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President

August 11, 2011

Electronic Submittal: <http://www.arb.ca.gov/lispub/comm/bclist.php>

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

Re: Cap and Trade Program Regulation (July 25, 2011 Proposed 15 Day Modifications)

Dear Clerk of the Board:

The Western States Petroleum Association (WSPA) is a trade group representing twenty-seven companies that explore for, develop, refine, market, and transport petroleum and petroleum products and natural gas in California, Arizona, Nevada, Hawaii, Oregon and Washington. Most of our companies have operations within California and are significantly affected by regulations proposed by ARB.

Because of the substantial impact on WSPA members, the economy, and likely potential impact on energy supplies, WSPA has been an active participant in the public policy discussions about the implementation of AB 32. We have previously commented on issues affecting the Cap and Trade program and benchmarking regulations to ARB (December 15, 2010). In addition, WSPA has made comments on many aspects of AB 32 implementation addressing key aspects such as leakage, trade exposure, cost containment, linkage, offsets, and most recently on the Supplement to the AB 32 Functionally Equivalent Document (SFED) and on Mandatory Reporting (MRR).

#### Support for Market-based Approach

WSPA supports a market-based approach to the implementation of AB 32. We continue to believe that a well designed market based approach will be the most effective means to meet the Greenhouse Gas (GHG) reductions mandated by AB32. ARB has made progress in its efforts to develop its cap-and-trade program and we appreciate the positive amendments made in the July 25, 2011 Proposed 15 Day Modifications. WSPA reiterates its support for the Cap and Trade program and a market-based approach to implementing AB 32.

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However, based on the Discussion Draft and ARB's recently released 15-day package, a number of serious concerns remain. These concerns need to be addressed to make this a workable program. WSPA recommends the following to address these issues:

- Abandon the simple barrel methodology as inappropriate for the State. Instead, an EII-based benchmarking methodology is recommended as we work toward a complex-weighted barrel methodology
- 10% Reduction in Initial Allocations is inappropriate and should be abandoned
- Re-evaluation of trade exposure and leakage risk to refineries
- Review environmental and economic implications before including fuels under the cap
- Revise certain identified definitions and requirements in the proposed Cap and Trade program
- Add a provision to monitor indicators for 1) market operation and 2) economic health
- Develop a schedule for tools, guidance and infrastructure development

Several important issues are addressed below and detailed in a number of attachments. WSPA is committed to working with ARB to resolve these issues in order to develop an effective cap and trade program.

### Benchmarking

WSPA's understanding of the primary objectives for allocating free allowances to trade exposed sectors are 1) to minimize leakage and 2) to provide transition assistance. The selection of the benchmark methodology can have significant impact on whether the program successfully works to support these objectives or, instead, frustrates progress toward a workable system to implement AB 32.

WSPA supports the use of a well-designed benchmarking method that results in an equitable distribution of allocations. We agree with the ARB's statement in Appendix B of the proposed regulation that "benchmarks are metrics that enable the comparison of GHG performance across similar industrial facilities" and that benchmarks can be used as a basis for allocation in a market-based system such as cap and trade. Characteristics of a well designed benchmark include:

- Accurate and reliable reflection of a facility's energy (and carbon) efficiency
- Direct relationship to GHG emissions
- Appropriate application to affected comparable facilities
- Clarity and transparency in calculating methodology
- Consistent with the objective of minimizing leakage and providing assistance during a transition period
- Equitable treatment of facilities irrespective of location (i.e., on-site or off-site)
- Does not award windfalls

Using these criteria, it is clear that changes proposed in the July 25, 2011 version of the Cap and Trade Regulation for both the refining sector and the oil and gas production sectors need to be revisited.

**Recommendation:** WSPA recommends that ARB incorporate the GHG emissions from net power and heat used to produce the product into any product based benchmarks for upstream and refining and for all sectors.

Upstream Benchmarking. With respect to oil and gas (“upstream petroleum and natural gas operations”) a benchmark that differentiates between operations that produce “light” and “heavy” crude oil has serious concerns.

As presented, the proposed API gravity-based approach, does not consider EOR production processes, imposes an arbitrary immediate 10% penalty and fails to consider electricity consumption<sup>1</sup>. If enacted it will, (i) significantly and adversely affect California producers relative to out-of-state oil producers, thus violating the intent to protect against “leakage,” (ii) create wide disparity in free allowance allocations among in-state producers, and (iii) potentially disadvantage future light crude oil production growth in the state.

WSPA provides a detailed analysis of these issues in Attachment A and we invite follow-up discussions in the near future.

**Recommendation:** WSPA recommends that ARB return to their initial approach that proposed different benchmarks for thermal and non-thermal operations.

Downstream Benchmarking. For Downstream (refining and related operations), again with respect to the criteria identified above, WSPA believes that the simple barrel methodology clearly works against ARB’s objectives to minimize leakage and a smooth start to the program. It is clear that the simple barrel method is simply inadequate and not a suitable benchmark for use in California because it:

- does not consider all the various products produced by a refinery
- applies a one-size fits all methodology for non-comparable sources
- fails to distinguish between facilities that produce their own on-site generated and consumed products such hydrogen, power, steam, flexigas or fuel gas
- rewards a facility based on the number and type of equipment it operates rather than the efficiency with which it operates that equipment
- does not reflect nor reward early actions to reduce energy consumption or improve operational efficiency

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<sup>1</sup> It is noteworthy that the above issues related to the heavy/light approach were considered in the development of thermal/non-thermal approach for the ISOR. Further, the data utilized for the development of the oil & gas production was developed for a thermal/non-thermal protocol. Thus, the thermal/non-thermal approach was vetted by key stakeholders in advance of its use in calculating oil & gas production benchmarks.

- is neither accurate nor representative of industry operations nor reflective of either energy or carbon conservation

In summary, use of the simple barrel method could lead to an inequitable distribution of allowances and disruption in the allowance trading market.

In view of the shortcomings of the Simple Barrel Method and the strengths of the EII method, ARB should adopt the Adjusted EII methodology for refineries in the first compliance period as we work toward a complex-weighted barrel methodology.

**Recommendation:** WSPA recommends that ARB use an Adjusted EII benchmark for refineries within the State. Attachment B provides substantiating comments.

Incorporate Indirect Emissions into Benchmarks. The GHG emissions that are incorporated into any product-based benchmarks for all sectors should include the emissions for the net power and heat used to produce the product. In order to ensure that there is even treatment of operators with cogeneration facilities compared to net purchasers of electricity and heat, indirect emissions from imported power and heat should also be included in the benchmark calculation.

WSPA provides a detailed analysis of these issues in Attachment (A) following our discussion of upstream benchmarking and we invite follow-up discussions in the near future.

#### 10% Reduction in Initial Allocations [aka “haircut”]

The petroleum industry is both an energy intensive and trade exposed industry and therefore should be eligible for 100% allowance assistance per section 95870. This fact makes it clear that benchmarking should be per the adjusted EII methodology. However, in Appendix B – product output based benchmarking, ARB proposes a 90% benchmark stringency, in essence a 10% haircut from the cap and trade program.

ARB has justified this 10% haircut in a number of ways, including the need to fund reserve allowances so as to fund program needs. WSPA does not agree with the stringency concepts for the 10% haircut, but understands the concept of holding back some allowance to fund various accounts when the Cap and Trade program is initiated. We are concerned however, that the initial 10% reduction in initial allocations<sup>2</sup> implicit in ARB’s proposal is excessive, unsubstantiated by need, and in fact may cause irreparable harm at the start of the program when it may be most vulnerable.

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<sup>2</sup> The 10% reduction in allocations results from ARB’s proposal to peg the benchmark at 90% of the “average” operator. In other words, ARB’s choice of a benchmark that is 10% more stringent (i.e. 10% lower energy intensity) than the average performer reduces initial allocations by 10%.

The 10% haircut is excessive when one considers the provisions within Section 95870 (Disposition of Allowance). We note that the proposed Section specifies that 1% of the first compliance period allowance budget is to be set aside for the Reserve and 0.5% of the allowances from those same years are to be set aside for the Voluntary Renewable Electricity Reserve Account. Hence, it seems clear that 98.5 % of total First Compliance Period allowances should be available for initial distribution to industrial facilities including the refining sector.<sup>3</sup> This amount contrasts with the 90% remaining at the start of the program and does not even take into consideration the 2% reduction that is inherent in the program for 2013 and 2014. In short, if the 10% reduction in the initial year is realized, the first compliance period (2013 and 2014) will see a total reduction of 14% reduction in emissions – well in excess of program requirements and comprising nearly the entirety of the original AB 32 target.

