Coalition for Fair and Equitable Allocation

VIA WORKSHOP COMMENT LOG AND ELECTRONIC MAIL

February 14, 2014

Rajinder Sahota
California Air Resources Board
1001 I Street
Sacramento Ca, 95814

Dear Rajinder:

The Coalition for Fair and Equitable Allocation (Coalition) herby submits its comments on the January 31, 2014 INFORMAL DISCUSSION DRAFT (Discussion Draft) of the Cap and Trade Regulation (Regulation). These written comments are in follow-up to verbal dialogue with staff representatives Elizabeth Scheele, Eileen Hlakva and Mark Sippola on February 11, 2014. The February 11, 2014 meeting was the first opportunity granted to engage staff on the concepts presented at the October Board meeting which resulted in Resolution #13-44 Attachment A—Refinery Allocation Methodology, Atypical Benchmark.

Amending the refinery benchmarking and associated industrial allocation methodology is a significant policy and technical exercise, which establishes a foundation of the Cap and Trade Program (Program) and determines the baseline competitive position (both intrastate and interstate) for California refiners. The Coalition was formed to protect small refineries in California from competitive disadvantages threatened in the proposed refinery benchmarking and allocation methodology. The Coalition includes Kern Oil & Refining Co., Alon USA, Inc., San Joaquin Refining Co. Inc., Lunday-Thagard Refining Co., and Phillips 66.

The Coalition generally supported the majority of the provisions within the 45-day regulatory package and continues to support the recognition of an atypical refining category for the purposes of benchmarking and industrial assistance. But, as the adopted Resolution noted, there is still some important work to be done to finalize this regulatory package. The Coalition is specifically providing comments on the following, which are described in more detail below, to assist staff in that final work:

1. Continued support for separately benchmarking atypical refineries in recognition of the structural constraints of smaller, less-complex facilities and the inappropriateness of benchmarking them against larger more complex facilities;
2. Recommend removing the concept of "jointly operated" from any atypical refinery definition because conceptually it is irrelevant to the atypical consideration, practically unworkable as defined in the Discussion Draft, and does not recognize of the variety of intercompany relationships between California refiners nor that intermediates produced by atypical refiners are a significant percentage of their product slate;

3. Concern regarding the lack of transparency in the significant change in the CWB Atypical Benchmark and the need for additional data to support that change;
4. Concern regarding the lack of an open and transparent regulatory process; and
5. Request for additional data analysis related to the leakage risk associated with in-state production of intermediate products.

Comment Details

1. **The Atypical Refinery Distinction and Separate Benchmark Appropriately Acknowledges the Uneven Playing Field of the Refinery Sector.**

Formal recognition and separate benchmarking of "atypical" refineries in the Cap and Trade Program is a key policy recommendation the Coalition supports. As the Board has acknowledged, not all refineries in California are large and complex; the atypical category appropriately recognizes that smaller, less complex facilities cannot reach the efficiencies of larger, more complex facilities because of a lack of economies of scale and heat integration opportunities. As the concept of what constitutes an "atypical" refinery is regional in nature—comparing apple to apples, staff has appropriately established criteria for an "atypical California refinery" based on analysis of the state's existing inventory of facilities. ***The Coalition continues to support the proposed California-specific atypical criteria metrics of less than 12 process units and 20 million barrels of crude throughput per year.***

2. **The Concept Of "Jointly Operated" Is Fatally Flawed And Should Be Removed From The Regulation In Its Entirety.**

The Coalition fundamentally opposes the concept of "jointly operated" as being irrelevant to the atypical distinction. This additional concept seems to be based on an incomplete or flawed view of how California's refining industry operates. The Coalition's opposition is especially acute as the definition of "jointly operated" was crafted without any input from our members (as discussed in more detail below). The concept of "jointly operated" as a disqualification from otherwise meeting the definition of an atypical refinery is flawed in that the disposition of refinery products – primary or otherwise – has no impact on a facility's ability to achieve certain levels of efficiency, which is the essence of the atypical designation. Atypical refiners, by definition, do not possess the complexity and size to fully refine a barrel of crude oil, nor do they have the level of heat integration of a larger refinery.

