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Executive Vice-President and Chief Operating Officer

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Via Web Submittal: http://www.arb.ca.gov/lispub/comm2/bcsubform.php?listname=july-27-linkage-ws&comm_period=1

Ms. Lucille Van Ommering
California Air Resources Board
1001 I Street,
Sacramento, CA 95814

RE: Linkage of CARB Program to other local, regional, and National programs

Dear Ms. Van Ommering:

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 products in California and five other western states.

WSPA member companies own and operate facilities that include oil and natural gas production properties, refineries, marketing terminals, pipelines and retail gasoline outlets. The companies produce fuels and other products that will all be impacted by the implementation of AB 32.

As we have previously indicated, it is critically important that the California Air Resources Board (CARB) clearly describe how the AB 32 program will interact with future programs. This includes federal and other programs such as international carbon markets, other regional efforts or state programs.

We offer the following comments on the overall issues affecting linkage and then provide responses to the questions raised by CARB in the agency's presentation.

Linkage with a Federal Greenhouse Gas (GHG) program

WSPA strongly believes that should a federal GHG control system established, then the California AB 32 program should be replaced with this federal program. This approach is far superior to attempting to link a California program to a broader federal program.

WSPA agrees with comments that have been made by Dr. Stavins that "a federal system – absent the complications of overlapping state systems – represents the most cost-effective, environmentally

effective, and simplest approach to achieving economy-wide reductions in GHG emissions.”¹ This argument applies to both the Cap and Trade (C&T) system that California is designing as well as the complimentary standards contained in AB 32.

Risks of parallel Federal and State GHG Programs

Should California choose to continue its AB 32 program in parallel with a federal system, we agree with Dr. Stavins’ comments that noted “Emission reductions achieved in California due to more stringent state regulations would be offset by increases in emissions in other regions. As a result, these state policies would result in few (or no) additional emission reductions, while imposing additional costs by limiting the market’s flexibility to achieve emission reductions in the least costly way possible.”

Dr. Stavins also noted, “A complementary state policy that imposed overlapping requirements to those mandated by a federal policy also creates few (or no) incremental emission reductions, but may impose additional costs.” The end result of a more stringent California program run in parallel with a federal program will be a policy that would “adversely impact California’s economy, help the economies of other states, and provide no additional GHG emission reductions.”

Design of California Program and Linkage

In the absence of a federal approach, WSPA appreciates the care and overall intent of CARB staff to consider seriously the best circumstances and economic requirements to link its program to others. WSPA agrees with CARB that there are many considerations that must be examined when linking programs and the agency has properly identified some of the challenges involved in this endeavor.

The level of similarity between the programs that are to be linked will have a large impact on the economic benefits of that linkage and will, as well, impact the risks of emissions and economic leakage.

Overall, properly designed, linkage can enhance cost effectiveness by providing a broader system with more opportunities for GHG reduction.

A properly designed offset program can enhance cost-effectiveness and provide indirect linkages to other systems. WSPA continues to support the use of a well designed offset system which does not contain geographic or quantity limits.

We agree with Dr. Stavins’ analysis that “Although restrictions on offset use are often proposed as a solution to concerns about offset quality, geographic and quantity restrictions would do little to address quality.”

In this context, Stavins asserts that CARB’s current quantitative restriction on offsets “would impose a limit on offset use that may raise both the costs of achieving AB 32 GHG targets and allowance prices in California.” An unreasonably high cost of offsets in California would inhibit efforts to reduce GHG

¹ *Evolving GHG Trading Systems Outside Its Borders: How should California Respond?*; Robert Stavins, Harvard University; Johnathon Borck and Todd Schatzki, Analysis Group, Inc.. July, 2009

emissions within the State and create a negative incentive for a country with a more reasonable cost approach to link with California's offset program.

This is yet another reason for a serious review of cost containment measures and consideration of applying the 49% limit to the broadest possible market.

Direct linkage if done properly can offer significant cost savings by reducing the aggregate costs of achieving GHG targets. However, WSPA agrees with Dr. Stavins that, "while providing many economic benefits, linkages potentially create distributional impacts that are difficult to mitigate fully."

Implications of Linkage and Reciprocity

The CARB workshop highlighted key issues that influence the linkage of multi-jurisdictional GHG programs. WSPA notes that linkage recognizes the compliance instruments (e.g., allowances, offsets, and/or any other credits) from other programs to meet compliance obligations in California's cap-and-trade program.

Linkage also highlights the concept of reciprocity which links compliance instruments from California's cap-and-trade program to meet compliance obligations in other GHG trading programs.

We caution against CARB setting the criteria for linkage – either directly or through offset programs – too stringently or making them too complex. Doing so could limit linkage opportunities with potentially acceptable programs, thereby diminishing the overall benefits of linkage.

While CARB has taken the initiative in setting regulatory or policy precedents, the agency must recognize its limitations in addressing what is acknowledged as a global issue. We note, for example, the curious statement by Staff at the workshop, of the need to "protect the State from emission reductions outside the state."

Notwithstanding the AB 32 emission reduction targets, control of GHG emissions is a global challenge that needs to be addressed in that manner. Legitimate GHG emission reductions, including those that might be used as offsets, should be encouraged.

Unreasonably stringent programs in California will result in a lack of reciprocity that will inhibit, rather than enhance, the welfare of Californians. In fact, extraordinarily stringent standards will reduce, rather than enhance, the very emission reductions the State is hoping to encourage.

In response to the request from CARB, we offer the following comments on slides 37 and 38 which discuss the possible requirements for linking.

Bullet 1- Require linking only to programs that have similar reporting requirements and methods to ensure that a ton is a ton across programs.

