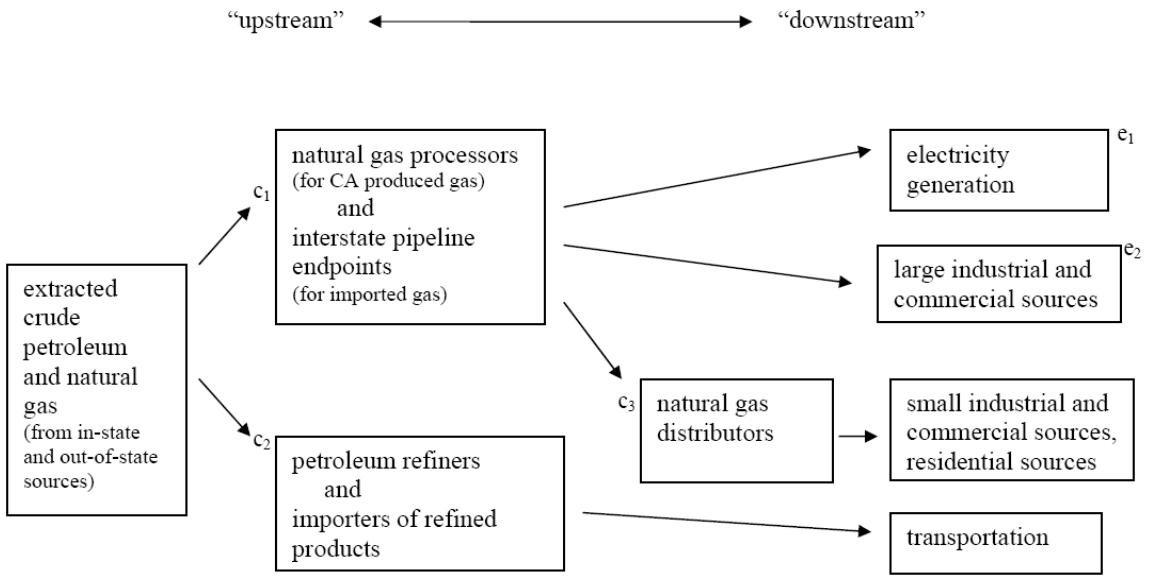
[16] http://docs.cpuc.ca.gov/PUBLISHED/AGENDA_DECISION/80074.htm, March 13, 2008

[17] Defined to include end-user combustion at facilities below CARB's reporting threshold for GHG emissions (25,000 tonnes of CO2 per year), as well as emissions from natural gas infrastructure, including fugitive emissions from pipelines and compressor stations.

[18] MAC Final Report at 39.

The MAC's majority opinion was based on careful review of the relevant facts – including regulatory and administrative considerations.

Figure 4-1
Uses of Fossil Carbon and Fossil Carbon-Based Products In the California Economy



With respect to the natural gas sector, the MAC identified the following additional considerations that we believe led to the majority opinion:

1. With respect to coverage of all GHGs, the MAC identifies two methodologies for defining allowances: (i) based on direct actual emissions; and (ii) based on "proxy" methods. The MAC concludes that "Administrative arrangements to enable such a proxy method will need to be designed to ensure that they are administratively simple while also sufficiently robust… reliable proxies do not exist for all sources of GHG emissions."[19]

2. With respect to fossil fuels, in deciding not to include non-CO_2 emissions in the cap-and-trade program, the MAC recommended not to include combustion emissions of CH_4 and N_2O due to the "highly variable nature of these emissions and the high cost of accurate monitoring." The

[19]MAC Final Report at 24.

MAC majority also clearly advises against including fugitive emission sources under the cap-and-trade program because of monitoring difficulties.

The WCI Draft:

The WCI Draft recommends "a base program from the start of the cap-and-trade program that includes the electricity sector, large stationary combustion sources, industrial process and waste management emissions, and fossil fuel production and processing". Natural gas production (including coalbed methane production) and processing covers the exploration, production, and treatment of natural gas. Facilities include well fields, pipelines, and processing equipment. Natural gas transmission and distribution pipelines are considered stationary sources with combustion emissions (i.e., from compressor engines) and fugitive/process emissions (i.e., gas venting and fugitive emissions). In its July recommendations, the WCI recommends that the second compliance period[20] regulate "residential, commercial, and industrial fuel combustion at facilities below the WCI thresholds, and transportation fuel combustion from gasoline and diesel".

The major differences between the CPUC/MAC California focused reports and the WCI Draft are as follows:

- WCI is considering a threshold of 10,000 to 25,000 tonnes of CO_2e per year per facility[21].
- The WCI draft recommends incorporating the production and processing sector into the cap-and-trade program.
- WCI recommends establishing the point of regulation at the local distribution company (LDC) in order to regulate the residential commercial sector

El Paso supports the regulation of "large" stationary combustion sources. That is, a downstream regulatory design that focuses on emissions as opposed to employing fuel as a proxy for emissions. This is a consistent regulatory theme we observe in all three reports. We recommend that the CARB ensure that the 25,000 tonnes per year of CO_2 (and not CO_2e) be preserved and maintained in linking the California cap-and-trade program with the WCI. The CPUC and MAC have acknowledged the complexity of including fugitive emissions in a cap-and-trade program and applicability threshold determination. These emissions should not be included in the cap, though they can be addressed through offsets.