The "jointly operated" definition's reliance on percentage of Primary Refinery Products production is also misplaced. The product slate of an atypical refinery is necessarily different than that from a typical refinery, a direct demonstration of their fundamental difference in refinery configuration. Coalition members produce "Primary Refinery Products" as defined in the Regulation and also produce by necessity a much greater percentage of additional refined products, including a range of intermediate products, specialty oils and bunker fuel oil. While excluded from the definition of "Primary Refinery Products," these other products nonetheless have value and are bought, sold and imported on a daily basis. This refinery commerce is usually, but not always, conducted between an atypical and a typical refinery. These dynamic interactions make up the complex California refining system, and are integral to its flexibility and continued operations.

No one atypical refinery operates in a vacuum. The "jointly operated" definition proposed in the Discussion Draft arguably removes the atypical distinction of three of the Coalitions' members, and could potentially impact others as market conditions vary. From recent discussions we understand it was not staff's intent to capture multiple Coalition members. But we were also unable to clearly get CARB to articulate the policy intention or justification for the jointly operated limiter. These recent discussions have lead the Coalition to be concerned that staff does not fully appreciated the daily interactions between atypical and typical refineries in California, nor the emissions leakage potential if the imports of those products were increased from their current levels rather than produced in-state. Additionally, the Discussion Draft was not accompanied with any additional economic or environmental analysis to support it positions, such as inclusion of a 50% threshold of Primary Refinery Products. It is our hope that the recent conversations with staff highlight the reality that all smaller refineries interact commercially with other refinery counterparties on a regular basis, and that CARB staff will remove this concept from the Regulation.

From a technical standpoint, "jointly operated" is not necessary as the Complexity Weighted Barrel (CWB) methodology already accounts for the energy inputs associated with intermediate products and their transfer and use between facilities. The specific CWB term is referred to as "Non-Crude Sensible Heat". The energy required to address non-crude inputs at both typical and atypical facilities is already accounted for, and therefore already established in the benchmark itself. Likewise, the general policy of the Program, and its price on carbon, will reward the most efficient facilities without the need for additional adder.

Staff's "operated jointly" proposal also creates inconsistencies between the existing Cap and Trade and Mandatory Reporting Regulations (MRR), as well as the historically accepted definition of "facility". The definition of a stationary source has been established over the many decades of air pollution control laws, and is already defined in both the MRR and Cap and Trade Regulations, as is the definition of a "Petroleum Refinery" or "Refinery." These definitions are complementary and consistent in that each location/operation is a separate and distinct compliance entity. Grouping multiple facilities together, including competitors, solely because it is has a variety of contractual relationships with a separate (and equally specialized) facility is an application of inconsistent policy. This "carve out" is especially troublesome as it seems to be written in an attempt to affect only a single facility in California, but in fact, it has much wider implications and does not actually further the policy goals of the program.

The California refining industry is a complex intersection of related facilities and operating entities. By pushing a "jointly operated" concept, it seems that CARB is implying that a "facility" must be truly independent of the rest of the industry, which is impossible. This impossibility is precisely why the long held definitions used in traditional air pollution control are appropriate—because they limit the scope and enforcement of the Regulation to the actual location of the emissions and do not attempt to sort through myriad of commercial relationships which exist today. California's dozen or so refineries are truly interdependent on each other for a wide variety of needs and business transactions too numerous to completely list. The current definition shows the danger in trying to parse a separate sub-group.

As written, the "jointly operated" definition contained in the Discussion Draft is vague and ambiguous, with numerous undefined terms, in stark contrast to the explicit requirement located in the rest of the Regulation and within MRR. The enforceability of the definition is questionable, prone to multiple interpretations, and threatens inappropriate unintended consequences beyond the Cap and Trade Regulation. These concerns have already been provided to you under separate cover. Any alternative definition drafted will most certainly run into similar problems and issues because the concept itself is fatally flawed. ***Therefore, the Coalition recommends that time and energy not be spent trying to fix the proposed definition, but that it rather be removed from the Discussion Draft in its entirety.***

3. **The Significant Changes in the CWB Benchmarks Must Be Verified and Justified by CARB.**

The Discussion Draft revised the Atypical Benchmark from 6.78 to 5.11 allowances per CWB. This change is a significant adjustment downward, on the magnitude of greater than 25% (and it is still not final). In discussions with staff it was discovered that a CARB calculation error played the biggest part in the change, with facility data adjustments playing a smaller role. This change is very disconcerting to the Coalition on a number of fronts. From a process perspective, our opportunity to address this smaller number in front of the Board was compromised, and our ability to double check the calculation itself has not been provided.

