

September 27, 2011



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

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

RE: CA CAP and Trade 2010 Rulemaking to Consider the Adoption of a Proposed California CAP 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 is 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.

Benchmark Basis & Initial Reduction

The proposed regulation includes provisions for granting free allowances to industrial facilities based on the following formula:

$$\text{Allocation} = \text{Output} \times A \times B \times C$$

Where:

“Output” is the amount of product produced

“A” is the assistance factor as determined by the leakage risk of the product

“B” is the product benchmark

“C” is a factor that declines in proportion to the overall cap decline

In the proposed regulation, the benchmark is set 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, introducing this level of stringency at the outset of the program will create immediate harsh 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. We do not believe there is any 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, we maintain that the 90% initial reduction is overreaching, beyond the needs of the program, and will cause unintended consequences like leakage.

Benchmark Methods:

ARB has chosen to use output based benchmarks as one of the factors in granting free allocation to qualified facilities. 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.

We appreciate that ARB has accepted, in large part, the method proposed by WSPA which recognizes both baseline emissions and a calculation of relative refinery efficiency. One element that ARB has not accepted is the need to temper the influence of calculated refinery efficiency. Figure 2, of Appendix A to 2nd 15-day Cap-and-Trade Regulatory Text: Refinery Allocation Methodology illustrated a roughly 25% difference in allocation among members of the sector. As discussed in the following paragraph, this difference is 3 to 5 times too large. The WSPA methodology included a tempering factor, limited to zero or a positive number to reduce the impact of the raw calculated efficiency. But this tempering factor disappears, and likely become negative as applied by ARB in conjunction with the stringent treatment of the benchmark. As a minimum, Tesoro recommends that the *Adj*_t factor as described in the following equation from section 95891 (d) (2) (A), be limited to a positive number:

$$Adj_t = ((Avg/EIIBest) * Ft - 1) / (1 - Ft)$$

Tesoro has discussed 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 associated with the Coker modification project at Tesoro's Golden Eagle Refinery. Second, that refinery benchmarking is subjective. Different 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 are seemingly logical choices as a basis for a benchmark. Unfortunately, one finds that the results of these various methods are divergent, such that one can easily favor some and discriminate against others by simply selecting one method versus another. Third, use of any of these 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, and considers an indicator of energy efficiency, but tempers the results such that differences between refineries are reasonable relative to opportunities for improvement. We believe that the WSPA proposal met these objectives, but the stringency of the ARB benchmark has eliminated the effectiveness of the tempering factor. By reducing the stringency of the benchmark, the tempering could be restored and the allocation methodology would meet ARB's primary objective of setting a correct incentive for the initial period and allowing 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 supply of these. ARB has included reasonable mechanisms for allocations related to hydrogen and steam.

However, ARB's current approach is discriminatory against refineries that rely on 3rd Party Cogeneration Operators for a portion of their power supply. There is currently no mechanism for these plants, or the Cogeneration Operators, to receive any quantity of free allowances. This is in contrast to refineries operating internal cogeneration units, who will receive allowances related to their baseline emissions including the cogeneration operation, and refineries purchasing power from utilities who will receive rate consideration associated with the utilities sale of free allowances at auction. It has been ARB's position that cogenerators should receive financial consideration related to their cost of allowances from their trade exposed industrial customers. This is only possible if the industrial customers receive allocations which reasonably correspond to the emission profile and allocation system. To accomplish this, we propose that emissions related to power provided by a Cogeneration Operator to a refinery be included in the refinery baseline emissions. One way to accomplish this would be a simple modification to the equation in section 95891 (d) (2) (A):

Current Equation:

$$BEY = GHG + (SPurchased - SSold) * 0.06244 - eSold * 0.431$$

Proposed Equation: $BEY = GHG + (SPurchased - SSold) * 0.06244 + (ePurchased\ Cogen - eSold) * 0.431$

Where *ePurchased Cogen* is the power, in MWhr purchased by the refinery from the third party cogen plant.

Another possible solution would be to provide allowances directly to Cogeneration Operators for emissions related to power sales to refineries.

As written, the regulation places refineries associated with 3rd Party cogeneration operators at a significant disadvantage and in fact discourages continued operation of the 3rd Party cogeneration plants.

Trade Exposure:

The California refining industry is heavily exposed to leakage and should be classified as a High Energy Intensity Trade Exposed Industry, and not as a Moderately Trade Exposed Industry. Refined products can enter the state from refineries in other states and international sources. Crude oil currently refined in California can be diverted to foreign refineries operating with less stringent environmental standards. . ARB has been made aware of discrepancies in census data, discrepancies between CEC data and EIA data (wherein the CEC data accurately reflects the full slate of California refinery products and EIA data is inaccurate) , the importance of exports to Arizona and Nevada (states which can import products from the Rocky Mountains or Gulf Coast), and possibly low estimates of the energy intensity of the California Refining Sector. We believe that objective review of these issues lead ARB to the conclusion that the California Refining Industry is Heavily Trade exposed and should be treated as such in the Cap and Trade Regulation.

Fuels Under the Cap in 2015:

Placing fuels under the cap will place a high financial burden on providers and/or users of propane, gasoline and distillate fuel in California and potentially delay or defeat economic recovery for the state. Emissions from consumer use of these products results in about 170 million tonnes/yr of emissions.

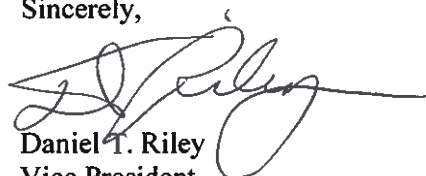
At the minimum auction price of \$10/tonne, this burden would equate to approximately \$0.10 per gallon or approximately \$1.5 to \$2.0 billion per year. California gasoline taxes are the fourth highest of any state in the US and about 40% higher than the national average, California diesel taxes are the highest, 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 leaving the state.

This burden is not only excessive, it is also inequitable. 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.

Our recommendation is that fuels not be included under the cap. Including fuels under the cap is redundant with the low carbon fuel standard and vehicle mileage standards. 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.

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

Sincerely,

A handwritten signature in black ink, appearing to read 'D. Riley', with a long horizontal flourish extending to the right.

Daniel T. Riley
Vice President
State & Local Government Affairs