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10-11-1 & 10-11-2

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Ms. Mary Nichols, Chairman
Air Resource Board
1001 I Street,
Sacramento, CA 95814

SUBJECT: Comments to the California Air Resources Board From the California Independent Petroleum Association Regarding the Cap and Trade Regulation and Changes to the Mandatory Reporting Regulation

Dear Chairman Nichols:

The California Independent Petroleum Association respectfully submits the following comments on the Cap and Trade and Mandatory Reporting Regulations.

The mission of the California Independent Petroleum Association (CIPA) is to promote greater understanding and awareness of the unique nature of California's independent oil and natural gas producers and the market place in which they operate; highlight the economic contributions made by California independents to local, state and national economies; foster the efficient utilization of California's petroleum resources; promote a balanced approach to resource development and environmental protection and improve business conditions for members of our industry. CIPA represents over 470 independent oil and gas producers, royalty owners, and service and supply companies with operations in California.

CIPA appreciates the opportunity to submit the following comments to the California Air Resources Board (CARB) for its consideration. The members of CIPA believe that domestic petroleum production already plays a meaningful role in helping the state meet its policy goals for reducing greenhouse gas emissions in California since every barrel produced in-state is one less barrel that must be imported from foreign countries

Moreover, CIPA and its members are doing their part, to the extent practicable, to reach further reductions. California oil and gas production already faces the most rigorous environmental regulation in the industry both nationally and internationally. As a result, California oil and gas production should be *expanded* to fully capture the environmental benefits of the regulatory regime in this state. California production is more environmentally sensitive than imports, and the transportation necessary to facilitate the imports, which are often produced with little or no environmental regulation.

CARB desperately needs to listen to constructive voices in the implementation of AB 32 and ensure that the greenhouse gas emission reductions required by the statute are achieved while maintaining the competitiveness of California's economy and domestic oil and gas production.

Mandatory Reporting

The CARB staff report notes that the proposed revision to the regulation is necessary to support a California greenhouse gas cap and trade program and to harmonize with the U.S. EPA federal mandatory GHG reporting requirements. The staff report goes on to note that the revisions are also necessary, and authorized, to "prepare, adopt, and update" California's inventory of emissions related to climate change formerly conducted by the Energy Commission.

Goals of Changes

The staff report sets out the following goals for the proposed regulatory changes to the Mandatory Reporting regulation:

1. Collect data that are sufficiently rigorous and consistent to support GHG cap and trade and other ARB programs;
2. Harmonize California reporting requirements with U.S. EPA reporting requirements to simplify and streamline GHG reporting;
3. Provide consistency with Western Climate Initiative reporting requirements while addressing specific California needs under AB 32 and other state law;
4. Provide for third-party verification of reported emissions data consistent with international standards.

Unfortunately, the proposed regulatory changes only succeed at #1 and #4 above: rigorous and costly data collection and costly third party verification. There are more exceptions to than harmony with U.S. EPA regulations and California compromises on its reporting threshold rather than recognizing appropriate California needs meaning that under these changes the WCI tail will wag the California dog *even though under the proposed cap and trade design California will go it alone*!

Reporting Requirements for Emissions Below 25k

Facilities and suppliers with emissions between 10,000 metric tons and 25,000 metric tons of CO_2E would be included in the mandatory reporting program, but would have abbreviated reporting requirements. These reporters would report their combustion emissions using default emission factors or any other method of their choosing from the U.S. EPA regulation (USEPA MRR 2009-2010). They would also report process emissions, although these are unlikely to occur at facilities of this size.

CIPA objects to these reporting requirements. Requiring reporting below 25, 000 tons from parties with no compliance obligations will be costly, create confusion, is in no way a "harmonization" with US EPA reporting requirements and only serves to align with the Western Climate Initiative at a time when CARB is adopting a cap and trade scheme that encompasses California only. The mandatory reporting requirement threshold should remain aligned with the US EPA standard of 25,000 MTCO2E.

Who Reports

In the case of onshore petroleum and natural gas production, the reporting footprint is defined as the geological basin. Reporters would be required to determine and report

emissions from stationary combustion, and specified process and vented emissions. The reporting entity may be either a facility operator. But in all of the effort to harmonize, there is still confusion relative to current and ongoing reporting framework for local air districts. Oil and gas operators in California with multiple locations conceivably could be required to comply with air district, CARB, WCI and federal reporting requirements which will be confusing and costly especially given the enforcement penalties at CARB's disposal for such things as "inaccurate information".

