



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

Michael D. Wang

Director, Legal, CA Climate Policy & State Air Issues

Via E-mail and Web Submittal (cap and trade and ODS):

http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=odsinvestigation-ws&comm_period=1

<http://www.arb.ca.gov/cc/capandtrade/capandtrade.htm>

October 17, 2014

Ms. Edie Chang (echang@arb.ca.gov)

Deputy Executive Officer

Air Resources Board

1001 I Street,

Sacramento, CA 95814

Re: Comments on the Air Resources Board's Preliminary Determination of the Compliance Offset Investigation for Destruction of Ozone Depleting Substances

Dear Ms. Chang:

The Western States Petroleum Association (WSPA) is a trade association that represents 26 companies that explore for, develop, refine and market petroleum, petroleum products and natural gas in the Western U.S. As you are aware, many WSPA members have extensive operations in California and are significantly affected by the Air Resources Board's (ARB) many regulatory programs including AB 32.

Unauthorized Confiscation of Offsets

WSPA is aware of ARB's Preliminary Determination of the Compliance Offset Investigation for Destruction of Ozone Depleting Substances (ODS), dated October 8, 2014. This document identifies 231,154 offset credits generated from destruction of ozone depleting substances that may be subject to invalidation due to alleged violations of the Resource Conservation and Recovery Act (RCRA) requirements by a Clean Harbors facility in Arkansas. WSPA understands the need to maintain the integrity of the offsets program. However, we are concerned, as are many regulated entities and market participants, by the lengthy and confusing process undertaken by ARB in this investigation, the lack of communication to stakeholders and by the removal of offsets from the holding and compliance accounts of individual regulated entities. While we understand that offsets could be suspended for purposes of further

investigating certain transactions, the removal of offset from the holding and compliance accounts for individual entities is an action that is not authorized under the Cap and Trade (C/T) regulation, and which will further delay use of valid offsets for compliance purposes.¹

WSPA also believes that ARB's action to suspend all 4.3 million offset credits generated from projects involving the Clean Harbors facility from May 29, 2014 through the pendency of this investigation represents an unreasonable and counter-productive interpretation of Section 95985. In particular, subdivision (d) of Section 95985 appears to give ARB the discretion to suspend only those offsets associated with the particular projects identified in ARB's preliminary determination.² ARB's interpretation in this instance is also at odds with existing rules and policies governing offsets as well as policies embedded in other project protocols.³ Actions that might give rise to an invalidation of offsets from a particular project should be tied to the project itself, and not the facility more broadly. In this particular case, ARB wrongly pulled all offsets related to the Clean Harbors facility from entities' accounts before issuing a preliminary determination.

WSPA submits that any temporary suspension of offsets should be based on specific findings of fact and limited to projects "designated for invalidation" in a preliminary ARB determination, not on a decision by ARB to launch an investigation that may lead to invalidation of an undefined subset of offset credits at some unknown future date.

Process Issues

WSPA is concerned that ARB took more than four months to reach a preliminary determination in the matter, thereby withholding all 4.3 million offsets from the market for more than a third of a year, and sending a negative signal to the offset market (offset project developers and investors). WSPA notes that Section 95985(f) requires notified parties of potentially invalidated offsets to provide all necessary information to ARB within 25 days and that ARB has to make a final determination within 30 days of receiving all information. The 10-day comment period that ARB has initiated by its ODS preliminary determination is not called for in the regulation and does not substitute for the lack of an appeals process for the project owner/operator.

¹ Pursuant to Section 95985(g) of the regulation, ARB can only remove offset credits from individual holding or compliance accounts once they have been invalidated in a final determination by the Executive Officer

² "When ARB makes an initial determination pursuant to section 95985(c) it will immediately block any transfers of ARB offset credits for the applicable Offset Project Data Report." ARB's October 8, 2014 preliminary determination identifies specific time periods for two projects – CAOD0018-A and CAOD0006-C – where the facility was allegedly not operating in accordance with its RCRA permit.

³ Section 95973(b): "In addition, an offset project must also fulfill all local, regional, and national environmental and health and safety laws and regulations that apply based on the offset project location ***and that directly apply to the offset project***, including as specified in a Compliance Offset Protocol. The project is out of regulatory compliance if the project activities were subject to enforcement action by a regulatory oversight body during the Reporting Period. An offset project is not eligible to receive ARB or registry offset credits for GHG reductions or GHG removal enhancements for the entire Reporting Period ***if the offset project is not in compliance with regulatory requirements directly applicable to the offset project during the Reporting Period.***" (emphasis added)

While ARB notes that “None of the compliance offset credits currently under review have been used for compliance in the Cap-and-Trade Program”, this decision could still create compliance hardships for operators that planned to surrender the implicated credits by November 3, 2014 to meet their 30% retirement obligation for 2013.⁴

Problematic Precedent

Tying up Offset Market and Creating Enforcement Risk

ARB’s interpretation of Section 95985 in this instance also establishes a problematic precedent for facility operators relying on offsets from unrelated projects that may be implicated in future compliance offset investigations. WSPA agrees with ARB that offsets are a critical cost containment mechanism. As we stated in our October 16, 2013 comments on then-proposed amendments to the C/T regulation, offsets are necessary to prevent leakage of emissions and economic productivity to other states, and are currently in short supply.⁵ Arbitrary, wholesale suspension of offsets during ARB investigations will exacerbate this pre-existing problem and may leave some facilities exposed to enforcement actions for failing to meet compliance deadlines, even if ARB later determines that the offset credits in question are valid.

