

COALITION FOR SUSTAINABLE CEMENT MANUFACTURING & ENVIRONMENT  
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January 9, 2010

Professor Larry Goulder  
Chair, Economic and Allocation Advisory Committee  
California Air Resources Board  
1001 I Street  
Sacramento, CA 95814

Subject: California Cement Industry's Comments on the Economic and Allocation Advisory Committee's ("EAAC") January 2 and 7, 2010 Draft Reports

Dear Professor Goulder and Members of the EAAC:

The Coalition for Sustainable Cement Manufacturing and Environment ("CSCME"), a coalition of all six cement manufacturers operating the 10 cement plants in California,<sup>1</sup> would like to take this opportunity to comment on EAAC's January 2 and 7, 2010 draft reports entitled "Allocating Emissions Allowances Under California's Cap-and-Trade Program." CSCME is pleased to find that the prior versions of the report were amended to better characterize the risk of leakage in energy-intensive, trade-exposed ("EITE") industries, the policy options for minimizing that risk, and the important role that leakage minimization plays in achieving AB 32's environmental objectives.

Despite these revisions, CSCME still has several significant concerns regarding the report. In particular, we note that much of the analysis and many of the recommendations are general in nature. In contrast, the challenges associated with minimizing emissions leakage in the California cement industry are unique, especially in comparison to the electric power and transportation fuel sectors, which appear to be the primary reference point of the report. Consequently, we believe it is appropriate for the EAAC to acknowledge both the generality of its recommendations and areas in which more detailed industry-specific analysis is still required to confidently make conclusions about the optimal approach for minimizing leakage in specific industries.

The following comments represent CSCME's specific observations and suggested revisions.

- **CSCME disagrees with the Committee's view that the use of allowance value and the implementation of a border adjustment are "alternative" approaches.**

In section 6(2) of its report, the Committee recommends that CARB use free allocation to address leakage "only in circumstances where the alternative of some form of border adjustment is not practical." As stated in previous submissions, CSCME would like to emphasize that these two approaches should not be considered mutually exclusive and, within certain policy design parameters, are complementary. In the unique circumstances of the California cement industry, both types of measures are critical to address the significant risk of leakage. The use of allowance value is necessary to lower compliance costs within the state of California in order to reduce leakage to cement imports

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<sup>1</sup> The Coalition includes Cemex, Inc., National Cement Company of California Inc., California Portland Cement Company, Mitsubishi Cement Corporation, Texas Industries, Inc. and Lehigh Southwest Cement Company.

and minimize the risk of cross-sectoral leakage. However, the use of allowance value alone may not be sufficient to create a level playing field with imports. Consequently, an effective border adjustment measure is a critical complementary measure to minimizing the risk of leakage to imported cement that does not face an equivalent incremental cost burden. The Committee's recommendations should not preclude the use of both measures where necessary to address the unique circumstances of the cement industry.

CSCME suggests the following minor revision to ensure that the EAAC's recommendations do not pre-judge the most appropriate regulatory approach for the California cement industry:

2. The EAAC [sic] recommends that the ARB employ free allocation only for the purpose of addressing emissions leakage associated with energy-intensive trade-exposed industries, and only in circumstances where the alternative of some form of border adjustment is not practical or is insufficient alone to address emissions leakage for a particular industry.

- **CSCME reiterates its strong objection to EAAC's proposal that "border adjustments or other leakage-oriented measures should be of short duration (though renewable)" because such an approach would result in disinvestment and leakage.**

In section 6(3) of its recommendations, the Committee states that any leakage-oriented measures should be "of short duration (though renewable), thereby allowing more adaptability." CSCME strongly opposes this recommendation because it intentionally and necessarily introduces uncertainty and unpredictability into the regulatory regime. Like other energy-intensive industries, the cement industry is highly capital intense with long-lived assets, and investment decisions require certainty and predictability over the long-term. The introduction of leakage-oriented measures that require periodic "renewal" undermines the ability to make sound present and future investment decisions in the California cement industry, including high cost facility alterations as well as the development and implementation of major new technologies such as carbon capture and sequestration ("CCS").

In fact, absent predictability in the duration of leakage-oriented measures and in the conditions for renewal, adoption of the Committee's approach would result in substantial disinvestment in the California cement industry. Investment will shift to other jurisdictions where there is greater regulatory certainty and where production (and associated transportation) may generate higher GHG emissions, thus generating the leakage that the relevant measures were intended to address.

The Committee does not provide a rationale to support its implied view that the significant risk of leakage, particularly in the cement industry, will decrease over an unspecified "short duration" or the circumstances that would lead to such reduction. The EAAC does not suggest logical and transparent criteria to govern the decision to renew such a policy. In the absence of logical and transparent criteria, decisions to renew the policy are likely to be arbitrary and subject to political manipulation. This would result in a substantially less predictable investment environment -- thereby increasing rather than decreasing the risk of leakage.

