



Written Statement of

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on

“Climate Change Legislation: Allowance and Revenue Distribution”

before the

Senate Finance Committee

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I. Introduction

NPRA, the National Petrochemical & Refiners Association, appreciates the opportunity to submit this testimony regarding *Climate Change Legislation: Allowance and Revenue Distribution*. NPRA is a national trade association with more than 450 members, including those who own or operate virtually all U.S. refining capacity, as well as most of the nation's petrochemical manufacturers who supply "building block" chemicals necessary to manufacture products ranging from pharmaceuticals to fertilizer to Kevlar. We commend the committee for addressing this important topic and would like to discuss with you our concerns with H.R. 2454, the "American Clean Energy and Security Act of 2009" ("ACES").

NPRA members produce the gasoline, diesel and jet fuel that power virtually all of our nation's transportation needs. In addition to providing the energy necessary for the driving public, these fuels are essential for shipping companies, farmers and livestock producers, our nation's airlines, and the United States military. Petroleum-based fuels are and will continue to be a critical component of our nation's energy needs and economic growth for decades to come.

Climate change is a complex public policy challenge that must be addressed with realistic, long-term strategies recognizing the vital role that all forms of energy – traditional, supplemental and renewable – will play in maintaining our country's freedom, economic strength and quality of life. Any policy to address climate change must be based on cost-effective approaches that maintain the global competitiveness of the American economy.

There are several incontrovertible principles that must be followed as the climate debate progresses in order to maintain our global competitiveness, keep energy costs reasonable, and allow consumers continued access to the reliable fuels that run our transportation infrastructure and help sustain our economy. Unfortunately, H.R. 2454 not only fails to comply with any of these principles, but enactment of this legislation will result in the exact opposite.

This legislation's cap-and-trade allowance allocation regime is an ill-conceived, poorly disguised, and heavily regressive increase in the federal motor fuels excise tax on petroleum products. If enacted into law, H.R. 2454 will adversely impact all gasoline, diesel and jet fuel consumers, including truckers, farmers, airlines and the driving public. This legislation quite simply is intended to have a detrimental and disproportional impact on the nation's domestic refining industry, and it will impede our nation's energy security by providing foreign refiners with a distinct competitive advantage over U.S. refiners.

Passing H.R. 2454 in its current form will impose a massive tax increase on American motorists and consumers and drive the domestic petroleum refining industry overseas. NPRA urges this Committee and the entire Senate to take a drastically different approach to a federal carbon constraint program to avoid the twin policies of increasing the tax burden on consumers and outsourcing of our nation's transportation energy future that are embedded in H.R. 2454's provisions.

II. Negative Impact on Consumers

At its core, the climate change legislation narrowly passed by the House threatens to destroy the economic viability of the domestic refining industry. By singling out refiners and

making them responsible for the emissions of both their facilities and the fuels they produce, every consumer in the United States will be forced to bear the burden of this ill-conceived “new energy future.”

In 2008, Americans consumed nearly 270 billion gallons of finished petroleum products such as gasoline, diesel fuel, jet fuel and home heating oil.¹ EPA’s projected and very conservative carbon cost of \$20 per ton for CO₂ would translate to a cost increase of roughly 20 cents per gallon,² which means the cost of producing gasoline, diesel fuel, jet fuel and other petroleum-based products would increase by more than \$53 billion in the first years after enactment of H.R. 2454, with even more significant increased costs as the carbon cap decreases. According to the champions of H.R. 2454, all of these increased costs would be passed along to consumers at the pump.

Climate change legislation would also affect industries dependent on moving goods and people. The trucking industry has stated that any change, however slight, in the price of transportation fuels will have a disproportionate impact on its economic viability. The American Trucking Association states that in 2008, trucking companies consumed more than 39 billion gallons of diesel fuel, which means that a one-cent increase in the average price of diesel costs the trucking industry an additional \$390 million in fuel expenses.

The Air Transport Association says that cap-and-trade legislation would serve as an “additional, exorbitant tax” on jet fuel.³ Higher shipping costs inevitably find their way into higher costs for the goods being shipped.

