Western States Petroleum Association
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Catherine H. Reheis-Boyd
President

January 11, 2010

Kevin Kennedy
Assistant Executive Officer
Office of Climate Change
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Subject: WSPA Comments on the Cap and Trade Preliminary Draft Regulation

Dear Mr. Kennedy,

The Western States Petroleum Association (WSPA) is a non-profit trade association representing twenty-eight companies that explore for, produce, refine, transport and market petroleum, petroleum products, natural gas and other energy supplies in California and five other western states.

First we would like to express our disappointment that staff did not grant stakeholders sufficient time to provide comprehensive comments. The Cap and Trade Preliminary Draft Regulation (PDR) was released the day before the Thanksgiving holiday. On December 14, 2009, the California Air Resources Board (CARB) held a workshop to discuss the PDR and to request input and comment on the PDR and on options suggested for some cap and trade design elements.

Considering that two major holiday periods were right in the middle of the comment period, it has been very difficult for stakeholders to develop comprehensive comments. Therefore we recommend that CARB hold the comment period open, so that we can provide more complete comments at a later date.

We have separately submitted comments on accelerating inclusion of fuels under the Cap and Trade Program to 2012, as requested at the CARB workshop. WSPA opposes accelerating fuels into cap and trade to 2012. This letter provides comments on other issues and concerns raised at the December 14, 2009 workshop and by the PDR.

<u>General Comment</u>
WSPA is concerned that the program contemplated by the PDR will have severely limited offsets, have limited working partners in WCI and virtually no linkage to other programs such that credit trading and availability of offsets will practically be impossible.

Further, California industry is already the most energy efficient in the world. WSPA is concerned with industry's ability to cost-effectively achieve emission reductions without leakage of emissions or jobs, or both.

Auction - Transitional Issues

WSPA believes that CARB has limited authority to conduct anything but an auction to cover solely administrative costs. Further, WSPA believes that even if CARB were granted broader authority to conduct a more significant auction through new legislation, CARB would have to transition from a minimal auction to a more significant auction over the life of the program.

A significant auction will require companies and facilities to generate a significant and unknown amount of capital to purchase surrender allowances. Consider, for example, a 100% auction where all facilities in the cap and trade program would be required to participate, assuming a price of $20/ton to $40/ton, facilities would be required to generate approximately $14 to $30 billion in capital. This is a significant capital requirement for facilities within the state. An analysis should be done to assess the potential impacts of significant auctioning on leakage of emissions and jobs. With these and many other questions unanswered, WSPA believes it is imperative that, even if CARB receives legislative authorization for a significant auction, California minimize auctions at the outset of the program and then make a smooth transition to potentially higher auction levels by 2020. This will minimize the disruption on the state's energy/fuel generators and consumers.

By beginning deliberately and with attention to implementation challenges, California will be able to test its market infrastructure and mechanisms, gain better understanding of the impacts of leakage, and better able to quantify the impacts on consumers' exposure. A deliberative process will also reduce the risks on consumers and the regulated industry at the outset of the program when structural challenges first become apparent. A careful process will also allow facilities' operators to better understand the auction, the market, and what they need to do to compete in a global economy, as California moves to become a lower carbon state.

Leakage & Trade Exposure

WSPA believes that leakage and trade exposure are critical issues that must be appropriately addressed for California's program to be environmentally and economically effective. This is particularly important as CARB moves to implement what seems to be a California-only program.

We have serious concerns that there will be no WCI or federal program for the US will be available for linkage, especially in the initial compliance period. That makes evaluation of the leakage (emissions and jobs) potential of a California only program even more critical.

We believe that California's oil industry is Energy Intensive and Trade Exposed (EITE) and should be treated as such in the cap and trade program. We have urged the EAAC to fully evaluate the leakage and trade exposure potential of cap and trade options.

In our letter to EAAC, we attached the recently released report prepared by Ensys for the American Petroleum Institute (Ensys Waxman-Markey Analysis October 2009) that analyzes the key cap and trade design elements of the federal Waxman-Markey (WM) climate change legislation (HR 2454). We have also provided this report to CARB staff.

