RIO TINTO
MINERALS

January 6, 2010

Dr. Lawrence Goulder, Chair
Economic and Allocation Advisory Committee
California Air Resources Board
1101 I Street
Sacramento, CA 95814

Re: Response to EACC's draft report on California's cap-and-trade program

Dear Dr. Goulder and Committee Members:

We welcome the opportunity to comment on the December 14, 2009 draft report prepared by the Economic and Allocation Advisory Committee (EAAC) concerning emission allocations under California's cap-and-trade program.

We strongly support efforts at all levels of government to reduce greenhouse gas emissions. We advocate, however, for a free output-based allocation of allowances – or relief from the system's compliance burden – to avoid leakage and protect the company's ability to compete in a global marketplace. For California exporters who are energy-intensive and trade-exposed, border adjustments – which focus on correcting import bias – will not prevent leakage nor support their ability to remain competitive and continue contributing to California's tax base and trade balance.

Background on U.S. Borax

U.S. Borax operates one of the largest borate deposits in the world in Boron, California, and supplies 42 percent of the world's demand for refined borates – essential ingredients in insulation materials, crop fertilizers, ceramics, glass, wood preservatives and other products that contribute to sustainable development. The company has been a California business since 1872 and has operated in Boron since 1928, where current operations are projected to continue for another 70 years.

The majority of its production volumes are exported from California to customers in more than 100 countries through Borax's distribution facility in the Port of Los Angeles, where it operates the only privately owned berth. The company is the largest exporter of high-value dry bulk goods out of the port and a major shipper of ocean containers.

In Boron, the company employs 800 people, is the seventh largest property owner in Kern County and contributes $4.5 million annually to the local tax base. It also invests an additional $120,000 each year to programs that sustain local communities.

Borax also invests in aggressive, voluntary strategies to reduce greenhouse gas emissions, energy use, and water use. The company succeeded in voluntarily reducing its greenhouse gas intensity (emissions per ton of product) by 8.5 percent and its energy intensity by 5.5 percent in the last five years, and has reduced fresh water use by 25 percent in the same time period. New five-year reduction targets have been set for water and energy use and GHG emissions to drive continuous improvement. Today, Borax is the only mining company in California that is recognized as a Climate Action Leader with the California Climate Action Registry, and has verified its greenhouse gas emissions back to 2000. It is also worth noting that Borax's parent company, Rio Tinto, is a member of the U.S. Climate Action Partnership and equally committed to the urgent need for climate change action.

Energy Intensity of Borate Production

Once mined, borate ores are refined in an energy-intensive process that involves dissolving the ore, and crystallizing and drying the final products. Borax uses steam and electricity that is produced on-site or purchased, as well as natural gas, to run its refining operations. A significant percentage of its cost base – which is already higher than its competitors' – is energy-related. Any cap-and-trade system will not only increase the cost of natural gas, steam and electricity, it will also require the company to hold allowances for the greenhouse gases it emits, primarily associated with the combustion of natural gas to produce steam and electricity to run its operations.

Borate Industry Trade Exposure

The world's leading borate producers are located in California and Turkey, followed by Argentina, Chile, Russia and China. In this highly competitive global market, cost increases cannot be passed on to customers without losing share of sales. Borax has lost 25 percent of global share of refined borate sales over the last decade due to higher labor, energy and regulatory costs of doing business in California. While the United States is a net exporter of borates, growing quantities are imported from Turkey and South America to the eastern United States.[1] Although Borax's costs are higher, the United States Geological Survey notes that refined borates produced in California are done so with "lower emissions than other countries."[2] If California producers continue to lose share of sales, global emissions of greenhouse gases will increase.

Recommendations

Only the free allocation of allowances or relief from the compliance burden associated with the cap-and-trade system will prevent leakage and ensure that California exporters like Borax can continue to compete in the global marketplace.

Recommendation #2 of the EAAC's December 14 Report concludes that free allocation of allowances may be advisable only "to address emissions leakage problems associated with energy-intensive, trade-exposed industries." However, the EAAC further advises the preferable approach will be to use border adjustments to avoid leakage unless "the information needed to introduce border adjustments effectively" is unavailable.

