June 27, 2012

Clerk of the Board
California Air Resources Board
1001 I Street, Sacramento
California 95814

Electronic submittal: http://www.arb.ca.gov/lispub/comm/bclist.php

Re: **Comments, Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms**

Dear Sir/Madam:

Valero Refining Company – California, Ultramar Inc. and Ultramar Ltd. (collectively "Valero"), appreciate this opportunity to provide comments regarding the California Air Resources Board ("ARB") proposed amendments to the California cap on greenhouse gas emissions and market-based compliance mechanisms, as posted for public comment on June 11, 2012. Valero owns and operates two refineries in the state of California with a combined throughput capacity of over 305,000 barrels per day, and a refinery in Québec, Canada with a throughput capacity of 265,000 barrels per day. Valero refines and markets products on a retail and wholesale basis through an extensive bulk storage and pipeline distribution system.

As an operator of facilities in both California and Québec, Valero does not support linkage at this time due to differences between the two cap-and-trade programs introducing the potential for inequitable treatment of covered entities. The California program is significantly more prescriptive than Québec's which will result in programs being administered differently to meet their unique requirements. Before considering linkage as a viable option, ARB and Québec should allow both cap-and-trade programs to be fully developed and implemented. After both programs have been implemented and operational for a reasonable period of time, ARB and Québec should evaluate the performance of both programs and determine which one is most effective in meeting emission reduction goals. If ARB elects to pursue linkage at that time, both ARB and Québec can assess what changes are required to both programs to ensure that emissions reduction goals are achieved and covered entities are treated equitably. While these comments only contemplate linkage with Québec, which provides a small market relative to California, they can be expanded to apply to other trading partners that may link with ARB's cap-and-trade program in the future to ensure the success of multiple linked programs by ensuring availability of credits, fluidity of the market and reasonable pricing.

Valero is providing the following additional comments and recommendations regarding the proposed amendments.

1. <u>ARB should defer linkage until the California and Québec cap-and-trade programs have been successfully implemented and demonstrate success.</u> Neither California's nor Québec's cap-and-trade programs have been implemented. With California's "adaptive management" approach, it is highly

likely that the California program itself may undergo modifications as the program develops and matures. Rather than linking the programs when it's not clear whether, or how, either one of them will work in practice, and when it's highly likely that each program will be a moving target, it seems prudent to allow each program to develop on a standalone basis and have an opportunity to demonstrate success before attempting to link them. ARB should consider the possibility that the Québec program may prove to be the best option when considering the long-term viability of a cap-and-trade program. In which case, the ARB program may require modification prior to linkage.

It is also worth noting that the relative size of the Québec cap-and-trade market may not significantly impact the California market. ARB should consider whether linkage should also be deferred to incorporate other cap-and-trade programs to provide a more robust trading market.

2. <u>ARB should provide additional review and validation that linkage between the California and Québec cap-and-trade programs result in equitable coverage in both jurisdictions.</u> In ARB staff's Initial Statement of Reasons ("ISOR") dated May 9, 2012, ARB comments that "(l)inking the two programs would result in equitable treatment for covered entities in both jurisdictions". However, ARB goes on to comment that "the regulations in Québec are not as detailed as those in California in some respects, however staff's evaluation is that the end result of each regulation will be substantially similar. Staff believes that the minor differences identified between the two programs will not adversely impact the environmental integrity of a linked cap-and-trade program".

   Valero believes the differences between the two programs are more than minor. The California program is significantly more onerous than the Québec program and opens the door for inconsistencies in how the regulation is administered. This could ultimately affect California program participants by requiring compliance with more prescriptive requirements and allow Québec more flexibility in how regulated parties are treated. There are also substantive differences between the two programs that clearly show the programs are not "substantially similar". For example, there are inconsistencies in the refining units that are regulated under the two programs and it is not clear what the limitations are regarding emission credit trading from specific sources.

   The California cap-and-trade regulation places significantly more constraints on regulated parties through the inclusion of hundreds of more defined terms which ultimately establishes the basis and intent of what and how California intends to regulate entities. For example, the California regulation has 288 defined terms while the Québec regulation has 15. The Québec program does not include a definition for "offset verification" where the California regulations does, which highlights the differences in the Québec program and the ability to demonstrate that the two programs will ensure equitable treatment of regulated entities. It seems improbable that consistency between the two programs is possible when the fundamental element to define regulatory scope, i.e. definitions, is so blatantly different.

3. <u>ARB should define how future year allocations will be administered to ensure consistency with Québec requirements.</u> Without ensuring equivalency between how allocations are administered, there could be market impacts if California facilities are purchasing too few or too many offsets to meet compliance obligations. This uncertainty could affect the market value of allowances by either artificially inflating or deflating value based on demand.

4. <u>ARB should present a complete cap-and-trade program to ensure covered entities can fully assess compliance obligations.</u> Valero has previously requested in prior comments that ARB fully develop the cap-and-trade program elements before modifying or changing the regulation. With respect to

linkage with Québec, ARB posted their revised regulation for comment on May 9, 2012 while Québec was still developing revisions to their regulation. This makes it very difficult to fully assess impacts when one regulation is unavailable for review. In fact, the English translation of the revised Québec regulatory changes was not issued for review until June 11, 2012. Complicating matters was the fact that a full English translation of the entire regulation was not provided making a comprehensive review within the timeframe allowed difficult.

5. ARB should clearly demonstrate the transparency and accountability of Québec emission inventories before entertaining linkage with the California cap-and-trade program. In the ISOR, ARB states that "(t)he decision to propose linkage of the California and Québec cap-and-trade programs followed extensive discussions between California staff and Québec staff on the harmonization of regulatory provisions. In these discussions, staff considered which items must be identical, which need to be consistent, and which could be different in a linked program. Staff of the jurisdictions each concluded that the remaining differences would not adversely affect the efficiency or equity in a regional program". ARB should have fully engaged regulated parties in better reviewing and defining what regulatory program elements should be equivalent between the two programs. In addition, the involvement of the Western Climate Initiative ("WCI"), which Valero has previously commented on the lack of transparency in the WCI process, makes the linking process between jurisdictions a "below the radar" activity in which stakeholders have neither knowledge in, nor input to, the process.

Valero strongly urges ARB to consider and address the issues outlined above before moving forward with linkage to the Québec cap-and-trade program. As proposed, we believe the methodology used to develop linkage between the California and Québec cap-and-trade programs are fundamentally flawed and do not ensure equitable treatment for covered entities in both jurisdictions. We hope that ARB can work with us in a manner that is reasonable, technically feasible, cost effective, and considers the practical impact of AB32 on jobs, the economy, and the consumer. Please contact me at (210) 345-2120 should you have any questions or need clarifications concerning our comments.

Sincerely,

Patrick Covert
Executive Director, Regional Environmental and Regulatory Affairs
Corporate Environmental
Valero Companies