Under WM, the refining sector would receive a free allocation of only 2.25% allocations that would constitute only 5% of refiners' total emissions obligations. Under WM, Ensys finds that "the impacts on US refining and on US petroleum imports dependency would be substantial." The Ensys analysis also predicts that "throughput reductions at US refineries are largely offset by non-US refinery gains."

In other words, “net global GHG emission reductions would be small” as a result of implementation of the WM bill. The report further concludes that the associated consequences, including US refinery closures and job losses, are potentially substantial.

For the West Coast, Ensys concludes that as early as 2015, implementation of WM could reduce refinery throughput by 200,000 barrels per day and that by 2030 refinery throughput could be cut by as much as 1 million barrels per day.

Clearly, such an impact would have a significant effect on the California refining industry, could reduce transportation fuels supplies and could have a negative impact on California’s economy, including job losses. Increased market volatility is a possible outcome if fuel supplies are insufficient to meet demand.

This potential impact of the allocation design for California’s cap and trade program is even more pronounced because California is already importing a significant amount of its transportation fuel from outside our state.

It seems clear that the refining and oil industry in general is energy intensive and trade exposed in California and that the California allocation scheme is likely to influence significantly the competitiveness of California’s oil industry. To achieve its environmental goals, California needs to design its program to minimize leakage. WSPA believes that in order to do so, the AB 32 program designed by CARB should recognize the fact that the refining and oil industries are EITE.

<u>Offsets</u>

From the earliest days of AB 32 implementation, WSPA has advocated that the most cost-effective approach to achieving the emission reduction goal of the legislation is via a well designed market program (like cap and trade) that includes a robust offsets component that has no geographic or quantitative limits. We are very disappointed that the PDR proposes very limited use of offsets and, counter to the adopted Scoping Plan, is even contemplating limiting those offsets geographically.

WSPA urges CARB to undertake the economic modeling of limiting offset limits (as is required by the adopting resolution) before finalizing rules that severely limit offsets. WSPA further urges that economic modeling should evaluate the potential cost and leakage impacts of limiting offsets to 4%, 20%, 50% and the no offset limit option.

Additionally, the approach contemplated by CARB for development and enforcement of offset protocols is bureaucratically intensive with potential for CARB to become a severe bottleneck in the offset generation process. Under the proposed program, WSPA believes it is highly likely that very few, if any, authorized/approved offsets will be available for the first compliance period 2012 to 2015 and possibly even over the 2020 timeframe. If CARB’s cap and trade program is to truly be cost-effective, CARB must find a way to authorize or approve significant, worldwide offsets with minimal bureaucratic hurdles.

Real, permanent, quantifiable, verifiable and additional offsets that are recognized by other emissions trading systems (like the EU ETS) must be automatically authorized or approved for use in California. Additionally, other offsets like those managed by the Climate Registry must be similarly authorized and approved for use in California.

<u>Linkage</u>

One way to address the increase the of available offsets is via linkage to other programs. Unfortunately, the linkage criteria contemplated in the PDR is written in a manner that would allow linkage to only programs that are virtually identical to California's. WSPA believes linkage to other programs (even to the WCI) will be practically impossible. CARB must streamline the linkage criteria to allow California's program access to credits and offsets in other programs worldwide.

One of the goals for AB 32 is for California to be a model for the world. That can only happen if California is able to link with other programs. WSPA believes that it would be very valuable for CARB to provide to stakeholders a list of those programs that CARB believes will be viable linking partners in 2012 when the California program commences operation.

Compliance Period

WSPA supports the 3-year compliance periods as recommended in the Scoping Plan.

Enabling Tools, Policies, Infrastructure , etc for Compliance

For regulated entities to comply with the PDR, CARB must develop tools, guidance, organization, and infrastructure, etc. such as:

- A registration process, organization and tracking system to handle the registration, fee collection system for registration, etc.;
- Carbon accounting methodology for different types of fuels;
- Emissions surrender obligation process, organization and tracking system;
- Offset protocol approval system; and,
- Streamlined permitting process.

