



Western States Petroleum Association
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Catherine H. Reheis-Boyd
President

August 1, 2014

Mary Nichols
Chair, California Air Resources Board
California Air Resources Board
1001 "I" Street
Sacramento, CA 95814

Dear Chairwoman Nichols:

I write to you today to seek clarification regarding a number of recent statements your representatives have made regarding the January 1, 2015 expansion of California's cap and trade program to transportation fuels. As you know, the Western States Petroleum Association believes this regulatory expansion will have a significant impact on the fuels markets and potentially consumers, most of whom are unaware of the change and its impact on fuel costs.

WSPA and its members share the Air Resources Board's objectives to reduce greenhouse gas emissions to 1990 levels by 2020. Toward this end, we have worked with the Board and its staff on implementation of cap and trade regulations for stationary sources of greenhouse gas emissions. Expanding the program to fuels is a major, unprecedented step. No other jurisdiction in the world has attempted to regulate gasoline and diesel markets through a cap and trade mechanism. That is why we are recommending the program be delayed – so that all Californians can be properly educated, obligated parties can understand how the program is intended to work, and appropriate controls are in place to prevent unnecessary disruptions to markets and fuel supplies.

We would ask that you provide us an explanation or clarification of the statements catalogued below.

- 1. "They really don't have to pony up anything until November, 2018." (Dave Clegern, spokesperson for CARB, *Inland Valley Daily Bulletin*, July 2, 2014)**

This statement is inconsistent with our understanding of the existing regulation. Chapter 3 of CARB's April 2013 Regulatory Guidance Document states that starting in 2015, each obligated company is required to surrender a minimum of 30 percent of the emissions allowances for a given year by November 1 of the following year. This means, at a minimum, that fuel providers will be required to

“pony up” 30 percent of the anticipated allowance costs from the sales of fuels (\$2.7 - \$12.9 billion) by November of 2016.

As a practical matter, if obligated companies elect to purchase only 30 percent of their necessary allowances in each year of the program, they will face compounding obligations and costs in subsequent years that will require they purchase 240 percent of their annual obligations in 2018. While we have no way of predicting how individual companies will choose to meet their obligations under this regulatory expansion, to suggest they have no obligations in 2015, 2016 and 2017 is inaccurate and presumes compliance strategies that are unrealistic and cannot be predicted.

Finally, a widely accepted and responsible business practice is to address increases in manufacturing costs in a ratable manner – meaning in a time period proximate to when those costs are incurred. Deferring the added compliance costs imposed by the cap and trade regulation for several years would be a deviation from this practice.

2. **“Stanley Young, a spokesman for the Air Resources Board, said many companies coming under the cap in January have bought allowances ahead of time. He declined to say how much any oil supplier has already purchased, but he said ‘many of these fuel suppliers have been purchasing this, which means that they have been spending money.’ He suggested the cost of compliance has already been incorporated into the price of fuel.”** (*The Sacramento Bee*, June 30, 2014)

Again, this statement suggests CARB has insight into the compliance strategies of individual companies which are confidential and proprietary. The scale of allowance trading to date also suggests this statement could be construed as being inaccurate or misleading. Expansion of the cap and trade program to fuels will dramatically increase the compliance costs of fuel providers and nothing in the public record regarding current or previous allowance auctions indicates any significant advance purchases of allowances necessary to meet these future obligations has occurred.

This statement also appears to be a contradiction to the statement made by Dave Clergen on July 2. CARB representatives appear to be asserting both that fuel suppliers have already spent money to purchase allowances for future obligations and that fuel suppliers will not pay anything until November 2018 to meet their obligations. We would ask that CARB clarify its position in this regard so as not to potentially confuse the public regarding this impending regulation.

3. **“The ARB itself estimated in 2010 that gas prices could increase 4 percent to 19 percent by 2020 as a result of cap and trade, but ARB officials said that estimate is outdated. [Stanley] Young said ‘we don’t believe there will be any discernible increase in pricing’ next year.”** (*The Sacramento Bee*, June 30, 2014)

We are unaware of any updated economic impact analysis regarding the potential impacts this regulation will have on fuel prices and consumers. Absent an update, we are confused how CARB can claim its own assessment is outdated.

It appears CARB is asking the public to disregard its only economic analysis as “outdated” while offering no new analysis in its place. Asking Californians to accept on faith this first-of-its-kind

regulation of fuels under a cap and trade program in the absence of an economic impact assessment is concerning.

4. **"There's no rule that any cost of compliance must be passed through the consumers. That's purely a decision of the ... suppliers." (Dave Clegern, spokesperson for CARB, *Bakersfield Californian*, July 1, 2014)**

This statement is one the most confusing of all of CARB's recent announcements on this issue and suggests a serious misunderstanding about the very purpose of expanding the cap and trade program to gasoline and diesel. It is our understanding and belief that the cap and trade program is intended to help the state meet the goals of AB 32 by establishing a price for carbon in the marketplace for fuels. By increasing the cost of carbon-based fuels, consumers are expected to change their behavior, adopt alternative transport modes and take other steps to reduce greenhouse gas emissions.

As your own advisor, Professor James Bushnell, said in a paper just this week, "Just about every serious person who has thought about this expects the costs of the carbon that is contained in petroleum-based fuels will be reflected in retail prices," (Cap and Trade's Moment of Truth, Energy Institute at Haas, July 14, 2014).

You expressed a similar view in the November 2013 edition of *Issues in Science and Technology* when you wrote, "GHG emissions will be reduced if people drive less, and people can be nudged to drive less by cities that reduce urban sprawl, enhance public transportation, and raise the price of travel to incorporate externalities of carbon emissions, pollution, and energy security."

In the same column, you expressed concern over policies that "shield consumers from price increases" because they slow the "behavioral response" in the transition to transportation options that result in fewer emissions.

These statements appear to affirm our understanding of CARB's purpose in bringing fuels under the cap and trade program, i.e. to increase prices to consumers as a means of changing behavior. If fuel price increases are not the intended effect, we question the purpose of this program and how it will reduce greenhouse gas emissions, which is the mandate of AB 32.

5. **"We do not set the prices of the allowances." (Stanley Young, spokesperson for CARB, *San Diego Union Tribune*, July 16, 2014)**

We are perplexed by this statement since CARB indeed does set the minimum price of allowances. By establishing a minimum price, CARB ensures that market forces will not allow prices for carbon to fall below a minimum level. Moreover, CARB determines by how much those minimum prices will increase in future years.

CARB also has complete control over how many allowances will be offered for sale. By adjusting the supply of allowances, CARB has the ability to control the supply and demand dynamic that in an unfettered market would establish a price for carbon. It therefore is confusing to hear a CARB official claim the Board does not establish prices for allowances.

We welcome any explanation, clarification or correction you may wish to provide to address our concerns about CARB's public statements. We would especially ask that you clarify which of the statements discussed above reflect the Board's current thinking on expansion of cap and trade for fuels, i.e.:

- a) Consumers will see gasoline costs increase between 4 percent and 19 percent;
- b) Consumers will not see impacts of the regulation until 2018;
- c) Consumers already are paying the higher costs for fuels;
- d) Consumers will not see any impact on fuel costs as a result of the regulation.

This program, unless delayed or modified, will have a major impact on California fuel markets and very possibly, consumers. We believe the State has an obligation to Californians to provide widely available, accurate and consistent information.

Sincerely,

Catherine Reheis-Boyd
President
Western States Petroleum Association