KERN

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VIA ELECTRONIC MAIL AND CT-3-2-18-WKSHP-WS

March 16, 2018

Rajinder Sahota
Assistant Division Chief
Industrial Strategies Division
California Air Resources Board
1001 I Street
Sacramento Ca, 95814

Re: Comments on Cap and Trade Regulation Workshop March 2, 2018

Dear Ms. Sahota:

Kern Oil & Refining Co. (Kern) is providing comments on the California Air Resources Board's (ARB) March 2, 2018, workshop regarding proposed changes to the Cap and Trade Regulation in response to ARB Resolution 17-21 and Assembly Bill 398 (AB 398). Kern is specifically providing comments on the following: (1) Adjusting assistance factors for compliance years 2018 through 2020; and (2) Urging ARB to revisit refinery sector benchmarking.

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 135 employees. With a refining capacity of 27,000 barrels per stream day, Kern is one of only two remaining small refiners in California producing transportation fuels. California Energy Commission data indicates that roughly 25 years ago a dozen small refineries operated in the state. The demise of over 80 percent (%) of California small refiners over the last 25 years is due in large part to exponentially expanding regulatory burdens and accompanying compliance costs. Kern urges ARB to recognize and alleviate the disadvantage to small refiners in moving forward with amendments to the regulation.

Adjusting Industry Assistance Factors Back to 100 Percent

Kern strongly recommends that ARB reconsider the current proposal to maintain the 75 % assistance factor for the petroleum refining sector for budget years 2018 through 2020 in favor of setting this assistance factor at 100 % beginning in 2018. Resolution 17-21 and AB 398 provide instructions for addressing assistance factors used in determining the number of allowances a facility is granted each year for application toward their compliance obligation. The need for additional protection against leakage warrants retroactive allocation of allowances for compliance years 2018 through 2020.

As acknowledged by Staff in the February 2018 Preliminary Discussion Draft[1] (Discussion Draft), effectuation of a smooth allocation path is critical to protect against emissions leakage and enable earlier investments in onsite equipment upgrades. A consistent application of the 100% assistance factor across all compliance periods is essential to maintain a smooth allocation path. Kern's analysis shows an acute increase in projected compliance costs expected with the existing 75% assistance factor as compared to maintaining the 100% assistance factor across the third compliance period, translating to an incremental difference estimated at no less than $1 million for Kern using today's average price for carbon allowances.

Small refiners, like Kern, will incur increasing difficulty in meeting the costly compliance obligation as the cap on emissions declines dramatically post-2020, making facility reinvestment virtually impossible to afford. ARB must increase the assistance factor for 2018 through 2020 to appropriately encourage on-site investments. Programmatically, enabling Kern to redirect that proposed increased compliance obligation of $1 million instead to efficiency upgrades and facility improvements is preferential because it would achieve actual emissions reductions at the facility level instead of purchasing single-use compliance instruments.

The diversity of the refinery sector – ranging from 10,000 to 270,000 barrels per day capacity – makes ARB's analysis of leakage risk problematic because it fails to account for constraints imposed upon small refineries' ability to pass on or otherwise absorb the costs of complying with the regulation. That is, ARB is relying on leakage analyses that fail to consider the disadvantage small refineries face as compared to large refiners within California whose size, efficiencies, and market share drive fuel pricing and ability to pass through compliance costs. Given Kern's lack of complexity and vertical integration, Kern's revenue stream is primarily dependent on wholesale finished product prices, but Kern is unable to maximize the value of such products. With only 1% of the state's total finished fuels production, Kern's ability to pass along compliance costs is dictated by the larger market players, forcing Kern to absorb any difference in actual costs to comply.

Need for an Atypical Refinery Sector Benchmark

ARB must reassess the need to separately benchmark "atypical" refineries in response to the inequalities embedded in the current single benchmark. Kern urges ARB to dedicate adequate resources to review refinery sector benchmarking. Kern has been intimately engaged with ARB Staff on refinery benchmarking since the inception of the regulation. Specifically, Kern's involvement was quite considerable between 2012 and 2014 during the development of amendments to adopt the Complexity Weighted Barrel (CWB) method and analyses to determine appropriate benchmarks for the entire sector.

Kern has previously expressed concerns over the limitations of the CWB methodology as it is being used to benchmark the California refinery sector and continues to emphasize those same concerns. The CWB measures product – it does **not** account for efficiency limitations – and

[1] https://www.arb.ca.gov/cc/capandtrade/meetings/20180302/ct_pdd_02232018.pdf

appropriately comparing facilities for benchmarking is a separate and distinct exercise to measuring product. Although CWB is an accurate measurement of a refinery's "product," a refinery's emissions per product is affected by that refinery's size and complexity. Solomon (the creator of CWB) stated at ARB's August 13, 2013, workshop that the accuracy of the CWB is irrelevant as to whether atypical refineries should be separately benchmarked. Kern urges ARB to reconsider the existing single benchmark in order to appropriately assess the few remaining small, low-complexity refineries within the sector.

As a small, less-complex California refinery, Kern has experienced the uneven playing field of the California refinery sector for the past three years the single benchmark has been in place. A small subset of refineries, which includes Kern, are currently responsible for one of the highest reduction requirements of any sector under the entire Cap and Trade regulation despite contributing only 2% toward total refinery sector emissions. Most benchmarks are reflective of 90% of the sector average[2], but in the refining sector the current single benchmark requires small, less-complex transportation fuel refiners to reduce emissions by over 40% just to meet the benchmark. In fact, with the existing 75% assistance factor and cap decline rates for 2018 through 2020, Kern must purchase allowances accounting for roughly 55% of the facility's covered emissions in order to maintain compliance. Kern's reduction significantly deepens as the lower cap adjustment factor is applied each year. By 2030, most sectors will be receiving less than 50% of allowances needed to meet compliance; in stark contrast, Kern anticipates receiving as little as 20% of allowances needed for compliance by 2030.

Kern cannot understate the importance of establishing a more appropriate atypical benchmark to our company and our employees. As a smaller company, Kern is less able to absorb regulatory costs and ensuring fair treatment of our facility is critical. Kern welcomes the opportunity to once again work with Staff on a proposal that appropriately acknowledges the structural constraints imposed by size and complexity, and recognizes the unfair competitive disadvantage imposed up smaller, less-complex refineries by the single benchmark previously codified.

Thank you for your consideration of these comments. If you have any questions, or if we can provide any additional detail, please do not hesitate to get in touch. As always, Kern is committed to working with Staff throughout this regulatory process.

Sincerely,

Melinda L. Hicks
Government Affairs Manager
Kern Oil & Refining Co.

cc: Jason Gray, ARB
Jennifer Haley, Kern Oil

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[2] Slide 11 of the October 12, 2017, Staff presentation.