CARB should not incorporate the natural gas production and processing sector in the California and the WCI cap-and-trade programs as covered sectors. Based on USEPA's 2005 estimates, approximately 35% of the emissions profile from the natural gas production and processing sector is methane-related. Reduction of methane venting/leaks from oil and gas systems was an "early action" measure approved by the Board in June 2007. The CARB staff is evaluating reduction opportunities from this sector. Further,

[20] From 2015

[21] WCI in its July 23, 2008 recommendations has proposed a 25,000 metric tons of CO2e per year per facility

as explained in our previous comments to the WCI (especially El Paso's comments dated March 18, 2007), the CARB should not include fugitive emissions in a cap-and-trade program. This is mainly because the integrity of a cap-and-trade program is dependent on several factors, including measurements of emissions with sufficient accuracy and consistency. In exempting the agriculture and forest and land use sectors, the WCI cites that "emissions [from these sectors] cannot be calculated or measured precisely and cost-effectively" for inclusion in a cap-and-trade program. This statement is also very true also for the natural gas sector, which faces similar issues with the inclusion of methane emissions from thousands of small fugitive emission sources[22] along the natural gas value chain. The natural gas production sector also faces other complex issues, such as frequent acquisition/divestiture activity and complex ownership that result in additional administrative burdens. Despite these technical and complex organizational issues, the WCI has proceeded to regulate the production and processing sector. We urge the CARB to lend its expertise and experience to the WCI in formulating appropriate reduction measures, and not include the production and processing sectors within a cap-and-trade program either in California or the WCI.

El Paso supports the recommendations of the CPUC with respect to regulation of the residential and commercial sectors and recommends their adoption by the CARB**.**

Therefore, for the natural gas sector, there are key differences that the CARB should carefully consider and address before linking its program with the WCI.

b) <u>Emissions cap and recommended reduction measures</u>

In the Scoping Plan, the CARB recommends a mix of measures in Table 2[23]. The CARB estimates a total reduction of approximately 169 million tonnes of carbon dioxide equivalents ($MMTCO_2E$) through the measures listed in Table 2. To achieve the AB 32 targets, CARB has proposed an emissions cap of 365 $MMTCO_2e$ covering electricity, transportation, residential/commercial and industrial sources by 2020. Also included in the Scoping Plan is Figure 2, which depicts a 2020 business-as-usual (BaU) emissions forecast of 512 $MMTCO_2e$ from these sectors. The Scoping Plan concludes that implementation of certain recommended measures for these sectors (as outlined in Table 2) is expected to reduce emissions by 112 $MMTCO_2e$[24], resulting in total GHG emissions of 400 $MMTCO_2e$, prior to implementation of yet undefined and additional reduction measures of 35 $MMTCO_2e$ from the capped sectors and the implementation of the 365 $MMTCO_2e$ cap and trade program.

> Outside the cap-and-trade target of 365 $MMTCO_2e$, the remaining reductions of 147 $MMTCO_2e$[25] are either undefined, uncertain or appear to be voluntary. Table 1 below provides El Paso's interpretation of a select few recommended measures for the capped sectors.

[22] Fugitive GHG emissions are methane leaks from pipelines and system components such as compressor seals, pump seals, valve packings, and flanges and piping connectors. Fugitive emissions are not unique to the natural gas industry.

[23] Table 2: Recommended Greenhouse Gas Reduction Measures, page 11, June 2008 Climate Change Draft Scoping Plan

[24] Table 4: Sector Responsibilities Under Cap-and-Trade Program (at page 17) and "shaded" measures in Table 2: Recommended Greenhouse Gas Reduction Measures (at page 11) of the Scoping Plan.

[25] Difference between 2020 BaU of 512 MMTCO2E and the cap for certain sectors of 365 MMTCO2E

Recommended Reduction Strategies	2020 Reductions (MMTCO2E)	Comments
California Cap-and-Trade Program	147	WCI linkage will produce a mandatory cap-and-trade program with appropriate compliance and enforcement. See detailed comments in the previous section.
California Light-Duty Vehicle GHG Standards	31.7	California Light-Duty Vehicle GHG Standards face legal challenges. HSC §38590 requiring original equipment manufacturer (OEM) certification would be dependent on the EPA waiver request. Hence, outside the "feebate" proposal outlined in HSC §38590, there is significant uncertainty related to a 31.7 $MMTCO_2e$ target.
Energy Efficiency	26.4	El Paso supports maximizing energy efficiency and appliance standards
Renewable Portfolio Standard (RPS) of 33% by 2020	21.2	See comments in Section 2
Additional Emissions Reduction from Capped Sectors	35.2	These reduction measures are undefined. See Comments in Section 1.b
Energy Efficiency and Co-Benefits Audits for Large Industrial Sources	Undefined	See Comments in Section 3

In the appendices to the Scoping Plan[26], the CARB advises that "[p]articipating in a cap-and-trade program will not excuse facilities from obligations imposed on them by other measures adopted under AB 32. Rather, reductions achieved through those other measures will result in reduced emissions and the need for fewer allowances to comply with the cap-and-trade program".

