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Kevin Kennedy, Chief
Program Evaluation Branch
Office of Climate Change
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: WSPA Comments on AB 32: Implementing a Quantitative Limit on the Use of Offsets in a Cap and Trade Program

Dear Mr. Kennedy,

The Western States Petroleum Association (WSPA) is a non-profit trade association representing twenty-eight companies that explore for, produce, refine, transport and market petroleum, petroleum products, natural gas and other energy supplies in California and five other western states.

We are submitting the following comments in response to your solicitation for stakeholder input on AB 32: Implementing a Quantitative Limit on the Use of Offsets in a Cap and Trade Program.

WSPA member companies own and operate facilities that include oil and natural gas production properties, refineries, marketing terminals, pipelines and retail gasoline outlets. The companies produce fuels and other products that will all be impacted by the implementation of AB 32.

Because of this, WSPA reiterates our commitment to engage constructively with CARB and other stakeholders. It is critical that implementation of AB 32 and the Scoping Plan mesh with the federal program when one is established.

It seems clear that melding these programs is critical to the successful implementation of California's GHG reduction program under AB 32. We urge that CARB clearly describe in its program how the AB 32 program will interact with the future federal program and with other programs such as international carbon markets, other regional or state programs.

WSPA also reiterates our belief that a market-based mechanism, such as a cap and trade program, provides the dual benefits of environmental action and cost-effectiveness to achieve the emission reduction goals of AB 32. WSPA appreciates that the Scoping Plan and Board Resolution 08-47 adopting that plan recognize the potential for significant economic effects from the limiting of offsets and requires consideration of the potential supply of offsets on those effects.

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Our comments below outline initial principles for establishing a robust and fair offsets program and how such a program would fit within the overall cap and trade framework.

WSPA believes that robust offsets represent a critical element of a cap and trade program. To function effectively, the offsets program must be part of an "overall" program – in which the elements work seamlessly both inside and outside of the State to make the overall program as credible and cost-effective as possible.

Through the Scoping Plan, CARB has already established how 80% of the total needed emissions reductions will occur. Further limiting the remaining 20% of the needed reductions will not only create unnecessary burdens on California's economy but will also reduce wider participation and innovation in carbon reductions.

To enable the early reductions needed by 2012, offsets may be the only viable options available due to lead time and capital limitations. CARB must develop and implement a process to ensure that offsets are available from day one of the program.

However, limiting offsets can have a pronounced impact on the cost of the program. For example, US EPA's March 14, 2008 analysis of the Lieberman-Warner Climate Security Act of 2008 *S. 2191 (*http://www.epa.gov/climatechange/economics/pdfs/WaxmanMarkeyExecutiveSummary.pdf) showed that allowing unlimited use of offsets can result in a 71% decrease in program costs.

US EPA analysis of Waxman-Markey April 20, 2009 concludes that eliminating the opportunity to use international offsets would nearly double the price of allowances and associated energy price impacts (http://www.epa.gov/climatechange/economics/pdfs/WaxmanMarkeyExecutiveSummary.pdf).

Further, a study by Charles Rivers Associates (CRA), looking only at the use of offsets in CA, showed that broad use of offsets could reduce program costs by 80% and prevent the loss of over 300,000 jobs due to leakage.
(http://www.arb.ca.gov/cc/scopingplan/economicssp/meetings/040408/chevron_slides_for_arb_workshop_offsets_v4.pdf).

Currently, compliance pathways within California are unclear -- particularly in the early years. Those pathways will remain unclear until new technologies have been developed, until regulatory hurdles/barriers have been minimized, and until emission reduction projects are implemented.

WSPA believes that AB 32 implementation requires offsets be included to provide a viable compliance pathway for California sources. Even after viable pathways within California have been defined, offsets will be necessary to ensure technologically feasible and cost effective compliance..

WSPA believes that Offsets are Critical to Program Design:

Offset Credits keep jobs in California
Domestic and international offsets can dampen the impact to the US economy by lowering the overall compliance cost of a national climate change program while maintaining emissions reductions goals. As previously demonstrated, the broad use of offsets can reduce program costs by up to 80% - helping to maintain the competiveness of California industries, keeping jobs in California and reducing the impact on consumers.

