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

RE: Phillips 66 comments on CARB's Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation posted September 4, 2018

Dear Board:

Phillips 66 appreciates the opportunity to submit these comments on the Proposed Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation (Regulation) posted on September 4, 2018. We have actively been participating in this rulemaking process and look forward to continuing this important dialogue.

Phillips 66 has significant operations in California covered by the Regulation, including petroleum refining, coke calcining, and supplying of petroleum products. Other business units include pipelines, terminals and lubricants manufacturing. Over 1,400 Phillips 66 California employees in 15 locations produce and deliver products to our California customers every day. We provide revenue to California government including $13 million of State tax and over $34 million in property taxes annually.

With this letter, we reiterate our previous comments dated March 16, May 16 and July 5, 2018[1,2,3], and incorporate them into the Administrative Record by reference. As a member of WSPA, Phillips 66 also supports WSPA's comments and comments by Latham and Watkins made on WSPA's behalf. Following are further clarifications and amplifications especially in the critical area of cost containment.

[1] https://www.arb.ca.gov/lists/com-attach/37-ct-3-2-18-wkshp-ws-B3dWOAdvUG8GbFI7.pdf
[2] https://www.arb.ca.gov/lists/com-attach/1227-ct-4-26-18-wkshp-ws-B3dUOlI6Um1RO1M6.pdf
[3] https://www.arb.ca.gov/lists/com-attach/11-ct-6-21-18-wkshp-ws-VjVXJQFfVHUEdwll.pdf

Proposed Price Ceiling Fails to Adequately Address and Balance Six Criteria from AB 398

1. **Adverse Economic Impact:** AB 398 mandates "the need to avoid adverse impacts on resident households, businesses and the state's economy" in adopting a price ceiling. The ISOR Appendix C, Updated Standardized Regulatory Impact Assessment (SRIA), discusses the relative economic impacts of the proposed price ceiling structure versus a current regulation "baseline scenario" and versus two alternative price ceiling structures (higher cost structure Alternative 1 and lower cost structure Alternative 2). Alternative 2 with a lower price ceiling resulted in a reduction of $5.0 billion in cost to industry in 2030 versus the current regulation. CARB, however, rejects this lower price ceiling arguing that the net overall impact to consumers and the State is small and because it "may be too low to incent the abatement technologies" (p. 84). CARB falls short in considering economic benefit from Alternative 2.

   NERA's most recent work, referenced in WSPA's submitted comments, evaluates the relative economic impact to individuals and the State economy under different price ceiling assumptions. NERA's work clearly demonstrates greater economic harm with CARB's proposal than other alternatives.

2. **2020 Tier Prices of Allowance Price Containment Reserve (APCR):** The ISOR states that the proposed 2021-2030 price ceiling continues the price design structure of the current APCR and argues that this is important to communicate a similar minimum-to-maximum price "window of expectation" for long-term carbon reduction investments. CARB's proposal which escalates at 5% plus CPI annually creates an always widening and unjustified spread between the floor and price ceiling. This spread becomes even wider than exists with the current regulation single tier prices after 2027 as CARB notes, when cost control may be especially critical. CARB falls short in establishing good cost control with this proposal.

3. **Full Social Cost:** A core guiding principle is that the cost of carbon reduction should in no circumstance exceed the Social Cost of Carbon (SCC) (or social benefit to society), thus preserving net positive benefits to society. Dr. Robert Stavins of the Harvard Kennedy School points out that creating a program where program costs can exceed the SCC risks overall economic harm to society. Dr. Stavins and Dr. Steven Rose of EPRI have done extensive research in this area. CARB's proposed price ceiling escalating at 5% plus CPI annually, elevates the price ceiling to values higher than the central-tendency SCC values recommended. CARB therefore falls short in properly considering and giving proper weight to SCC in setting the price ceiling triggers. **The SCC should serve as a "not-to-exceed" principle for California allowance prices.** In fact, concerns about economic impact, leakage and linkage argue for a ceiling lower than the SCC.

4. **Auction Reserve Price:** The annual escalation in the auction floor price of 5% plus CPI provides an investment signal. However, there is no justification to escalate the floor price beyond the CPI annual inflation rate.