We agree that if all the reduction measures are achieved, it will reduce the need for allowances within the cap-and-trade program. However, CARB has not addressed "Plan B" – i.e. the path forward if the proposed recommended reduction measures are not achieved and the resulting impact on the "capped sectors". As outlined above, the California Light-Duty Vehicle GHG Standards are riddled with legal uncertainties. The RPS target of 33% has yet to be codified into statute. This is extremely ambitious; CARB does not define the "back stop" or the impacts on the emission caps if the RPS target is not met. Finally, CARB seeks additional reductions of 35.2 $MMTCO_2e$ from the capped sectors, yet has not identified how these reductions could be achieved. In our opinion, over 88 $MMTCO_2e$ from the recommended measures are either

[26] At page C-15

uncertain or undefined. Therefore, the "capped sectors" face significant uncertainty regarding compliance with such reduction measures.

With the effective date of AB 32 less than 4 years away and recent financial losses experienced by US companies[27] stemming from legal decisions related to the Clean Air Interstate Rule (CAIR), it is highly critical for CARB to provide regulatory certainty for the capped sectors. This will require development of attainable emissions targets via market based mechanisms for the appropriate capped sectors. Layering on additional reduction measures on the capped sectors with significant technical and/or legal uncertainty related to their effectiveness will create undue burden on the integrity of the cap-and-trade program and its impacted sectors.

2. ***Renewable Portfolio Standard:***
"Achieve 33 percent Renewables Portfolio Standard by both investor-owned and publicly-owned utilities."

CARB has proposed an RPS goal of 33% by 2020 to decrease California's "reliance on fossil fuels, thus reducing GHGs from the electric sector" for both the investor-owned utilities (IoUs) and publicly-owned utilities (PoUs). The California Energy Commission (CEC) estimates that about 12 percent of California's retail electric load is currently met with renewable resources. Senate Bills 1038, 1078, 1250, and 107 require retail sellers of electricity to increase the amount of renewable energy they procure each year by at least 1 percent, until 20 percent of their retail sales are met with renewable energy, by December 31, 2010. The PoUs are "encouraged" but not required to meet the same RPS targets.

Achieving the reduction of 21.2 $MMTCO_2e$ requires an approximate increase of 175% in the use of renewable energy from the current level of 12%. In the Scoping Plan, the CARB has neither defined how it will achieve the 33% target, nor has it reviewed technical issues related to the use of renewable energy sources in achieving these targets. One such issue is the role of natural gas in the targeted RPS. The electric sector, whether employing renewable energy (mainly wind and solar) or other fossil fuels, needs uninterruptible sources for generating electricity. As such, the energy infrastructure must include a "backstop" to insure that the electric power plants can provide uninterruptible electric supplies to California electric consumers. Natural gas is the best "backstop" due to its wide availability and ability to fuel combustion for generation on a moment's notice. The California electric service providers should hold "firm" interstate natural gas pipeline capacity for this reason, thus providing cost-effective "insurance" against potentially significant gas and electric price swings and supply disruptions that would be detrimental to all California consumers.

El Paso recommends that CARB review the feasibility of the 33% RPS and also ensure that electric service providers dependent on renewable energy sources, such as wind and solar, hold firm interstate natural gas capacity to be able to use natural gas as back up to provide uninterruptible power to California.

[27] PPL Corporation (PPL), Form 8-K filed with the Securities and Exchange Commission, July 11, 2008. PPL advised approximately $100 million impairment charges related to emissions after a recent court ruling invalidated the CAIR.

3. **Energy Efficiency and Co-Benefits Audits for Large Industrial Sources:**
"Require assessment of large industrial sources to determine whether individual sources within a facility can cost-effectively reduce GHG emissions and provide other pollution reduction co-benefits."

CARB has proposed energy efficiency audits at all major industrial facilities with emissions greater than 500,000 TCO_2e per year. At this threshold, these facilities are most likely to be regulated by the cap-and-trade program. A well-designed cap-and-trade program aims to achieve reductions in the most efficient manner and with the lowest marginal cost. The program would provide price signals to the capped sector to undertake appropriate activities to reduce its emissions (and energy consumption). Since energy efficiency programs are typically the "low hanging fruit", it is very likely that the major industrial facilities would have undertaken appropriate efficiency measures. As such, we recommend that these energy efficiency audits be voluntary, not mandatory, and CARB rely on the cap-and-trade program to regulate such facilities. Mandating energy audits and regulating the replacement of equipment creates undue burden on both CARB staff and the industrial sources.

4. **Other Measures Under Evaluation:**

CARB is evaluating a host of measures for possible inclusion into the final Scoping Plan to be approved by the Board later in the year. El Paso offers the following comments on these matters:

a) Other Sector-Based Measures: Industry – Refineries/Oil and Gas Production

Per the US EPA[28], methane (CH_4) emissions from natural gas systems[29] were 111.1 $MMTCO_{2e}$ in 2005; emissions have declined by 13.3 $MMTCO_2e$ (11 percent) since 1990. This decline is due to improvements in technology and management practices, as well as some replacement of old equipment. Much of these reductions are due to the participation of these companies in the US EPA's Natural Gas Star program.

As stated in Section 1.a; approximately 35% of the emissions profile from the natural gas production and processing sector is methane-related. The reduction of methane venting/leaks from oil and gas systems was an "early action" measure approved by the Board on October 25, 2007. Currently, the CARB staff is evaluating reduction opportunities from this sector. Therefore, CARB should not impose additional reduction measures on this sector at this time.

