



Western States Petroleum Association
Credible Solutions • Responsive Service • Since 1907

Catherine H. Reheis-Boyd

Executive Vice-President and Chief Operating Officer

August 28, 2009

Via web posting: <http://www.westernclimateinitiative.org/documents/public-comments/postcomment/9>

Mr. Jean-Yves Benoit, Committee Chair (jean-yves.benoit@mddep.gouv.qc.ca)
WCI Cap Setting and Allowance Distribution Committee
Province of Quebec
Édifice Marie-Guyart, 6^e étage
675, boulevard René-Lévesque Est
Québec (Québec) G1R 5V7

Subject: WSPA Comments on Draft Statement of Principles on Competitiveness and Review of Proposed Options for Addressing Industrial Competitiveness Impacts

Dear Mr. Jean-Yves Benoit,

The Western States Petroleum Association (WSPA) is submitting the following comments in response to your solicitation for stakeholder input on “Western Climate Initiative (WCI) Draft Statement of Principles on Competitiveness and Review of Proposed Options for Addressing Industrial Competitiveness Impacts.”

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

WSPA member companies own and operate various types of facilities (e.g., oil and gas production properties, refineries, marketing terminals, retail gasoline outlets, etc.) that will all be impacted by the implementation of the WCI. In addition, WSPA member companies produce and market transportation fuels and other fuels that will also be impacted by the implementation of the WCI.

WSPA is committed to working constructively with WCI toward achieving its Greenhouse Gas (GHG) reductions goals as efficiently and as cost-effectively as possible. This has been demonstrated by our consistent interaction with WCI at workshops and through submittal of comments, including those last week on offset definition and eligibility criteria,

We believe there is widespread recognition that whatever GHG reduction decisions are made, they must be formulated in a way that promotes a strong partnership among all elements.

Competitiveness and Leakage are Directly Related

WSPA believes that competitiveness and leakage are directly related. As programs to implement GHG reductions are formulated, it is clear that economic regions and market sectors must remain competitive; otherwise, emissions leakage and economic leakage will occur.

We are pleased to see that WCI is reviewing issues that could affect competitiveness as it designs a cap and trade program. WSPA endorses the three principles WCI has outlined to prevent impacts on competitiveness:

- Minimize emissions and economic leakage
- Address transitional challenges
- Harmonize cap and trade approach across WCI

WSPA views those three principles as vital to the successful implementation of a WCI program. We believe it is especially critical for WCI to ensure that leakage is minimized from the outset of the program rather than attempting to mitigate its impacts after the damage has already been done.

Leakage (in both an economic sense and with respect to GHG emissions) is largely driven by differing regional impacts. In order to ensure policy and regulatory consistency between regions and with respect to possible federal actions, it is important to ensure: 1) policies, guidelines and procedures are prepared in an open and transparent process and, 2) that interested parties are provided an opportunity to submit comments for WCI to consider and act upon.

We cannot overemphasize the need for transparency and a well-documented vetting process. All stakeholders, including WCI members, must be provided the opportunity to participate in review of the methods, protocols and analyses used to evaluate costs and impacts on the potential for leakage.

Leakage (Economic and Emissions) Must be Minimized

Climate change is a global issue and is best addressed through national programs that are linked or coordinated nationally and internationally. This is the most effective way to minimize leakage.

WSPA believes that, if U.S. and Canadian federal GHG control programs are put in place, the best approach would be for the WCI partners to participate in these federal programs. In the presence of these broader programs, a co-existing WCI regional program might not add much value but could significantly increase complexity and administrative cost.

The potential negative impacts of multiple programs at the state, regional and federal levels, is highlighted by Goulder, Jacobsen and Van Benthem in their recent report on state-level emissions limits on greenhouse gases, where they say: “...*the co-existence of the Federal and state efforts can make state-level efforts ineffective. ... Whatever reductions are achieved in the more aggressive state will reduce pressure on the Federal cap and thereby allow facilities in other states to increase their emissions.*”¹

¹ Lawrence H. Goulder, Mark R. Jacobsen, and Arthur A. van Benthem, Impacts of State-Level Limits on Greenhouse Gases per Mile In the Presence of National CAFÉ Standards (May 2009). Page 24.

We believe this statement equally applies to potential negative impacts between the WCI program and possible Canadian and U.S. federal programs. This is why we encourage the use of broader federal programs over state and regional approaches if they are available.

In the current situation, where there is an absence of a federal approach, minimizing leakage requires the WCI's cap and trade program to mesh closely and efficiently with GHG control programs outside the WCI Partner Jurisdictions. To meet the goals of the WCI program in a scientifically sound, technologically feasible and cost-effective manner, WSPA supports linking the WCI program with national and international market programs, especially through the use of offsets.

Linkage by way of offsets can both reduce leakage and enhance cost-effectiveness. We have previously described our position on linkage and offsets and we refer you to those submittals.

In addition, WCI must clearly describe how its cap and trade program will be harmonized with elements of other GHG control programs, such as California's AB 32 and any other state or regional programs that may develop through the legislative and regulatory processes.

