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Catherine H. Reheis-Boyd
President

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Via web: http://www.arb.ca.gov/lispub/comm/bclist.php

Dr. Steve Cliff (SCliff@arb.ca.gov)
Assistant Division Chief
California Air Resources Board
1001 I Street,
Sacramento, CA

Re: WSPA Comments on Proposed 15-day Amendments to the California Cap on Greenhouse Gas Emissions and Market – Based Compliance Mechanisms

Dear Dr. Cliff:

The Western States Petroleum Association (WSPA) appreciates the opportunity to provide comments on the ARB's 15-day Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms (Proposed Amendments). WSPA, a trade group representing 27 companies that explore for, develop, refine, market and transport petroleum and petroleum products, understands this document is the product of an extensive communication effort by the staff of the California Air Resources Board (ARB) and stakeholders. While much has been accomplished through this process, it seems clear that further amendments will be necessary and we look forward to continuing our work with the ARB as the Cap and Trade (C/T) program progresses.

As you are aware, WSPA has been actively participating in the public discussions surrounding the details of the C/T program. Recognizing that we have provided extensive comments in the past, these comments will focus on changes noted in the version released by ARB on March 21 and issues that will need resolution in the coming years.

Outreach Process

It is important to recognize the continuing effort by ARB to communicate with, and understand, the issues identified by the many stakeholders who are affected by the C/T program. While unresolved issues remain, the process used by staff to develop the final proposal recognized the important and dynamic balance between a transparent process and the need to protect confidential business

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information associated with a market-based system to reduce GHG emissions. We appreciate the efforts by staff who went to great lengths to explore issues and identify possible solutions.

Industry Assistance Factor

WSPA supports the ARB proposal to increase the Industry Assistance Factor (IAF) to 100% (up from 75%) during the second compliance period for petroleum refineries and other industry groups classified by the ARB as "Moderately exposed". The proposed change in the 2nd compliance period recognizes the risk of emissions leakage and the potential harm to domestic (i.e., within California) facilities.

WSPA remains concerned about the risk of leakage during the 3rd compliance period, when the IAF is proposed to be reduced to 75%. We look forward to working with ARB to investigate the adverse impacts of the proposed IAF reduction and the potential for increasing the IAF in the 3rd compliance period so that leakage risks are minimized.

Refinery Benchmark

The proposed benchmark of 3.89 allowances per CWB for refineries is too low. Based on data prepared by Solomon in response to ARB questions, if the 2008-2010 emissions from refineries are about 31.5 million metric tons, and assuming a 90% stringency (consistent with ARB policy), a benchmark of 4.08 allowances per CWB appears to provide the appropriate amount of allowances.

Hydrogen Plant Benchmark

The new hydrogen plant benchmark proposed by ARB may be materially inaccurate due to inconsistent communication of hydrogen reporting requirements. Specifically, the reporting requirements that have been in-place, and were used for benchmarking, are not consistent with the new reporting Guidance provided to verifiers and reporters on March 21. This inconsistency puts companies in potential compliance jeopardy through, for example, vulnerability to allegations of material misstatements. This issue just emerged within the past two weeks, yet it could impact reporting of 2013 data, which is due to ARB next week (April 10). WSPA believes this issue must be addressed with respect to the implications on the development of the hydrogen benchmark, as well as near term and future reporting required by ARB.

> Recommendation: Given the uncertainty in MRR as to what is reported and what should be reported, at a minimum, the recent guidance proposed by ARB should be rescinded and amended, depending on the outcome of further dialogue with stakeholders. It is likely that ARB will need to revisit the hydrogen benchmark as well. We look forward to working with staff to ensure that future reporting Guidance is consistent with the MRR Regulation and can be achieved in practice by regulated entities.

Mandatory Recordkeeping and Reporting (MRR)

WSPA members continue to work with ARB as we collectively gain understanding of reporting requirements. Certainly, with the April, 2014 deadline already upon us, these requirements become even more important. The task of reporting for 2014 and beyond may become more complicated as companies begin reporting using guidance ARB is still developing for the Complexity Weighted

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Barrel (CWB). As can be expected when dealing with reporting from complex facilities, challenges associated with issues such as data gaps, intermittent meter malfunctions, alternative measurement methods, and postponement requests, will emerge from time to time.

