August 11, 2011

TESORO

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

Electronic Submittal:
http://www.arb.ca.gov/lispub/comm/bclist.php

Subject: CARB Proposed Regulation to Implement the California Cap-and-Trade on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols

Dear Clerk of the Board:

Tesoro Corporation is an independent refiner and marketer of petroleum products. Tesoro operates seven refineries in the western United States with a combined capacity of approximately 660,000 barrels per day. We operate the Golden Eagle refinery in Martinez, CA and the Los Angeles Refinery located in Wilmington, CA, and we are the second largest refiner of clean fuels for the state of California. Tesoro is a member of the Western States Petroleum Association (WSPA) and have participated in the development of comments submitted to CARB regarding the Cap and Trade Regulation. Tesoro concurs with and hereby incorporates by reference comments submitted by WSPA. Following are specific comments on the proposed regulation.

Trade Exposure:
The California refining industry should be classified as a High Intensity Trade Exposed Industry, and not as a Moderately Trade Exposed Industry. The California refining industry is heavily exposed to market leakage since refined products can enter California from out-of-state and international refineries operating under less stringent environmental standards with little to no market barriers.

An objective review of the information and data provided to ARB will lead to the conclusion that the California Refining Industry is Heavily Trade exposed and should be treated as such in the Cap and Trade Regulation. ARB has been provided information which identifies discrepancies in census data and discrepancies between CEC data that more accurately reflects the full slate of California refinery products. ARB has also been provided information which identifies discrepancies in EIA data which does not accurately reflect the full slate of California refinery products. This data highlights the importance of exports to Arizona and Nevada (states which can import products from the Rocky Mountains or Gulf Coast), and likely serves as the basis for the artificially low estimates of the energy intensity attributed to the California Refining Sector.

Tesoro has attached a graph from FACTS GLOBAL ENERGY which represents refineries that have been for sale, sold or shutdown since 2008 by region of the world. The EU has had the most plants both for sale and shutdown which is consistent with the competitive disadvantage of their markets from importation of fuels originating from countries such as India that are not subject to GHG and other regulatory costs.

The graph shows North America as having the 2nd most plants shutdown for many of the same reasons; imported fuels taking market share in an oversupply situation. This graph supports the conclusion that refined products move and trade across the globe negatively affecting competitive markets making California refineries highly trade exposed.

Fuels Under the Cap in 2015:

Fuels should not be included under the cap due to excessive costs to the consumer and business and the inequities created between industries... Placing fuels under the cap will place a high financial burden on providers and/or users of propane, gasoline and distillate fuel in California that may delay or defeat economic recovery for the state. Emissions from consumer use of these products results in about 170 million tonnes/yr of emissions. At the minimum auction price of $10/tonne, this burden would equate to approximately $0.10 per gallon or approximately $1.5 to $2.0 billion per year. California gasoline taxes are the fourth highest of any state in the US and about 40% higher than the national average. California diesel taxes are the highest in the nation; specifically 55% higher than the national average. Though California's population has grown slightly during recent years (due to foreign immigration and births), more people have left California for other states than have moved here. Cost of living is frequently cited as a primary reason for citizens and businesses leaving the state.

This cost burden of including fuels under the cap is not only excessive, it creates inequity in the regulations between industry that additionally impact consumers and businesses. Power generation and imports result in approximately 90 Million Tonnes/yr of CO2e emissions, yet free allowances to the utilities will offset an estimated 94% of the cost of carbon over the life of the program. No allowances are proposed for producers or consumers of fuel.

Including fuels under the cap is redundant with the low carbon fuel standard and vehicle mileage standards. Also, as presently structured treatment of fuels under the cap is inequitable relative to treatment of utility power. The cost to producers and/or consumers of fuels will be excessive.

Benchmark Basis & Initial Reduction

The proposed regulation includes provisions for granting free allowances to industrial facilities. It also establishes the benchmark at a level of 90% of industry average for the refining sector and most other industries. Setting the benchmark at this level will create an immediate shortage of free allowances leading to a level of stringency in the program that will create immediate impacts, dilute the impact of the assistance factor, and be redundant with the cap reduction factor. The only clearly stated need for allowance withholdings during the first compliance period are 1% for the price containment reserve and 0.5% for renewable electricity emission reductions. There is no justifiable reduction in free allowances beyond 1.5% in the first compliance period. Because the cap reduction factor already provides for a 2%/year reduction in free allowances, the 90% initial reduction is overreaching, beyond the needs of the program, and will cause unintended consequences like market leakage.