WSPA opposes this 10% reduction in initial allocations because its use will penalize all operations, even the high performing facilities. Any significant reduction in initial allocations will undermine one of ARB's key objectives in allowance allocation, which is transition assistance and minimizing leakage. Significant reductions in initial allocations will, instead, lead to leakage and adverse economic impacts to the State.

The mandated haircut is excessive because the most recent emissions projection reflecting the economic downturn reveals that such reductions are unnecessary given the economic downturn. The ARB's most recent emission projections show that the "Business as Usual" (BAU) target has been dramatically reduced leading, directly, to a reduction in the required AB 32 emission reductions.

Finally, we note that the "haircut" should not be thought of as merely an impact on some arbitrary benchmark. Rather, more precisely, it is an impact on industry and on all market participants. ARB should fund the initial reserves without the large haircut and distribute the remaining allowances equitably in order to facilitate a smooth start to the program. We stress that excessive removal of allowances such as proposed, will make allowances artificially scarce and could dramatically impact market participants without a corresponding reduction in GHG emissions.

WSPA provides additional comments on this issue in Attachment C.

**Recommendation:** ARB should distribute all allocations at an amount equal to 100% less the initial reserve funding requirements. While any reduction from 100% allowances will lead to leakage, if it is impossible for ARB to follow through on their commitment for full industry assistance, then the initial "haircut" should be no greater than 1% given all anticipated funding and program requirements.

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<sup>3</sup> We recognize that allowances will be needed to support various funds in 2015-2017 and beyond. Funding requirements should be evaluated in 2014 after the program and market participants have a year of experience in the Cap and Trade Program.

## Fuels Under the Cap

WSPA continues to oppose ARB's proposal to include Fuels under Cap and Trade in 2015 because there are too many unanswered questions about how this system will operate, both initially (during the first 2-year period) and in subsequent years when fuels are categorically included within the Cap and Trade Program starting in 2015.

We have previously asked ARB to study issues and alternatives relating to inclusion of fuels within a Cap and Trade Program before finalizing a decision whether to include fuels within this program. In addition, WSPA has highlighted a number of issues related to reporting and verification of product data reporting in the Mandatory Reporting Regulation that will require further discussion and evaluation.

**Recommendation:** WSPA recommends that for this regulatory package, ARB defer inclusion of fuels within a Cap and Trade program until a thorough study of the alternatives to inclusion as well as the economic and environmental implications of possible ARB actions are clearly defined. In order for that study to be completed and reviewed, at a minimum, ARB should defer inclusion of Fuels within a Cap and Trade Program until the onset of the 3<sup>rd</sup> compliance period, (2018).

## Appropriate Tools Developed

The ARB proposal has not adequately defined many of the tools (i.e., forms, registrations, procedures, software) required for a Cap and Trade Program (even one with the proposed "soft start" in 2012). Hence, a smooth and efficient start of the program is uncertain. If development of appropriate tools is further deferred, efficient functioning of the program could be put in jeopardy.

**Recommendation:** WSPA recommends that where ARB has identified specific dates for program implementation, but that will require ARB tools (such as registration forms) for successful implementation, those dates should be deleted and a timeframe instead be defined. For example, instead of saying the registration is required on January 1, 2012, the regulation should say, registration is required 30 days after ARB publishes (releases) the registration tools.

Further, WSPA recommends that ARB develop a schedule for development procedures and requirements associated with the Cap and Trade Program to allow interested parties to develop their approaches in line with ARB concepts. This collaborative process will facilitate involvement by stakeholders and ensure broad input into details required by the Cap and Trade Program.

## Trade Exposure

The California refining industry is heavily trade exposed and clearly subject to leakage because refined products can, and regularly do, enter the state from refineries in other regions and from

international sources. The California refining industry should be classified as a Highly Trade Exposed Industry, and not as a Moderately Trade Exposed Industry.

ARB staff has been made aware of discrepancies in census economic data, discrepancies between CEC data (which more accurately reflects the full slate of California refinery products) and EIA data that reflects only a portion of the sector. These discrepancies as well as new commodity flow data suggest a more robust review of trade exposure for refining is in order. We believe that a comprehensive review of these issues will lead ARB to conclude that the California Refining Industry is Highly Trade Exposed and should be treated as such in the Cap and Trade Regulation.

**Recommendation:** ARB Staff should convene a public process to review recent federal and state trade and commerce and energy data from federal and State sources and re-evaluate the trade-exposure of the California refining industry.

### Market Design and Cost Containment Mechanisms

WSPA understands the balance that must exist between free participation in a market and controls needed to ensure fair dealing and prevent market manipulation. However the changes that we see in the proposed modification are very small changes compared to the serious market impacts, fairness concerns, and reduced offset supply concerns that we raise below and in Attachment D.

**Direct and Indirect Corporate Relationships.** The definition of a corporate relationship is very low and the two or more equity owners may also hold disclosable corporate associations with numerous other unrelated joint venture, partnerships or limited liability companies, thus creating an extremely complex web of inter-company communications and reporting requirements which are pragmatically infeasible.

**Holding Limits.** WSPA disagrees that imposing holding limits is required to reduce market manipulation. The position limits included in the regulation are a rule developed by the CFTC to regulate futures markets. No agency has ever attempted to use such limitation to regulate the inventory or spot market as suggested in the regulations and nothing on the record supports such a position. To the contrary, evidence available from the administration of carbon markets in Europe suggests that auction frequency, not holding limits, can control the risk of market manipulation most effectively. As written, the proposed regulations limit the ability of WSPA companies to trade and cost optimize to a fraction of the amount needed.

**Recommendation:** We recommend that ARB revise this section using the language proposed in Attachment E.

**Offsets.** WSPA supports a robust offsets program as a critically important element of a cost-effective emission reduction and trading program. In the December rulemaking, regulations creating the allowance reserve were adopted which take allowances from the

cap in each compliance period and supplement that reduction in the cap by increasing the offset limits on specific facilities.

**Quantitative Limit on Offsets Recommendation.** Since the significant reductions in the cap due to the allowance reserve occurs throughout the program, ramping up in the second and third compliance period, WSPA proposes that the limit on offset use should extend to the full nine year period.

#### Enforcement

ARB has proposed to add a new section 95858 regarding compliance obligations for under-reported emissions in a previous compliance year. WSPA supports ARB's approach of requiring the surrender of additional compliance instruments only if the under-reporting exceeds five percent of the originally reported emissions. WSPA also believes that a facility's potential obligation to surrender compliance instruments for a previous compliance period should be subject to a reasonable time limit.

With respect to penalties and violations, as specified in sections 96013 and 96014, WSPA believes that the degree of culpability should be an express component in determining penalty amounts, and that determining penalties on a "per ton per day" basis would result in potential penalties that are exponentially high in relation to any harm.

**Recommendation:** WSPA proposes that ARB revise sections 95858, 96013 and 96014 as shown in Attachment F, to incorporate the concepts summarized above and to provide additional clarity in section 95858.

WSPA has identified many other detailed technical concerns that need revision in the July 25, 2011 proposed 15-day modification. To assist ARB in its review, we provide a matrix of Issues and Citations (Attachment G).

Thank you for the opportunity to comment on these proposed regulations. We look forward to working with you in the future to resolve uncertainties and cooperatively contribute to the start of a successful market-based system to implement AB 32.

Should you have any questions, I will be happy to answer them or you may contact Mike Wang (mike@wspa.org; 626-590-4905).

Sincerely,



cc: CARB Board Members  
CARB Executive Officer  
CEC Commissioners  
CalEPA Secretary

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## **Attachment A: Benchmarking for Oil and Gas (Petroleum and Natural Gas) Operations**

The GHG emissions that are incorporated into the benchmarks for upstream and refining and for all sectors should include the emissions for the net power and heat consumed and sold. In particular, some of the operations within the upstream and refining sectors have cogeneration facilities which contribute to the direct emissions. Some of the power from these facilities is consumed onsite and some is exported. Only the power consumed onsite should be charged against the facility emissions in the benchmark calculation.

Furthermore, in order to ensure that there is even treatment of operators with cogeneration facilities compared to net purchasers of electricity and heat, indirect emissions from imported power from the grid and heat from other facilities should also be included in the benchmark calculation. Otherwise, ARB would be creating an incentive for companies to favor purchasing power from the grid and/or outsourcing thermal purchases because it does not count against their benchmark performance. Note that the raw data for the both the imported and exported power is already reported in the facilities' MRR reports.

To address these changes, a calculation supporting this approach was provided to ARB as part of the WSPA oil and gas thermal and non thermal benchmark proposal.