> Recommendation**:** WSPA recommends ARB continue to work with stakeholders to review options for addressing infrequent, but nonetheless expected, events that result in data gaps or meter calibration challenges, while still allowing companies to receive unqualified positive verifications.

Offsets

WSPA strongly supports the adoption of the new protocols for Coal Mine Methane. We support ARB's efforts to improve the use of offsets as a means to control cost of compliance. We note, however, that in the recent release of the Update to the Scoping Plan, ARB acknowledges that offsets are insufficient to meet the 2013-2020 maximum offset demand if every entity chose to use the maximum number of allowable offsets. (P.93).We also note, in the same document, ARB has acknowledged that California's stringent regulatory requirements limit the potential for generating in-state offsets.

> S95854: WSPA continues to oppose the 8% limit on use of offsets to meet a compliance obligation as this could limit the development and implementation of cost-effective GHG projects. We recommend instead that ARB remove the 8% limit on use of offsets so the offset market accurately reflects the relative abundance (or scarcity) of offsets. We encourage ARB to continue working with C/T stakeholders to develop additional, viable offset protocols to facilitate C/T program compliance and to help contain costs that would otherwise be incurred by regulated entities.

Offsets – Forestry Offset Liability

As we noted in our previous comments, WSPA remains concerned that the date of issuance of July 1, 2014 for forestry offsets is too soon to allow for processing of forestry offsets purchased prior to the regulatory changes.

> Recommendation:
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> WSPA recommends that the July 1, 2014 deadline for issuance for the new liability regime be revised to January 1, 2015. It would allow ARB more time to issue the ARBOCs from projects currently in the pipeline for issuance, and that have already come into contract under specific conditions.

Compliance Obligations for Renewable Fuels

S92852.2 Emissions without a compliance obligation. ARB has added renewable diesel to the list of source categories that combustion of which does not count toward a covered entities compliance obligation. Although the intent of this section appears to reduce the compliance burden of biomass derived CO2, this section does not include certain renewable liquid fuels, such as cellulosic. ARB has a definition of "Renewable Liquid Fuels" which covers all renewable fuels including renewable diesel.

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WSPA proposes that ARB add Renewable Liquid Fuels into the list since it will cover renewable diesel in addition to other renewable liquid fuels.

Recommendation:

ARB should include all renewable liquid fuels rather than only renewable diesel, revising the text as follows: **S92852.2 (a) 9. Renewable Liquid Fuels.**

Administrative Burden

WSPA is concerned with a number of complicated reporting rules that could jeopardize the ability of regulated entities to participate in the auction. We understand the agency's need to identify participants who may have the intent of disrupting the allowance market (i.e., "bad actors"). That intent notwithstanding, rules must be designed so parties with legitimate interests in a market system are able to avoid inadvertent missteps. The agency already has substantial ability to initiate enforcement actions against participants up to, and including, cancelling an auction. Accordingly, the addition of even more restrictive rules will not enhance ARB's ability to deter unwanted behavior.

Registration of names of employees (S 95830(c)(1)(I))

We appreciate and agree directionally with ARB's proposed revision to Section 95830(c)(1)(I). This change goes a long way to preserve ARB's intent and also recognize the needs of market participants.

Recommendation:

ARB should further clarify this section as follows: "…all persons employed by the entity with full knowledge of the entities market position"

Updating Registration Information (S 95830(f)(1)), Corporate Associations and re-verification information (S 95833(c))

As we indicated in previous comments, WSPA recognizes the ARB must be notified when details of company registrations change. However, as the registration requirements grow in complexity, it is incumbent upon ARB to grant more time for changes to be fully implemented throughout the companies, up to and including registrations on file with the ARB. Changes in employees, consultants and advisors, and most of all, corporate associations, may not be communicated quickly nor widely within regulated entities. While we appreciate the proposed extension from 10 days to 30 days, this extension still does not provide enough time for information transfer within large entities. The extent of compliance risk to regulated entities for potential violations of this administrative requirement alone justifies additional time.

Recommendation:

ARB should revise this requirement to a 60-day notification. However, the language still lacks of clarity which could cause inadvertent non-compliance.