WSPA urges CARB to develop a work plan with completion dates, of all necessary tools, policies, infrastructure, etc that CARB must have in place in order for regulated entities to comply with the PDR. Businesses do not want to be in a position where we have a compliance responsibility, with no guidance or tools to comply. CARB needs to have these tools in place before compliance mandates are triggered.

Monitoring of Economic Indicators

Throughout the AB 32 implementation process we have urged CARB to identify and monitor key economic indicators. These include energy adequacy and affordability, to ensure that any adverse impacts can be identified quickly and corrective action taken in a timely manner.

Key indicators could include data on employment in manufacturing, auto sales, rental vacancy rates, energy adequacy and affordability, and other data in tables of California Economic Indicators provided by the California Department of Finance and contained in the IPER and other data bases provided by the California Energy Commission. We urge that the regulation include provisions for the monitoring and analysis of the indicators on a routine and timely basis.

Surrender Obligation for Fuel Deliverers

WSPA recommends that the methodology for calculating surrender obligations for fuel delivers should be designed to ensure a level playing field for all fuels. To prevent picking winners and losers, manufacturers of petroleum fuel should not be uniquely obligated to a more stringent surrender obligation calculation methodology than any other fuel.

Allowances to Entities Without Compliance Obligation

The PDR contemplates giving free allowances to a number of stakeholders outside of facilities and entities with surrender obligation. CARB should not provide free allowances without a surrender obligation.

Set Asides for Voluntary Actions for Renewable Electricity
CARB is considering cap adjustments (set asides) as cap and trade design measures to encourage voluntary actions for renewable electricity. WSPA does not support design measures that provide incentives for one type of action at the expense of the overall allowance budgets in the cap and trade program.

However, WSPA has long supported that Voluntary Early Actions that meet recognized criteria (e.g. real, permanent, quantifiable, verifiable and additional) should be recognized in the form of offsets. Offset credits should not have an expiration date and should be able to be useable unless retired or used for compliance.

Cost Containment Principles
WSPA does not support the use of "political" price collars and ceilings or auction reserve mechanisms to "control" costs. WSPA does not believe that those mechanisms provide the transparency and market efficiency that make the market effective. Those features in California's market would only serve to make CARB the driver (controller) of market price.

CARB must not pick winners and losers. WSPA opposes price collars and other price/supply controls in the hands of CARB staff. As we have stated above, and as we have said many times before, a robust offsets program along with viable linkage to other programs is the best way to achieve the AB 32 emission reduction goals in the most cost-effective manner.

Carbon Capture and Storage (CCS)
CCS is one of the important technology options for GHG reductions. The definition of greenhouse gas sequestration should be amended to clarify that it includes geologic sequestration as follows:

> (70) "Greenhouse gas sequestration" or "GHG sequestration" means, in the context of offset credits, the process through which agricultural and forestry practices **and geologic process**, remove carbon dioxide from the atmosphere. In general terms, GHG sequestration also means the fixation of carbon in a carbon sink through biological, **geologic,** or **other** physical processes.

Compliance Pathway Analysis
WSPA is concerned that the program contemplated by the PDR will have severely limited offsets, limited working partners in the WCI and virtually no linkage to other programs such that credit trading and availability of offset will practically be impossible. This limitation is even more problematic because California industry is already the most energy efficient in the world.

In addition, WSPA is seriously concerned with industry's ability to achieve cost-effective emission reductions without leakage of emissions or jobs, or both. We understand that EAAC will look into the compliance pathway issue. We urge CARB to utilize the EAAC work on compliance pathway analysis to identify potential emission reductions to cost-effectively achieve the AB 32 goal.

Thank you for considering our comments. As we have indicated above, please consider these comments as first draft comments.

We hope that you will accept further comments as we are able to develop them in the next few weeks. If you have any questions, please contact me at the number or e-mail address shown on the letterhead.

Sincerely,

cc: Linda Adams, CALEPA
Cindy Tuck, CALEPA
Dan Pellissier, CALEPA
CARB Board Members
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