In the ARB Proposed Regulation to Implement the California Cap-and-Trade Program Staff Report: Initial Statement of Reasons (ISOR) dated October 28, 2010, ARB staff proposed to establish the following output metrics for crude oil production:

- Barrels of crude oil extracted using thermal production techniques.
- Barrels of crude oil extracted using non-thermal production techniques.

In Appendix J of the ISOR, ARB stated that:

“Although staff prefers to apply a “one product, one benchmark” principle, an exception was made for oil extraction because non-thermal alternative techniques are not usually substitutable in the wells where thermal EOR is applied.”

WSPA fully supported this approach and subsequently worked closely with ARB staff to ensure the development of an accurate and verifiable method for calculating oil and gas production sector benchmarks based on the thermal/non-thermal production documentation. Thus, we believe this

approach was thoroughly assessed by ARB staff with the cooperation of affected facilities for validity, traceability, and accuracy.

The thermal/non-thermal approach is one way to properly consider the development and production of a natural resource (i.e., an oil reservoir) having site-specific characteristics that restrict – and in some cases, dictate – the production processes that can be used. Certain reservoirs in California contain crude oil that require steam injection (thermal EOR) for efficient recovery. WSPA believes that ARB’s GHG benchmarking process must consider oil field characteristics and also consider how those characteristics change over time (i.e., as oil fields age, the need for EOR techniques, such as waterflooding, steam injection (thermal), and injection of other materials such as polymers or carbon dioxide, increases).

In the proposed regulation, Appendix B: Development of Product Benchmarks for Allowance Allocation, dated July 2011, ARB staff states that:

“After consideration of stakeholder written comments and discussions with stakeholders on this issue, staff changed the benchmark to use the American Petroleum Institute’s gravity metric (API gravity) to differentiate products in the oil production sector. This method results in a benchmark for the production of heavy crude oil (API gravity <20) and a benchmark for the production of light crude oil (API gravity >20). This recognizes that heavy and light crude oil represent slightly different products. Staff believes this new approach is more consistent with a focus on products rather than processes in the benchmarking work. The impacts of this change in approach are not believed to be dramatic because most California heavy crude is extracted using thermal techniques and most light crude is extracted using non-thermal techniques.”

WSPA and other stakeholders were unaware that ARB staff was considering an alternative to thermal/non-thermal benchmarking approach until the release of the Discussion Draft document. ARB did not discuss the heavy/light crude oil approach as a viable option in advance of the publication of the Discussion Draft. Furthermore, the ARB staff comments in the proposed regulation, cited above, are not accurate. The change in approach will indeed have a significant impact (discussed further below) on Cap & Trade benchmarking now and in the future, especially as thermal-based crude oil production is likely to increase in future years.

WSPA understands that one goal of the benchmarking effort is to avoid creating “big winners” and “big losers” in terms of free allocations of allowances.

However, the heavy/light crude oil approach does just that as clearly demonstrated in Figure 1 of Appendix B for the proposed regulation.

As can be seen for what is termed “light crude”, the range of carbon emission intensity spans an order of magnitude with a wide variation from facility-to-facility, creating “big winners and “big losers”. (WSPA understands that there are errors in the calculations used to develop Figure 1 and in the resulting benchmarks published in the 15-day package. When the benchmarks are corrected by ARB staff, it is anticipated that the variance in data will be even greater).

With regard to the comment by ARB staff that “this new approach is more consistent with a focus on products rather than processes in the benchmarking work”, this statement simply does not reflect the fact that crude oil is a natural resource and the method of extracting it has a more transparent connection to GHG emissions than an arbitrary separation based on API gravity.

As previously noted, the heavy/light crude oil category methodology to upstream benchmarking was only recently introduced to public review. There has been no vetting of this approach with stakeholders. In fact, the benchmark numbers in the proposed regulation reflect analytical errors that ARB staff have acknowledged, which makes it impossible for affected facilities to fully assess the impact of the proposed 15-day modifications or estimate compliance obligations. Several key issues have become evident as a result of the abrupt change from a thermal/non-thermal approach to a heavy/light crude oil approach:

- Insufficient information has been provided to verify the proposed benchmark approach.
- The accuracy of the revised benchmark values (even after correction by ARB staff) will still be subject to question, as ARB has not provided a process for affected entities to verify data inputs.
- ARB staff has acknowledged that facilities under common ownership were aggregated for the purpose of calculating benchmarks, but has not provided the aggregation method.
- It is unknown and impossible to verify or confirm how ARB staff gave proper consideration of electricity usage in upstream oil production.

The oil & gas production benchmark should be based on data of the same quality and collected/verified using the same rigor as is required for the mandatory reporting of GHG emissions data. The lack of transparency of the methodology used by ARB in its development of the proposed benchmarks and industry average GHG intensities, coupled with the errors that ARB

acknowledges, raises significant questions as to the integrity of the benchmarks, and is not acceptable.

Furthermore, the industry data ARB used to determine the oil & gas production benchmark failed to incorporate indirect GHG emissions associated with electricity and heat used/produced in the production process. For California producers, electricity and heat usage in oil production can vary widely, and for some, represents a significant portion of energy consumed. The lack of appropriate consideration of electricity consumption in the benchmark represents a systemic error in ARB's approach.

The GHG emissions that are incorporated into any product based benchmarks for upstream and refining and for all sectors should include the emissions for the net power and heat used to produce the product. In particular, some of the operations within the upstream and refining sectors have cogeneration facilities which contribute to the direct emissions. Some of the power from these facilities is consumed onsite and some is exported. Only the power consumed onsite should be used to develop the facility emissions in the benchmark calculation.

Moreover, in order to ensure that there is even treatment of operators with cogeneration facilities compared to net purchasers of electricity and heat, indirect emissions from imported power from the grid and heat from other facilities should also be included in the benchmark calculation. Otherwise, ARB would be creating an incentive for companies to favor purchasing power from the grid and/or outsourcing thermal purchases because it does not count against their benchmark performance.

Note that the raw data for the both the imported and exported power is already reported in the facilities' MRR reports. To address these changes, a calculation supporting this approach was provided to ARB as part of the WSPA oil and gas thermal and non thermal benchmark proposal. To address these concerns in the WSPA refinery Adjusted EII benchmark proposal the only requirement would be to subtract the emissions from the sale of power because the EII takes electricity and cogeneration into account in the calculation of the EII.

One other consideration relates to ARB's application of a 10% reduction off of the average GHG intensity to calculate each upstream benchmark. Imposing a 10% reduction off of the average GHG intensity fails to recognize the already difficult challenge that upstream producers face in trying to maintain production at a given GHG intensity – let alone at a GHG intensity that can be reduced to match the cap decline factor – due simply to the natural decline in reservoir pressure and productivity as production continues. To counter the reservoir decline curve and maintain production, additional energy (i.e.,

additional direct or indirect GHG emissions) input is required. This inevitably leads to increasing GHG intensities per barrel of production – even without a switch to more energy intensive forms of EOR.

## **Attachment B: Downstream (Refinery) Benchmarking Methodology**

### **A simple product benchmark is simply not applicable to the refining sector.**

ARB proposed consideration of a simple barrel benchmarking methodology that simply divides a facility's total GHG emissions by the amount of product barrels of gasoline, jet, diesel and asphalt the facility produces. However, a simple product benchmark is simply not applicable to the refining sector because it:

- Does not measure nor reflect the efficiency of a refinery. CO<sub>2</sub> emitted per barrel of refined product is an indicator of “what the refinery does” rather than “how efficiently it is done”. This benchmark simply rewards facilities having fewer pieces of equipment and, consequently, making fewer products (both in type and, in some cases, quantity).
- Only includes some products like gasoline, jet, diesel and asphalt products but excludes other products (for example, lubricants, hydrogen, flexigas, refinery gas and co-generated electricity among others). Hence use of the simple barrel method penalizes California's more sophisticated and cleaner refineries.
- Is not transparent because it requires use of refinery product data – information that is business confidential and is reported to CEC and DOE under trade secret protection.
- Does not consider efficiency with which an operator operates facility equipment. This creates the perverse incentive for facilities to simplify their operations and/ or configuration instead of operating more efficiently. Hence, the simple barrel method will grossly miss the mark of incentivizing efficient operations to achieve emissions reductions. If anything, it will increase the potential for leakage.

**Simple barrel approach does not reflect nor reward early actions to reduce energy consumption or improve operational efficiency.** This is especially true when applied to large, complex refineries that make the vast majority of clean fuels required by the ARB. In short, California needs these complex refineries that supply over 97% of its cleaner burning fuels, yet simple barrel benchmarking penalizes them by ignoring key operating processes within each facility. As already stated, penalizing these more sophisticated refineries may lead to leakage.

