



Kern Oil & Refining Co.

7724 E. PANAMA LANE
BAKERSFIELD, CALIFORNIA 93307-9210
(661) 845-0761 FAX (661) 845-0330

April 5, 2014

VIA ELECTRONIC POSTING

Comment List: CAPANDTRADE13

Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, CA 95814

Dear Chairman Nichols and Board Members:

Kern Oil & Refining Co. (Kern) is providing comments on the March 21, 2014, Proposed Amendments to the Cap and Trade Regulation (Proposed Amendments) – specifically the withdrawal of the atypical petroleum refinery benchmark without any warning or input sought from stakeholders. This policy change contravenes the Board’s previous approval the then staff-recommended separate atypical benchmark for smaller, less-complex refineries at the October 2013 Board Meeting and the Board’s directive in Resolution 13-44 for staff to finalize the dual benchmarks. Staff further affirmed its intention to separately benchmark atypical refineries through releases in late January and February 2014 and at an all-refinery meeting on March 5, 2014. Two weeks of secretive analysis of an unchanged record inexplicably reversed the Board approved policy to separately benchmark atypical refineries, which was developed and supported by over 18 months of intense dialogue between stakeholders, multiple industry experts and staff. **Kern urges the Board to reject the Proposed Amendments and direct staff to reinstate the atypical refinery benchmark in a subsequent 15-day package to be considered at a later Board Meeting.**

As a small, less-complex California refinery, Kern is acutely aware of the uneven playing field of the California refinery sector. Kern is a small, privately owned petroleum refiner located in Bakersfield, California, in the southern San Joaquin Valley. Kern has operated for over 70 years and employs approximately 120 employees. Kern’s refining capacity is 27,000 barrels per stream day. The consequences of a single benchmark would be devastating to Kern and a threat to its continued viability. The lack of process and transparency leading up to this significant policy change, flawed logic offered to justify it, and severe hardship a single benchmark would impose on smaller, less complex refineries should compel the Board to reject the Proposed Amendments and direct staff to reinstate the atypical benchmark.

A. Failure to Follow Appropriate Process and Lack of Transparency

The starting position of ARB for refinery benchmarking for the second and third compliance periods back in 2012 was the generic “one product one benchmark” despite ARB’s inability to adopt a single approach for the first compliance period. But, after months of stakeholder dialogue, data analysis, expert testimony and multiple refinery-specific workshops, staff proposed at an early October 2013 workshop to separately benchmark the State’s “atypical” refineries. By contrast, the switch to a single benchmark occurred behind closed ARB doors over a matter of two weeks without any input sought from industry or warning given before the release of the Proposed Amendments. ARB’s proposal to set a single benchmark disregards the established record and inexplicably relies upon an identical refinery dataset staff previously relied upon to justify a separate atypical benchmark.

On August 28, 2012, ARB’s own expert Ecofys suggested ARB consider separately benchmarking Kern and other “atypical” refineries.¹ Despite multiple meetings, beginning in November 2012, and comment letters highlighting the issue, Kern could not get staff to analyze the sector data or substantively respond to Kern’s concerns. The lack of progress prompted Kern to join with similarly situated refiners to engage ARB staff and Board members to protect smaller, less complex refineries from the competitive disadvantages of a single benchmark.²

Testimony provided by worldwide acknowledged refining expert Solomon Associates (Solomon) and Ecofys at an ARB workshop held August 13, 2013, proved to be a turning point in the proceeding. Solomon and Ecofys clarified that the “atypical” issue is not related to a failing with the Complexity Weighted Barrel (CWB), which is merely an artificial stand-in for product. CWB is an accurate measurement of a refinery’s “product,” but a refinery’s emissions per product (i.e., efficiency) is affected by that refinery’s size and complexity. Per Solomon “smaller and simpler (i.e., a lower complexity) refineries tend to have poorer energy efficiency, for reasons such as limitation on economy of scale and fewer streams of feed and products and therefore less heat integration and exchange opportunities for energy saving and optimization.”³ Smaller, less-complex refineries therefore cannot reach the efficiencies of super refineries. In every Solomon-involved benchmarking worldwide, each region has had its own particular “atypical” refineries.⁴

On October 7, 2013, staff proposed to separately calculate a CWB benchmark for atypical refineries citing to the previous workshop and further data analysis.⁵ At the October 25, 2013, Board meeting, staff presented dual benchmarks and the Board directed staff to finalize those

¹ August 28, 2013, Ecofys Preliminary Work Product, p. 44 “Exclusion of Atypical Refineries”; p. 45 “Table 11: Potentially atypical refineries together with indication for not being a ‘mainstream’ refinery”.

