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COMMENTS OF CALIFORNIA INDEPENDENT PETROLEUM ASSOCIATION ON PROPOSED RULEMAKING TO CONSIDER ADOPTION OF AB 32 COST OF IMPLEMENTATION FEE REGULATION

In accordance with the Notice of Public Hearing to Consider Adoption of a Proposed AB 32 Cost of Implementation Fee Regulation and the Proposed Amendment to the Existing Regulation for the Mandatory Reporting of GHG Emissions, as noticed by the California Air Resources Board (CARB) on May 8, 2009, the California Independent Petroleum Association (CIPA) hereby respectfully submits their comments. CIPA appreciates the opportunity to provide comments on the proposed fee regulation.

Introduction and Background

CIPA is a non-profit, non-partisan trade association representing approximately 400 independent crude oil and natural gas producers, royalty owners and service and supply companies operating in California. CIPA's oil and gas producing members are generally small to medium size companies who do not refine, market or sell crude, natural gas or related products on the open market. Simply, our members extract oil and natural gas.

The California Global Warming Solutions Act of 2006, Assembly Bill 32 (Nuñez, Chapter 488, Statutes of 2006) requires California to reduce its greenhouse gas emissions to 1990 levels by 2020. On December 11, 2008, CARB approved a Scoping Plan, which is California's plan for meeting the greenhouse gas emissions reductions required by AB 32.

The administration, implementation and enforcement of the Scoping Plan's measures, because the nature and scope of the measure represent an exponential expansion of state government generally and CARB specifically, and the enabling statute was not a tax levy, necessarily require a source of fiscal funding separate from the state's general fund.

AB 32 authorizes CARB to adopt a schedule of fees to be paid by sources of greenhouse gas emissions to support the costs of carrying out AB 32. The AB 32 Cost of

Implementation Fee is included in the Scoping Plan, and the fee is authorized in Health and Safety Code Section 38597, which states:

"The state board may adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001. The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and are available upon appropriation, by the Legislature, for purposes of carrying out this division."

Using this section as the basis for its authority, CARB proposes to establish a fee schedule to support CARB's implementation of AB 32. On May 8, 2009, CARB noticed a Proposed Regulatory Order which contemplates the adoption of the AB 32 Cost of Implementation fee regulation. Generally, the revenues from the assessed fees would be used to pay the ongoing AB 32 program costs incurred by CARB and other state agencies, beginning in the 2009-2010 fiscal year, currently estimated at approximately $36.2 million per year.

Comments

CIPA has met with CARB staff on several occasions to discuss the Fee Regulation. Staff was professional, accessible and excellent to work with. CIPA realizes the difficult job of putting this regulation together and appreciate staff's efforts. While we hold the staff in high esteem, we were not able to reach consensus on all of our issues.

1. Lack of Authority of Enabling Statute.

In the instant proceeding, we are faced with a GHG fee imposed to recover CARB's ostensibly reasonable costs of administering, implementing and enforcing California's AB 32 regime. CIPA opposes the implementation of a tax in the name of a fee. The California Constitution delineates the requirements for the passage of a tax levy at Article 13, and Assembly Bill 32 did not meet the legislative hurdle for the establishment of a tax. Moreover, that this fee is being developed to apply retroactively collides again with the state constitution.

While these seminal questions are of great interest and import to the members of CIPA, we understand that the issues are for a different jurisdiction. Nevertheless, in order to fully express CIPA's response to the rulemaking before us we are compelled to make note here of what we believe to be issues of great weight.

Since climate change policy was enacted by the California Legislature as a perceived public policy goal of the state, it should be conducted and paid for as a general government measure, paid for from the state's general fund- transparent and accountable to all Californians.

However, what has become common knowledge in perennial state budget disputes over taxes and fees is the judicial carve-out wherein the Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* that case law clearly indicates that the police power is broad enough to include mandatory remedial measures to mitigate the past, present, or future adverse impact of the fee payer's operations, at least where the measure requires a causal connection or nexus between the product and its adverse effects.

AB 32 requires that "the sources of greenhouse gases" regulated under AB 32 are the entities that will pay the fee. However, the proposed regulation would apply to a portion of the state's greenhouse gas emissions, unfairly burdening industries associated with these emissions. And insofar as some fee payers are not the sources of the emissions, we believe the AB 32 fee scheme fails the *Sinclair Paint* causal connection requirement.

2. Inability of Regulated Parties to Fully Understand Appropriateness of Fees.
In this rulemaking CARB proposes to establish a fee schedule to support implementation of AB 32 by CARB and other state agencies. Funds collected would be deposited in the Air Pollution Control Fund and would be available upon appropriation by the Legislature.