The simple barrel benchmarking method is inaccurate, not representative of industry operations, not reflective of either energy efficiency or carbon conservation, and can lead to an extremely inequitable distribution of free allowances and sudden disruption in the petroleum market. The use of this proposed simple barrel methodology could result in some refineries being

required to either initially reduce emissions or purchase compliance instruments in amounts between 20% to over 40% of total annual emissions while other refineries will be provided windfall free allowances exceeding 300%.

**What is needed: Facility GHG (CO2) Emissions must be compared using an appropriate metric.**

The Cap and Trade Program should start on an equitable basis using a benchmark that realistically compares facility operations and emissions. The comparatively lower CO2 emissions of a simple refinery does not make it necessarily “good” any more than the higher emissions of a more sophisticated refinery does not make it “bad” because they are simply performing different jobs.

California refineries have been optimized to squeeze every drop of transportation fuels including ARB gasoline and ARB diesel out of a barrel of crude to meet demand. Hence, the majority of the California refineries are more complex and produce more products. More refining may mean more CO2 emissions but from more efficient facilities. Simple and complex refineries are complementary parts of the “system” required to supply the market. A simplistic benchmark based on tonnes of CO2 emitted per barrel of refined product would favor simple refineries and penalize more sophisticated refineries. Penalizing more sophisticated refineries may lead to leakage.

**WSPA believes that the proposed Adjusted EII Methodology is consistent with the recently adopted Cap and Trade Rule for the first compliance period.**

We agree with ARB that an appropriate benchmarking method must avoid or minimize leakage<sup>4</sup>. We also agree that the method must be clear and accurately reflect GHG emissions from facility operations.

WSPA has proposed an Adjusted EII benchmarking methodology as an interim method that is fair and recognizes the range and complexity of the refining sector.

An Adjusted EII benchmark based on the Solomon Energy Intensity Index (EII™) metric more accurately represents the range of operational CO2 efficiency in refineries on an equitable and scientific basis.

- The EII™ metric is internationally recognized and supported by Solomon’s data base.

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<sup>4</sup> (Appendix B, Page 2, 7/2011 Cap and Trade Discussion Draft – “In developing a product-based benchmarks, staff attempted to create a uniform framework that could be applied across all industrial products facing a leakage risk.”

- EII™ industry standard since 1980
- EII™ is a measure of how efficiently different processes in a refinery produce product.
- EII™ measures and evaluates all the processes in each refinery and sums up the efficiency of each into one EII metric for the entire refinery
- EPA uses EII™ in its Energy Star® Program
- Energy efficiency is a surrogate for lower carbon footprint
- EII™ is available for refineries that emit 98 % of California's emissions
- EII™ is based on data base of over 300 refineries worldwide
- Rewards early action by recognizing energy efficiency
- Encourages further reductions in emissions through the true-up of actual emissions compared to baseline
- Reduces the potential for leakage
- Protects against windfalls to sector and facilities
- Creates a representative and appropriate baseline for the refining sector
- Capable of being implemented in time for program start
- Like the third-party verifiers for the Mandatory Reporting Regulation, Solomon is an independent third-party that verifies to ARB the EII™ of each refinery.

### **Benchmarking and Issuance of Allowances – New Entrants**

WSPA supports ARB's provision to grant emissions to "New Entrants." WSPA strongly recommends that this provision be extended to facilities with "significant modifications" completed prior to 2011. The standards for a "significant modification" can be established with enough stringency to appropriately limit its use. For the refining sector, this could be defined as a project that required full CEQA review and exceeds certain production output thresholds.

**Recommendation:** ARB should expand the New Entrants provision for the issuance of allowances to recognize significant expansions and modifications in operations.

## **Attachment C: Why the 10% reduction in allowances for electricity utilities and cement Should Not Apply to Refiners**

In its proposed cap-and-trade rule package (Proposed Regulation (December, 2010), ARB stated:

- The proposed Section 95870 Disposition of Allowance provides that:
  - In order to fund the Reserve, 1% of the first compliance period (2012-2014) allowance budget is to be used and 0.5% for the Voluntary Renewable Electricity Reserve
  - Reserves needed to fund the Advance Auction would come from the next period: 2015-2020
  - Hence, it seems clear that ARB anticipated that 98.5% of total First Compliance Period allowances for 2012-14 should be available for distribution to industrial facilities including the refining sector
- Table 8-1 Industry Assistance shows Petroleum Refining receiving 100% Industry Assistance.
- Table 9-1 Product Output for Establishing Emissions Efficiency Benchmarks shows an Energy Intensity Index such as proposed by WSPA as being appropriate for Petroleum Refining.
- Table 9-2 Cap Adjustment Factors for Assistance to Industry show an adjustment for industry of 1.0 for 2012.

The WSPA comment letter of December 15, 2010 recognized these key elements in the draft rule and requested an allocation methodology that would be back-loaded (e.g., emphasizes emission reductions in the latter compliance periods) as ARB proposed. This approach would reduce the risk of leakage, keep refining allocations at 99 to 98 percent in the early years of the program, and still achieve reductions set by AB 32 by 2020.

- ARB has asserted that it needs a 10% reduction in allocations (“hair cut”) across the board to fund: reserve (1%); renewable set aside (1-2%); and auctions (1-2%). However, as stated earlier, these numbers have been revised in the ARB proposal for the first compliance period. Moreover, neither our review of the draft Cap and Trade Regulation, nor our discussions with ARB ever indicated how ARB justified this approach. Hence, it is not clear that the percentages are at all comparable or that the allowance arithmetic is at all accurate.
- The “precedent” that ARB argues has been set by the electricity and cement industry is not appropriate to the refining industry. For utilities, in

particular, the RPS has already reduced the need for allowances to cover electricity made from fossil fuel.

- BAU emission in 2012 are already expected to be 93% of the reported 2002 emission (92.18 vs. 98.85 MMTCO<sub>2e</sub>).
- While GHG reductions from implementation of the LCFS are impossible to determine with any certainty, even ARB has deemed it unlikely that the LCFS will lead to reduced instate refinery GHG emissions.
  - For the refining industry, in 2012, BAU emission is expected to be **98%** of 2008 emissions (33.87 vs. 34.54 MMTCO<sub>2e</sub>).
- Refining is an Energy Intensive Trade Exposed (EITE) sector.
  - California refining competes on a worldwide scale.
  - This differs from supplying electric power in California, all of which is accounted for and capped under AB 32.
- Short-term efficiencies beyond 1 to 1.5% are not likely for refining sector given the drive to improve energy efficiency over the past few years (often in conjunction with California Fuel Requirements):
  - A more back-loaded scheme for refining would allow the refining industry lead time to plan for the carbon constrained economy similar to the period provided to electric utilities under the RPS.
  - Refining planning horizons must address the long lead planning, permitting and construction timeframe (from 5 to 7 years) to implement energy efficiency projects.
- A 10% Hair Cut will penalize all refineries even the high performing facilities and will severely penalize some refineries even if the Adjusted EII methodology is applied.
- ARB Staff are asserting that 10% reduction in all allocations is needed to fund all reserves, etc.
  - 10% reduction across-the-board appears to over-fund the initial reserve requirements while making compliance more difficult in the early (transition) years. Why make the problem harder?

**Recommendation:** In order to determine the most appropriate reduction in the initial allocation, ARB should calculate the ACTUAL AMOUNT of reserves required to be funded in the FIRST TWO YEARS and then determine what percent reduction is needed to fund that requirements.

## **Attachment D: Market Issues, Design and Definitions**

### Application of “Facility” Definition for Oil & Gas Production

With the incorporation of the 40 CFR 98 Subpart W definition for “facility” into the revised MRR regulation, the proposed Cap & Trade regulation now contains multiple and confusing references to the term “facility” as it applies to oil & gas production operations:

- The proposed Cap & Trade regulation, §95812(c)(4) states “The applicability threshold of oil and gas producers will be determined at the operating entity listed on the state well drilling permit or operating permit in accordance with section 95151(a)(1) of MRR. The applicability threshold for oil and gas producers is 25,000 metric tons or more of CO<sub>2</sub>e per data year.”
- In the amended MRR regulation, §95151(a) refers to §95150 for source categories and §95101 for applicability. Section 95150 refers to federal regulations at 40CFR98.230(a)(1)-(a)(8). The citation at 40CFR98.238 defines onshore petroleum and natural gas production facility as "all equipment... in a single hydrocarbon basin".
- Finally, the proposed Cap & Trade regulation §95802(a)(95) defines “Facility” as “any physical property, plant, building, structure, source, or stationary equipment located on one or more contiguous or adjacent properties in actual physical contact or separated solely by a public roadway or other public right-of-way and under common ownership or common control, that emits or may emit any greenhouse gas.”