Borax urges the EAAC to revise its recommendation to note that border adjustments are not effective for those energy-intensive, trade-exposed California companies that export products. Further, EAAC should explicitly recommend that California exporters who are energy-intensive and trade-exposed should either be freely allocated allowances or be relieved of their compliance burden under the cap-and-trade system. In the absence of free allowances or relief from the compliance burden, leakage will occur in these industries leading to a net global increase in greenhouse gas emissions and a negative impact on California's economy, including job losses and diminishing tax revenues.

As the EAAC's December 14 Report notes, border adjustments can "work well in protecting against leakage in the production of goods used or consumed in California" by implementing corrections at the border "so that imported goods face the same change in cost" associated with the carbon control or allowance costs born by California producers under a cap-and-trade system. This correction will ensure that imported products cost the same as California products and prevent leakage resulting from California consumers switching to the lower cost imported products.

However, border adjustments simply cannot work for products that are never imported to – and only exported from – California, like borates. The two domestic producers of borates are both located in California. Due to shipping costs and the small market, it is nearly

[1] *While imports of borates are known, data for borate production and consumption is not publicly available in order to avoid disclosure of proprietary data*

[2] *U.S.G.S., Mineral Commodity Summaries, Boron at 35 (January 2009)*

certain that borates will never be imported into California. Therefore, it is impossible to adjust the cost of a product that is never imported into the state.[3]

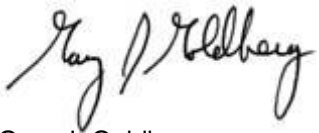
If the exclusive mechanism for avoiding leakage is border adjustments, energy-intensive, trade-exposed California industries that exclusively export products will no longer be cost competitive – domestically or internationally – once a cap-and-trade system is implemented. By definition, trade exposed industries sell products with prices set by global supply and demand trends. These industries cannot increase costs for their product without losing share of sales. When these industries' production processes involve intensive use of carbon-based fuels, there will be significant cost increases that cannot be passed on to their customers. Since border adjustments will not work for industries whose products are exclusively exported from California, leakage can only be mitigated by providing free allowances to offset cost increases, or by exempting the industry from the cap-and-trade system.

California borate producers' leading competitor is Eti Maden, which is owned by the Turkish government and enjoys lower operating costs and a less stringent regulatory environment. Eti's capacity for refined borates has quadrupled in the last 20 years while domestic production has remained steady. In a recent statement posted on its website, Eti announced plans to increase production by 20 percent over the next two years. Turkey does not impose any requirements for industries to conserve energy, improve their efficiency or limit greenhouse gas emissions. If the price for California borates increases because of the cap-and-trade system, there is no doubt that significant leakage will occur and that Eti will increase its global share of sales at the expense of the California economy. Moreover, total greenhouse gas emissions associated with borate production will increase in volume and intensity.

Free allowances or relief from compliance burdens are necessary to California's century-old borate industry's survival. California's cap-and-trade system must recognize the unique circumstances facing this industry and others like it to avoid devastating impacts to the California economy and the global greenhouse gas emissions inventory.

Thank you for the opportunity to comment on EAAC's December 14, 2009 draft report. We will be contacting you in the near future to schedule a meeting to discuss this further. We look forward to working with you and the Committee as a constructive part of the process.

Sincerely,



Gary J. Goldberg
President and Chief Executive Officer

cc: Linda Adams, California Environmental Protection Agency
Andrew Altevogt , California Environmental Protection Agency
Victoria Bradshaw, California Governor's Office
Steven Cliff, California Air Resources Board
David Crane, California Governor's Office
James Goldstene, California Air Resources Board
Kevin Kennedy, California Air Resources Board
John Moffatt, California Governor's Office
Mary Nichols, California Air Resources Board
Dan Pellissier, California Governor's Office
Michael Prosio, California Governor's Office
Cindy Tuck, California Environmental Protection Agency
Bob Houston, The Houston Group

[3] *California borate customers represent an extremely small percentage of global demand – the largest risk for domestic borate producers is product substitution to avoid carbon costs*