In particular, we ask WCI to articulate the process by which the various elements of its program would be synchronized with the relevant elements of other programs, that could quite possibly be under development concurrently.

Minimizing Emissions Leakage

Minimizing emissions leakage is critical to successful implementation of the WCI cap and trade program. If emissions simply move out of the region, the region will bear a significant economic burden on goods and services for no environmental benefit or, worse and more likely, there will be a net environmental penalty on a global basis.

We believe that the actions by the European Union (EU) and the Australian government are useful to consider as WCI shapes its policy approach to reducing leakage. In particular, we note that these governments have made progress in creating criteria and developing approaches to generate data on the potential for emissions leakage.

Competitiveness Implications in the European Union (EU)

In February 2009, the European Commission (EC) updated its September 2008 analysis regarding leakage, by issuing a memo assessing carbon leakage in the EU's energy intensive industries in the context of the EU emission trading scheme. While the collective experience on this subject continues to evolve, the following citation identifies a key issue that WCI should consider as its program is being developed:

“Heavy industry, including the cement, steel, aluminum and chemical sectors, argue that a tightened ETS (Emission Trading Scheme) would inflate their costs to such an extent that they would be forced to move their factories and jobs beyond the EU's borders, leading to a ‘leakage’ of CO2 emissions without any environmental benefit”.²

² *Article from EurActive.com. ‘Carbon Leakage’: A Challenge for EU Industry (January 27, 2009), at <http://www.euractiv.com/en/climate-change/carbon-leakage-challenge-eu-industry/article:176591>*

EU Refining is Exposed to Emissions Leakage

While not mentioned in the citation above, it is clear that refining is also exposed to emissions leakage.

In an April 2009 memo to the European Commission, Chris Beddoes, EUROPIA Executive Officer, highlighted that the WoodMac analysis commissioned by EUROPIA “shows that, even in this period of relatively strong Refining margins from 2004-2008, the cost of buying CO2 allowances would be a significant part of value added; it highlights that non EU trade in refined products is substantial and growing. It confirms that EU Refining is exposed to significant risk of carbon leakage, with both quantitative criteria exceeding the thresholds defined in the ETS Directive by a significant margin.”³

Attached is a EUROPIA slide presentation that contains more detail regarding the WoodMac analysis and illustrates the degree to which refining in the EU is exposed to international trade. As noted above, we believe that refining in the WCI Partner Jurisdictions may be similarly exposed to trade, both international and intraregional, and that this must be addressed in the WCI program by including provisions to minimize the potential for leakage.

Competitiveness Implications in Australia

A December 16, 2008 Australian Institute of Petroleum (AIP) press release included the following statements in reference to Australia’s Carbon Pollution Reduction Scheme (CPRS) and its treatment of Energy Intensive Trade Exposed (EITE) industries:

“The effective treatment of EITE industries under the CPRS is critical to ensuring that otherwise competitive Australian industries are not artificially disadvantaged through the imposition of additional carbon costs that are not faced by their international competitors.

“Without adequate EITE emissions treatment...the Australian refining industry will be less competitive than Asian refineries not facing similar carbon costs and will lose attractiveness as a future investment destination. This would place significant pressure on the viability of a number of Australian refineries over the period to 2020, and may lead to refinery closures and the transfer of their carbon emissions to other countries.”⁴

In February, 2009 the Australian Government, in its “Assessment of activities for the purpose of the emissions-intensive-trade exposed assistance program,” not only outlines a process to assess the risk of leakage from trade-exposed industries, but concludes that “Australia’s adoption of a carbon constraint before other countries may have a significant impact on its emissions-intensive-trade exposed industries.

³ Letter from Europia: EU Refining: an independent assessment of the EU ETS Carbon Leakage Criteria. April 14, 2009

⁴ Tilley, Dr John, Media Releases – AIP welcomes a more realistic approach to the design of the Australian emissions trading scheme, (December 16, 2008), at http://www.aip.com.au/topics/mr16_12_08.htm

The Government is committed to providing assistance to these industries to reduce the risk of carbon leakage...”⁵

We believe Australia's observations and concerns about leakage apply to WCI as well, and that lessons should be drawn from Australia's experience as the WCI program is being designed.

Implications about Competitiveness in California

Attached is a memo from the Analysis Group, a consultancy commissioned by WSPA to examine economic and emissions leakage in California. We believe that the findings outlined in this memo apply to programs being considered by the WCI.

The Analysis Group concluded that, while recent studies of a federal cap and trade program show that the reductions in emissions by U.S. firms under a federal climate policy could be offset by increases in emissions by foreign firms, *“Leakage may be even a greater concern at the state level, where regulated firms are more exposed to competition from imports from other states, as well as those from other countries.”*

The memo also stresses that *“When emissions leakage occurs, the result is particularly unfavorable for the regulated region. It suffers the consequences of economic leakage for no net environmental gain.”* This is why it is particularly important for California that the AB 32 program be designed so as to be compatible with any future federal program.