Considering whether to allow the use of offsets is not about nibbling at the edges, but fundamentally decreases program cost to California's consumers. If California geographically limits the availability of offsets from other US states it can cost the state almost 1% of the entire state GSP by 2020 (CRA).

The economic benefits achieved through an offsets open market is particularly important in trade exposed industries, where leakage is expected if costs are not minimized. Leakage undercuts the environmental efficacy of the program by moving emissions – and jobs – out of state. The Board was clear in its resolution – offsets are fundamental and staff must carefully consider the economic implications of limiting offsets.

Offsets provide a linkage to other climate change programs – and minimize California costs

Linking current and emerging carbon markets globally will help to establish a level playing field for covered sectors. Each program retains its individual control while utilizing the same offset program – a design that can enhance global participation.

The use of offset credits that are accepted in multiple programs will lead to a more uniform cost of GHG reductions among programs, and will ensure that California does not carry an excessive GHG cost burden.

WSPA believes that CARB should link with offset programs that:

- were established or recognized by federal, State or tribal law or regulation, or founded on the International Organization for Standardization's requirements, or any offsets program, or parts thereof, that has proven to be compatible with the programs that meet the above criteria, and that was established or recognized prior to enactment;
- were developed through a peer review or public consultation process or has developed offset project type standards, methodologies and protocols through a peer review or public consultation process;
- utilize publicly published standards, methodologies and protocols requiring that credited emission reductions or sequestration are permanent, additional, verifiable and enforceable;
- require emission reductions or sequestration be verified by a State regulatory agency or an accredited third-party independent verification body; and,
- require credits issued are registered in a publicly accessible registry, with individual serial numbers assigned for each ton of carbon dioxide equivalent emission reductions or sequestration.

Offsets will drive technology and innovation improvements

Opportunities for offsets encourage participation from other sectors and stimulate technology innovation in those sectors. Stimulating technology in all areas of the economy is critical to meeting the emission reduction goals under AB 32.

Significant capital investments will be required to achieve meaningful emission reductions. Therefore, an unlimited offset system must be established early to address the need for a stable environment for capital-intensive investments and to provide the incentives to drive future technology.

Offsets must be real and verifiable
Use of the UN Clean Development Mechanism (CDM) Certified Emission Reductions (CERs) is critical to the success of a California program because it is a way to help assure offsets are high quality and globally tradable.

CERs are considered difficult to generate and carry more weight than other voluntary unenforced programs. Purchasers of offsets must be assured that the credits they are purchasing are tied to real and verifiable projects. This provides certainty for both compliance purposes as well as to help ensure the environmental goals of the program are met.

We believe that CARB should look to the Kyoto Protocol and Federal legislation for the definitions of offsets criteria. Any differences will make it difficult for harmonization and will only create unnecessary restrictions that will lead to leakage and increased program costs.

CDM extension and reform is critical and California can lead the way
As a leader in carbon policy, California has an important role to play in shaping the emerging post-Kyoto framework. One of the most critical ways to demonstrate leadership is to help frame the new CDM process and define the CDM + framework. California's offsets program can also serve as a template for international action by establishing:

- a clear definition of additionality, and evaluating it on a systematic basis; this will also facilitate additional project development;
- the criteria to define the various approaches to offset credit generation programs, such as policy-based, sector-by-sector performance-based or technology-based offset programs that can then be accepted by others.

Offset protocols
CARB must adopt regulations that specify the process for issuing offset credits. CARB must also develop methodologies to determine offset credits for different project categories.

Further, where a non-California source (that would have been included in a California cap were it located in California) generates emission reductions, those emission reductions should be eligible to generate offsets unless they are covered by another GHG control program.

In order for California to lead, it must recognize the CDM Program and recognize offsets
It is critical that California clearly and specifically recognizes it will allow the use of CDM credits in its program as early as possible. Any modifications or limits should also be clearly articulated as early as possible, and not attempt to achieve other policy goals by such limitations.

The sooner California makes this decision, the sooner the market will generate the needed liquidity and the quality projects necessary to meet the needs of the cap and trade program.

49% Limit
Although we do not support a numeric limit on offsets, we believe that if a 49% limit is to be applied, it should be applied at the facility or corporate reporting entity when compliance takes place. This will provide facilities the needed certainty to decide how to comply with the program.