WSPA recommends that ARB immediately rescind the block it placed on transfers of offset credits not identified as “designated for invalidation” in its October 8, 2014 preliminary determination. Alternatively, WSPA requests that ARB expedite issuance of a final determination on the Clean Harbors ODS investigation so that regulated entities holding valid offsets can use them to satisfy their compliance obligations in the current compliance period.

Unclear Criteria and Timing of Violations

In its ODS preliminary determination, ARB discussed the regulatory reasoning behind the RCRA violations that caused the potential invalidation of offsets. However, ARB did not lay out any general principles or criteria for its determination, other than Section 95985(c)(2), which indicates that the project activity and implementation must follow all local, state, or national environmental and health and safety regulations during the reporting period for which the ARB offset credit was issued.

While ARB determined that the offsets in question were still real, quantified, and verified reductions, some of the offsets have been designated for invalidation. It’s understandable that a project should not create offsets that actually result in displaced environmental pollution or in safety or health hazards, however, the current language and ARB’s preliminary determination do not provide any guidance on determining a significance threshold. For example, a notice of

⁴ “The Executive Officer has 30 calendar days from the day that all information is submitted to make a final determination whether to invalidate any compliance offset credits subject to review.” Presumably this 30-day clock starts to run sometime after the close of the October 17 comment deadline, suggesting that the final determination could fall well beyond the November 3 deadline.

⁵ “Recent analysis by the American Climate Registry that finds there will be a shortage of offset supply by 29 percent in the first compliance period and up to 67 percent by the third compliance period.”

violation from a fire department for a minor infraction that does not pollute the environment or does not result in an actual hazard could potentially cause an offset credit to be considered for invalidation. Further, given that offset invalidation periods are 3 or 8 years, and the statute of limitations on most laws are 5 years, ARB needs to lay out specific principles on what constitutes a violation and the particular timing of the violation that could potentially invalidate an offset credit.

While WSPA is satisfied with the preliminary determination with regards to the fact that only about 5% of the offset credits are now designated for invalidation, it should be noted that the ultimate reasoning for narrowing the offset invalidation (to those offsets generated after the agreed upon receipt date for the EPA report by the offset generator) creates an unclear delineation for future preliminary determinations. The receipt of a letter does not suddenly change the state of existence of a violation. Without clear guidance that can be applied to future offset investigations, offset purchasers and project owners/operators are at risk for invalidation or C/T enforcement.

Discrepancy between Jurisdictions with Regards to Offset Liability

While ARB requires that any jurisdictions to which it links must have equal climate change programs, there is a very wide discrepancy between California and Quebec with respect to the liability for invalidated offsets. Because the Quebec agency, like ARB, approves offset protocols and verifies (through third-party contractors) the offset projects, the agency takes on the liability for invalidated offsets. As such, Quebec has an offset pool that will replace any offsets that are later found to be invalid. In California, however, the offset liability lies with the purchaser, who has no control over the project owners/operators and their compliance with all environmental, safety, and health laws and regulations. No party would be likely to purchase offsets that it knows would become invalidated. (If that were found to be the case, ARB would have other means to enforce against the violator.) Therefore, in the interest of uniformity and equality between jurisdictions, ARB should establish an offset replacement pool rather than leave the liability with purchasers and expose them to market and enforcement risks.

Further Regulatory Amendments

Moving forward, WSPA requests that ARB work with us and other AB 32 stakeholders to develop amendments to the C/T regulation to clarify the process and criteria by which offsets would be considered for invalidation – and that capture the recommendations on offset policy noted in our October 16, 2013 comment letter, including:

- Acceptance of valid national and international offsets;
- Removal of the offset limit (which inhibits investment in offset programs and undermines the goal of AB 32 to reduce GHG emissions);
- Allowing greater flexibility in holding limits to facilitate transfer of offsets and improve market liquidity;
- Allowing compliance entities to carry over offsets between compliance periods;
- Redistributing unused offsets back to compliance entities; and

- Improving the potential supply of eligible offset projects both geographically and by changing the project commencement date

These proposals recognize the important role offsets can play to reduce unnecessary upward pressure on allowance prices and prevent depletion of the allowance price containment reserve (consistent with Board Resolution 12-51) while meeting the environmental goals of the program. Exposure to the high costs in the final tiers of the APCR and market volatility may ultimately lead to emissions and jobs leakage as companies struggle under carbon costs higher than those which are workable in the relevant geographical markets.

Thank you for considering these comments. Should you have any questions, please feel free to contact me at either my cell 626-590-4905 or mike@wspa.org.

Sincerely,



cc: Rajinder Sahota (rsahota@arb.ca.gov)
Mary Jane Coombs (mcoombs@arb.ca.gov)