The whole point of this year-long exercise is to establish viable benchmarks heading into the next compliance period. Now we are scrambling to finalize the benchmark in the final days, based on ever changing data that has yet to be verified outside of CARB. Such a process is problematic. ***The Coalition recommends that staff provide as much information as possible to the public such that the benchmark calculation and methodology can be verified or allow for an independent third party verifier to confirm CARB's calculations and assumptions.***

4. CARB Failed to Conduct Any Stakeholders in the Requisite Stakeholder Process Following the October Board Meeting Prior to Releasing the Discussion Draft in January.

The 15-day regulatory amendment process is intended to be a smoothing and shaping exercise on firmly established, stakeholder vetted, and Board approved policies. Unfortunately, that is not occurring on this specific topic as whole concepts have been defined without stakeholder input AFTER the Board meeting occurred. The Board clearly had concerns about the lack of clarity on the "jointly operated" issue and requested on three separate occasions for staff to confirm that a robust stakeholder process would be used to solve the issues presented in October. The process since that time has been closed, without stakeholder input being sought. In fact, attempts to meet and discuss prior to the release of the Discussion Draft were rejected by staff.

Releasing a Discussion Draft can be useful, but when the timing of such a release dictates truncated review and analysis, the spirit and intent of the Administrative Procedure Act is compromised. Because CARB has taken the view that "nobody can see anything, until everybody sees everything", the entirety of changes to all affected the sections of the regulation were released at the same time. This causes a real hardship on the stakeholders' ability to access limited staff resources for discussion purposes. Couple the short timeline with an imposed deadline to get an official 15-day noticed package release for the purpose of making the April Board Meeting, and it becomes obvious how the process has been shorted.

This truncated process creates a potential obstacle to the adoption of this final package as there is the very real possibility of unintended consequences associated with the Staff proposal surrounding the "jointly operated" facilities concept. The Coalition continues to strongly believe that this is an inappropriate attempt to combine otherwise independently operated small refineries with other independently operated larger facilities for sole purposes of allowance allocation, but has not had sufficient time to meet with various levels of CARB management to walk through the issues and discussion its policy implications.

The Coalition and CARB Staff worked together almost daily leading up to the October Board meeting. Amending the refinery benchmarking and associated industrial allocation methodology is a very significant policy and technical exercise. We again note that the administrative process associated with refinery benchmarking was clipped at the end of the October rulemaking with the concept of "jointly operated" only day lighted in the weeks before the Board Meeting without any substance associated with the concept. These amendments require in-depth analysis and significant decisions affecting the potential long-term viability of entire facilities. The idea of a robust public process is defeated by having to make such evaluate such critical issues in a relatively rushed manner.

5. ARB Failed to Conduct Any Leakage Analysis Associated with In-State Production of Intermediate Products.

The "jointly operated" concept, by definition, only impacts California's smaller refiners. As noted above, this sub-group of California facilities produces a significant amount of intermediate refinery products. Information on regional imports of these products are kept by the Energy Information Administration (EIA). This data shows a historical trend of increased out of state intermediate/unfinished oil imports into California. Imports of intermediates or unfinished oils could be advantaged by the jointly operated concept. ***Before the jointly operated concept advances in the regulatory process, the Coalition requests a full leakage analysis consistent with the previous work done by CARB for this regulation.***

Thank you for your attention to this important matter. With these amendments tentatively scheduled for the upcoming April Board Meeting, the Coalition stands ready to provide feedback and engage in constructive dialogue so that we can avoid a last minute regulatory process. Any questions or follow-up comments can be directed to Jon Costantino at 916-552-2365 or at jcostantino@manatt.com.

Sincerely,

/s/

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Coalition Director

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