In the Initial Statement of Reasons (ISOR), CARB tells us that because greenhouse gas emissions and their subsequent impacts on global warming affect all Californians, staff has developed the Fee so that state government costs to implement the AB 32 program are streamlined and these costs are equitably distributed among a broad range of greenhouse gas sources. We are told further that this approach will also minimize the burden the Fee may place on individual entities or sectors of the economy.

The ISOR points out that this proposed regulation was developed through an extensive public process involving a broad range of stakeholders. While this is true, there were several workshops and it was our experience that staff met with parties upon request in open dialogue regarding the impact on affected parties, what was missing from the process was transparency relative to the establishment of the revenue requirement.

For example, we understand that the fee will be established based upon a series of equations. Essentially, for CIPA members it is the amount of combustion emissions from associated gas use in oil production or the amount of on-site produced/consumed gas by gas producers times an emission factor.

The equation for the Common Carbon Cost[1] is the Total Revenue Requirement divided by the component emissions times their respective emissions factors. The equation is below.

$$CCC = \frac{TRR}{(Qng \times EFng) + (Qg \times EFg) + (Qd \times EFd) + (Qc \times EFc) + (Qie \times EFie) + TEi}$$

What is missing is the data to support the equation's variable- TRR. Parties have had to litigate under the Public Records Act to get data relative to the establishment of the amount of money needed to be collected, the underlying data supporting the relevant state activities and the analysis undertaken to reconcile what was and will continue to be spent with what is proposed to be collected. In fact, after an initial approximately 3200 pages, CARB has just last Friday released another 5,000 pages.

Developing a position on the Fee Regulation before us is impossible until we understand how the revenue requirement was established. Once we understand this, we can then do

[1] The Executive Officer shall calculate a Common Carbon Cost (CCC), which represents the cost per MTCO2E emitted by the applicable greenhouse gas emission sources to recover administrative costs to implement AB 32. §95203(b)

the appropriate analyses to determine causal connection, equity, cost-effectiveness and a host of other benchmarks for determining the legality, equity and cost benefit required of all regulations under the Administrative Procedures Act.

With a mountain of data released a week before the hearing and an as yet undetermined amount of data that remains undisclosed we cannot answer a number of threshold questions. The first order questions regarding the recently released data and that data which could be expected to still come are:

1. Is the material provided all of the records we should expect CARB to have in its possession?
2. Do the records provided fully explain how CARB calculated the figures that appear in Appendix C of the Initial Statement of Reasons for the fee regulation?
3. Do the records provided explain to which of the five program elements (inventory and reporting, scoping plan, regulations, science and analysis, administration and support) and to which of the various actual GHG reduction measures the expenses are properly allocable?

Until we fully understand how the revenue requirement was established and that it comports with the enabling statute, we cannot perform the necessary analyses to establish the appropriateness and equity of the fee. The reluctance of CARB to include the revenue requirement development in what was otherwise an open public process vis-à-vis the fee's levy gives us pause.

CIPA would respectfully request that this rulemaking be delayed until all data releases from CARB are complete and that the affected parties have adequate time to substantiate the revenue requirement. Transparency and good government demand no less than a careful consideration of these current deficiencies.

3. AB 32 Fees Practical Impact for Oil Producers Consuming Produced Natural Gas

We understand from workshops and the ISOR that CARB views this effort as an upstream, broad-based, economy-wide approach that is predictable, simple to administer and based upon existing data. The fee would apply to four fuels: gasoline, diesel, coal and natural gas. The fee would also apply to process emissions from refineries and cement manufacturers.

The fee would be paid by: refineries, natural gas utilities and/or ***select users*** of natural gas, facilities that burn coal, cement manufacturers and gasoline and diesel importers. Specifically, at proposed §95201[2] Applicability, subsection (a)(1) Natural Gas Utilities, ***Users*** and Pipeline Owners and Operators, parts (C) and (D) read:

> (C) All California owners or operators of natural gas extraction operations that consume natural gas produced on-site and that are subject to Mandatory Reporting Regulation. Fees shall be paid for each therm of natural gas consumed of the natural gas produced on-site.
>
> (D) All California owners or operators of oil production operations that consume associated gas that is produced onsite and that are subject to the Mandatory Reporting Regulation. Fees shall be paid on the reported quantities of emissions resulting from the combustion of these fuels.

A design principle for this regulation has been to assess the fee "upstream" whenever possible in order to minimize the number of entities subject to the fee and reduce the complexity and the administrative burden of the regulation. For the purposes of this regulation, "upstream" is the point in California's economy where fuel delivery or production is intended for eventual delivery to consumers.