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Recommendation:

ARB should further clarify this section as follows: "…all persons employed by the entity with full knowledge of the entities market position"

We recognize and appreciate that ARB changed the required frequency to update registration information provided pursuant to section 95830(f)(1)from within 30 days to each calendar quarter of the change. WSPA also supports the proposed clarification to section 95830(c)(1)(H) allowing updated information to be submitted within 30 calendar days provided they are related to entities registered in the C/T program.

Disclosure of Corporate Associations (S 95830(c)(1)(H), S 95833(a), (f)(7) and (e)(3))

As we commented previously, ARB proposes new language for corporate associations that requires disclosure where there is greater than 20% ownership of any operation worldwide, regardless of whether it is in California or has any C/T program obligation. In large multinational entities, this would likely involve hundreds if not thousands of "associations".

Aside from the burdensome nature of the requirement, attempting to maintain an updated list creates huge enforcement risk for a company and could limit their ability to participate in an auction.

These challenges also would exist for associations with multiple partners, joint ventures, or multiple owners, especially if the entity within the State of California operates independently with its own executive management. For that reason, WSPA opposes the proposed amendments.

Recommendation:

ARB should eliminate the proposed new language that requires identification of associations "regardless of whether the second entity is subject to the requirements of this article" and instead state that the requirement should apply **ONLY** where the association operates in California, or has a mandatory or voluntary involvement in, or linkage to, the California C/T program.

Understanding this is a complex issue and will involve input from numerous stakeholders, we recommend ARB initiate a process to identify and implement alternatives to the currently proposed regulations.

WSPA supports ARB's proposed change in section 95833(e)(3) to require notification of changes to information disclosed on corporate, direct and indirect corporate associations on a quarterly basis in lieu of the prior 30-day time limit.

§95833(f)(7).

The proposed language appears to clarify that a corporate association exists only if 1) the primary account representative or alternate who is an employee of one registered entity manages compliance instruments both for their employer and another registered entity or 2) the PAR/AAR has access to "market position" information for another registered entity ***and*** the authority to act on such information on behalf of that entity. We agree that these circumstances warrant application of the requirements for corporate associations.

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Recommendation:

To avoid potential unintended corporate associations between unrelated registered entities who happen to be represented by the same third party PAR/AAR, ARB should further amend the second sentence of this section as follows: "If any primary account representative or alternate account representative of a registered entity***, who is also an employee of that entity,*** has access to the market position (current and/or expected holdings of compliance instruments and current and/or expected covered emissions) for multiple registered entities …"

Know-Your Customer Requirements § 95834 (c)(2)

We do not believe that 10 days is enough time to provide the requested documentation associated with 95834(b). We request that ARB change this to 30 days similar to other registration and documentation requirements provided for in the regulation.

Auction Administration §95912 (d)(4)(E)

As we noted in previous comments, the requirement to keep accurate records for the past 10 years of investigations, at the risk of an audit or an enforcement action, is not reasonable. WSPA suggests the language in this section be changed to reflect that only on-going investigations are included – and then *only for the entities involved in the Cap and Trade Program or linked GHG programs* - rather than the whole panoply of commodities, or securities, that are not directly related to cap and trade programs.

Program Restrictions

Facility Shutdown

We appreciate and support the changes made by ARB in the proposed 15-day package.

Annual Allocation Holding Account (95831(a)(6))

It appears ARB created a new "annual allocation holding account" to ensure allowances allocated prior to the beginning of the following year will not cause an entity to exceed its holding limit at the time of allowance allocation (October 25 or the first business day thereafter). As further specified in §95870, the allocated allowances remaining in this account will automatically be transferred by ARB to the entity's Holding Account on the first business day of each year. It seems unnecessary to restrict the opportunity to transfer allocated allowances into the compliance account only between October 25 and the first business day in January. Entities should be able to trade credits allocated as currently allowed out of such an account. Because this new account is not subject to the holding limit, we understand ARB may want to restrict additional CIs from being deposited into this account.

Recommendation:

The rule language should clarify that allowances in the annual allocation holding account are not subject to the compliance account holding limit and not restricted in their ability to be transferred between October 25th of one year and January 1st of the following year.