By extension, the WCI program also must also be designed to be compatible with broader programs outside WCI Partner Jurisdictions. WSPA believes that the most effective way to do this in the context of both California's and the WCI's programs, is to influence the development of future federal GHG control programs.

The Analysis Group recommends that *“In the near term, CARB should avoid setting overly stringent interim GHG targets or implementing costly complementary measures while broader cap-and-trade systems are being developed.”* To set more stringent cap-and-trade targets and impose less flexible regulations through command and control complementary measures in California or in the WCI program, compared to what is anticipated at the federal level, may serve only to impose greater costs on the State's consumers and businesses, and increase leakage of both emissions and jobs.

In addition, The Analysis Group concluded that ... *“When evaluating potential leakage and competitiveness effects, CARB should focus not only on current trends and immediate impacts, but also on longer term effects.”* These longer term effects could have significant impact on future investments in California and the WCI Partner Jurisdictions.

The Analysis Group memo provides suggested program evaluations to assess leakage, including consideration of *“...the added costs not only of the cap-and-trade program but also the*

⁵ *Australian Government, Department of Climate Change, Assessment of activities for the purposes of the Emission-intensive-trade exposed assistance program (February, 2009) at www.climatechange.gov.au/whitepaper/assistance/pubs/guidance_paper.pdf*

complementary measures contained in AB 32.” This same suggestion must be considered by WCI during the development of its program if WCI decides to implement complementary measures.

WSPA believes that a well designed market mechanism is a better approach to GHG reduction than the use of complementary measures which are not needed if a market mechanism is in place.

California Refining is Exposed to Emissions Leakage

The Analysis Group study concludes that *“Under AB 32, industrial sectors will bear added costs from the cap-and-trade and the complementary measures”* and that *“these costs will be greatest for sectors that are energy and GHG emissions intensive.”* The study further states that the petroleum refining sector is an industry with high energy costs which will *“likely face the highest direct costs under a GHG cap-and-trade program.”*

Because of this, the Analysis Group determined that, *“the added costs imposed by AB 32 policies combined with competitive pressure from out-of-state firms create the potential for leakage in the petroleum sector.”* They further state: *“Imposing additional costs on refiners in California that are not faced by out-of-state refiners may increase imports of gasoline to California. The resulting shift in refining activity from California to other states or regions is economic leakage, and it could lead to emissions leakage.”*

The Analysis Group memo also provides a number of program design recommendations that can minimize leakage, including:

(1) development of a geographically broad and harmonized cap-and-trade system like one nationwide program that would reduce leakage; and,

(2) implementation of the following cost containment provisions that help to minimize the cost of achieving GHG targets.

They note that:

- Banking and borrowing can lower costs by allowing sources to reduce GHG emissions when and where there are cost advantages.
- Multi-year compliance periods provide the advantages of banking and borrowing during well-defined, limited time periods.
- Access to broad offsets without geographic or numeric limitations is crucial to maximize cost effectiveness.

Once again, we believe the recommendations the Analysis Group made for the AB 32 program are also applicable to the WCI program.

Avoid Unintended Consequences

Maintaining a competitive environment requires that any programs WCI and other entities may develop are robust and are designed to avoid unintended consequences. Included in the list of potential unintended consequences is the possibility that due to leakage, environmental impacts could

actually be worsened by implementation of GHG control programs, and that there could be negative impacts on both the economy and future energy supplies.

For example, as policy makers develop programs to address climate change it is critical that they also understand correctly the options and alternatives available for our future energy supply. This is important because the program must not inhibit the ability of our industry to supply fuels reliably to consumers and to ensure that the regional economy continues to function.

It is also important to design programs that are compatible with WTO and other trade provisions.

Conclusion

WSPA is pleased that WCI is closely evaluating the issue of emissions leakage and considering the pros and cons of the various policies being undertaken throughout the world. Consistent development and implementation of GHG reduction objectives and processes, together with other regional, federal and international objectives, and linkage of programs whenever possible, will minimize the potential for leakage and preserve economic competitiveness.

We urge you to also consider how the studies cited herein, and others that WCI may have reviewed, can provide insights into the potential impacts on the petroleum industry as a trade-exposed industry. Our overarching request is that WCI seek every opportunity to continue learning from the work of others who have considered these issues in the design of their GHG control programs.

Thank you for considering our comments. We look forward to continuing working with you and WCI staff on this challenging endeavor. If there are any questions, please contact me at (916) 498-7752.

Sincerely,



cc: Eli Levitt (eli.levitt@ecy.wa.gov)
Patrick Cummins (pcummins@westgov.org)
Tim Lesiuk (tim.lesiuk@gov.bc.ca)
Michael Gibbs (mgibbs@calepa.ca.gov)
Dianne Nielson (dnielson@utah.gov)
Linda Adams (LAdams@calepa.ca.gov)
Dan Pellissier (DPellissier@calepa.ca.gov)
Cindy Tuck (ctuck@calepa.ca.gov)
Lucille Van Ommering (lvanomme@arb.ca.gov)

Attachments