5. **Leakage:** CARB is required to consider "the potential for environmental and economic leakage" in establishing a price ceiling. The risk of environmental and economic leakage is exacerbated with prices increasing at CPI + 5% annually and with the current limited linkage to California's Cap-and-Trade program.

6. **Cost of Reduction:** CARB is required to consider "the cost per metric ton of greenhouse gas emissions reductions to achieve the statewide emissions targets". The Appendix C SRIA makes the following statements on pages 59-60:

- "Staff analysis of abatement options suggests that there are sufficient abatement opportunities below the price ceiling for covered entities to react to high prices through direct reductions."
- "in the unlikely event cost containment is triggered", and
- "it is impossible to know in advance what covered or non-covered entities will do to comply".

These statements suggest that CARB is intentionally setting price containment points at levels to drive emissions abatement regardless of the costs involved. While we do not know with exactitude the technology mix or the costs to achieve the State's goals, CARB should not set a price ceiling that exceeds the SCC, and that is so high as to cause economic harm.

Following are additional points with respect to the proposed price ceiling and the six factors which should be considered

- **CARB sets overly aggressive speedbump and price ceiling targets** – CARB states in the ISOR Appendix D that allowance budgets from 2013 through 2030 are binding on expected GHG emissions and that the supply of allowances will not exceed demand during the regulatory period. As such CARB recognizes that preservation and use of banked, otherwise unused/unsold and reserve allowances is essential and expected. Since the reserve allowances can only be accessed at speedbumps or ceiling prices, this suggests that program prices could reach those price points. Setting the speedbumps and price ceiling too high necessarily risks volatility and economic harm to the state economy.
  - This conflicts with AB 398 Criteria 1 and 5 above.

- **CARB improperly uses consultant price forecasts** - CARB presents studies from three third-party consultants in the ISOR, Appendix D pp. 13-14, as evidence that allowance prices will increase over time. CARB seems to, in part, rely on these studies to also conclude that they do not expect allowance prices will reach the price ceiling (ISOR, p. 28). While CARB asserts consistency in the findings shown in Appendix D, Table 2, it is important to note that ICF cites a very wide range on its estimate. It is also important to note that CARB uses a study from California Carbon Info (CCI) dated 2016. We are aware the CCI may have an updated view with higher values. **Using outdated consultant views as justification for the price ceiling proposal is arbitrary and risks harm to the economy.**
  - This conflicts with AB 398 Criteria 1, 5 and 6 above.

- **Speedbump and price ceiling targets exceed the social cost of carbon** – While the SCC is a measure of the societal benefit to reducing carbon, abatement costs which exceed the SCC only serve to harm the economy, as Dr. Stavins points out. As mentioned earlier, the proposed price containment points are set at levels destined to exceed the SCC.
  - This conflicts with AB 398 Criteria 1, 3 and 6 above.

<u>**Recommendation**</u>**: CARB should set the price ceiling to no higher than the Social Cost of Carbon.**

Tier and Price Ceiling Escalation

Annual escalation of the floor price, speedbumps (future Reserve) and price ceiling should be such that it never allows costs to exceed the Social Cost of Carbon. As CARB's own work shows, proposed escalation of 5% plus CPI annually would allow the proposed second speedbump to be higher than central tendency SCC in most years and the price ceiling always higher than SCC. There is no justification for additional escalation beyond CPI.

> **<u>Recommendation:</u> Annual price escalation should be CPI only with no additional assigned escalation factor to ensure that allowance prices never exceed the SCC and to avoid economic harm.**

Establish "Speedbump" Prices at 1/3 and 2/3 interval between Floor and Ceiling

A successful outcome to cost containment design would be a steadily increasing but stable price structure over the span of the 2019-2030 program. With the legislature's designation of two price reserve tiers (speedbumps), we are aware of no justification for placement of these other than at 1/3 and 2/3 intervals between the floor and ceiling. CARB's proposal to 1) place them at ½ and ¾ price intervals between the floor and ceiling and 2) place the majority of the volume in the second vs. first speedbump combine to impede access to and increase the overall cost of Reserve allowances to obligated parties.