To that end, the design of the fee appears to CIPA to hinge on the ability of those subject to the fee to recover the costs of the fee in the sales price of their product. CARB staff assert throughout the Proposed Regulation that regulated parties should be able to pass on the cost of the fee to downstream consumers. In fact, CIPA members subject to this fee certainly will not be able to pass on these costs.

CIPA members cannot pass along the cost to the consumer because they are price takers not price setters. They operate in a world market where they compete with crude from all over the world. Because there is not an ability to price the cost of this fee into the product when it goes to market, the practice of burning produced gas at the production site will be curtailed and the gas will be flared. And, with a reduction in electricity

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[2] The measure will add new Article 3, §95200-95207 to Title 17, California Code of Regulation.

production using produced gas, there will be increased demand for conventional utility electricity demand from formerly distributed resources.

The application of the fee to operators who burn produced gas cannot be passed on in the form of market pricing, will lead to the inefficient practice of flaring instead of the sustainable practice of distributed generation and will lead to increased demand for conventional electricity. As such the fee, as designed, clearly neither meets the requirement of the legislation, nor the stated intent of the fee design.

Moreover, with respect to the application of the Fee to natural gas in general, we note that in the Scoping Plan, CARB lists recommended greenhouse gas reduction measures for both capped and uncapped sectors[3]. The cap and trade measure adopted by the Board is essentially a "hybrid" design, where electric generating facilities and large industrial sources are covered at the "*point of emission*".

With respect to natural gas, small industrial combustion and the residential commercial sectors are covered "where the fuel enters into commerce". This is widely considered to be at the Local Distribution Company (LDC) level as noted in the Western Climate Initiative's (WCI) design recommendations released on September 23, 2008.

In its recent Interim Decision[4], the CPUC found that the natural gas sector has already employed technologies to mitigate and reduce emissions. The CPUC accordingly proposed to exclude the natural gas sector from the AB 32 cap-and-trade regulation at this time.

CIPA respectfully submits that if a fee is to be established, notwithstanding our objections noted above, CARB should redesign its fee proposal to ensure that any fees designed to recover the costs of administering, implementing and enforcing AB 32 be

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[3] *See* "Climate Change Proposed Scoping Plan", Table 2: Recommended Greenhouse Gas Reduction Measures, issued October 2008.

[4] *See* "Interim Opinion On Greenhouse Gas Regulatory Strategies" issued on October 16, 2008 in Docket No. 06-04-009.

levied in a manner consistent with CARB's Scoping Plan, the CPUC's Interim Decision, the WCI's design recommendations, and the statute itself.

4. The Potential Impact of a Reduction of the Mandatory Reporting Threshold. Because the AB 32 program is still under development there are many more questions raised by this rulemaking than answered and these unanswered questions lead to regulatory uncertainty. Regulatory uncertainty always translates into greater risk in the marketplace.

As the program continues to mature, staff informs us that they intend to periodically re-evaluate the sources covered by this fee to determine whether the additional sources of greenhouse gas emissions should also be included in the Fee regulation. Staff says they will also continue to evaluate how the state's AB 32 program can best be funded. For example, they note that if a cap-and-trade program were adopted that generated revenue and covered a sufficiently broad range of the state's greenhouse gas emissions, it would be appropriate to evaluate funding the State's implementation of AB 32 from that revenue instead of this fee. This is indeed good news. We would oppose, on its face, a multi-level fee scheme, wherein parties are charged multiple times for the same product or use of that product.

But one area in particular in which change is being contemplated that would have significant impact on this Fee rulemaking is very concerning. When we complained to staff about early changes to the draft Fee Regulation that swept up the emissions from natural gas burned on site at production facilities for the reasons articulated above, we were told that it would only impact those who are mandatory reporters under Title 17, California Code of Regulations. In other words, the fee would only be paid by those who emit >25,000 tons and must already report those emissions, so that there would not be additional record keeping and reporting, just the addition of the fee.

However, at a June 5, 2009, workshop on Cap and Trade Reporting, the staff presentation discussed the movement from >25,000 tons emissions as the threshold for mandatory reporting and participation in the cap to >10,000 tons, ostensibly to conform to the latest Western Climate Initiative design.

CIPA is opposed to a lowering of the threshold on its face, and object to tying participation in the Fee to a threshold that CARB is already planning to lower in the very near future. We believe that the Fee regulation should be amended to specifically reference a 25,000 ton emission threshold as a trigger for those required to pay the fee under §95201(c) and (d).

Thank you for the opportunity to comment on this important matter. Understanding that AB 32 is California law, CIPA continues to be open to working with staff to make for the best possible, least intrusive regulatory process that can be achieved. If you need any assistance or have any questions, please don't hesitate to contact me.

Sincerely,

/s/

Blair Knox
Director of Public Affairs