WSPA believes that the proposed regulation should provide clear language stating that the “single hydrocarbon basin” definition from the MRR is to be used only for establishing GHG reporting requirements, which is consistent with federal regulations. However, compliance obligations under the Cap & Trade regulation should be limited to “facilities” that exceed the 25,000 tpy threshold, where “facility” is defined as contiguous or adjacent properties under common control as defined under §95802(a)(95).

**Recommendation:** WSPA recommends that the proposed regulations reflect that the scope of the Cap & Trade compliance obligation for oil & gas production apply only to facilities, as defined in §95802(a)(95) for contiguous or adjacent properties that exceed the 25,000 ton threshold.

### Corporate Associations/ Ownership

Section 95833 requires disclosure requirements for direct and indirect corporate associations. The thresholds for requiring disclosure of direct and indirect are quite low. Section 95833(a) (2) reiterates that a direct corporate relationship exists when an entity holds compliance instruments in its “own holding account” in which another entity has an ownership interest with other entities”. WSPA understands the need for disclosure of direct and indirect corporate contacts in order for the cap and trade system to be transparent and to allow ARB to monitor for market manipulation.

The problematic issue is the conditions that attach to the activities of direct and indirect corporate entities. For example, section 95911(c) limits the number of compliance instruments that can be bought at any specific auction by an entity or a “group of entities with a disclosable corporate association”. These limits are set at 25% of the future vintage compliance instrument and 10% of the current vintage compliance instruments that are available at any given auction. Section 95920 also limits the number of compliance instruments that can be held by an entity or group of entities with a disclosable corporate association.

These two limits create significant legal and pragmatic compliance difficulties for joint ventures, partnerships, and limited liability companies. For instance, in order to determine compliance with these requirements, the equity owners of these joint business relationships would be required to disclose their bidding strategy and compliance instrument ownership positions to each other. This problem is further exacerbated when the two or more equity owners are competitors in either the same or other industrial sectors. Such disclosures may be prohibited by both state and federal antitrust laws and regulations.

In addition, the two or more equity owners may also hold disclosable corporate associations with numerous other unrelated joint venture, partnerships or limited liability companies, thus creating an extremely complex web of inter-company communications and reporting requirements which are pragmatically and legally difficult or even legally infeasible. We note that in 95833(a)(4) there is an exception that does not require entities to take “other action” that violates “other rules”. The section does not provide any guidance on what the entities must do or provide in these cases. Rather than providing a pathway for compliance, it adds additional uncertainty and compliance exposure.

**Recommendation:** WSPA supports the disclosure requirements of section 95833 that give ARB or the market administrator the opportunity to monitor these direct and indirect corporate associations for inappropriate activity. WSPA recommends the auction and holding account limits apply only to the specific joint venture, partnership or limited liability company and not be applied to entire group of associated

corporate entities and their own unassociated disclosable business entities.

### Equity in Allocation Process

WSPA is concerned with the allowance allocation scheme proposed in the draft regulation because it appears to penalize industries other than the utilities. In other words, the system proposed by ARB would provide the electricity distribution utility sector “more than their share” of allowances, while other industries, including the petroleum industry, would be then given the “left-overs” on a pro-rata basis.

Specifically, under the proposed allocation scheme outlined in Appendix A of the July 25, 2011 Proposed 15-day modifications, the electricity distribution utility sector will get 100% of customer cost burden plus 25% of their expected energy efficiency savings plus an amount related to renewable energy investments that they made in 2007 thru 2011. Approximately 1% of these allowances are allocated in recognition of projected energy efficiency, 0.5% of allowance from years 2013 – 2014 are allocated for recognition of renewable electricity emission reduction. Hence, the utilities’ allocations would be *in excess* of their expected customer cost burden in 2013 range from 0.17% to 25.5%.

**Recommendation:** Allowances should be allocated proportionally among all sectors. We think it critical that all sectors are treated equitably and that all industry including the petroleum industry be provided the same recognition for energy efficiency and early reduction as is given to the electricity distribution utility sector.

### Allowances for Electricity Costs to Highly Trade Exposed Industry Sectors

WSPA strongly supports ARB’s determination that because oil and natural gas production operations are global in nature, California facilities are highly trade-exposed. A natural extension of this determination is that any factor that could affect competitiveness of the in-state oil & gas production sector should receive explicit consideration and appropriate compensation under the cap and trade program. For California producers, electricity usage in oil production can vary widely, and for some, represents a significant portion of energy consumed.

The proposed regulation indicates that industrial customers (including oil and natural gas production) may receive energy efficiency programs or other indirect assistance, instead of the direct allocation of allowances or allowance value to address carbon cost impacts. For oil and natural gas production, energy efficiency programs, which can be useful for residential consumers or small commercial enterprises, do not provide value. Direct allowance distribution to the oil & gas production sector, more fairly addresses the impacts of higher energy costs that would otherwise disadvantage this highly trade-exposed sector. To allay concerns over the potential “double counting” of

allowances already thought to be provided to the utility sector, the allowances for imported electricity can be deducted from the utility sector to prevent double counting.

WSPA understood that ARB staff had agreed prior to the release of the proposed regulation that direct allocations would be provided to make the oil & gas production sector “whole,” but not until the CPUC acts on utility pass-through rules.

**Recommendation:** The proposed regulation should: (i) clearly address the matter of allowance distribution associated with electricity consumption for the oil & gas production sector and (ii) how the proposed regulation will mitigate the impacts of higher energy costs that would further disadvantage this highly trade-exposed sector.

### Market Design and Cost Containment Mechanisms

WSPA understands the balance that must exist between free participation in a market and controls needed to ensure fair dealing and prevent market manipulation. However the changes that we see in the proposed modification are very small changes compared to the serious market impacts, fairness concerns, and reduced offset supply that we raise below regarding holding limits, auction frequency, bid guarantees, and offset supply.

#### Holding Limits

WSPA disagrees that imposing holding limits is required to reduce market manipulation. The position limits included in the regulation are a rule developed by the CFTC to regulate futures markets. No agency has ever attempted to use such limitation to regulate the inventory or spot market as suggested in the regulations and nothing on the record supports such a position. To the contrary, evidence available from the administration of carbon markets in Europe suggests that auction frequency, not holding limits can control the risk of market manipulation the most effectively. As written, the proposed regulations limit the ability of larger entities to trade and cost optimize to a fraction of the amount needed.

Holding limits will cause a number of market distortions including reduced liquidity for the entire market as larger compliance entities move allowances in their compliance accounts to comply with the limits. This will be especially critical during the first compliance period, when liquidity is needed the most due to high industry assistance allocations. Large amounts of allowances trapped in compliance accounts will raise the overall cost of compliance as

larger compliance entities move allowances in their compliance accounts to comply with the limits.

The holding limit equation results in uneven treatment of larger compliance entities compared to smaller compliance entities. Because their compliance obligations exceed the holding limits, larger companies will actually face higher compliance costs overall than some of their smaller competitors and all are disadvantaged compared to other compliance entities. Compliance entities with a smaller emissions obligation will be better able to manage their exposure because they will be able to buy/sell/bank a much larger percentage of their allowances on a real-time basis, which will allow them to realize the lowest possible compliance costs. Large companies are unfairly penalized solely based on emissions which results in a higher cost of compliance on companies solely based on their compliance obligation.

Compliance entities should be allowed to purchase and hold a quantity of allowances that are proportionate to their compliance obligation and not be limited to an arbitrary amount based on the auction size. While modifications were made to future obligations, no changes were made to meet this simple objective.

As noted above, ARB also needs to revise the holding limits and also purchase limits that include holdings for associated companies, particularly those that are indirectly associated. Associated companies have no obligation to either communicate or review their trading strategies with a non controlling ownership or partnership. Companies should not have compliance exposure for companies that are not within their control.

**Recommendation:** We recommend that ARB revised this section using the language proposed in Attachment E.

### Auction Frequency

The cap and trade regulation currently provides for quarterly auctions for allowances for each of the compliance periods. This frequency does not reflect the most recent research and analysis conducted in connection with the management of carbon market auctions in Europe. Based on the most recent data, the European Union now requires that, starting in 2013, all auctions be conducted on a weekly basis or more frequently. The concern with infrequent auctions (including quarterly and monthly auctions) is that they provide more opportunities for speculators and financial intermediaries to manipulate markets between the auctions. Another concern is that infrequent auctions increase price volatility and can result in price spikes around the time auctions, which result in market inefficiencies. More frequent auctions provide

better price signals and help smooth price volatility, which are crucial elements for long-term planning purposes.