H.R. 2454 would likewise impose additional costs on the agricultural sector. In 2007, EIA projected every dime added to the price of gasoline and diesel oil, sustained over a year, costs U.S. agriculture \$400 million annually.⁴ Approximately 65 percent of farmers’ costs are dedicated to fuel, electricity, fertilizer, and chemicals. Rural households also spend 58 percent more on fuel as a percentage of their income than urban residents. A recent National Black Chamber of Commerce study predicted that under a cap-and-trade program, agricultural employment will decline by 59,000 workers by 2030. These facts emphasize that any ill-conceived cap-and-trade program would have a disproportionate effect on rural families and farmers.

III. Allowance Allocations

According to EPA’s recent estimates, the combined CO₂ emissions from domestic petroleum refineries and the emissions resulting from the use of their products constitute approximately 35 percent of the nation’s current CO₂ inventory. These emissions also represent about 50 percent of H.R. 2454’s total emissions allowance pool in 2014. However, in the House

¹ Energy Information Administration. http://tonto.eia.doe.gov/dnav/pet/pet_cons_psup_dc_nus_mbb1_a.htm.

² David Friedman, Union of Concerned Scientists, testimony before the House Energy & Commerce Committee on April 24, 2009.

³ Testimony of James May Testimony before the House Energy and Commerce Committee Subcommittee on Energy and the Environment, U.S. House of Representatives, June 9, 2009.

⁴ Testimony of Dr. Howard Gruenspecht, Deputy Administrator, U.S. Energy Information Administration, before the Committee on Agriculture, U. S. House of Representatives, October 18, 2007. <http://agriculture.house.gov/testimony/110/h71018/Gruenspecht.pdf>

legislation, refiners receive only two percent of the GHG emissions allowances during the early years of the cap-and-trade program. This forces the domestic refining industry to purchase well over 90 percent of the allowances it would need to comply with the cap.

This biased allowance allocation will impose extremely high costs on domestic refiners and, ultimately, on consumers. If refiners are forced to pay even a conservative carbon price of \$20 per ton with two percent of the emissions allowances, a domestic refinery with 100,000 barrels per day of capacity would have to spend roughly \$253 million annually to purchase emissions allowances for the fuels it produces. This cost would total roughly \$53 billion per year for the American refining community, and escalate significantly over time as the carbon cost increases and the emissions cap tightens. EPA concluded in a 2008 analysis of the Lieberman-Warner cap-and-trade bill that costs would be significantly higher if adequate nuclear, biomass or carbon capture and sequestration capabilities were not developed. Under such a scenario, EPA estimated carbon allowance prices would be \$69 per ton in 2020 and \$112 per ton by 2030. If fuel consumption remained stable at 2008 levels, EPA's estimate would result in consumers paying an additional \$185 billion annually in 2020 and \$300 billion in 2030.⁵

The true losers in this scenario are the American people. Every single citizen who depends on gasoline for their daily commute or to take their children to school, truckers who transport vital goods, farmers who require fuel to cultivate their fields, and even the American military will bear the brunt of this unfair allowance allocation.

IV. Principles

Aside from simply re-evaluating the allowance allocations, this Committee and the entire Senate must take an in-depth look at every facet of the House-passed legislation in order to understand just how seriously flawed it is.

At its core, the assumed goal of any carbon control program is to mitigate the effects of climate change. But the House bill ignored the obvious conclusion that one nation cannot do this alone. If climate change is truly a global problem, it requires a global solution. Without other nations willing to address this problem in a similar manner, any carbon control program implemented in the United States is meaningless and simply serves to harm U.S. competitiveness in global markets.

