Western States Petroleum Association
Credible Solutions • Responsive Service • Since 1907

Catherine H. Reheis-Boyd
Executive Vice-President and Chief Operating Officer

June 15, 2009

Electronic Filing: ccworkshops@arb.ca.gov

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

Subject: WSPA Comments on AB 32: Use of Allowance Set-Asides 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.

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.

We are submitting these comments in response to your May 18, 2008 Public Meeting that outlined the California Air Resources Board (ARB) proposal governing the Use of Allowance Set-Asides in a Cap and Trade Program.

Integration with other Green House Gas (GHG) programs

It must be stressed at the outset that it is critical that implementation of AB 32 and the Scoping Plan mesh with regional GHG programs and with the federal program when one is established.

Recommendation: We urge ARB to clearly describe how the AB 32 program will be amended to interact with the federal program, when it is finalized, as well as with the international carbon markets, and other regional or state programs.

1415 L Street, Suite 600, Sacramento, California 95814
(916) 498-7752 • FAX (916) 444-5745 • cathy@wspa.org • www.wspa.org

Importance of Market-based Mechanisms

WSPA reiterates our belief that a market-based mechanism, such as a cap and trade program, can provide lower-cost GHG emission reductions as the State works toward achieving the goals of AB 32. The legislature in enacting AB 32 recognized the critical need for equity in the development of a climate change program. As a result, ARB has the mandate to ñDesign the regulations, including distribution of emissions allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize the total benefits to California, and encourages early action to reduce greenhouse gas emissions.ò[§38562 b (1)]

Recommendation: ARB should closely evaluate the potential impact of creating inequities within the distribution of allowances under AB 32.

Design of the market including the amount and distribution of allocations must be established at the outset so that capped sectors and affected stakeholders have the context for evaluating the potential impacts of the assigned allocation. Given this information, market participants can determine how they wish to respond. Without this information, there simply is no opportunity for participants to make an informed decision on how to compete in the market.

Recommendation: Public comment on this topic should be left open until the allocation plan and overall market design are established in more detail.

Criteria for an equitable program

Market mechanisms that facilitate cost-effective methods to achieve the emission reductions mandated by AB 32, such as a Cap and Trade program, are critical elements of an efficient and equitably-implemented program. Key characteristics of an equitable program are:

- Transparency in market transactions so that all participants can participate and respond appropriately to market conditions;
- Unbiased market design that does not favor outcomes or products;
- Simple to administer with little or no bureaucracy;
- Minimal risk of leakage;
- Equitable cap and trade allocations; and,
- Equitable assessed share of reduction obligations.

WSPA offers more insights below into some applications of these criteria in a workable set-asides program.

Set Asides as part of an integrated program

WSPA believes that ARB must consider the set-aside program as part of an integrated GHG program. ARB must clearly define the objective of the set-aside allowance program, in the context of the other elements of the integrated GHG program, including early voluntary actions, offsets, complementary measures, and standard allowances. Without considering the whole program, a set-aside program could unnecessarily or unfairly penalize existing facilities and, as an unintended consequence, contribute to economic leakage.

Recommendation: Set-aside allowances should only be used for activities that are necessary to meet the strategic GHG reduction goal of AB32 and where other elements of Californiaõs integrated GHG program, including the cost of carbon, do not provide the necessary incentives for the strategic action. This approach should be utilized only after consideration is given to whether set-aside allowances or funding is more appropriate.

The scoping plan assumes that there will be market failures in activities such as water conservation, land use planning, or general emissions reductions in minority communities, and identifies complementary measures that ARB deems appropriate to address those issues. Therefore, those issues should not be addressed in an allowance set-aside program.

Use of Set-Aside Allowances

In general, the greater the use of set-asides, the higher the costs will be.

The impact of a small and constrained set-aside pool is unclear. The impact would depend on how large the set-aside pool is relative to the entire market and how many competitors exist in that small pool.

Set-Asides must be minimized

WSPA has serious concerns about placing allocations into a set aside pool. Allowances and the market design need to be fair and transparent without favoring technologies or picking winners and losers. Set-asides should not be provided for specified sectors because that action would: i) create favorites in the market that would mask competitive pressures, ii) increase economic impacts, iii) reduce the efficiency of emission reductions and, iv) result in leakage.

The adverse impacts resulting from a poorly-designed set-aside program could ultimately frustrate the purpose of AB 32.

WSPA understands the need for economic growth in California. We also understand the need to ensure a workable market for new entrants into the California economy. This may be particularly true in instances where the market may not provide an effective incentive for strategic needs that are being developed by Research, Development and Demonstration (RD&D) programs.

Recommendation: ARB should explore all options before embarking on a set-aside program that may unfairly penalize existing facilities or inadvertently encourage emissions and economic leakage.

Open markets

Concepts like creating separate markets will drive up costs and limit the ability of the California market to link to regional, national and international market programs.

Recommendation: As one of many initial steps, ARB could evaluate methods to improve flexibility in emission reductions through: i) development of a robust offset market and trading process, ii) inclusion of new offset programs such as additional Clean Development Mechanisms (CDM) for new entrants and new technologies and, iii) investigation of the use of offset credits for early actions taken voluntarily prior to the formal creation of the market.

Co-benefits

WSPA believes that the needs of low income and disadvantaged communities should be addressed directly and separately using a regional approach. Such a directed approach will be more effective, less costly and more visible to recipients within these communities.

Recommendation: Co-benefits should not be included as a factor in the design of allocations distribution or set-aside programs.

Retiring Set-Aside Allowances versus Distributing Allowances

The question posed by ARB relating to the difference in impact between retiring set-aside allowances and distributing allowances is unclear. From the definitions provided by ARB, it is unclear how these concepts differ. In reviewing the documents, it appears that, in either case, allowances are taken from the overall market and provided to a designated special interest or sector.

As stated above, a market works at maximum efficiency when all parties are exposed to the same competitive environment.

Recommendation: The best approach is to use offset credits because they are not part of the baseline and do not affect total allowance pool.

Summary

WSPA believes that ARB must consider the set-aside program as part of an integrated GHG program. ARB must clearly define the objective of the set-aside allowance program, in the context of the other elements of the integrated GHG program, including early voluntary actions, offsets, complementary measures and standard allowances.

WSPA believes that CARB must explore all options before embarking on a set-aside program that may unfairly penalize existing facilities and have the unintended consequence of contributing to economic or emissions leakage. If allowance set-asides are to be used, they will need to be part of the overall market design to ensure they are not creating sub-markets or disrupting the competitive environment. This issue cannot be overemphasized as any disruptions in the market can cause inefficiencies, create leakage and ultimately frustrate the objectives of AB 32.

Thank you for considering our comments. We look forward to continuing working with you and ARB staff to ensure the success of this challenging endeavor. If there are any questions, please contact me at (916) 498-7752 or Mike Wang of my Staff at (626) 590-4905.

Best Regards,

Catherine H. Reheis-Boyd

Cc: Mike Wang, WSPA