Although RGGI has a quarterly auction schedule, this design feature essentially dates back to 2006 and does not build upon recent experience with carbon markets. Furthermore, the RGGI market design has not been fully tested because the market is long, activity is slow and prices are low. Accordingly, the WSPA members do not believe RGGI is a useful or realistic precedent in this respect for the California market.

For example, in the EU ETS phase 2, the UK had larger, less frequent auctions (6-8 per year), where market volatility was directly attributable to the auctions. On the other hand, Germany had weekly, smaller auctions, and the market largely absorbed the volume without noticeable price impacts.

**Recommendation:** Increase auction frequency to monthly to both address issues of market volatility and reduce the opportunity for market manipulation due to the predictability of compliance entities to use each auction so that they can cost optimize due the holding limits. WSPA proposed language for this change is provided in Attachment E.

#### Auction reserve bid guarantee

WSPA notes that the regulation contains a requirement to provide the auction administrator with assurances in the form of bonding, cash, or a letter of credit. This requirement is unnecessary and does not add certainty or improve the stability of the C/T program. This is especially ineffective and burdensome for entities with large physical assets in the state and/or who may be investment-grade, credit-rated companies. WSPA proposes that ARB should develop an open credit threshold on a sliding scale based on the published credit rating of the company.

Some companies may have a published credit rating for the parent company that would need to be used for its sub companies.

**Recommendation:** WSPA proposed language change is in Attachment E.

#### Offsets

WSPA supports a robust offsets program as a critically important element of a cost-effective emission reduction and trading program. An effective and successful program can facilitate cost-effective GHG emission reductions from non- traditional industrial sources.

In the December rulemaking, regulations creating the allowance reserve were adopted which will take allowances from the cap in each compliance period and supplement that reduction in the cap by increasing the offset limits on specific facilities. As a method to reduce the costs of the cap reduction going to the allowance reserve, offsets are materially different, because they are an option to be used in a compliance strategy. If all of the offsets are not used then the policy of taking credits from the cap to fund the allowance reserve will result in a tightening of the cap and a corresponding increase in costs to all market participants. In the proposed modifications ARB changed the quantitative limit for use of offsets from annually to tri-annually.

**Recommendation:** Since the significant reductions in the cap due to the allowance reserve occur in the second and third compliance period, WSPA proposes that the offset limits should be expanded from three years to the full nine year period.

#### Promote innovation by allowing more flexibility in measurement of offsets

Impacts on innovation stimulated by offsets were frequently cited as a concern in developing offset policy. Offsets are a driver of innovation. This might occur through two pathways:

First, use of offsets in uncapped sectors (e.g., agriculture and forestry in California) creates an incentive to innovate in areas that would not otherwise be reached by the carbon price signal under the cap. As emissions reductions from offsets lead to learning-by-doing, costs fall and the supply of offsets increases, providing further opportunities.

Second, offset use in developing countries might not only contribute direct emissions reductions it could also serve as a vehicle for technology transfer. The technology diffusion process, kick-started with offsets, would contribute additional emissions reductions.

#### Offset Supply Policies

Offsets are an important component of compliance with AB 32. Given that the emission targets are very aggressive and require equipment that is technology-forcing, there is a danger that offsets will not be developed in sufficient quantity to provide the needed program flexibility. For example, we note that ARB has only approved a handful of protocols at this time, when there are

eleven protocols that have been developed by the Climate Action Registry.<sup>5</sup> Two key protocols, landfill gas for North America and coal mine methane have been developed and used by Climate Action Registry for several years. We recommend that these be considered by ARB in early 2012. The North America landfill gas protocol would add over 50% more offsets in the first compliance period. The coal mine methane protocol holds the potential to provide a large supply of valuable and verifiable offsets that could ensure that AB 32 emission reductions are achieved cost-effectively.

### Offset Liability

Offset liability in the proposed modifications allows for certainty for the market to develop insurance. However if this insurance market is either very expensive or does not meet the needs of the covered entities, the buyers and the developers of offsets will face increased transaction costs and market uncertainty. This will increase costs to all in the market.

In contrast, ARB, assumed that insurance will meet the needs of the market. We propose that ARB review this assumption in early 2013 using, as a criteria, both the existence of insurance and the actual use of it by covered entities. Early review of the availability and use of insurance to address offset liability is essential to prevent offset supply issues that will arise in 2015, caused by the long lead times needed to develop offsets.

All of these issues, the lack of available protocols, the chilling effect on the market from the offset liability costs, and the overly prescriptive ARB approval process, have the serious potential to limit the amount of offsets and reduce the ability of the market to function efficiently to achieve emission reductions cost-effectively.

**Recommendation:** ARB must be more aggressive in promoting the use of offsets. This would be accomplished by: i) increasing the speed at which offset protocols are adopted; ii) streamlining the process by reducing the prescriptive details of the approval process, iii) focusing on approving independent offset approval agencies to issue usable offsets to reduce bottlenecks and increase the supply of offsets and iv) adopting policies to either provide a buffer account or review the availability and use of insurance in early 2013.

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<sup>5</sup> WSPA continues to be concern that offset requirements appear overly prescriptive. By limiting offsets quantitatively and geographically, ARB is reducing the expected size of the offset market and thereby reducing the number of less-costly emission reduction options.

## **Attachment E – Proposed Language for Holding Limits, Credit Approval, Auction Frequency**

### **Proposed changes for holding limits**

95920 (d)(3) The holding account limit for compliance entities will be calculated pursuant to section 95920(c)(1) as two times the average of the entities previous two year's reported emissions.

### **Proposed changes for Auction/reserve bid guarantee**

#### **Pg A-140 for auctions bids:**

Section 95912 (h) Registrants must provide a bid guarantee to the auction administrator at least one week prior to the auction.

- (1) The bid guarantee must be in one or a combination of the following forms:
  - (A) A bond issued by a financial institution with a United States banking license.
  - (B) Cash in the form of a wire transfer or certified funds, such as a bank check or cashier's check.
  - (C) An irrevocable letter of credit issued by a financial institution with a United States banking license.
  - (D) If California participates in a joint auction with one or more Canadian Provinces pursuant to 95912 (b) then bonds or irrevocable letters of credit issued by a financial institution with a Canadian banking license will be acceptable.
  - (E) Proof of publicly reported credit rating higher than ARB established credit threshold for auctions and allowance reserve bids.
- (2) The amount of the bid guarantee must be greater than or equal to the sum of the value of the bids submitted by the auction participant.

#### **Pg A-144 for reserve allowance bids:**

Section 95913 (e) Submissions of Bids to Purchase. At least two weeks prior to the scheduled sale, an entity shall submit:

- (1) To the reserve sale administrator a bid consisting of a price equal to on of the three tier prices and a quantity of allowances and
- (2) To the financial services administrator a bid guarantee in an amount greater than or equal to the sum of the maximum value of the bids submitted by the entity, in one or a combination of the following forms:
  - (A) A bond issued by a financial institution with a United States banking license.
  - (B) Cash in the form of a wire transfer or certified funds, such as a bank check or cashier's check.
  - (C) An irrevocable letter of credit issued by a financial institution with a United States banking license.
  - (D) If California participates in a joint Allowance Price Containment Reserve with one or more GHG ETS programs in the Canadian Provinces

to which it links and covered entities from linked systems are eligible to purchase from the Reserve pursuant to 95913(b), then bonds or irrevocable letters of credit issued by a financial institution with a Canadian banking license will be acceptable.

(E) Proof of publicly reported credit rating higher than ARB established credit threshold for auctions and allowance reserve bids.

(F) Substantial asset base within the State

Pg A-130 Proposed changes for Auction Frequency amend Section 95910(a) subsections (1) and (2) to read as follows:

Section 95910(a)

(1) In 2012, auctions will be held on August 15 and monthly thereafter on the 15<sup>th</sup> of every month.

(2) Beginning in 2013, auctions shall be conducted on the 12<sup>th</sup> business day of every month throughout the end of the program in December 2010.

