March 12, 2014

Richard Corey
Executive Officer
California Air Resources Board
1001 I Street
Sacramento CA, 95814

RE: Phillips 66 comments on February 26, 2014 – Cap and Trade Regulation Proposed Benchmarks for Refineries and Related Industries

Dear Mr. ~~Corey~~ Richard:

Thank you for taking the time to listen to our concerns on March 6, 2014. Phillips 66 is a significant employer in California with over 1,200 employees. Our operations covered by the rule include oil refineries, a calciner, petroleum product pipelines and terminals. The comments detailed below focus on two aspects of the February 26, 2014 Cap and Trade Regulation –Proposed Benchmarks for Refineries and Related Industries **("February Proposed Benchmark")**:

1. Atypical Refinery Benchmarking—Jointly Operated Definition
2. Coke Calcining – Inappropriate Cap Adjustment Factor (categorization under Table 9-2: Cap Adjustment Factors for Allowance Allocation)

I. Atypical Refinery Benchmarking – Jointly Operated Definition:

We have engaged in several discussions with CARB staff, particularly in the past few weeks, where we have been provided with an opportunity to express our concerns regarding the February Proposed Benchmark, as well as to discuss the data related to the Santa Maria Refinery. Our concerns, as expressed in our meetings and in supporting technical documentation provided to staff, may be summarized as follows:

The regulatory process regarding refinery benchmarking remains in flux, particularly since we have yet to see final language defining "jointly operated."

The use of 2008 date relative to our Santa Maria Refinery to determine the CWB is not appropriate. Data from the 2009-2012 CWB more accurately portrays Santa Maria's carbon footprint. Staff has been provided with detailed documentation regarding the impact of using the 2008 data versus the 2009-2012 data and other details regarding calculation methodology.

The Santa Maria Refinery meets the proposed "Atypical" refinery metrics approved by the Board in October 2013 based on both its size and complexity. The use of the anomalous 2008 CO2e/CWB data distorted the impact of the proposed regulation, which the use of the more representative sample based on the 2009-2012 average CO2e/CWB will correct.

If this correction is made, the Santa Maria facility would not fall below the proposed Atypical benchmark level and fits within the range of the small atypical refinery category. Phillips 66 supports Staff's proposed distinction between typical and atypical refineries based on having less than 12 process units and less than 20 million barrels crude through the atmospheric distiller during an allocation year as reflective of the facility's size and complexity. The "jointly operated" definition should be dropped from the February proposed Benchmark for the following reasons:

- This definition is written so it impacts just one company, Phillips 66.
- The definition has been a moving target. Since October 2013, CARB staff has proposed three different definitions – (1) October 2013 - refineries joined by pipeline are "jointly operated"; (2) January 31, 2014 - "Jointly operated" requires a level of 50% of the input to its atmospheric distillers; (3) February 26, 2014 – 50% input lowered to 10%.
- CARB staff has not provided sufficient policy justification or analysis to support any of these proposed definitions.
- The 10% jointly operated definition creates an unintended perverse incentive to manufacture asphalt in small quantities solely to fit into the atypical category rather than to optimize refinery operations.
- The February Proposed Benchmark also does not properly define finished products sold by refineries and uses this flawed definition of primary products to apply the 10% threshold with respect to "jointly operated".
- CARB's failure to either properly define "primary products" or to recognize that intermediate products such coke, sulfur and intermediate gas oils are distinct commodities that are sold in commerce has artificially created the need for the jointly operated concept.
- For benchmarking purposes, CARB should treat intermediate refinery products in the same manner that it treats other intermediate products such as lactose, non-fermented lactose, flat gas manufacturing, mineral wood fabrication and aseptic tomato paste, all of which have distinct benchmarks.
- The February Proposed Benchmark does not address the problem of leakage or imports and fails to identify any safeguards to prevent leakage from occurring. To the contrary, CARB's treatment of intermediate refinery products incentivizes leakage and will lead to unintended consequences such as displacing California-manufactured intermediate products with intermediate imports from out-of-state.
- The "jointly operated" definition was also mistakenly based on Phillips 66's practice of reporting its operations in Santa Maria and Rodeo to the Energy Information Agency ("EIA") as a single facility. This combined reporting was started in 2009 and was done because our data did not fit the EIA's standard reporting forms; but for all other purposes these refineries operate independently.