WSPA agrees that it is critical, when linking programs, to ensure that the programs being linked have well define and largely similar GHG protocols for the measurement, calculation and estimation of

emissions. Similar provisions also are needed to address the global warming potentials for the various GHGs to ensure that a ton of CO2 equivalent is a ton of CO2 equivalent (i.e., “a ton is a ton”).

However, when addressing other issues that do not have a material impact on the legitimacy of GHG emissions, such as reporting frequency, CARB should allow great flexibility.

Bullet 2 - Require linking only to programs where there is agreement with current and future caps – i.e. stringency.

WSPA agrees that similar stringency with regard to current and future program goals is beneficial to effective linking between programs. More important though is a good understanding about the stringency of the programs that are being linked.

This will allow the linkage to be initiated with all stakeholders having a clear knowledge of how the programs that are being linked compare. However, WSPA does not believe that a contract or Memorandum of Understanding (MOU) or other agreement is necessary to ensure this similarity in stringency.

WSPA would like to understand more clearly what CARB means by “agreement on current and future emission caps” and more importantly, how CARB would define similar stringency in general. There are many very different ways to define stringency (e.g., the cost of allowances, % reduction targets over time vs. a base level, GHG emissions per capita, cost of GHG emission reduction as a % of GDP, etc), all of which may result in very different program requirements if the goal is to link programs with similar stringencies.

Emission goals may be very dynamic and change over time. It is important that linked systems have the ability to revisit their goals and the impact of these goals on effective linkage.

Bullet 3 - Require linking only to programs in which there is a process for making future changes to linked programs.

WSPA does not agree a need exists for agreement on a process for making changes to already linked programs. If criteria are created for the initial linkage and changes are made that violate the criteria, then the linkage should be re-evaluated. There are many ways for changes to occur, some of which may be very minute and others that may be significant, such as inclusion of an additional jurisdiction to a linkage agreement.

It is impossible to anticipate all possible changes and develop criteria that could respond to all scenarios. It also seems unlikely, and unwise, that an independent nation would agree to limit their changes by prior agreement. Depending on the impacts and implications of changes, WSPA recommends that programs linked to California’s efforts be periodically reevaluated by the Executive Officer or the Board.

Additionally, we believe it is critical that any re-evaluations provide certainty for holders of existing offsets and allow continued acceptance of these credits within the California program. It is important to develop and promulgate compliance procedures that separate the consequences of commercial transactions undertaken in good faith from those that may deal with noncompliance by nations or other jurisdictions with their international or domestic obligations.

In other words, valid exchanges between market participants in different jurisdictions should not be undone as a consequence of noncompliance by a nation or other jurisdiction.² This could have the impact of undoing a valid commercial transaction, undertaken in good faith by two firms.

We believe these issues require careful consideration. The key issues for commercial actors regarding exchange of allowances will be cost and credibility – all other measures of stringency will be secondary.

Bullet 4 - Require linking only to programs where there are similar cost containment provisions – e.g. safety valve, borrowing, offsets.

While it seems realistic to expect similar cost containment provisions might be needed to maintain program consistency, WSPA is concerned that not all cost containment provisions have the same potential impacts on the market. Issues such as price minima or maxima or cost off-ramps need to be evaluated for inclusion in the program and with respect to impact on linkage.

These issues should be reviewed and evaluated by the Board and/or the Executive Officer as noted earlier.

Bullet 5 - Require linking only to programs that use electronic registries or a common registry.

WSPA agrees that it is important that the programs have the ability to directly communicate transfers and to ensure that credits are transferred (or exchanged). Careful record-keeping of transactions will ensure that emission reductions are not double-counted.

Bullet 6 - Require linking only to programs that have similar capability and effectiveness in enforcing program requirements.

WSPA is concerned about CARB's proposed concept requiring similar capability and effectiveness in enforcement because it seems both infeasible and unreasonable for CARB to judge another country or region's enforcement capability. WSPA believes it would be preferable to select objective criteria as a basis for determining enforcement equivalency.³

Bullet 7 – Require linking only to programs under an agreement that covers monitoring and enforcement procedures.

WSPA believes that contracts or MOUs have their own enforcement problems. For example, how would CARB enforce such a contract? How would an MOU be enforceable outside California?

It should be clearly preferable to identify criteria that address the principle stated in bullet 1, that a ton is a ton, and to link to programs with both the methodology and the framework to ensure that the reductions are real, quantifiable, verifiable and permanent.

² For example in the Kyoto debate, there are consequences for nations that fail their obligations. One is prohibition in participation in emissions trading, Clean Development Mechanism (CDM) and Joint Implementation (JI).

³ For example, CARB could define criteria for specific mechanisms that promote disincentives for falsification of data or misrepresentation of emissions.

Bullet 8 – Limit linking to programs with similar methods of allocating allowances and similar program scope.

We agree that there are many issues such as similar allowance allocation schemes and sectors covered that are important in determining whether two systems can be effectively linked. However, WSPA is not sure that these are essential for linkage of GHG programs. Instead, WSPA urges that only requirements that are truly essential be adopted to avoid an overly restrictive process.

WSPA acknowledges CARB for the careful thought that went into the presentation on linkage. We also appreciate that CARB recognizes (as we do) the importance of linking the California market to others to provide a broader market, better market liquidity and to encourage emission reductions in the lowest cost manner.

We look forward to continuing our dialogue with you on this issue. If you have any questions, please contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Cathy A. Boyd".

cc: Kevin Kennedy, California Air Resources Board

Attachment: *Evolving GHG Trading Systems Outside Its Borders: How should California Respond?*; Robert Stavins, Harvard University; Johnathon Borck and Todd Schatzki, Analysis Group, Inc.. July, 2009