[28] Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990 – 2005, April 15, 2007

[29] IPCC Source Category 1B2b. Natural gas systems includes exploration/production, processing, transmission and distribution

b) Carbon Fees

CARB is considering the implementation of "carbon fees" on interstate natural gas pipelines and processing plants. CARB indicates that such fees can be employed as "a powerful tool to incent emission reductions by affecting the relative prices within the economy". In other words, CARB is proposing a carbon tax. To incent reductions, CARB estimates that these "fees" would likely need to be set between $10 and $50 per $MMTCO_2e$. The following table provides price impacts to different fossil fuels as a result of a tax in the range of $10 to $50 per tonne CO_2.

$/Tonne CO	Natural Gas ($/MMBtu)	Gasoline ($/gallon)	Coal ($/MMBtu)
$10	$0.53	$0.10	$0.95
$20	$1.06	$0.21	$1.90
$30	$1.60	$0.31	$2.85
$40	$2.13	$0.41	$3.80
$50	$2.66	$0.51	$4.75

In addition, CARB indicates that these "fees" could also provide a source of revenue to pay for environmental reductions, offset increased consumer costs and as outlined in Section 4.d to offset administrative costs associated with implementation of the program. Hence, it is clear that carbon taxes are being considered not to provide "price certainty" to the regulated sectors (the often stated advantage of a carbon tax), but being reviewed as an additional measure to the cap-and-trade program and other recommended reduction standards and measures, and as a source of revenue to fund a plethora of programs. In reviewing the implementation of such a fee structure for natural gas, the Scoping Plan advises the following:

- The administrative design related to scope and coverage would be the same for an upstream carbon fee or for an upstream cap-and-trade program;
- Implementing an upstream carbon fee would require development of a monitoring and reporting system to track all fossil fuels produced in or imported into California, as well as fuel exports;
- The fees would be levied on all natural gas processing plants, the state's seven interstate natural gas pipelines, and pipelines from Mexico;
- To provide the needed GHG emission reductions, carbon fees would need to increase over time;
- The fees would be set high enough to drive investment and fuel use choices toward more efficient and lower carbon options;

- The level of the fees might need to be adjusted from the schedule initially adopted by the Board if emissions reductions are insufficient to support meeting the 2020 target.

The CARB should reject this concept for legal, technical and policy reasons.

i. Technical and Policy

The carbon fee measure being evaluated by the CARB is essentially a carbon tax. Under this scheme, the tax rate ($10-50/tonne) would be set up and effectively adjusted upwards to cap the marginal cost of control, but provides no certainty with respect to achievement of AB 32's goals. The actual reductions are dependent on the cost benefit impacts on the economic growth or social welfare of the end users of fossil fuels. CARB essentially contemplates developing the cap-and-trade and the carbon fees as complementary regulatory measures. An additional carbon fee or tax structure, operating in conjunction with a cap-and-trade program, would significantly hurt natural gas consumers and have tremendous negative impacts on the California economy.

In 2005, California used over 5,700 million cubic feet (MMCF) of natural gas per day[30]. About 85% of the natural gas supplies comes from outside California. The CPUC has correctly concluded that natural gas demand is "relatively inelastic" [31] and "switching to other fuel sources (e.g., fuel oil) in response to high natural gas prices or shortages is less prevalent in recent years due to more stringent air quality standards". Even if legal obstacles were overcome, the application of a carbon fee on top of increased costs due to a cap–and-trade program and mandatory early action reduction measures, has the potential to significantly increase the price increases on natural gas for delivery into California.

CARB should regulate those sectors that can provide the greatest emission reductions, most reliably, at the lowest cost. With linkage to a cap-and-trade program in the WCI, a vast majority of El Paso facilities will be covered by the cap-and-trade program. As explained in Section 1 with respect to the natural gas sector, CARB should adopt a downstream design that covers the actual emitters of GHGs. El Paso does not support the use of a proxy method for actual emissions, whereby the cap is defined in terms of the carbon content of the fuel and allows for a cap to be placed upstream on fuel producers and transporters, nor a carbon tax policy which does not provide any assurance as to compliance with AB 32's goals. The gas production and transportation sector has already been targeted for early action reduction measures as explained above, in addition to cap-and-trade program for a majority of its sources. As noted in Table 1, a carbon tax or fee of $50/tonne amounts to an increased cost of $2.66/MMBtu to the price of natural gas borne by the consumers of natural gas. Therefore, even if efficient pass-through of carbon taxes or allowances can be accomplished, adding a carbon tax on the interstate pipelines with facilities already subject to the cap-and-trade program, could potentially result in natural gas

[30] http://www.pge.com/pipeline/library/regulatory/downloads/cgr06.pdf., 2006 California Gas Report, p. 19
[31] (R.) 06-04-009, Preliminary Staff Recommendations for Treatment of Natural Gas Sector Greenhouse Gas Emissions, July 12, 2007

prices increasing over $5/MMBtu – which is over 50 % of the current pricing for deliveries of natural gas carried by the interstate pipelines into California[32].