- The "jointly operated" definition also marks a fundamental change to the longstanding definition of stationary source facility. By linking otherwise independent facilities as a single facility for purposes of an atypical determination, CARB is modifying the overarching policy definition of federal and state stationary source permitting.

- Defining "jointly operated" is inherently difficult because most refineries are accessible by underground pipeline to receive or deliver a multitude of refining feed stocks. Facilities also can operate jointly through company ownership, third party long-term contract, or commodity streams.

- The "jointly operated" concept from the February Proposed Benchmark is outmoded, inaccurate, creates perverse incentives for leakage, and impacts just one company. It should be eliminated.

RECOMMENDATION: Phillips 66 requests CARB re-evaluate our data and move forward with the Cap and Trade Regulation without the jointly operated definition and therefore retain the current definition of facility within the rule, remaining consistent with GHG reporting.

II. Calciner NAICS code utilized by CARB is in error and conflicts with a published warning from the US Department of Commerce to businesses not to make this error.

Phillips 66 and CARB staff have been in discussions about the application of the declining cap adjustment factors shown in the California Air Resources Board (CARB) Table 9-2 of the Cap and Trade regulation to the coke calcining sector. The category of factors currently applied to other sectors with process emissions greater than 50%, incorrectly and without justification excludes coke calcining. The justification for selecting the slower declining cap factor for coke calcining is clearly supported by existing CARB documentation.

CARB has previously stated the requirements to be granted a slower cap decline factor: (1) process emissions greater than 50%; (2) a high leakage risk; and, (3) high emissions intensity. It is clear these conditions have all been satisfied vis-à-vis coke calcining. Specifically the calciner meets the necessary criteria as listed below:

- Calciner have >90% process emissions, far exceeding the 50% required for the alternative declining cap factor as shown in Table 9-2 "Cap Adjustment for Allowance Allocation". The emissions criteria are easily demonstrated in Phillips 66' MRR reporting.

- ARB's C&T Rule Table 8-1 classifies Calciner (NAICS) as High Leakage Risk.

- ARBs Appendix K, Table K-10, K-45 lists NAICS Code 324199 as having an Emission Intensity value of 9,754. This is above the 5,000 threshold to support the alternative declining cap of Table 9-2. In addition, Phillips 66' internal calculations show values >9,000 emission intensity when you look at it both in terms of with and without taxes.

There has been an unaddressed and mistaken assumption that calciners do not have high emissions intensity based on the emissions intensity of industries under the combined category of NAICS Code 324 (Petroleum and Coal Products Manufacturing). NAICS Code 324 is made up of five subcategories: Petroleum refineries, two related to asphalt manufacturing, one for lubricant manufacturing, and 324199 - for "All Other

Petroleum and Coal Products Manufacturing". We believe that use of **NAICS code 324 is an error** and is too broad for coke calcining categorization. This is verified by NAICS guidance.

California calciners appropriately use the NAICS Code 324199. Additionally, the U.S. Department of Commerce identifies that NAICS Code 324199 as appropriate and recommends specifically for "Calcining petroleum coke from refined petroleum." The selection of appropriate NAICS Code 324199 from the U.S. Department of Commerce is compelling. Indeed, the Code section explicitly warns businesses not to make this error.

NAICS Code 324199 also applies to other industries that are similar to calcining (primarily using coke ovens), whereas the broader Code 324 applies to many industries that are very different from calcining. Industries associated with NAICS Code 324199 have high emissions intensity, as already published in Appendix K of the 2010 Cap and Trade rulemaking. Therefore, it is perplexing and silent on why coke calcining has been omitted from Table 9-2's slower cap decline factor after so many instances of pointing this out. Calciners meet all three requirements to be eligible for the slower declining cap adjustment factors.

RECOMMENDATION: Phillips 66 requests coke calcining is assigned the slower Cap Adjustment Factor in the upcoming 15-day amendment package.

We hope we have demonstrated that pursuing the "jointly operated" concept is inappropriate based on the above and new information we are providing at this time. Calcining operations appropriately should be classified within the Code that is referenced and the slower Cap Assistance Factor must be applied.

Thank you for your attention to these important and unanswered rulemaking matters, please don't hesitate to call me at (916) 447-5572.

Sincerely,

Stephanie R Williams
Manager, State Government Relations
Western and Rocky Mountain Regions

Encl: attachment

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