> **<u>Recommendation</u>: Establish the speedbumps at the 1/3 and 2/3 interval between floor and ceiling, assuming adoption of a reasonable price ceiling as recommended above.**

Oppose allowance diversion to Reserve in 2021-2030

Preserving liquidity of available allowances is essential to maintain a stable program. Phillips 66 agrees with CARB's conclusion that the allowance budgets from 2013 through 2030 are binding on expected GHG emissions and that supply of allowances will not exceed demand during the regulatory period. **We support CARB's conclusion to neither cancel unused allowances nor lower the program caps to correct what is only perceived oversupply.** Obligated parties should not be penalized for their actions which may have resulted in early overcompliance.

However, Phillips 66 opposes the allowance set-aside from 2021-2030 cap supply in the existing rule since the future reserve will be adequately stocked with the supply directed by AB 398. Furthermore, it is not necessary to set aside additional allowances for what we consider to be a now-outdated policy adjustment for allowing over 4% offsets in 2026-2030. This serves to penalize the increase in allowable offsets, an important and necessary component of the climate program. Eliminating these set-asides will retain 75 million allowances in the regular auction and further provide liquidity and stability to the program.

If CARB chooses to pursue these additional set-asides, these allowances should be made available earlier rather than later in the future reserve structure.

Recommendation: Eliminate the diversion of 75 million allowances supply from 2021-2030 supply to the future reserve.

Offsets

Phillips 66 supports the continued use of offsets as a necessary component of the climate program and an important cost-containment provision within the Regulation. We also appreciate staff's proposed requirements to describe what constitutes "Direct Environmental Benefits (DEBS) in the State" in §95989, as well as, how to implement DEBs requirements under AB 398. This approach will provide certainty to in-state offset projects and a pathway for out-of-state projects to secure a DEBS determination, if appropriate.

Phillips 66 also supports CARB's larger vision to expand the supply of national and international offsets to encourage greater global offset project development and large-scale natural lands GHG emission reduction and carbon conservation. We are encouraged that CARB is restarting positive conversations and potential rulemaking for tropical forest opportunities.

Industrial Trade Assistance and Cap Adjustment Factors

Phillips 66 supports the CARB proposal of an industrial assistance factor of 1.0 for 2018-2030 recognizing the highly energy-intensive and trade-exposed operations of California refineries.

We support the proposal for a different cap reduction factor for coke calcining recognizing the nature of its process emissions.

Allocation True-Up

Third Compliance Period Industrial Allocation True-Up Correction: Upon approval of extending the second period industry assistance factors to 2018-2020, there will be a need for CARB to make a true-up correction to allocation for calendar years 2018 and 2019. The current regulation already has provisions to accomplish this feat. We appreciate the flexibility already built into the Regulation. Section 95870(e)(1) – Disposition of Vintage 2013-2020 Allowances, Allocation to Industrial Covered Entities – states "The Executive Officer will allocate allowances to each eligible covered entity *by October 24* of each calendar year 2014-2019 for allocations from 2015-2020 annual allowance budgets." {emphasis added} There is nothing in the regulation that prohibits this action earlier in the year. This is a special circumstance that justifies such an early action by CARB.

It is important that CARB provide this one-time early true-up correction for 2018 and 2019 allocation as soon as possible because 1) it provides earlier certainty for planning, 2) it eliminates the need for qualifying statements on Cap-and-Trade program financial obligations in corporate financial statements and 3) it potentially frees up funds for earlier investment in GHG reduction.

Recommendation: Phillips 66 requests that CARB use the flexibility already built into the Regulation and provide the Industrial Allocation Factor correction for 2018 and 2019 vintages by June 1, 2019. We believe this can be done without regulation change and ask that CARB plan on this action and provide corresponding guidance.

Conclusion

Phillips 66 supports AB 398's recognition of the importance of adding cost containment features to the Cap-and-Trade program. CARB must preserve stable allowance pricing throughout the program's extension to 2030, using effective price speedbumps and the price ceiling, to protect California consumers and the State economy from price shocks and unintended consequences, and to provide certainty for low carbon investments. The mandated cost-containment features must be designed with the expectation that speed bumps and ceiling price will be triggered. Additionally, maintaining liquidity of allowances is essential to price stability and the long-term viability of the program.

If you have any questions or need further clarification, please call either myself at 832-765-1770 or Steve Smith at 832-765-1779.

Thank you for your consideration of these critical points.

Sincerely,

John Askounis

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