Benchmark Methods:

The AB-32 regulation gave ARB the authority to issue free allowances in an equitable manner that maximizes the total benefits to California and encourages early action to reduce green house emissions. ARB has chosen to use output based benchmarks as one of the factors in granting free allocation to qualified facilities.

Within the various industrial sectors, ARB has estimated that entity emissions range from less than 25% to about 500% of the benchmarks. Incentives for California entities to reduce emissions by a factor of 4 or 5 are not "correct," but are simply discriminatory given that California is among the states with the lowest carbon footprint in the nation.

Tesoro has expressed its views and results of its studies regarding refinery benchmarking with ARB on several occasions. Three essential points have been discussed. First, consistent with commitment from ARB management, the benchmark method must recognize the emission reductions from early actions such as the Coker modification project at Tesoro's Golden Eagle Refinery. Second, that refinery benchmarking should not be subjective. Subjective measures of refinery activity such as crude thruput, product output, clean product output, refinery activity, refinery energy intensity, refinery carbon intensity or volume and quality of feedstock's and products may appear as logical choices as a basis for a benchmark but can easily favor some and discriminate against others.. Third, use of any of subjective benchmarks exaggerates the difference between refineries by a factor 3 to 5 relative to any practical opportunity to reduce emissions. For these reasons Tesoro favors a benchmark that strongly considers baseline emissions for each refinery. The WSPA proposal considers baseline emissions, energy efficiency, and reduces the disparity within the sector while meeting ARB's primary objective of setting a correct incentive for the initial period and allows the program to start with minimal interruptions.

Indirect Emissions: Basis & Inclusion in Baseline and Benchmarks

Some refineries are self sufficient, generating all of their own power, steam and hydrogen while others rely partially or totally on 3rd party and public utilities for their energy supply. For those refineries that are self sufficient, the generation of these utilities is considered "inside their fence" and therefore eligible for inclusion in their free allocation calculation. This compares to a refinery that purchases their utilities that may not be eligible for free allocation since they are not considered "inside their fence".. The market will require the refineries who purchase their energy to pay for the CO2 costs at a 100% basis with no free allocations, thereby giving them a disadvantage by increasing their costs in an area they have no control over. This will have the affect of picking winners and losers. Refineries that purchase their energy compared to to those who generate their own energy must be awarded comparable levels of free allowances or be eligible for CO2 cost rebates. .

Tesoro appreciates the opportunity to submit comments on the Cap and Trade Program Regulations.