Oil and Gas

The staff report states that when the U.S. EPA Subpart W Rule is made final, CARB will reconfigure this article to conform with the existing California MRR format. But the federal rule is complete and CARB has had the opportunity to facilitate conformity, but has chosen not to with respect to the reporting threshold. As noted above, CIPA objects to reporting requirements for parties with no compliance obligation.

CIPA further notes objection to two specific areas that the CARB proposal deviates from the federal rule:

Meters- Section 95153(a), Natural gas pneumatic high bleed device and pneumatic pump venting. Operators would be required to install metering of natural gas venting on 50 percent of all high bleed devices and pneumatic pumps by January 1, 2013.

Dissolved CO2- reporting requirements for dissolved CO_2 in produced water resulting from Enhanced Oil Recovery operations where supercritical phase CO_2 is injected into oil and gas fields to stimulate productivity. Currently, only thermal EOR activities take place in the California. This method is included in the reporting regulation to ensure that should critical phase CO_2 EOR activities begin in California that there is a method in place to quantify emissions. It doesn't go on and does not need to be in the regulation.

Cap and trade

Consistent with our previous comments, we believe that market mechanisms such as cap-and-trade are far preferable to draconian command and control regulations and can be deployed to reduce the costs of achieving greenhouse gas emissions reductions under AB 32. Flexible options for compliance are fundamental for companies that have already undertaken considerable reductions through efficiency measures and/or best available control technologies, have limited ability to make onsite reductions or desire to expand their operations in California.

We wrote to the Board in June 2010 regarding the draft regulation, and noted that Assembly Bill 32 was premised on the notion that "National and international actions are necessary to fully address the issue of global warming. However, action taken by California to reduce emissions of greenhouse gases will have far-reaching effects by encouraging other states, the federal government, and other countries to act."[1]

[1]Health and Safety Code §38501(d) as added by Chapter 488, Statutes of 2006.

Unfortunately, the "encouragement" has fallen far short of far-reaching. The global nature of climate means that action by California alone will do little to address the issue. Nevertheless, the situational political winds dictate the likely design and timing of climate policy at the federal and state level and cap and trade is politically dead at the federal level. California proceeds alone at its economic peril.
California will begin its cap and trade system without the commensurate participation it had hoped to stimulate from neighboring political subdivisions and the federal government, which in turn will have major consequences likely resulting in a range of negative economic impacts on California businesses.

The proposed regulation unfortunately is doomed to failure because of the limited participation by other jurisdictions and the demise of a federal cap and trade program. The state only program, which the Board appears determined to pass before it is fully baked, poses huge risks of harm to jobs and the California economy due to among other factors, economic leakage. Moreover, the associated greenhouse gas emissions leakage will undermine any integrity the Board may have hoped for in the program. **We believe that many proposed aspects of the program will unnecessarily exacerbate this risk and CARB should give full consideration to both the limited linkage to competing jurisdictions and the incompleteness of the regulation and put this measure over until it is complete and there are enough real trading partners to avoid massive leakage.**

In fact, this damn the torpedoes, full speed ahead whether the regulation is complete or not mentality reminds us of the ill-fated electricity deregulation scheme and we believe that CARB's rush to pass the Cap and Trade Regulation before it is ready will blow up, just as deregulation blew up, as soon as allocation gives way to auction with the only question being how dire the resulting economic consequences.

Complete the Regulation before Passing It
We are concerned that CARB has begun a pattern of passing regulations before they are completed and using the 15 day update process to attempt to fill in holes. We believe this is illegal and wrong and the practice flies in the face of requirements that the record be complete prior to voting on a measure- if for no other reason than it precludes regulated parties from doing a complete analysis and filing fully informed comments to say nothing of the practice making it impossible to do a complete cost effectiveness analysis required by both the Administrative Procedures Act as well as AB 32.

The full range of details required to understand and implement the cap-and-trade program have not yet been fully sorted and accounted for. Many of the tools, provisions, and methods still being developed by CARB will provide crucial information for business operations in California. There is no confidence that the information will be available or even determined prior to the last quarter of 2011 or even before the start of the market in 2012.