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Timely Surrender of Compliance Obligations (S95856 (c),

If ARB is to implement the concept of an "Annual Allocation Holding Account", then we recommend section (c) be changed as follows:

> *"(c) A covered entity must transfer from its holding account or annual allocation holding account to its compliance account a sufficient number of valid compliance instruments to meet the compliance obligation set forth in sections 95853 and 95855."*

Timely Surrender of Compliance Obligations (S95856(h)):

Recommendation:

WSPA recommends ARB eliminate this section. However, if ARB determines this section mandating the order of retirement is necessary, then there should be language added that gives companies the option of directing the order of retirement for the various types of compliance instruments. Towards this end, we recommend:

> *New Section 95856(h)(1)(E) to read: "Alternatively, a covered entity can specify the order of retirement of compliance instruments and their amounts by providing written instructions to the Executive Officer no later than October 15 of each compliance year, prior to the November 1 retirement date."*
>
> *New Section 95956(h)(2)(E) to read: "Alternatively, a covered entity can specify the order of retirement of compliance instruments and their amounts by providing written instructions to the Executive Officer no later than October 15 of the year following the compliance period, prior to the November 1 retirement date."*

Timely Surrender of Compliance Obligations (S95856(h)(1)(A))

WSPA supported the prior 15 day draft that allowed offset credits to be surrendered without an annual 8 % limit. If any limit at all is applied to offset use, it should be applied only to the full compliance period. The imposition of an annual limit is contradictory to, and inconsistent with, the intentional multi-year (two or three year) compliance period flexibilities built into the program. Moreover, an annual limit would likely act, in reality, to limit the use of offsets to significantly less than 8 percent since there is variability in the development and implementation of offset projects and offset supply.

Recommendation: Remove the 8% limit on use of offsets.

Holding/Purchase Limits

WSPA continues to be concerned that the current holding and purchase limits are extremely restrictive. The outcome will likely be a constrained market that limits participants' flexibility to comply at the lowest incremental cost. The conservatively low holding/purchase limits disproportionately impact those entities with large compliance obligations, particularly those sharing holding limits and purchasing limits with one or more directly related entities. Furthermore, this problem will be compounded in 2015, since the compliance obligations of fuel providers are typically much higher than the increase in the holding limit. These constraints leave such an entity no alternative other than to prematurely move large quantities of compliance instruments to its

compliance account, rendering useless the multi-year compliance period flexibilities and exposing the company to significant risks of stranded assets in the event of operational or corporate activity changes over the compliance period.

As you are aware, the Emissions Market Assessment Committee (EMAC) recognized these concerns in its November 8, 2013 report and offered two possible recommendations: 1) consideration of adjusting or scaling the holding/purchase limits based upon the compliance obligation for a particular entity and 2) consideration of additional flexibility in movement of compliance instruments from the compliance account, including allowing a portion of the compliance instruments to be removed and offered for resale into the market. The opinion of the EMAC was that making these modifications would provide additional flexibility to the regulated entity, while still preserving the goal of preventing market manipulation.

Recommendation:

ARB should consider for adoption the recommendations prepared by the EMAC. ARB should place specific emphasis on scaling of holding/purchase limits that reflects the size of the entity's obligation, and provides increased flexibility and control by the regulated entity with respect to management of the accounts.

Auction Administration/Bid Guarantee (S95912(j)(3))

ARB has proposed the following language: "A bid guarantee submitted in any form other than cash must be payable within three business days of payment request." While this is an improvement from an earlier requirement of one day, this still seems to be an overly aggressive requirement. Certainly payment and reconciliation must be done promptly, but systems and people do fail and some provision needs to be made for the "normal course of business".

Recommendation:

WSPA recommends the period be at least five working days to account for weekends, holidays, etc.

Allowance Price Containment Reserve (95913(f)(5)(E))

ARB previously proposed the following language: "The allowances defined in section 95870(j)(1) will be sold beginning with the latest vintage and then the preceding vintages, from latest to most recent, until all accepted bids at the highest price tier are filled or until all the allowances defined in section 95870(j)(1) have been sold." In the interest of cost containment, it appears ARB has agreed to provide "additional" allowances, by taking from later vintage years and making them available earlier, without replacing the later vintage years' allowances. We remain concerned that this approach does not provide "additional" allowances. Rather, it merely creates the potential for a shortage of allowances in later years and possible price volatility.

