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May 26, 2009

Kevin Kennedy, Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: WSPA Comments on Implementing AB 32 – Emissions Leakage Issues in Cap and Trade

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, 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 Implementation: Emissions Leakage Issues in Cap and Trade.

We are pleased to see that ARB is evaluating the potential for "emissions leakage" that would arise from a cap and trade program in California. Critical to this evaluation is that CARB design the program to minimize leakage at the outset of the program rather than mitigating the impacts of leakage on sectors later on in the process.

Leakage (in both an economic sense and with respect to GHG emissions) is largely driven by differing regional impacts. It is therefore important to show clearly: 1) the assumptions and calculation methods used by CARB to estimate the economic costs and emissions benefits of the GHG program; and, 2) the improvements that may result from implementing a cap and trade program.

We cannot over emphasize the need for transparency and a well-documented vetting process. As stakeholders, we want the opportunity to participate in review of the methodologies and analyses evaluating costs and impacts on leakage.

We also reiterate our April 30, 2009 comment that it is critical that the implementation of AB 32 and the Scoping Plan mesh with the federal program when one is established to minimize emissions leakage. While WSPA recognizes that the federal program has not yet taken shape, it seems clear that efficiently melding these programs is essential to the successful implementation of California's GHG reduction program under AB 32.

We urge that CARB clearly describe how requirements in the AB 32 program will be harmonized with elements of the federal program and with other regional or state programs.

The need for effective melding of the state and federal program is highlighted by Goulder, Jacobsen and Van Benthem in their recent report on state-level emissions limits on greenhouse gases, where they say: "*…the co-existence of the Federal and state efforts can make state-level efforts ineffective. …* Whatever *reductions are achieved in the more aggressive state will reduce pressure on the Federal cap and thereby allow facilities in other states to increase* their *emissions*."[1]

Emissions Leakage

Clearly, minimizing emissions leakage is critical to successful implementation of AB 32 and the Scoping Plan. If emissions simply move out of state, Californians will bear a significant economic burden on goods and services for no environmental benefit.

We believe that the recent actions by the European Union and the Australian government are useful to consider when shaping California's policy approach to reducing leakage. In particular, we note that these governments have made significant progress in creating criteria and developing an approach to generate data on the potential for emissions leakage.

Concerns about Emissions Leakage in the EU

In February 2009, the European Commission updated their September 2008 thinking regarding leakage, issuing their memo on assessing carbon leakage in the EU energy intensive industries in the context of the Community's emission trading scheme. While the collective experience on this subject continues to emerge, the following citations identify issues that CARB should consider as the State develops its program:

"Heavy industry, including the cement, steel, aluminum and chemical sectors, argue that a tightened ETS (Emission Trading Scheme) would inflate their costs to such an extend that they would be forced to move their factories and jobs beyond the EU's borders, leading to a 'leakage' of CO2 emissions without any environmental benefit".[2]

"European big business and environmental NGOs have disputed the data used by the European Commission to assess whether polluting industries are likely to suffer from foreign competition as a result of Europe's climate change legislation." [3]

"The chemicals industry has expressed its discontent with the preliminary tables. Many sub-sectors fulfilled the Commission's key criteria for qualifying as exposed to carbon leakage, namely exposure to international trade and major cost increases as a result of the EU ETS.

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1 *Lawrence H. Goulder, Mark R. Jacobsen, and Arthur A. van Benthem, Impacts of State-Level Limits on Greenhouse Gases per Mile In the Presence of National CAFÉ Standards (May 2009). Page 24.*

2 *Article from EurActive.com. 'Carbon Leakage': A Challenge for EU Industry (January 27, 2009), at http:www.euractiv.com/en/climate-change/carbon-leakage-challenge-eu-industry/article:176591*

3 *Article from EurActive.com. Commission faces revolt over 'carbon leakage' plans (May 26, 2009), at http://www.euractiv.com/en/climate-change/commission-faces-revolt-carbon-leakage: plans/article- 182634*

Nevertheless, the industry said incomplete assessments had left some vulnerable sub-sectors subject to auctioning." [4]

EU Refining exposed to emissions leakage

In an April 2009 memo to the European Commission Chris Beddoes – EUROPIA Executive Officer highlighted that the WoodMac analysis commissioned by EUROPIA: **"***shows that, even in this period of relatively strong Refining margins from 2004-2008, the cost of buying CO2 allowances would be a significant part of value added; it highlights that non EU trade in refined products is substantial and growing. It confirms that EU Refining is exposed to significant risk of carbon leakage, with both quantitative criteria exceeding the thresholds defined in the ETS Directive by a significant margin.***"**[5]

Emissions Leakage in Australia

On Dec 16, 2008, the Australian Institute of Petroleum's (AIP) press release stated in reference to Australia's Carbon Pollution Reduction Scheme (CPRS) and its treatment of Energy Intensive Trade Exposed (EITE) industries:

"*The effective treatment of EITE industries under the CPRS is critical to ensuring that otherwise competitive Australian industries are not artificially disadvantaged through the imposition of additional carbon costs that are not faced by their international competitors.*

In commenting on the EITE industries framework in the CPRS White Paper, Dr John Tilley, AIP Executive Director, said, "AIP is encouraged by the inclusion of the value added metric as a measure of emissions intensity and will work closely with the Government to fully assess the methodology to be used to apply the metric."

"The Australian petroleum refining industry currently competes successfully against refineries located in many countries that are unlikely to impose carbon costs any time in the foreseeable future" said Dr Tilley. "In recent years, a growing proportion of Australian liquid fuel demand has been met by imports sourced from Singapore, Taiwan, Vietnam, South Korea and China."