## Attachment F: Proposed Changes to Section 95858, 96013, and 96014

### § 95858. Compliance Obligation for Under-Reporting in a Previous Compliance Period.

If, after an entity has surrendered its compliance instruments for a compliance period pursuant to section 95856, the Executive Officer determines, through an audit or other information, that the entity under-reported its emissions under MRR for any emissions sources that form the basis for the entity's compliance obligation, then the following shall apply:

- (a) If  $EMd - CO \leq 0.05CO$ , then the entity is not required to take any further action.
- ~~(a) If the difference between the emissions used to calculate the compliance obligation and subsequently used to calculate the number of compliance instruments surrendered pursuant to section 95856 and the emissions determined by the Executive Officer to be under-reported for the sum of those emissions is less than five percent, then the entity is not required to take any further action.~~
- (b) If ~~the difference between the emissions used to calculate the compliance obligation and subsequently calculate the number of compliance instruments surrendered pursuant to section 95856 and the emissions determined by~~ $EMd - CO > 0.05CO$ , then upon the receipt of notice from the Executive Officer ~~to be under-reported for the sum of those emissions is more than five percent, then~~ the entity must surrender additional compliance instruments for the previous compliance period in the following amount:

$$Cla = EMd - CO - (CO * 0.05)$$

~~Where:~~

(c) Not later than six months from the date the entity receives notification from the Executive Officer that the entity must surrender additional compliance instruments due to under-reported emissions for a previous compliance period, the entity shall surrender the quantity of compliance instruments determined in accordance with subsection (b). The provisions of section 95857 shall not apply and the entity shall not be subject to penalties under this Article if the additional compliance instruments are surrendered during the six month period. The entity may use compliance instruments from subsequent compliance periods to meet this surrender obligation.

(d) For the purposes of this section:

‘Cla’ is the number of additional compliance instruments that must be surrendered to ARB ~~to cover under reported emissions~~ in accordance with this section;

‘CO’ is the ~~emissions number used to determine the~~ quantity of compliance ~~obligation~~ instruments surrendered pursuant to section 95856 ~~for any~~ to meet the entity’s compliance obligation for the previous compliance period; and

‘EMd’ is the ~~number of the~~ entity’s corrected total emissions for the previous compliance period, determined by the Executive Officer ~~for the sum of the emissions sources subject to a compliance obligation;~~

~~(e) The entity will have six months from the time of notification by the Executive Officer to surrender additional compliance instruments for under reporting emissions under MRR as determined pursuant to this section. The provisions of section 95857 shall not apply during these six months. The entity may use compliance instruments from subsequent compliance periods to meet these requirements. The entity may only use CA GHG allowances or allowances issued by a GHG ETS approved pursuant to subarticle 12 to meet the requirements of this section.~~

(e) Any determination that an entity under-reported its emissions for a previous compliance period shall be made by the Executive Officer no later than five years from the deadline for

[submission to the Executive Officer of the verified emissions data report for that compliance year.](#)

### **§ 96013. Penalties.**

Penalties may be assessed pursuant to Health and Safety Code section 38580 for any violation of this article as specified in section 96014. In determining any penalty amount, ARB shall consider all relevant circumstances, including the criteria in Health and Safety Code section 42403(b), [and the degree of culpability for the violation.](#)

### **§ 96014. Violations.**

- (a) If an entity fails to surrender a sufficient number of compliance instruments to meet its compliance obligation as specified in sections 95856 or 95857, and the procedures in 95857(c) have been exhausted, there is a separate violation of this article for each 1000 required compliance ~~instrument~~instruments that ~~has~~have not been surrendered, or otherwise obtained by the Executive Officer under 95857(c).
- ~~(b) There is a separate violation for each day or portion thereof after the end of the Untimely Surrender Period that each required compliance instrument has not been surrendered.~~
- (eb) It is a violation to submit any record, information or report required by this article that:
- (1) Falsifies, conceals, or covers up by any trick, scheme or device a material fact;
  - (2) Makes any false, fictitious or fraudulent statement or representation;
  - (3) Makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry; or
  - (4) Omits material facts from a submittal or record.

(~~d~~c) The violations stated in section 96014(~~e~~b) are in addition to an entity's obligations under other provisions of this article requiring submissions to ARB to be true, accurate and complete. [A submission may be considered a violation of section 96014\(b\) or of the obligations referenced in this section 96014\(c\), but not both.](#)

## Attachment G: Matrix of Issues and Citations

<u>Section</u>	<u>Page</u>	<u>Issue/Comment</u>	<u>Recommendation</u>
Definition 202 – Primary Refinery Products	A-34	<b>Primary Refinery Products</b> Defines Primary Refinery Products as aviation gasoline motor gasoline, jet-fuel, distillate fuel oil, renewable liquid fuels and asphalt. For each refinery, ARB will convert blendstocks into finished fuel, by using a blending ratio. WSPA has concerns with this definition as it excludes many refinery products such as LPG, Petroleum Coke, No. 6 Fuels among many others, plus it does not take into account products consumed onsite such as hydrogen, power, steam or flexigas. Further, it not clear or transparent as to how the blending ratio is derived and how it will be used to develop the final facility product total. As used in Appendix B, the primary product is used for benchmarking purposes in the Simple Barrel methodology. It is not clear, how ARB will manage the seasonal and annual changes in product volumes in the benchmarking calculations.	WSPA opposes the Simple Barrels benchmarking methodology for many reasons, including the fact that the Primary Product definition is flawed and not transparent. WSPA recommends that the Adjusted EII methodology be adopted in lieu of Simple Barrel approach, that will obviate the need for this flawed “primary product” definition.
Definitions 199 “Positive Product	A-33/34	<b>Product Data Verification Statement/Positive Product Data Verification Statement</b>	WSPA recommends that product data verification not occur in 2011 and that the

Data  
Verification  
Statement”  
and 208 –  
Product  
Data  
Verification  
Statement

The July 27, 15 day proposed changes to both the MRR and the Cap and Trade regulations, incorporate a new requirement to report and verify product data at facilities. WSPA has commended that product data “verification” required by the MRR regulation and on Fuels under the Cap and Trade Program (see our comments above) be postponed for 2011 until ARB better understand the issues associated with fuels and products for the MRR and the Cap and Trade program.

product data  
verification statement  
not be required until  
verification is needed.

95812.(c)(4) A-50

**Oil and Gas Production**  
This section references section 95151(a)(1) in the MRR. Section 95151(a)(1) no longer exists in the MRR.

WSPA recommends that ARB correct to 95151 (a) as 95151(a)(1) no longer exists.

95820 A-54

**Compliance Instruments**  
This section authorizes ARB to issue GHG allowances and Offset credits as compliance instrument that is an authorization to emit a ton of CO<sub>2</sub>e GHG. WSPA believes that compliance instruments from Cap and Trade program should be eligible for compliance in other programs such as LCFS.

WSPA recommends adding a provision allowing compliance to LCFS via transfer of compliance instruments from Cap and Trade program.

95830 A-56  
(d)(1)(B)

**Registration with ARB**  
Registration will be required by January 1, 2012 or within 30 days of effective

WSPA believes a specific date should be deleted and the section amended to require

date of the rule. In order for this provision to become effective, the tools and system requirements must be provided sufficiently ahead of time for compliance to occur.

registration when ARB publishes appropriate tools and provides 30 days notice to registrants.

95830 (e) A-57

**Registration with ARB**  
Section 95830 details the registration process for the entities including the information that must be submitted and the deadlines for submittal. Subsection (e) defines that registration is complete when the EO approves the registration and notifies the entity. There is no timeline for EO approval.

WSPA recommends that the regulation state that the EO has 30 days from the entity's submittal date to approve or disapprove the registration.

95831(a)(4) A-59

**Compliance Accounts**  
Section 95831(a)(4)(B) does not allow compliance instruments to be moved from the compliance account. WSPA believes that the rule must allow compliance instruments within a compliance account to be transferred to another account by the holder.

WSPA recommends that this section be amended to allow for compliance instruments within a compliance account to be transferred to another account by the holder.

(B)95832(f) A-66  
(4)

**Designation of Account Representatives**  
Section 95832(f)(4) requires that an entity submit any changes to the account within one day of the change. WSPA believes that one day is simply infeasible for submittal of a revision

WSPA recommends that this section be amended to allow 10-days for submittal of changes.

even with electronic record-keeping.

95833(a)(1) A-69

**Disclosure of Direct and Indirect Corporate Associations**

Section 95833(a)(1) describes the disclosure requirements for direct and indirect corporate association with other registered entities. Although this seems to be an improvement from the current rule language WSPA believes the language is still unclear.

WSPA recommends that ARB engage in further discussions with stakeholder, including WSPA, to further clarify issues for rule amendment in the second 15 day package of amendments. For example, clarification of issues such as what constitutes control? Define how would joint ventures be addressed if an entity controls 25% of shares but has no controlling interest?

95834 A-71/72 & 73

**Disclosure of Beneficial Holding**

WSPA believes that the section should be clarified to define the exact meaning of beneficial holding -- is it relating to a trader or is it relative to owners and operators?

WSPA recommends that ARB engage in further discussions with stakeholder, including WSPA, to further clarify issues for rule amendment in the second 15 day package of amendments.