An "upstream" design, whether a tax or cap-and-trade, aims to employ fuel consumption in the economy as a proxy for emissions. This is theoretically the economic equivalent of requiring allowance retirement at the point of emission, but may not be exactly the same in practice as direct regulation of the emissions at the emitting sources. Under this design, the expectations for reductions are highly dependent on the effective transmittal of the compliance price signals experienced by the select few upstream entities through the economy. When designing GHG regulations, legislation or policy, limited attention has been paid to reviewing the structure of the US natural gas sector when evaluating a carbon tax or an upstream cap-and-trade program. An "ideal" GHG program should attempt to optimize the "coverage" of emissions with administrative simplicity, while maintaining compliance integrity and ensuring fairness among all sectors. The main touted advantage of an upstream program is the administrative simplicity – i.e., fewer sources regulated. Regarding a carbon tax based GHG regulatory structure, it is a "roll of the dice" with the hopes for meeting environmental goals. However, at no time should "perceived" administrative simplicity trump coverage, fairness and compliance integrity.

The "upstream"[33] sources in the natural gas sector include natural gas producers, processors and importers of natural gas (including LNG), transmission/storage and distribution companies. These facilities typically have relatively insignificant emissions compared to end users like power plants or large industrial facilities. The theory that the upstream natural gas entities could attach billions of dollars of allowance cost to their cost of business and therefore transmit the price signal through the economy, is flawed without explicit regulatory provisions. Further, there may be numerous existing supply/business contracts between the current covered entities and their customers that would prohibit such huge costs to be passed through. In such cases, the GHG compliance costs would far exceed the gross revenues generated by the business. Further, significant volumes of natural gas are used as "feedstock" and not for combustion. The upstream design is ripe for double counting, especially with natural gas liquids exported to refineries for blending.

Finally, other than in theoretical realms, to our knowledge there has been no practical application of an upstream emission fee/tax scheme in the US. Several Scandinavian[34] countries and the Netherlands have employed carbon-based taxes with mixed results. A recent paper[35] explored the practical effectiveness of a carbon tax in Scandinavia. The paper indicates that Denmark saw a 15% decline in CO_2 emissions between 1990 and 2005, whereas Norway experienced a 43% increase in its per capita CO_2 emissions during the same period. The availability of "product" substitution is a dominant factor in achieving reductions. With respect to Denmark, substituting

[32] Weighted average prices at California border of $9.45

[33] The term upstream employed in the comments refer to sectors within the natural gas economy prior to end use. This terminology, though commonly employed in GHG regulatory design discussions, is inconsistent with standard industry nomenclature.

[34] Finland, Sweden, Denmark, and Norway.

[35] Taxation as a Regulatory Tool: Lessons from Environmental Taxes in Europe, Monica Prasad, Northwestern University, March 2008

coal use with natural gas and other renewable forms of energy may have created this one time "windfall" reduction.

In 2005, California's power mix[36] consisted of approximately 20% coal, 38% natural gas and the remaining from zero emitting sources (nuclear, hydro and renewable energy sources). Due to lack of immediate substitution of natural gas and demand inelasticity, it is very conceivable that the imposition of such carbon fees/taxes would potentially raise energy prices in the State without tangible environmental benefits.

ii. Legal

CARB has limited authority to impose administrative fees under AB 32

The scope of CARB's authority to levy fees under AB 32 was the subject of much debate during the enactment of AB 32. CARB's fee authority is specified in Health and Safety Code Section 38597. Section 38597 states that CARB, "may adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division … *for purposes of carrying out this division*." (emphasis added) This specific fee language was amended into AB 32 on August 30, 2006. The analysis for the Assembly and Senate both describe this fee provision as providing authorization to CARB, "to adopt a schedule of fees *to pay for the costs of implementing the program* established pursuant to the bill's provisions." (emphasis added)

While the text of AB 32, and the analyses of it, indicated that CARB's fee authority was limited to covering the administrative costs for implementing its provisions, some of the opponents to AB 32 began raising questions regarding the scope of CARB's fee authority. In response to concerns raised regarding the scope of AB 32's fee authority, the author of the bill, Assembly Speaker Nunez, submitted a letter of legislative intent into the Assembly Daily Journal. That letter was submitted specifically to address the question of CARB's fee authority under AB 32. That letter states, "[i]t is my intent that any funds provided by Health and Safety Code Section 38597 *are to be used solely for the direct costs incurred in administering this division*. (emphasis added) This intent is further demonstrated by the fact that Section 38597 is contained within Part 7 of the bill, which relates to CARB's administrative functions." In other word's CARB's fee authority under AB 32 is limited to funding the administrative functions of implementing AB 32.

However, statements made in the Scoping Plan regarding imposition of carbon "fees" appear to go well beyond funding CARB's administrative costs associated with implementing AB 32. The Scoping Plan states that fees "can be used as a powerful tool to incent emission reductions by affecting the relative prices within the economy … carbon fees can affect consumption and investment within the economy and reduce GHG emissions." These and other statements in the Scoping Plan go well beyond CARB's fee authority under AB 32 to impose fees to cover the direct administrative costs of

[36] Net System Power: A Small Share of California's Power Mix in 2005, Table 2, California Energy Commission; http://www.energy.ca.gov/2006publications/CEC-300-2006-009/CEC-300-2006-009-F.PDF,

implementing AB 32. The Legislature only intended to grant CARB limited fee authority to cover the administrative costs of implementing AB 32. The Legislature never intended to give broad fee authority to CARB under AB 32, a fact further supported by statements made by key Legislators who voted to support AB 32. Assembly member Horton publicly stated, "[t]o ease concerns on costs to implement AB 32, Assembly Speaker Fabian Nunez committed to printing a letter in the Assembly Journal concerning the 'fees' that the Air Resources Board (ARB) would be entitled to levy - specifying that the fees would be limited to covering administrative costs."