Setting a quantitative limit of the number of allowances available based on WCI or California market size to all entities will not provide certainty since one participant could use all of the offsets. Additionally, this limit should be measured against business as usual, as previously approved by CARB, not more stringent and unapproved measurements or projections.

Given the cost reductions that offset provisions can generate, Staff should compare the anticipated cost savings with anticipated compliance costs, and clearly justify why any limits are needed.

CARB must also evaluate the leakage impacts of limiting offsets and specifically evaluate if the "49% of required reductions" as stated in the Scoping Plan will actually translate into offsets contributing only 5% or less to the total compliance option (i.e. the number of allowances).

WSPA believes that if the 49% limit is retained, then the impact of a 49% limit based on the difference between 2020 BAU and 1990 levels must be evaluated – not simply 2012 and 1990 levels. Moreover, WSPA believes that if the 49% limit is retained, then offsets originating in California should be unlimited – and not count against the 49% limit.

Additional limits should be avoided

We understand CARB is considering specific trading limits and/or restrictions on the type of offsets credits available – around 5% per facility when basing the 49% limit against a 2012 baseline rather than the 2020 BAU which has been approved by the Board. The argument for this requirement is that CARB must drive local reductions.

It is inaccurate to assert that reductions will not take place in California if the offsets are unlimited offsets, because 80% of the scoping plan directs local action. Considering that development of sufficient credits is unlikely before the first compliance period, CARB must not limit reductions by project type until sufficient credits are available.

Limiting use of CERs from the UN CDM program to address additionality concerns will only limit California's competitiveness. Limitations will also likely frustrate the market and therefore slow emission reductions at the early stages.

Economic evaluation is required

Before CARB makes any decision to limit the use of offsets, we urge CARB staff to undertake the following evaluation and review, and to make an informed decision on the proposal to limit the use of offsets. Staff should complete the economic analysis as directed by the Board Resolution – i.e., calculate and consider the economic implications of limiting offsets.

After reviewing the economic implications of limiting offsets, CARB should compare the perceived benefits of offset limits with the cost of the limits. The analysis should:

- evaluate a policy under which unlimited offsets is the rebuttable presumption, and if limits are to be imposed, such limits should be justified technically and economically;
- evaluate offsets as a cost control mechanism that delivers the environmental goal while controlling costs – maximizing the use of offsets may be the most cost-effective tool for California; and,
- compare against EU, AU, US proposals – all of which have implemented or are discussing much higher levels of offset use.

CARB's analysis will document whether California industry will be competing with competitors in jurisdictions where they are not only subject to less command and control, but are able to utilize a higher percentage of offsets.

Credit for early action/voluntary early action offsets
In order to encourage early and voluntary emission reductions, CARB must adopt a program to identify early reductions. Early actions that take place outside of the cap and trade sources should qualify as offsets and should not be limited.

The program must also provide the certainty that is needed for entities to make the appropriate decisions to undertake emission reductions now, rather than wait for the certainty of the full program. Rather than focus on limitations, CARB must include design elements that encourage those early offset reductions.

A framework and defined program, working from existing protocols such as the CDM would turn potential opportunities into real reductions.

Progress against plan
We believe it is especially critical that policy makers get our energy supply future correct. We do not want to end up with a program that inhibits the ability of our industry to reliably supply fuels to consumers or that results in unintended negative consequences to the State.

We all recognize that there are many uncertainties and unanswered questions in this complicated process. Given this uncertainty, it is important the programs that are chosen be scientifically sound, technologically feasible and cost-effective.

To ensure that the program is on the right track, we urge CARB to develop and monitor a list of early indicators for both GHG emission reductions and economic vitality. These variables can be used to monitor environmental and economic perspectives, including the adequacy, affordability and reliability of energy supplies.

In summary, WSPA believes that the broad use of offsets is a critical component of a well-designed cap and trade program that provides GHG sources the opportunity for cost-effective reductions and for enhancing linkage with other reduction systems.

We also believe that the use of offsets encourages wider participation and innovation in carbon reductions. WSPA supports the broad use of global offsets – as part of the cap and trade program and any complementary measures.

Thank you for considering our comments. We look forward to continuing working with you and CARB staff to ensure the success of this challenging endeavor. If there are any questions, please contact me at (916) 498-7752.

Sincerely,

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