The refining industry is unique in that refineries around the world can produce identical and globally fungible grades of finished products. In other words, a gallon of diesel fuel produced in India can be used in the same manner as a gallon of diesel fuel produced in Indiana. Therefore, a U.S. refinery competes directly with other refineries internationally. If U.S. refineries are forced to scale back production due to higher marginal operating costs that cannot be passed through to consumers due to a cap-and-trade program, a refiner in India will make up for that reduction in finished product supply. This competitive disadvantage would clearly have a widespread, adverse impact on the domestic refining community and even more importantly on the consumer and national energy security. A 2008 study of the potential impacts of the Lieberman-Warner cap-and-trade-bill concluded the legislation would reduce refining capacity

⁵ EPA Analysis of Lieberman/Warner, http://www.epa.gov/climatechange/downloads/s2191_EPA_Analysis.pdf

in this country by 3 million barrels per day, causing gasoline and diesel imports (as opposed to crude oil imports) to double from 15 percent to nearly 30 percent by 2020.⁶

As domestic refining capacity decreases, so do the number of high-paying, high-quality American jobs. For example, in July 2009 an Indian refinery sent its first gasoline shipment to the United States. Furthermore, other countries anxious to capture the U.S. market have substantially increased imports. Brazil has doubled its oil imports to the U.S., and Russia has increased them nearly ten-fold.⁷ To be clear, this is gasoline that will be sold at American gas stations and used by American consumers, and could easily have been produced in the United States by American workers were it not due to the increased costs the refining business already faces when compared to their foreign counterparts. Such import competition will only increase under the dramatically higher costs that would be imposed on domestic fuel producers under H.R. 2454.

Accordingly, in order to mitigate against a decline in international competitiveness and the emissions “leakage” that would occur with more refineries going overseas, any carbon control program must be compliant with the international trade regulations of the World Trade Organization (“WTO”), of which the United States is a member. By imposing a tax on goods specifically on countries that do not implement a carbon control program, the United States effectively imposes trade limits, which goes firmly against WTO policy. This has the potential to incite an international trade war.

In addition to ensuring adequate international participation, any carbon control regime must take a look at potential conflicts and contradictions with current regulations and harmonize any new requirements with existing regulatory mandates. In the past several decades, we have often seen programs adopted to regulate emissions under the Clean Air Act (“CAA”) that have the direct effect of increasing carbon emissions from industrial plants, including petroleum refineries. As a facility adjusts its operations to remove one pollutant from its processes, the energy intensity and the GHG emissions of the facility increase. Any carbon control program must be harmonized with all previous requirements that increase GHG emissions from domestic industrial operations. Once again, the House-passed legislation overlooks this basic principle. For example, H.R. 2454 would overlay a U.S. climate program with an international climate scheme if the program is certified by the Environmental Protection Agency. In addition, the bill fails to address the potential for duplicative, costly and contradictory regulations among the federal and various state governments.

In recent years, individual states have begun to implement their own carbon control programs and fuel standards. In 2009, the California Air Resources Board approved a Low-Carbon Fuel Standard (LCFS) for the State of California. The LCFS requires fuel providers to ensure the mix of fuel they sell into the California market meets a declining standard for GHG emissions. Last month, the Oregon legislature adopted an LCFS for use in the State of Oregon. A continuation of this trend could lead to each state setting its own, individual carbon controls

⁶ ICF International, “Addendum to Impact Assessment of Mandatory GHG Control Legislation on the Refining and Upstream Segments of the U.S. Petroleum Industry; Lieberman/Warner Climate Security Act of 2007, S. 2191.” April 2008.

⁷ *BNet Energy*. “Energy Roundup: Brazil, Russia Hinder OPEC Cuts, GE Blows Away Competition, and More.” April 14, 2009. <http://industry.bnet.com/energy/10001076/energy-roundup-brazil-russia-hinder-opec-cuts-ge-blows-away-competition-and-more/>

and fuels standard and requiring businesses to comply with dozens of different carbon programs and fuel standards. To manufacture individual fuel blends that would comply with dozens of different state programs would be virtually impossible. If carbon is to be constrained through federal legislation, then it is absolutely essential that this legislation pre-empt local and state carbon and fuels statutes and regulations. Again, the authors of H.R. 2454 overlooked this essential aspect of any federal legislation, as nothing in the legislation prevents localities and states from setting individual carbon controls or fuel standards. In fact, provisions of the bill actually *encourage* such a proliferation of overlapping state regulations.