"Without adequate EITE emissions treatment (i.e. more than the 60% level), the Australian refining industry will be less competitive than Asian refineries not facing similar carbon costs and will lose attractiveness as a future investment destination. This would place significant pressure on the viability of a number of Australian refineries over the period to 2020, and may lead to refinery closures and the transfer of their carbon emissions to other countries."[6]

In February, 2009 the Australian Government in its "Assessment of activities for the purpose of the emissions-intensive-trade exposed assistance program" not only outlines a process to assess risk of leakage from trade-exposed industries, but concluded that "*Australia's adoption of a carbon constraint before other countries may have a significant impact on its emissions-*

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4 *ibid*

5 *Letter from Europia: EU Refining: an independent assessment of the EU ETS Carbon Leakage Criteria. April 14, 2009*

6 *Tilley, Dr John, Media Releases – AIP welcomes a more realistic approach to the design of the Australian emissions trading scheme, (December 16, 2008), at http://www.aip.com.au/topics/mr16_12_08.htm*

intensive-trade exposed industries. The Government is committed to providing assistance to these industries to reduce the risk of carbon leakage…"[7]

On May 4, 2009 REUTERS reported that due to the global economic recession, Australia would delay its cap and trade program by a year.[8]

<u>Economic and Emissions Leakage in California</u>

Attached is a memo from the Analysis Group commissioned by WSPA that examines economic and emissions leakage in California. They conclude that while recent studies of a federal cap and trade program show that the reductions in emissions by U.S. firms under a federal climate policy could be offset by increases in emissions by foreign firms – ***"****Leakage may be even a greater concern at the state level, where regulated firms are more exposed to competition from imports from other states, as well as those from other countries.****"***

They also stress that "*When emissions leakage occurs, the result is particularly unfavorable for the regulated region. It suffers the consequences of economic leakage for no net environmental gain.****"*** This is why it is particularly important for California that the AB 32 program be designed so as to be compatible with any future federal program.

The Analysis Group recommends that ***"****In the near term, CARB should avoid setting overly stringent interim GHG targets or implementing costly complementary measures while broader cap-and-trade systems are being developed."* To set more stringent cap-and-trade targets and impose less flexible regulations through command and control complementary measures in California compared to what is anticipated at the federal level may serve only to impose greater costs on the State's consumers and businesses, and increase leakage of both emissions and jobs.

In addition, they concluded that **…** "*When evaluating potential leakage and competitiveness effects, CARB should focus not only on current trends and immediate impacts, but also on longer term effects****."*** These longer term effects could have significant impact on future investments in California**.**

The Analysis Group memo provides suggested program evaluations to assess leakage – including consideration of *"…the added costs not only of the cap-and-trade program but also the complementary measures contained in AB 32****."*** Specifically for the refining industry, measures in the Scoping Plan including energy efficiency, methane emissions and refinery flares could potentially contribute to leakage.

<u>California Refining Exposed to Emissions Leakage</u>

The Analysis Group study concludes that "*Under AB 32, industrial sectors will bear added costs from the cap-and-trade and the complementary measures***"** and that "*these costs will be greatest for sectors that are energy and GHG emissions intensive***".** They further state that the

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[7] *Australian Government, Department of Climaet Change, Assessment of activities for the purposes of the Emission-intensve-trade exposed assistance program (February, 2009) at www.climatechange.gov.au/whitepaer/assistance/pubs/guidance_paper.pdf*

[8] *Taylor, Rob (Reuters), Australia delays carbon trade, may toughen target (May 4, 2009) at http://www.reuters.com/article/environmentNews/idUSTRE53t1DK20090504?pageNumber=2&virtualBrandChannel=0*

petroleum refining sector is an industry with the high energy costs which will "*likely face the highest direct costs under a GHG cap-and-trade program.*"

Because of this, the Analysis Group determined that, "*the added costs imposed by AB 32 policies combined with competitive pressure from out-of-state firms create the potential for leakage in the petroleum sector.*" They further state: "*Imposing additional costs on refiners in California that are not faced by out-of-state refiners may increase imports of gasoline to California. The resulting shift in refining activity from California to other states or regions is economic leakage, and it could lead to emissions leakage.*"

Minimizing California Emissions Leakage

The Analysis Group memo also provides a number of program design recommendations that can minimize leakage, including:

(1) development of a geographically broad and harmonized cap-and-trade system like one nation-wide program) that would reduce leakage between competitors within the cap; and

(2) implementation of the following cost containment provisions that help to minimize the cost of achieving GHG targets. They note that:

- Banking and borrowing can lower costs by allowing sources to reduce GHG emissions when and where there are cost advantages.
- Multi-year compliance periods provide the advantages of banking and borrowing during well-defined, limited time periods.

Offsets help to contain costs by providing sources with the opportunity to reduce GHG emissions in areas not covered by the cap-and-trade system.

The benefit from offsets in controlling costs is true both in California and throughout the world. Verifiable offsets are crucial for reducing the overall cost of the program and help promote a reduction in global GHG emissions. We note that The Analysis Group also recommends that CARB "*consider limiting the costliest of AB 32's complementary measures, particularly those that affect sectors vulnerable to leakage.*"

We are pleased that you are taking a close look at the issue of emissions leakage and considering the examples and policies being undertaken in the EU and Australia. We urge you to also consider how the numerous studies from around the world can provide insights into the potential impacts of the petroleum industry as a trade-exposed industry.

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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