² Kern, Alon USA, Inc., San Joaquin Refining Co. Inc., Lunday-Thagard Refining Co., and Phillips 66 (on behalf of their Santa Maria facility) eventually formed the Coalition for Fair and Equitable Allocation.

³ August 6, 2013, Solomon Response to ARB Questions, pp. 1-2.

⁴ Ecofys, ARB’s expert, when advising ARB to consider and address the issue of atypical California refineries in its August 28, 2012, report, cited to the European Union as an example of a region that dealt separately with atypical refineries; however, obviously, what may have represented an atypical refinery in Europe does not determine what may be an atypical refinery in California.

⁵ October 7, 2013, Cap-and-Trade Refineries and Related Industries Workshop, Staff Presentation, pp. 5, 14.

benchmarks in Resolution 13-44. During its presentation to the Board, staff highlighted being “in constant communication with industry stakeholders and members of the public ensure [sic] an open and transparent rulemaking process, including workshops and regular meetings with stakeholders.”⁶ A nuance of the refinery benchmarking proposal linked facilities staff saw as “jointly operated” for purposes of an atypical determination, which prompted comments from several Board members and directions for staff to engage stakeholders to resolve that issue.

Staff rebuffed meeting requests after the October 2013 Board meeting asserting that all information related to the anticipated package was “market sensitive” and therefore could not be discussed prior to release. On January 31, 2014, after data confirmation, staff released an informal discussion draft regulation that included lower atypical and typical benchmark calculations attributed mostly to staff calculation errors. The release also included a revised “jointly operated” definition that proved problematic and had unintended consequences (i.e., it “linked” facilities that staff did not intend to link). On February 26, 2014, staff released another informal document entitled “Cap-and-Trade Regulation: Proposed Benchmarks for Refineries and Related Industries,” which slightly adjusted the typical and atypical benchmarks after final data confirmation and re-affirmed in writing staff’s intent to include two benchmarks in the 15-day Package. On March 5, 2014, staff held an all-refiner meeting to discuss the February release focusing on the “jointly operating” issue, which staff continued to struggle in defining and/or justifying. No indication was given that staff had any intention to drop the atypical benchmark.

On March 21, 2014, staff released the Proposed Amendments, which included a single refinery benchmark. In a subsequent telephone conversation, staff cited to “new information” and “new data” from two different Coalition for Fair and Equitable Allocations members (not Kern) that largely served as the basis for the policy switch. Staff refused, and continues to refuse, to provide any detail on that new information/data or its influence. Staff could not point to where that alleged data/information is reflected in the record, and actually confirmed that the refinery dataset utilized for the benchmarking curves in the February 26, 2014, release (that included an atypical benchmark) and the March 21, 2014, release (that has a single benchmark) were identical. ARB’s reliance on off-the-record data/information to surprise stakeholders with an eleventh hour switch to a single benchmark – overturning an atypical benchmark that was 18 months in the making and confirmed by Board Resolution – is unacceptable.

B. Absence of Justification to Abandon an Atypical Benchmark

On the record, staff provides three alleged justifications for abandoning the atypical benchmark: (1) the data demonstrates that CWB does not overestimate atypical refineries’ emissions intensity because “CWB normalizes for size, complexity, and product mix at refineries”; (2) that “some smaller, less-complex refineries are among the most emissions efficient ... in the State”; and (3) the wide variance of the emissions intensity of smaller, less complex facilities.⁷ These statements are countered by the record in this proceeding and take data out of context. Regardless, ARB’s

⁶ Meeting State of California Air Resources Board Transcript, October 25, 2013, p. 32, lines 16-19.

⁷ Proposed Amendments, Appendix A: Additions and Amendments to Product-Based Benchmarks in the Cap-and-Trade Regulation, March 21, 2014, p. 17.

ability to utilize **identical** data to justify completely opposite policy positions is not credible. Given the varying levels of input on those positions – 18+ months with input from stakeholders, experts and staff versus 2 weeks without any input – the justification for the atypical benchmark is on a much stronger policy and procedural position.

1. *CWB Does Not Normalize for Atypical Size and Complexity Efficiency Limitations.*

The supporting documentation released with the Proposed Amendments confuses quantifying refinery product with CWB versus setting an appropriate benchmark. The CWB methodology measures product – it does not account for efficiency limitations. Appendix A erroneously suggests CWB accounts for facility size and complexity relative to benchmarking. CWB accounts for these differences in determining a common, single product; however, appropriately comparing facilities for benchmarking is a separate and distinct exercise. CWB is an accurate measurement of a refinery’s “product,” but a refinery’s emissions per product is affected by that refinery’s size and complexity. Solomon (the creator of CWB) stated at the August 13, 2013, workshop that accuracy of the CWB is irrelevant as to whether atypical refineries should be separately benchmarked. An example was given that a glass factory can have an accurate CWB score but still could not be fairly compared to a refinery’s CWB.