It is axiomatic that any federal carbon control program must encompass the entire U.S. economy, not pick winners and losers, and treat industries and economic sectors equally and fairly. The House-passed legislation does not meet this principle. In the allowance allocation alone, the refining industry is treated dramatically different than other sectors. As previously stated, the combined CO₂ emissions from refineries and consumers constitute approximately 35 percent of the nation's current CO₂ inventory. These emissions make up approximately 52 percent of H.R. 2454's total emissions allowance pool in 2014, yet refiners receive only two percent of the CO₂ emissions allowances. As the Senate moves forward in this debate and if the body intends to explore a cap-and-trade mechanism, any proposal must treat all industries and economic sectors equitably in terms of allowance allocations.

Along with controlling carbon, a primary goal of a cap-and-trade program is to drive the commercial viability of developing technology that will lead to decreased carbon emissions and promote a "new energy future". Again, H.R. 2454 has fallen far short of achieving or even promoting this goal. In fact, by shortchanging some responsible parties with respect to allowances, they are forcing the very industries they expect to lead a "technological revolution" to spend hundreds of millions – and ultimately billions – of dollars to comply with a carbon emissions reduction program. Common sense dictates that as industries are forced to spend more money to comply, the funding to develop and advance such new technologies as renewable energy and carbon capture and sequestration will drastically decrease. As the program advances, industries will be forced to spend more money on compliance, leaving less money for developing and implementing newer, cleaner technologies in the future. Adversely, cap-and-trade proponents argue that investing in new technology will be cheaper than non-compliance penalties. However, forced development with the aim of avoiding financial penalties will have the same effect and will drain financial capital and research and development lead time.

To encourage investment, avoid market manipulation and price volatility, any carbon control program must be inherently simple, transparent, and cost-effective. Unfortunately, as the House sought to create an entirely new financial market for carbon credits, these three key principles were overlooked. H.R. 2454's 1,200 pages are not simple, transparent, or cost-effective. Even on its surface, the bill is complicated. It would give multiple federal agencies authority over different aspects of the cap-and-trade program. Under H.R. 2454, FERC would regulate the allowance and offset cash market, the CFTC would regulate the allowance derivatives, and the EPA and USDA would monitor compliance and offset certification. Clearly, this is a far cry from "simple" or "transparent".

The confusing nature of the House-passed program leaves a tremendous risk for market manipulation, and considering the current state of the U.S. economy, placing our nation's energy future and security in the hands of Wall Street and multiple government agencies is a risk that should not be taken, especially during these uncertain economic times.

Finally, in the past decade, many industrial producers, including the domestic refining community, have made great advancements in GHG controls and reducing their overall emissions. NPRA members have made significant progress in reducing energy intensity while at the same time engaging in highly energy-intensive activities in order to reduce sulfur in gasoline and reduce stationary source emissions at refineries. For example, NPRA members who responded to a survey on energy intensity and represent more than 80 percent of the nation's refining capacity reduced their energy intensity by more than two percent between 2002 and 2004. During that same period, the industry was also designing and constructing new process units to remove sulfur from gasoline and diesel fuels, an extremely energy intense activity. If the government mandates a carbon control program, these previous industry successes must be recognized. Under H.R. 2454, the EPA will issue offset credits for each ton of CO₂-equivalent emissions reduced, avoided or sequestered under an offset program begun after 2001. But EPA will only recognize such a credit if it was issued under any regulatory or voluntary GHG emissions offset program established before 2009 with established standards that ensure the reductions of sequestrations are "permanent, additional, verifiable, and enforceable"; and verified by a State agency or accredited third party. These stringent guidelines fail to take into consideration a significant amount of emissions reductions that have been accomplished in the past ten years.

V. Conclusion

In summary, NPRA believes the Senate must take a significantly different approach than the House of Representatives in crafting climate change legislation. H.R. 2454 is deeply flawed and ultimately will drastically increase energy costs to consumers. Additionally, the lack of allowances provided to the refining industry in relation to their compliance responsibility is unfair to domestic refiners and will undoubtedly lead to increased foreign imports, the loss of American jobs, and increased costs to American consumers. We urge the Committee to consider these principles, consumer impacts, energy security implications, and the viability of our nation's energy future. We look forward to working with members of the Committee as this debate progresses.