Enforcement

The staff report section on enforcement tells us:

> Section 95107 makes clear what constitutes a violation of the proposed revised GHG reporting regulation. The revised provisions clarify the number of days, or portions thereof, of violations for failing to comply with the revised regulation. For instance, if an emissions data report is not submitted, is submitted late, or contains incomplete or inaccurate information, each day or portion thereof that the report is late will constitute a separate violation of the proposed regulation. The section also clarifies what is meant by "inaccurate." In this instance, "inaccurate" means that the information is not within the level of reproducibility of a test or measurement method required by the proposed regulation. These same violations would result if a verification body fails to submit a verification statement by the required deadline in the proposed regulation (see proposed revised section 95103(f)). Each day or portion thereof that the verification statement is late would constitute a separate violation of the proposed regulation. Furthermore, given that section 95103(f) requires the reporting entity to obtain the services of a verification body and that such services must be completed by the regulatory deadline, a late submitted verification statement could also lead to a violation by the reporting entity.
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> In addition, this section also clarifies that each failure to comply with the methods in the proposed regulation for measuring, collecting, recording, and preserving information needed for the calculation of emissions constitutes a separate violation of the proposed regulation. This violation has been included in the proposed revisions because it ensures that reporting entities will utilize the methods required by the regulation, which further ensures the stringency of calculations and resulting reported emissions data.[2]

However, we do not see it so clearly and are concerned about the potential exposure to draconian enforcement actions over potential inaccuracies in complying with a half-finished, overly complex and sometimes convoluted set of requirements. Moreover, we are concerned that the violation and penalty structure as detailed in Section 95107 of the MRR could lead to a layering of penalties. In fact, we agree with the Western States Petroleum Association that "one piece of missing or incorrect data (out of potentially millions of pieces of data) could lead to potentially massive penalties. In other words, failure to measure, collect, record and preserve data could lead to a violation and penalty for "each ton, for each day" that the alleged failure occurred."[3]

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[2] STAFF REPORT: INITIAL STATEMENT OF REASONS FOR RULEMAKING REVISIONS TO THE REGULATION FOR MANDATORY REPORTING OF GREENHOUSE GAS EMISSIONS PURSUANT TO THE CALIFORNIA GLOBAL WARMING SOLUTIONS ACT OF 2006 (ASSEMBLY BILL 32); page 29

[3] Western States Petroleum Association comments Agenda 10-11-1, Public Hearing to Consider the Adoption of a Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols; December 15, 2010.

Allowances Not Auctions
CARB staff proposes that free allowances in the first compliance period be followed by auctions in the second and third, with specific recommendations on percentage allowance allocations based on assigned leakage risks.

An auction scheme for allowances will impose very high costs on regulated parties, which will, in turn, be passed through to the economy as a whole. Unless and until California has transitioned to a comprehensive national program with similar costs imposed on competitor states and nations an auction will fail and do untold harm to the state's economy. The regulation should be clear that auctions are not authorized until carbon trading reaches sufficient scale to reap its anticipated benefits and not decimate the state economy.

When California is part of a broad national program with similar allowance allocation requirements, we can consider if an auction is appropriate and cost effective, but until that occurs, CIPA supports only free allowance distribution for all sectors for each compliance period up to 2020.

Offsets should be Unlimited
We appreciate that CARB has recognized the two-fold value of offsets as a cost-control mechanism and a way to further the goals of emission reductions. We further appreciate that CARB staff has increased the ability to use offsets from four percent up to eight percent of the compliance obligation. Nevertheless, this expansion is too small to realize the full value to regulated parties and to the success of the regulation itself insofar as offsets are compliance cost mitigation instruments.

We agree with the AB 32 Implementation Group in their recommendation that CARB set no limit on the use of qualified offsets.

AB 32 Revenue
CIPA also agrees with the AB 32 Implementation Group that CARB has no current authority, under AB 32 or otherwise, to raise revenue for purposes unrelated to administration of the AB 32 program. The statement of reasons does not demonstrate that an auction to raise revenue is necessary for, or limited to, administration of the program, which is the only authority bestowed by AB 32. We also agree with AB 32 IG that an auction and its proceeds are not only unauthorized by AB 32, but equate to a tax that will require 2/3 vote of the legislature.

Respectfully submitted,

Norman Plotkin
For the California Independent Petroleum Association