It is also worth noting that the Legislature had earlier been given a series of recommendations regarding the development of a greenhouse gas reduction program by the Governor's Climate Action Team. Those recommendations were quoted in the analyses provided to the Legislature regarding AB 32. Those analyses state that the "initial draft of recommendations drafted by the Climate Action Team included four actions essential to meeting the Governor's GHG reduction goals." The quoted actions included levying "fees on gasoline and diesel sales to reduce demand for these fuels and to fund promotion of alternative, cleaner fuels." However, despite the Legislature's knowledge of this suggestion for imposing broad market-changing fees on fuels (similar to what is currently suggested by the Scoping Plan), the Legislature instead decided to grant CARB a much more limited fee authority relating only to covering the administrative costs of implementing AB 32.

The Legislature simply has not granted CARB the type of broad fee-making authority that would be required to implement the carbon "fee" recommendations contained in the Scoping Plan.

CARB can impose administrative fees, but not taxes

Health and Safety Code Section 38597 only grants fee authority to CARB. Further, AB 32 passed with less then the two-thirds super-majority required to impose a new tax. Therefore, any "fee" imposed by CARB pursuant to AB 32 must ensure that it does not constitute a tax under California law, and must satisfy the "nexus" requirements articulated in the California Supreme Court's Sinclair Paint decision. Sinclair Paint Company v. State Board of Equalization, *et al.* (1997) 15 Cal.4th 886

CARB cannot adopt "fees" or taxes that will violate the Commerce Clause

The Scoping Plan makes vague references regarding implementation of an "upstream" carbon fee. The Scoping Plan states, "fees would be levied on all natural gas processing plants, the state's seven interstate natural gas pipelines, and pipelines from Mexico." However, a proposed carbon "fee" or levy on pipelines delivering natural gas into California, if adopted, would run afoul of the dormant Commerce Clause and would be actionable as such. *See Dennis v. Higgins*, 498 U.S. 439 (1991) (holding that dormant Commerce Clause suits against states may be brought under the Civil Rights Act of 1871, 42 U.S.C. § 1983).

The Commerce Clause empowers Congress "[t]o regulate Commerce . . . among the several States." *See* U.S. Const., art. I, § 8, cl. 3. This authorization has a juridical converse, known as the "dormant Commerce Clause," which restrains States from improperly interfering with interstate commerce. The

purpose of the dormant Commerce Clause is to "effecuat[e] the Framers' purpose to 'prevent a State from retreating into [the] economic isolation," *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996), "that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979). The dormant Commerce Clause is aimed at preventing States from behaving as independent fiefdoms by extracting taxes or imposing regulations that discriminate against or unduly burden interstate commerce. A State may violate the dormant Commerce Clause either by imposing an undue burden on both out-of-state and local producers engaged in interstate activities, or by treating out-of-state producers less favorably than their local competitors.

The Scoping Plan seems to suggest enacting "fees" on natural gas that crosses into the State through interstate pipelines. In reference to enacting a carbon "fee" for interstate pipelines, it is unclear whether the Scoping Plan intends to also apply to natural gas that is merely being transported through California for use in another State or location. Further, the Scoping Plan specifically mentions interstate pipelines, and does not reference intrastate pipelines. If the proposed law only taxes interstate pipelines, it is discriminatory and is therefore, "virtually *per se* invalid." In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 282 (1977),[1] the Court articulated a four-part test to assess whether a state or local tax violates the dormant Commerce Clause. To pass Commerce Clause muster under *Complete Auto*, a tax (i) must apply to an activity having a substantial nexus with the taxing state, (ii) is fairly apportioned to the investment in the State, (iii) does not discriminate against interstate commerce, and (iv) is fairly related to services provided by the State. The test in *Complete Auto* is not a balancing test; if the State tax fails any of the four prongs, it violates the Commerce Clause. The proposed regulation fails to satisfy any of the four prongs.

Interstate gas pipelines are regulated by the Federal Energy Regulatory Commission (FERC). First, an interstate pipeline does not have a substantial nexus to any specific State and certainly no "substantial nexus" to a State in which they deliver gas. Second, the proposed "fee" would bear no relationship to a pipeline's investment within the State, but merely to the amount of carbon transported through the State. Third, the proposed "fee" discriminates against interstate carriers, if it only applies to interstate pipelines. *Cf Am. Trucking Ass'ns v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005) (upholding a flat tax on all intrastate trucks as nondiscriminatory). And fourth, the proposed "fee" would not be related to any services provided by the state.

Even if the proposed "fee" were non-discriminatory, there is the overarching concern, reflected in the other three *Complete Auto* factors, that the "fee" cannot unduly burden interstate commerce. In *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157 (1954), interstate pipelines challenged a Texas law that taxed pipelines for natural gas "taken" from Texas even though the gas would be shipped outside the state. The Texas tax was applied equally to intrastate and interstate activities, so there was not discrimination. The Court nevertheless found that if Texas could tax the "first taking", then other states could tax the "first unloading" and the "net effect would be substantially to resurrect the customs barriers which the Commerce Clause was designed to eliminate." *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. at 158. The Constitution simply does not permit local interests to unduly burden interstate commerce. Yet, that is what the California proposal seeks to do.