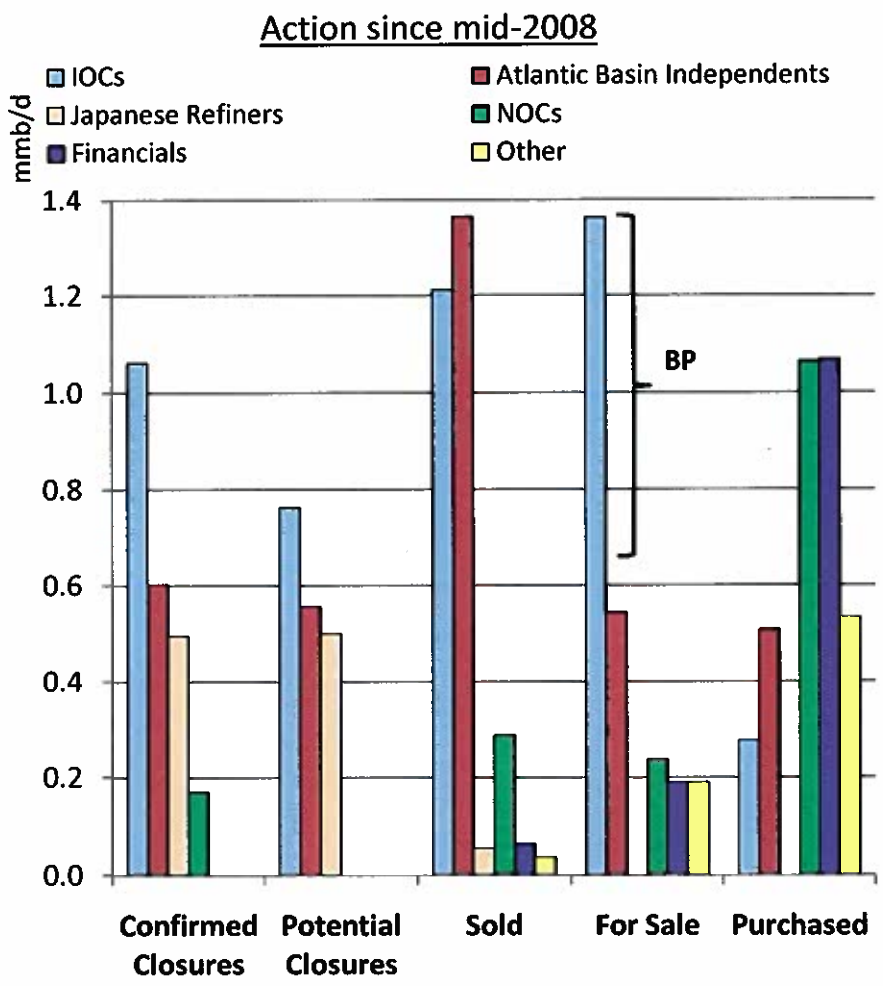
Sincerely,

Daniel T. Riley
Vice President
State & Local Government Affairs

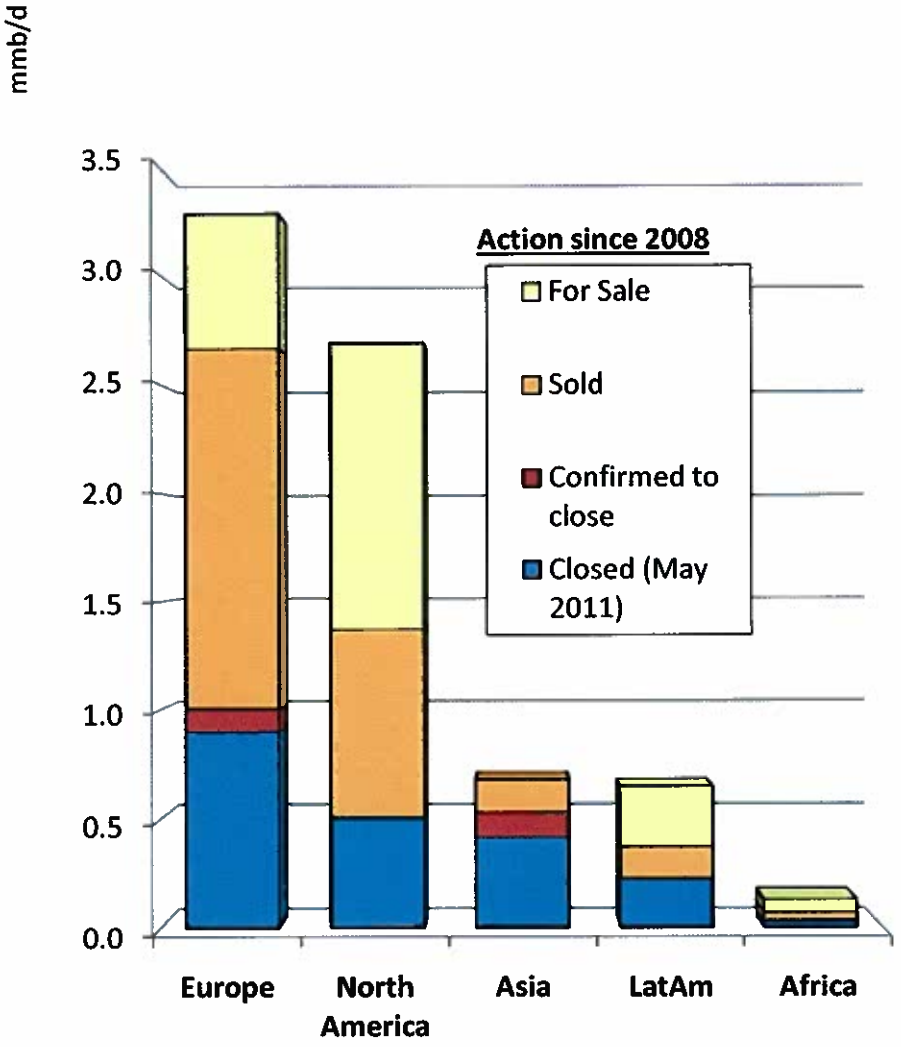
Attachment

Refinery Closures and Sales

Who?



Where?



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FACTS GLOBAL ENERGY