



Western States Petroleum Association
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Catherine H. Reheis-Boyd

Chief Operating Officer and Chief of Staff

May 8, 2008

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

Subject: **Cost Containment - Implementation of AB 32**

Dear Mr. Kennedy,

The Western States Petroleum Association (WSPA) is pleased to submit the following comments regarding “cost containment” for AB 32 implementation. WSPA is a non-profit trade association representing twenty-six companies that explore for, produce, refine, transport and market petroleum, petroleum products and natural gas in six western states – California, Arizona, Nevada, Oregon, Washington and Hawaii.

WSPA member companies own and operate various types of facilities (e.g., oil and gas production properties, refineries, marketing terminals, pipelines, retail gasoline outlets, etc.) that will all be impacted by the implementation of AB 32.

At the April 25, 2008 CARB Workshop and in the “Framework for Discussion” white paper, you and your staff generally discuss “cost containment” for a potential cap and trade program in California. As described in the white paper (and WSPA agrees), several important program design choices can contribute to the goal of cost containment. Of these program design choices, WSPA believes that a broad market is the best “cost containment” approach to achieve the needed greenhouse gas (GHG) emission reductions at the lowest cost.

As we have said in all our correspondence since AB 32 became law, WSPA is committed to work constructively with CARB to achieve the AB 32 GHG emissions reduction goals as efficiently and as cost-effectively as possible. We have expressed support for a broad market approach to achieve GHG emission reductions at the lowest cost.

We have also emphasized repeatedly that AB 32 needs to be implemented to achieve real and quantifiable emission reductions in a fair and equitable manner, to stimulate innovation and investment while protecting California’s economy and its citizens.

Experience has shown that cap-and-trade programs can achieve emission reductions at dramatically lower cost than conventional regulation. Cap-and-trade has successfully cut acid rain by more than half in the United States at an annual savings of \$1 billion – savings that show up in monthly electricity bills.

Similarly, a cap-and-trade program was used successfully in the 1980s to phase out leaded gasoline more quickly than anyone predicted, while saving \$250 million a year.

Cost-containment mechanisms are essential elements of a cap-and-trade program. It is widely recognized that there is substantial uncertainty about the cost of reducing greenhouse gas emissions to meet ambitious emissions targets. Moreover, in the short-run, unexpected developments could cause significant allowance price spikes, with attendant costs, much as can be observed in response to unanticipated developments in oil and electricity markets.

However, the specific design of a potential California cap-and-trade program will determine the need for and implications of particular cost-containment mechanisms in that program. We urge that CARB keep an open mind with regard to cost-containment mechanisms. Depending on the final design of the cap-and-trade program, such mechanisms may provide significant safeguards against unanticipated events and allowance price uncertainty. For example, cost-containment mechanisms can help address:

- Uncertainty about costs and allowance prices over a longer-term time horizon (e.g., of several years) - projections of 2020 allowance prices under a California cap-and-trade program in the Climate Action Team's updated macroeconomic analysis range from as low as \$22 to as high as \$206 per ton.¹

This degree of uncertainty about future allowance prices is generally consistent with the wide range of potential allowance prices that the U.S. EPA projected for the Lieberman-Warner Climate Security Act of 2008, with 2020 projections ranging from \$15 to \$100. A \$206 allowance price could increase the price of electricity by more than 7 cents per kilowatt hour.

- The possibility of short-term price spikes and economic disruptions - much of the longer-term allowance price uncertainty results from uncertainty about the costs of various emissions-reducing capital investments that would take a significant amount of time to plan and deploy.

Alternatively, it is widely recognized that there are relatively few low-cost means of *quickly* reducing emissions in response to unexpected circumstances. Therefore, in the same way that unexpected developments can cause short-run price spikes in electricity and oil markets, unexpected developments that cause California to fall short of its emissions targets could cause short-term allowance price spikes beyond the range indicated by the above modeling results.

It is critical to recognize that cost-containment mechanisms need not compromise the environmental integrity of a cap. They can be designed so that, if exercised, they achieve a net reduction in cumulative GHG emissions. The alternative of not employing cost-containment mechanisms may actually have worse effects on a program's environmental integrity.

Length of compliance period, banking, borrowing, and offsets are important elements of a cap-and-trade program. They offer a degree of protection against cost uncertainty.

¹ This excludes some extreme outliers, such as \$7 and \$442 per ton.

Even so, they could be teamed with other cost containment mechanisms as a means of providing added and needed cost protection. WSPA supports multi-year compliance periods, unlimited banking, limited borrowing and the acceptance of offsets without geographic or quantitative limitations.

Further, allowance price uncertainty may be most significant in the early years of the program. Therefore, serious consideration should be given to a “gentle transition” into the program.

An independent market oversight body has been proposed, including the use of a “market-maker” to actively manage allowance prices in a cap-and-trade system, WSPA believes that such a body needs to be more fully considered before being actively promoted.

A government “market-maker” has been suggested by ETAAC and others as a means of providing a “fast-acting cost containment mechanism that could address price volatility in a timely fashion.”² The concept of a market-maker is an important contribution to the policy debate as it seeks to introduce additional environmentally-neutral means of reducing cost uncertainty.

However, at this point, it is not clear that the proposal for active management of the carbon market by a market-maker is preferable to the alternative of establishing transparent and predetermined (and hence more predictable) mechanisms to control allowance price volatility. Substantial further study would be necessary to determine whether the use of a market-maker deserves serious consideration.

With respect to linkage to other programs - WSPA supports broad linkage to appropriate regional, federal and international market programs and offsets – but in a manner that does not compromise California’s ability to access offsets in the linking programs.

Thank you for considering our comments. We look forward to working with you and CARB staff to ensure that AB 32 is implemented in a cost-effective and technically feasible manner, and with the least disruption to energy supply and no negative impact to the state’s economy.

If there are any questions, please do not hesitate to contact me at 916-498-7752.

Sincerely,

A handwritten signature in blue ink that reads "Cathy A. Boyd". The signature is fluid and cursive, with the first name "Cathy" being the most prominent.

cc: Linda Adams
Cindy Tuck
Mary Nichols
CARB Board Members
Chuck Shulock
Edie Chang
Stephen Shelby
Joe Sparano - WSPA

² ETAAC Draft Report, p. 8-7.