Even if the Commerce Clause conflict is overcome, the CARB proposal on "fees" or taxes will need significant revisions that needs FERC approval and could result in unintended shift of natural gas to other states without carbon constraints

A California or other state's attempt to regulate GHGs from the natural gas sector at the interstate pipeline level would cause regulatory complications that, at best, will slow the implementation of and limit the effectiveness of the program. The FERC would need to accommodate cost recovery and pass-through of the carbon fees. FERC generally sets pipeline rates on a 'cost of service' basis, meaning the pipelines are permitted to include all of their prudently-incurred costs in their rates. At the same time, the interstate pipeline business is generally very competitive and pipelines cannot simply increase their rates without risking losing business to competitors.

If the interstate pipelines are held legally responsible to pay a significant carbon fees/tax for the CO_2 potential of their gas throughput, they would be forced to mount legal challenges to the state regulations. The resolution of those challenges could take years and the pipelines would seek recovery of those costs in their rates. Higher rates for service to the regulating state would not only raise the delivered cost of gas to the state's consumers, but would not accomplish the regulatory goal of placing the "tax" on the offending polluter. Moreover, it would create a disincentive for shippers to select that state's delivery points for their gas. This outcome, or even the risk of such an outcome, could further result in pipeline companies choosing not to develop new pipeline capacity to the regulating state and instead spend their capital developing projects in other regions.

c) Emission Offsets

Offsets should be permitted in the California cap-and-trade program linked to WCI for compliance with AB 32 goals[37]. As stated in previous sections, we believe it is prudent to have a single consistent national emissions trading framework. Having demonstrated its leadership and excellence to federal regulators, the efforts of California and the WCI and other regional/state entities should transition into a national program. In the interim, until national programs are in effect, El Paso believes that Regional Greenhouse Gas Initiative (RGGI) credits and possibly credits from the Midwestern Initiative should be allowed, if these programs are compatible with the proposed WCI program. Again, this would help lessen compliance costs in the states participating in regional initiatives, and would lead to other benefits stemming from increased flexibility.

[37] http://www.uscerp.org/
El Paso is part of the Coalition for Emission Reduction Projects (CERP). CERP is a diverse alliance that brings together leading energy companies, financial service providers, and developers of emission reduction projects. They aim to educate policy-makers about the key role that "offsets" can play in a U.S. cap-and-trade program.

Offsets are an excellent means of achieving GHG reductions from sources that cannot easily be covered under a cap-and-trade program due to difficulties in accurately measuring their emissions (for example, fugitive methane emissions from natural gas pipelines or facilities). Additionally, offsets are an important means of keeping compliance costs down and give covered entities the time necessary to develop and deploy new technologies.

El Paso advocates allowing for offsets, and suggests adoption of the following regulatory structure in the AB 32 or the WCI offset program:

1. Geographic limits should not apply as long as offsets meet rigorous standards for environmental integrity.
2. Percentage limits on the use of offsets are unnecessary and should be eliminated.
3. Early offset or reduction credits should be distributed to projects that meet well-defined standards.
4. WCI and/or CARB should develop a list of offset projects that are eligible for a streamlined review process.
5. Offset projects should not have to undergo a full re-evaluation on an annual basis; a limited multi-year crediting period should be used instead.
6. A consistent timeframe for offset eligibility should be set. El Paso recommends eligibility periods of 10-20 years. This will give offset developers assurance that they will be able to receive offset credits for a specified and fairly long duration of time, as long as the integrity of the project and other criteria are maintained.

Geographic Limits on the Use of Offsets:

Arbitrary geographic limitations should not be applied as long as offset projects meet rigorous standards set by WCI. Projects should be allowed from the rest of North America and internationally. El Paso recommends allowing offsets eligible under the current Kyoto Protocol guidelines – Clean Development Mechanism (CDM) and Certified Emission Reduction (CER) credits, in addition to other potential offset credits. We recommend this approach due to the reasons outlined below.

- Reduced compliance costs to California consumers - a viable means of keeping compliance costs down, such as extending the geographic scope of offsets, should be pursued. If linked to the WCI program, CARB and WCI must consider that the extension of offset eligibility to only industrialized countries will increase costs and will shift emissions-generating activities to countries that do not have national limits. Allowing the use of emission reduction and sequestration projects globally will help keep program costs down and create new incentives to provide offset projects in countries without a reduction program.

- Leadership - This approach will allow California to engage with the world on the issue of climate change and regain its leadership status on international climate policy.

- "Green-Tech" Transfer - As California molds itself into the "green tech" hub of the world, engaging in the development of robust international offsets will accelerate and incentivize the pace of the necessary technology to address climate change on a large scale. By providing a means of transferring U.S. clean energy technologies and expertise to the developing world, it will open a bridge of cooperation with key developing countries around the issue of climate change and technologies.

- Finally, the WCI or CARB can permit the use of offsets from developing countries without compromising high standards for environmental integrity. There are several standards and protocols already developed or currently under development in the United States that adhere to stringent quality and assure environmental integrity.