Moreover, although referencing the issue of international leakage -- the major concern for the California cement industry -- the Committee only refers to leakage-oriented measures being "conditional on the

absence of regional or national climate change efforts.” The Committee’s only justification for short duration is to allow for more adaptability but the Committee does not explain what such adaptability would consist of. One would have to understand the unique circumstances of an industry to determine if measures can be taken to effectively adapt to climate change regulations and remain competitive with imports. California cement producers compete in a globally competitive commodity industry and can not pass thru higher climate change compliance costs without losing sales to foreign cement producers that do not have such costs. California cement producers are already highly energy efficient compared to foreign cement producers and approximately half of the emissions are process emissions which are unavoidable until an economically feasible CCS technology becomes available. And, even if such a CCS technology becomes available, leakage protections will be necessary to insure its deployment since it will be a cost that foreign cement producers without comparable climate change regulations would not have.

Prematurely phasing out leakage protections before equally stringent climate change regulations are adopted throughout the world will result in leakage and would likely result in an increase in global emissions due to the high transportation related emissions associated with imports. The California Air Resources Board (CARB) is the entity that should determine what is the most environmentally effective framework to minimize leakage based on each industry’s unique circumstances and the Committee should appropriately qualify its recommendation in deference to CARB.

CSCME suggests the following minor revision to address its concerns:

3. The EAAC advises the ARB to adopt policy instruments that can be substantially modified or eliminated as leakage problems change with the emergence of regional, ~~or~~ federal, or international policies. The ARB should avoid policies that create property rights or other entitlements that cannot be changed should regional, ~~or~~ federal, or international policies be adopted. The ARB’s commitments to border adjustments or other leakage-oriented measures should be based on the unique circumstances of each industry and should generally be of short duration (though renewable), thereby allowing more adaptability, with the duration and applicable conditions for renewal set forth clearly to maximize predictability for future investment decisions.

The prospect of these changing circumstances implies that the ARB’s commitments should be easily adaptable to changing circumstances and conditional on the absence of regional, ~~or~~ national, or international climate efforts.

- **The Committee’s comments do not reflect a sufficiently detailed analysis of the relative competitive advantage of domestic versus imported products, particularly in relation to the unique circumstances facing the cement industry.**

In footnote 22 and section 5.1.4 of the January 7, 2010 draft report, EAAC states that local producers can have a cost advantage over imports “due to transportation or other costs” and that, as a result, increased costs of climate change regulation may only lower profits and not result in a shift in consumption to imports. CSCME has several concerns about this statement.

First, the statement certainly does not reflect conditions within the California cement industry, and it is doubtful that it reflects conditions for in California manufacturing industries in general. California producers face enormous federal and state regulatory compliance costs, energy, labor, materials, insurance, and other costs and conditions that not only may equalize, but in most instances exceed any absolute competitive advantage based solely on transportation costs borne by imports. Furthermore, as explained in earlier comments, the California cement industry's potential cost disadvantage under AB 32 is staggering, with a carbon price of \$30 per ton, for example, resulting in excess of a 30% increase in the price of cement. Thus, even with a price of carbon at the low end of current estimates, the impact on the price of cement is likely to be significant, will substantially outweigh any absolute advantage associated with the avoidance of transportation costs faced by imports, and will adversely affect the relative competitive conditions between California-produced cement and imported cement.<sup>2</sup> Accordingly, the Committee should avoid such general, hypothetical, and undocumented statements in the absence of detailed industry analysis that supports these claims.

Second, the statement implies that leakage is not a concern unless the absolute costs of domestic products exceed that of imports. It ignores the fact that export decisions are driven by marginal costs and an asymmetric increase in marginal costs for California cement producers would put them at a competitive disadvantage. This would reduce or potentially eliminate profits, which would precipitate plant closures and a shift in capital investment toward less stringently regulated jurisdictions -- thereby increasing leakage.

Accordingly, CSCME strongly recommends that the following two portions of the text be deleted.

Footnote 22:

22 In a market that imports products, local producers can enjoy a cost advantage due to transportation or other costs. In these circumstances, increasing CO2 regulation may raise local costs, but not enough to make imports cheaper than local production. In this case, local producers will experience lower profits but still maintain their local production as imports would still be a more expensive source.

Section 5.1.4:

For several of the remaining industries, the additional cost of putting a price on CO2 emissions may not exceed the additional cost of importing competing products.

- **The Committee's comments should more explicitly recognize that increased electricity costs for EITE industries can substantially increase the risk of leakage, and that any anti-leakage measures for such industries should offset these indirect emissions costs through the administrative allocation of allowance value.**

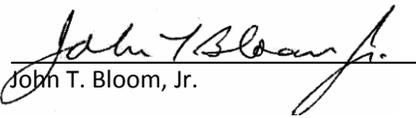
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<sup>2</sup> Depending on the country, foreign producers may also benefit from substantial subsidies or other state intervention that significantly distorts the conditions of competition in favor of imports.

Electricity costs can represent as much as 25-30% of total manufacturing costs for a cement producer, and the adoption of a cap-and-trade program has the potential to increase these costs substantially. Furthermore, due to the existing high electric power costs within the state, California cement producers have already invested heavily in measures to improve electricity efficiency -- making it one of the most electricity efficient cement industries in the world. To the extent that electric power cost increases are not offset upstream, any anti-leakage measure for the cement industry (or other EITE industries) should offset these indirect emissions costs through the administrative allocation of allowance value.

CSCME appreciates the Committee's efforts in drafting its recommendations and looks forward to maintaining an open dialogue regarding how to achieve California's climate change goals through carefully designed policy measures that minimize the potential for emissions leakage.

Sincerely yours,



John T. Bloom, Jr.

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