95834(b)(1) A-72

**Disclosure of Beneficial Holding**

WSPA believes that the 10-day registration period seems unreasonably strict.

WSPA recommends that this section be amended to allow 30 days for the registration period.

95852.2 A-89

**Emissions without a Compliance Obligation.**

Section 95852.2 details a list of fuel types that do not have a compliance obligation. WSPA believes

WSPA recommends that ARB add provisions that allow fuel providers to identify other fuels that could qualify to not

that by using a specific list of fuels, ARB is limiting innovation for new fuels.

have a compliance obligation.

95854(a) A-96

**Quantitative Limits on Designated Compliance instruments.**

Section 95854(a) allows the use of the compliance instrument through to the end of the compliance period. WSPA believes this limited use of compliance instruments will only add to cost of compliance.

WSPA recommends that the rule be amended to allow the use of the compliance instrument through to the end of the program, rather than to the end of a compliance period, as currently proposed.

95870(b) A-103

**Disposition of Allowances**

Section 95870(b) changes the Auction Reserve transfer requirement from 2% to 10%. WSPA does not understand the need for this increase.

WSPA recommends that the 2% transfer authority be retained.

95870(d) A-104

**Disposition of Allowances – Allocation to Electrical Utilities**

Section 95870(d) increases the allocation to electrical distribution utilities by approximately 10%. WSPA believes that the allocation to utilities be proportional based on emissions of the different sectors WSPA opposes this bigger proportion of the allowance budget going to the electrical distribution utilities at the expense of the industrial sectors. This makes the utility portion of allocation bigger than their portion of emissions (i.e. 59% of allocation vs. 56% of

WSPA recommends that allowances be allocated proportionally among all sectors.

WSPA recommends that ARB strike the word “industrial” in section 95870(e)(3).

emissions) WSPA believes it is critical that all sectors are treated equitably and that all industry including the petroleum industry be provided the same recognition for energy efficiency and early reduction as is given to the electricity distribution utility sector. (See our comments on equity in our cover letter).

95870(e)(3)	A-103	<p><b>Disposition of Allowances – Allocation to Industrial Entities</b>            Section 95870(e)(3) would give the to electrical distribution utilities the first share of allowances and then all other industries get a pro-rated share of what remains. WSPA opposes this electrical distribution utilities first scheme.</p>	<p>WSPA recommends that ARB strike the word “industrial” in section 95870(e)(3).</p>
Table 8-1 Industry Assistance Factors	A-106-8	<p><b>Table 9-1 Industry Assistance Factors</b>            WSPA believes that the 100% shown in the 2012-2014 columns for many sources does not “square” with ARB’s proposal for a 10% haircut in initial allocations In Appendix B.</p>	<p>WSPA recommends that the 10% haircut in Appendix B be deleted.</p>
95890	A-109	<p><b>General Provisions for Direct Allocation</b>            Section 95890 requires that an entity obtain a positive or qualified positive verification statement to be eligible for direct allocation.</p>	<p>WSPA recommends that the regulation be amended to allow an EO decision or a method for direct allocation in case a decision is pending on</p>

WSPA believes that this section needs to recognize that there are circumstances where an entity cannot get a qualified positive product data verification – this is a new procedure that could have complications.

a qualified positive verification or in case of an adverse verification opinion.

95891  
Table 9-1

A-114

**Product-Based Benchmarks**

The product-based benchmarks in Table 9-1 are not at all transparent. WSPA has many questions on how benchmarks were calculated. For example what assumptions were made to calculate the H2 plant benchmark - assume pure H2 production?

WSPA recommends that ARB conduct stakeholder workshops to provide transparency to the benchmarking process.

95892(a)

A-120

**Allocation to Electrical Distribution Utilities**

Section 95892(a) requires that allowances allocated to Electrical Distribution Utilities must be used exclusively for retail ratepayers.

WSPA recommends that the language be clarified to include industrial ratepayers in the retail ratepayers. Further WSPA recommends that Electrical Distribution Utilities also participate in the revenue distribution for other purposes such as to address the environmental justice requirements.

95911(b)(4)  
(A)

A-132

**Format for Auction**

Section 95911(b)(4)(A) requires that unsold allowances be transferred into the Allowance Price Containment Reserve.

WSPA recommends that the unsold allowances should be put into next auction not to the reserve.

WSPA believes that putting the unsold allowances into the reserve, as opposed as into the next auction, will artificially reduce the abundance of allowances and inflate a reserve that may not be needed and increase compliance costs.

95911(c)(1) A-134

**Auction Purchase Limit**  
Section 95911(c)(1) set the purchase limits that any entity is allowed to purchase at each quarterly auction. WSPA believes that the auction purchase limit is unreasonably low that will inhibit longer-term planning.

WSPA recommends that the purchase limits be deleted or significantly increased.

95912(c)(3) A-137

**Auction Registration**  
Section 95912(c)(3) requires EO approval of an entities registration before an entity may participate in an auction. However there is not timeline for EO approval.

WSPA recommends that the regulation require the EO to approve or deny a registration within 10 days of the completed registration submittal by an entity.

95912(h) A-140

**Auction Bid Guarantee**  
Section 95912(h) requires an auction participant to provide a bid guarantee in the form cash, bond or letter of credit. WSPA believes this requirement is unnecessary and does not add certainty or improve the stability of the program. WSPA believes it is especially ineffective and burdensome for entities with large physical assets in the state and/or who may

**Recommendation:**  
WSPA proposed language change to allow an open credit threshold on a sliding scale based on the published credit rating of the company is in Attachment D.

be investment-grade, credit-rated companies.

WSPA proposes that ARB develop an open credit threshold on a sliding scale based on the published credit rating of the company. Then companies could participate up to their threshold without posting collateral. If an entity wanted to go beyond their threshold it would have to post collateral for any amount above the threshold. The requirement to post collateral for everything (which is the current ARB proposal) would impose unnecessary cost and effort on entities. Under the WSPA recommendation, subsidiaries could use the published credit rating for the parent company.

95920

A-157

**Holding Limit**

Section 95920 sets the provision for the maximum number of California GHG allowances that may be held by an entity or a group of entities with corporate association at any point in time. WSPA believes that although holding limit provision is improved from the current regulation, it is still too stringent to be workable especially for WSPA members that will require managing significant number of

WSPA recommends that section 95929 be amended to set the holding account limit for compliance entities as two times the average of the entities previous two year's reported emissions calculated pursuant to section 95920(c)(1). (see the proposed language in Attachment D).

allowances.

95921(c)(4) and (5)	A-162	<b>Conduct of Trade</b> Section 95921(c) delineates the transaction information that must be submitted to the accounts administrator. Section 95921(c)(4) and (5) require that time and date be submitted for transactions agreements and settlements. WSPA does not believe that such information is necessary and will be difficult to track.	WSPA recommends that subsections (c)(4) and (5) be deleted.
95921(d)	A-163	<b>Protection of Confidential Information/Release of Information</b> Section 95921(d) delineates the release and protection of transaction price and quantity information. WSPA believes that release individual transaction price and quantity information does not provide adequate confidentiality protection.	WSPA recommends that this section be amended to require release of transaction price and quantity in an aggregated format for confidentiality protection.
95972(b)	A-169	<b>Offset Crediting Periods</b> Section 95972(b) limits the crediting period for sequestration offset projects to no greater than 30 years. WSPA believes that 30 years is too short for a crediting period for geologic sequestration projects.	WSPA recommends that the regulation be amended to provide 100 year crediting period for geologic sequestration projects.
95985(b)	A-243	<b>Invalidation of ARB Offset Credits</b> Section 95985(b) gives ARB 8 years to invalidate an offset credit. WSPA believes that 8 years is too long a	WSPA recommends that this section be amended to allow ARB only 3 years to invalidate offset credits.

period for an offset to be invalidated.

95985(b)

A-244

**Invalidation of ARB Offset Credits**

Section 95985(b) gives ARB the sole authority to invalidate credits. WSPA believes that invalidation should be judged by impartial 3<sup>rd</sup> party.

WSPA recommends that this section be amended to incorporate input and recommendations from an impartial third party.

Appendix B  
pg 13

**Appendix B – Benchmarking**

WSPA Opposes the simple barrel benchmarking because it is an inappropriate benchmark for refining.

WSPA opposes the light crude/heavy crude methodology proposed for crude oil production.

WSPA opposes the 10% hair cut because it is inappropriate for the petroleum industry.

WSPA supports the Adjusted EII benchmarking methodology.

WSPA supports the thermal/non-thermal methodology submitted by WSPA to ARB staff. (See the Benchmarking discussion in the cover letter).