By nature of the structural constraints highlighted by Solomon, in general, smaller, less complex refineries cannot achieve the top efficiency of larger, more complex refineries; conversely, atypical refineries have a much lower efficiency starting point than typical refineries. In other words, the best performing typical refineries can reach an efficiency level that is unachievable by atypical refineries and the worst performing atypical refineries start at a much lower efficiency level than the worst performing typical refineries. The California data set is only a limited demonstration of these points, which are more strongly illustrated on a national or worldwide scale. In addition, the best performing California atypical refineries can also be differentiated from their atypical California peers on the basis of product slate, as discussed below.

2. *Both Atypical and Typical Refineries Have a Range of Efficiency That Have Always Overlapped.*

Without dispute, there is always a range of refinery efficiency, no matter the size, and some overlap between most efficient atypical and least efficient typical is expected. From the inception of staff’s recommendation for two benchmarks, there has been overlap between the atypical and typical groupings (i.e., among the most efficient atypical refineries and the least efficient typical refineries). This overlap is apparent in every benchmarking curve that ARB has published since October 2013 and staff nonetheless continued to recommend separate benchmarks until very recently. The reliance on the presence of efficient atypical refineries that overlap with the efficiency of typical refineries to justify a single benchmark also misses two key facts: 1) those two refineries are mainly asphalt refineries and do not produce gasoline, which may account for their efficiency differences; and 2) the two worst performing refineries (and most detrimentally impacted) are the State’s smallest gasoline-producing facilities. Variation in a sub-group of refineries does not justify a single benchmark.

3. *The Alleged Wide Variance in Atypical Category Efficiencies is Exaggerated by Exclusion of Pertinent Data Points.*

ARB's supporting documentation in Appendix A to the Proposed Regulation highlights that it excluded one refinery's data from the benchmarking calculation because of abnormal operations in 2008. That particular facility however actually had normal operations in 2008, but has subsequently had a change in its operational status. Though that refinery would have fit into the atypical category, the particular refinery (a Coalition member) did not fight for its inclusion given staff's proposal for an atypical benchmark. Given the policy reversal and staff's stating reasoning for a single benchmark (the alleged wide efficiency variance in atypical group), exclusion of that facility is material because it supports the need for an atypical benchmark and in fact would have increased the previously proposed atypical benchmark. Another Coalition member submitted updated data to demonstrate one of its facilities belonged in the atypical category but the data was not included in the benchmarking calculation. Consideration of that data and inclusion of that facility in the atypical category would further support the need for the separate benchmark (i.e., the efficiency limitations of atypical refineries) and, again, would have increased the previously proposed atypical benchmark. Staff's selective consideration of data and failure to use data which supports the need for an atypical benchmark is troubling – especially given the extremely limited number of atypical data points that remain – a mere four facilities.

C. Creation of Winners and Losers

A single benchmark creates winners and losers. Shifting to a single benchmark would require certain Coalition Members to reduce emissions by 40% just to meet the benchmark level (90% of the average statewide refinery efficiency). ARB's own report demonstrates emissions reduction potential at individual facilities to be below 10%.⁸ Clearly requiring a reduction of 40% is unrealistic. ARB previously abandoned a single simple barrel approach (2010 benchmarking) in favor of a two-tier approach because of similar detrimental impacts to individual facilities. ARB has always had difficulty in assigning a single benchmark to the refinery sector because of the wide variance in facilities and the detrimental impact that would result. Those difficulties have not been alleviated by the current proposal; in fact, certain refineries are facing worse detrimental impacts under this proposal as compared with those impacts that prompted ARB to abandon a single benchmark in the first compliance period. One size does not fit all in the refinery sector and the proposed single benchmark threatens the viability of California's smaller, less complex refineries.

In conclusion, Kern urges the Board to delay a vote on the Proposed Amendments to ensure sufficient time to analyze this significant change in policy direction and to allow for appropriate consideration of input from stakeholders and the Board. The single benchmark currently proposed raises too many questions to be resolved in such a short period of time and stakeholders deserve better than the abbreviated and secretive process that preceded the abandonment of the atypical benchmark. Refinery benchmarking is too important to rush such a monumental change

⁸ See "Energy Efficiency and Co-Benefits Assessment of Large Industrial Sources, Refinery Sector Public Report" dated June 6, 2013.

in policy direction and the consequences of getting it wrong will be devastating to stakeholders like Kern. Any questions or follow-up comments can be directed to Melinda Hicks at 661-282-2646 or at mhicks@kernoil.com.

Sincerely,

A handwritten signature in blue ink, appearing to read 'mllhicks', is centered below the word 'Sincerely,'.

Melinda L. Hicks
Manager, Environmental Health and Safety
Kern Oil & Refining Co.