Recommendation:

WSPA recommends ARB delete this requirement. In lieu of the proposed language ARB should evaluate whether and to what extent longer-term potential imbalances exist between allowance supply and demand. WSPA suggests that ARB's evaluation include economic and

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legislative reports and that ARB establish a mechanism by which it could provide new, additional allowances to the market to prevent prices from exceeding the highest price in the APCR. ARB should further study other means of increasing the supply of compliance instruments, such as offset carryover across compliance periods, the redistribution of unused offsets, and expanding the offset market geographically and temporally.

Over-the-Counter Sales of Compliance Instruments (S95921(b)(3)(A) and (B) and 95921(b)(4)(A) and (B))

These sections require that a transfer request for an over-the-counter agreement for the sale of compliance instruments must include the dates on which the agreement was entered into and terminated, and the transfer was scheduled. The information has no bearing on the integrity of the trading process.

Recommendation: WSPA recommends ARB delete these requirements.

S95921(b)(3)(C) and 95921(b)(4)(D), (E), (F) and (G)

These sections require disclosure of the price of compliance instruments, transfers of products, and the pricing method. The auction settlement price and the reserve auctions are the best indicators of price containment. Reporting of over-the-counter transfer prices to CITSS will not provide added value to the market.

Recommendation: WSPA recommends ARB delete these requirements.

General Prohibitions on Trading (S95921(f))

ARB has proposed language that prohibits an entity from holding allowances for another entity that has ownership interest in those allowances, unless the entities share a direct corporate relationship. While such a requirement is understandable to ensure that a bank does not hold allowances for an industrial entity in order to get around a holding limit, the language is not clear enough to allow direct and indirect entities to hold allowances for each other. The ownership issue and financial interests could become muddy due to corporate structures.

WSPA is concerned with the trade restrictions and market complexity introduced in the proposed amendments. These proposed restrictions will eliminate critical transactions such as options, futures, forwards and right-of-first-refusal contracts. These types of transactions promote a robust and efficient market structure. As we indicated earlier in these comments, WSPA understands the agency's need to identify "bad actors", but rules must be designed so that honest parties are able to avoid inadvertent missteps.

ARB should provide guidance similar to that issued for resource shuffling that explains specific safe harbors or specific examples of "bad behavior". This is needed in the rulemaking to provide some measure of definition to allow regulated parties to understand the limits or boundaries that ARB intends to enforce.

Prohibitions on trading are overly broad and should be curtailed to permit legitimate transactions that support program objectives and create liquidity. For example, requiring that "an entity cannot acquire

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allowances and hold them in its own holding account on behalf of another entity" could be interpreted to interfere with the ability of entities to purchase allowances from market makers at auction prices.

ARB should provide a safe harbor for forward contracts under the trading prohibition. The new proposal includes additional language that deviates materially from the guidance provided by ARB in December of 2012. The new proposal uses very broad language that could be read to mean the safe harbor is practically inaccessible. This language needs to be scaled back to be consistent with the December 2012 guidance.

Additionally the beneficial holdings provisions do not allow escrow arrangements because by definition, such arrangements involve a holding on behalf of another. Escrow is a fundamental component of corporate transactions and this could create unnecessary obstacles to numerous corporate transactions involving covered entities. We support the addition of a safe harbor for escrow accounts, in addition to the safe harbor for forward contracts and for holding allowances between direct and indirect corporate associations.

> Recommendation: WSPA recommends ARB adopt the language regarding forward contracts consistent with the December 2012 guidance and take a similar approach for escrow accounts and transactions between direct and indirect corporate associations. We further recommend that ARB delete the proposed changes to "Prohibitions on Trading" requirements.

Jurisdiction of California (S96022(c))

ARB previously proposed the following language in 96022(c): "A party that has rights and protections under the Foreign Sovereign Immunities Act consents to civil enforcement of the laws, rules and regulations pertaining to this article in California's courts, subject to the rights and protections afforded to entities subject to the Foreign Sovereign Immunities Act, including removal to federal court." This language would create cross-jurisdictional double-jeopardy for affected compliance entities by making it possible to legally try them in both California and in the linked jurisdiction.

> Recommendation:
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> Strike or revise this language to make it clear that an entity that is subject to another jurisdiction linked to the California program cannot be tried in either California or U.S. Federal court (if the entity is a non-US entity).

We appreciate the opportunity to comment on the Proposed Amendments. Should you have any questions, feel free to contact me or Mike Wang of my staff (mike@wspa.org; cell: 626-590-4905).

Sincerely,

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