Quantitative Limits on the Use of Offsets

CARB should not set arbitrary quantitative limits on the use of offsets to meet compliance obligations. It is El Paso's view that if an emission reduction project can meet rigorous environmental integrity standards, there is no reason to limit the use of such projects. The main effect of percentage limits is to decrease the flexibility of the program, and to increase the overall costs of compliance. Without quantitative limits on the use of offsets, covered entities will invest in the least expensive option – implementing ways to reduce emissions at their own facilities, acquiring allowances through the cap-and-trade program, or through verifiable offsets. Allowing covered entities appropriate flexibility in meeting compliance will benefit the U.S. economy, since capital will be used in the most efficient way.

Eligible offset project types

CARB, in conjunction with WCI, should develop an initial list of eligible offset projects. Offset eligibility guidelines should be flexible, and both case-by-case and performance-based offset methodologies should be used. Using these methodologies in the early years of a program prevents limiting offset scope to only certain projects. Over time, standards could be established for case-by-case projects and maintained through a system like the RBLC (RACT/BACT/LAER Clearinghouse), which contains case-by-case information of the "best available" air pollution reduction technologies. Having such a database will also ensure uniform treatment of offsets across the WCI.

El Paso suggests the following categories of projects be considered eligible under a WCI linked cap-and-trade offset program. Eligible projects should include those projects listed as eligible under RGGI, along with other projects such as those that:

Reduce methane emissions from landfills;
Reduce methane emissions from municipal wastewater;
Reduce methane emissions from coal mines;
Reduce sulfur hexafluoride emissions from transformers; and
Projects that reduce fugitive and/or process methane emissions from natural gas systems.

Eligible offset projects[38] should include reductions at natural gas exploration & production facilities and natural gas pipeline and storage facilities that use techniques and technologies outlined below or approved by the CARB. Eligible offsets will include those described by the project owner in its protocol as beyond the typical or required emissions management practices already taking place before the offset project started.

At interstate pipelines, equipment where emissions detection, mitigation and/or reduction shall occur can include, but is not limited to, the following: unit valves on blown down compressors, blow down valves on pressurized compressors, rod packings on pressurized compressors, pressure relief valves, power gas vents for compressor unloaders, engine crankcase vents, pipeline blowdowns, replacement of pipeline or equipment components. With respect to the natural gas exploration and production sector, examples can include, but are not limited to, the following: coal mine methane recovery, No vent or reduced vent drilling, completion or work-over procedures, solar-powered instrument/process air compressor installations, low or no-vent process equipment/controller substitutions, vapor recovery units, and gas lift devices to reduce/eliminate the need for well-head venting. While there are several "protocols" and methodologies approved by various registries and entities, we recommend relying on existing methods to determine baseline emission rates and to develop project baselines as a guide. More specifically, the methods found in the Prevention of Significant Deterioration (PSD) regulations can be used to determine baseline emission rates. El Paso has recommended a number of tools for developing project baselines for the natural gas sector, which can be found in our comments submitted to WCI[39].

d) Voluntary Early Action

While CARB has adopted a policy to encourage early actions, we urge CARB to recognize and include early reduction credits from activities at natural gas facilities and other sectors that meet the accepted attributes of the offset credits. We believe such credits from the natural gas sector will aid the cap-and-trade programs by providing low cost emission credits to the market. WCI should develop a mechanism whereby both performance-based standards and case-by-case early action evaluation can be performed. Such early actions should be rewarded with emission allowances as opposed to "automatic rewards" through adjustments on the emissions cap or other incentives. Further, providing early action credits will maintain consistency with other regulatory programs like RGGI, the Clean Development Mechanism (Kyoto Protocol), EU ETS, etc.

e) Use of Possible Revenues

The Scoping Plan solicits input on the possible use of revenues generated by the cap-and-trade or the potential carbon tax programs. CARB has evaluated the recommendations of The Economic and Technology Advancement Advisory Committee (ETAAC), the CPUC and CEC. The CARB is considering the creation of a carbon trust along the recommendations of the ETAAC to direct

[38] El Paso comments to Karen Griffin on CPUC Recommendations for the Treatment of Natural Gas, July 26, 2007, Attachment "2" Page 1.
[39] El Paso WCI Comments, November 30, 2007, Appendix A http://www.westernclimateinitiative.org/ewebeditpro/items/O104F14463.pdf.

these potential revenues. The Scoping Plan lists several potential uses of the revenues.

At 365 MMTCO$_2$e by 2020, the market value of the California cap at $30/tonne is approximately $10 billion per year. If a carbon tax is levied on the fossil fuels, at 5,700 MMCF/day and $30/tonne, the carbon tax revenue levied on natural gas consumption would be another $3.6 billion/year.

There have been several studies that suggest full auctioning of allowances in a cap-and-trade program or carbon tax can be applied on the consumption of fossil fuels, and the revenues raised from these taxes can be recycled back into the economy to reduce other taxes (e.g. income taxes), generate revenues for the government that could be employed for other societal benefits and to fund lower carbon initiatives. The revenues from this "double dividend" theory have to be efficiently managed and directed to achieve environmental goals, and not be employed as a mechanism by the State to generate revenues directed for unfunded mandates outside AB 32.

Since there are billions of dollars at stake each year, we recommend transparency in the use of such revenues. We recommend that a significant portion of the revenues generated by the cap-and-trade program be employed for funding new R&D for new green technologies (e.g. carbon capture and sequestration) and for other direct environmental reduction programs.