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November 15, 2010

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

Re: Proposed Regulation to Implement the California Cap-and-Trade Program

Dear Mr. Kennedy:

Occidental Petroleum Corporation (Oxy) has four significant interests in California oil and gas extraction operations. Oxy owns and operates Occidental of Elk Hills, Inc. (OEHI), which produces oil and associated natural gas from the former U.S. Naval Petroleum Reserve located in Kern County. It also owns Vintage Production California, LLC which operates in various locations throughout California. In addition, Oxy's THUMS Long Beach Company and Tidelands Oil Production Company serve as the contract operator for the City of Long Beach for oil and gas fields owned primarily by the State of California. While both OEHI and THUMS operate on-site generation to meet a portion of the fields' electricity needs, each operation purchases significant amounts of electricity from an investor-owned utility to support their operations. Tidelands and Vintage also purchase significant amounts of electricity for their operations. Oxy is concerned that ARB's recommendations for the California cap-and-trade (C/T) program will disadvantage these operations relative to their competitors – a result ARB is trying to avoid. Oxy thus seeks clarification of ARB's proposed regulation to ensure that these operations, as trade-exposed entities, receive coverage for their carbon costs to avoid leakage and competitive displacement.

ARB proposes to provide free allowance allocations to energy-intensive trade-exposed (EITE) entities, including OEHI, THUMS, Tidelands and Vintage, to "*avoid imparting undue initial economic gain or loss*" in the early program years and to prevent leakage. The method of determining how many free allowances must be provided to achieve this objective is presented most simply in Appendix J of the Initial Statement of Reasons (ISOR), Figure J-5:

Current competitiveness is maintained if: Free allocation = carbon costs – carbon cost recovered

Table J-7 depicts ARB's expectations regarding how the carbon costs of an EITE will be recovered to ensure competitiveness:

	Produced On-site	Imported from Off-site
Heat Consumed	Direct Allocation	Direct Allocation
Electricity Consumed	Direct Allocation	Compensation Through Distribution Utility

This suggests that ARB will provide a free allowance allocation to an EITE entity for heat and electricity produced and used on-site. Electricity imported from off-site, however, will not be covered with free allowances. ARB's

> *Indirect carbon costs arising from purchased electricity from the grid will be reduced through compensation from distribution utilities that are given allowance value for the purpose of ratepayer protection.*

The rationale for §95891(c) explained in the ISOR also reinforces ARB's expectations. In discussing thermal-energy based equations, the ISOR states:

> *Electricity purchased from off-site is not part of the thermal energy-based allocation equation but receives indirect compensation through [the] distribution utility to offset the expected indirect GHG costs, as described in Section 95892.*

ISOR at IX-59.

In other words, to the extent the purchaser of utility power pays carbon costs in its rates, which it will, ARB intends that those costs be recouped by the utility's distribution of the free allowance value it receives for the benefit of ratepayers.

ARB's reasoning makes sense; if carbon costs are recovered through allocations of free allowance value by the distribution utility, providing additional free allowances could result in double recovery. Oxy is concerned, however, that ARB's intent will not be achieved if an EITE entity's serving utility does not provide a direct distribution of allowance value to the entity. Unfortunately, ARB contemplates and even suggests that there should be no direct allocation by the utility to these EITE entities:

> *The proposed regulation limits how the return of allowance value to customers might function. Staff believes that any rebates to residential customers should be made as separate payments and not simply deducted from customer bills....*

* * * * *

> *As shown in Table J-7, electric distribution utilities are expected to reduce the carbon costs faced by industrial sources due to power purchased from the grid. Staff envisions this compensation would be in line with that given to other customer classes. However, the form of compensation to industrial ratepayers might best be structured as energy-efficiency programs rather than per-customer rebates.*

Appendix J, J-61. Using this approach, there is no certainty that the carbon costs incurred by an EITE entity purchasing power from a utility will receive any carbon cost recovery. Energy-intensive entities, such as Oxy, have been leaders in energy efficiency because of the impact on profitability. It thus is unclear whether additional energy efficiency programs will have material value to EITE industries in the future. Moreover, even if an energy-efficiency program could be leveraged, a trade-exposed entity may not be able to realize full carbon cost recovery. As a result, those oil and gas extraction operations that generate electricity on-site will receive full coverage of their carbon costs (to the extent benchmarking permits,) while those operations which purchase electricity from the utility will not.

ARB's proposal does not meet the agency's own objective of ensuring that trade-exposed entities receive coverage of the emissions costs associated with their electricity use. ARB should rectify this inconsistency to avoid competitive impact in one of two ways: (1) require the utility to share the benefits of free allowance value with trade-exposed entities through *direct rebates* or (2) provide to an EITE entity a direct allocation of free allowances for power purchased from a distribution utility and exclude that entity's usage from the allocation of free allowance value to its serving utility.

Please let us know if you have questions, and thank you for your consideration.

Sincerely yours,

pr Frank E. Komin
General Manager
Oxy Long Beach Inc.

BZ:ev
cc: Claudia Orlando
Sam Wade
Evelyn Kahl