Kern Oil & Refining Co.
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December 15, 2011

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

Re: Comments on Proposed Amendments to Low Carbon Fuel Standard Regulation – Kern Oil & Refining Co.

Dear Clerk of the Board:

The intent of this letter is to provide comments on the proposed amendments to the Low Carbon Fuel Standard (LCFS) regulation, as scheduled to be heard by the California Air Resources Board (CARB) at the December 16, 2011 hearing. Kern Oil & Refining Co. (Kern) appreciates the opportunity to comment on the proposed modifications. Kern is one of only two remaining small refiners in California producing transportation fuels, and Kern is the only small refiner in California producing CARB Reformulated Gasoline and Ultra Low Sulfur Diesel.

In short, Kern respectfully but strongly suggests that any decision on adopting the proposed amendments be postponed beyond the current hearing scheduled for December 16, 2011. Kern is of this position for various reasons discussed below, all of which demonstrate that there is too much yet to be analyzed, yet to be disclosed, and yet to be decided, specifically with respect to the proposed amendments regarding high carbon intensity crude oils (HCICO).

As Kern understands the HCICO proposed amendments, crude oils will still be analyzed for determination of a carbon intensity value. However, rather than individual refiners being held accountable for their specific crude slates processed, the refining industry across the state will be considered as a whole within an "average refiner" approach. Calendar year 2009 has been proposed as a baseline year, for which the carbon intensity of all crudes processed by refiners in California has been determined and then set as a baseline target. CARB will then determine the carbon intensity of crude oil processed collectively by California refiners each subsequent year for comparison to this baseline. If the carbon intensity of crude oil processed by the refining industry during a compliance year exceeds that of the baseline year, then the entire industry is subject to a "penalty" by means of incurring deficits within the LCFS program.

Summary of Comments:

Kern has six primary comments for consideration as described below.

1. The current approach unnecessarily incentivizes refiners to process higher carbon intensity crude oils because the deficits incurred if/when the industry average exceeds the target baseline are then spread across the entire industry. Even those refiners who did not process any HCICO will be penalized in this approach since the deficits are spread across the entire refining industry, regardless of what each individual refinery actually processed. This distribution of deficits discourages actual reductions because the impact of incurring deficits is softened across the group. In fact, it provides incentive not to pay premium prices for purchasing a lower carbon-intensity crude oil because of the lack of individual accountability. No single refiner has any control over another refiner – how they run their business, how they acquire raw materials, or otherwise. Each refiner will be at the mercy of every other refiner hopefully choosing to operate for the benefit of the whole industry in order to not incur a deficit from HCICO. This holds especially true for those lower volume refiners with little impact on the average.

2. The size of refineries, in terms of crude oil processing capacity, varies widely across the state. As published in the National Petrochemical & Refiners Association's 2011 *NPRA United States Refining and Storage Capacity Report,* the crude oil processing capacity of California refineries ranges from less than 10,000 barrels per day to nearly 300,000 barrels per day; Kern's capacity is approximately 26,000 barrels per day – less than 1.5% of California's total capacity. The likelihood of a small refiner such as Kern impacting the industry average is minute at best. Small refiners are clearly being disproportionately and negatively impacted economically by the proposed HCICO provision and should be recognized as a distinctive subset of the California refining industry.

3. Kern staff has reviewed the listing of crude oils analyzed to date and has determined that Kern has little, if any, ability to access any of the listed HCICO sources. Kern is "land-locked," dependent solely on domestic sources of crude oil. At this time, it is unclear whether CARB plans on distinguishing between particular crude oil production fields within the state; with the information published to date and Kern's knowledge of production processes employed by its crude suppliers, Kern has no supporting data to suggest that any of the crude currently being processed by its refinery is HCICO. This being the case, Kern would incur deficits if the industry average exceeded the baseline target even though the carbon intensity of crude processed by Kern had been below the target. It is absolutely <u>wrong</u> for a company in Kern's position to subsidize any other refiner by incurring deficits when that company's operation made no contribution to the excess beyond the baseline target.

4. The majority of refineries in California have a significant level of flexibility for access to a variety of crude oil sources given their ability to receive crude oil via pipelines and/or

port access. These flexibilities allow larger, more accessible refiners additional benefits to be gained from world markets, better economics, enhanced trading options, wider access to differing qualities of crude, and more. These opportunities present a disadvantage to smaller and/or land-locked refineries such as Kern, in that the effects of these benefits will further exacerbate the already notable differences between a small refinery and the "average" refinery laid out in this approach. Further effect of this can be demonstrated in the ability of larger refining companies to make changes to refinery configurations in order to accommodate different crude slates. Kern's ability to make equipment and configuration changes is significantly limited and is in no way comparable to that of larger, integrated oil companies with multiple locations and corporate holdings in both upstream and downstream environments. These diversities in larger refiners help to absorb the costs associated with making crude slate and/or equipment configuration changes. This point further exemplifies the inability of any one refiner to control other refiners' business decisions as would relate to capital expenditures needed to make such configuration changes.

5. The "average" refiner approach makes forecasting and budgeting for compliance nearly impossible since compliance hinges on the industry as a whole and not simply the efforts a company puts forth to comply. A refiner may opt to purchase lower carbon intensity crude oil at premium prices in order to avoid generating any deficits. However, as the proposed amendments are written, if the industry average exceeds the baseline target, this refiner would still incur deficits based on the industry average. Therefore, additional credits will be required to offset these deficits, the price for these of course being in addition to the premium price already paid for the lower carbon intensity crude.

6. Insufficient data has been published to date communicating the carbon intensity values of specific domestic crude oil slates, specifically those crudes produced from individual production fields within the state of California. These carbon intensity values are key factors both in terms of refiners being able to assess the potential impacts of the proposed amendments at this time, as well as making strategic decisions about which crude oils should or should not be purchased in the coming years, where such decisions can still be influenced. Table 5 of CARBs October 2011 *Staff Report: Initial Statement of Reasons for Proposed Rulemaking* notes that the baseline crude average carbon intensity was derived using a crude oil mix comprised of nearly 40% crude produced within California. However, CARB has yet to publish or otherwise communicate carbon intensities of any specific California crudes that make up this significant piece of the total being processed within the state.

Efficiencies and prudent business decisions, in line with the intent of the LCFS, should not be disadvantaged by using an "average" refiner approach. Kern does not object to the portion of the proposed amendment that establishes a baseline for the industry, but does object to compliance then being demonstrated by the entire industry as an average. Kern suggests that each refinery be assessed for compliance, and incur deficits as appropriate, on an individual basis. The task for

making these demonstrations can not be any more burdensome that the average approach considering there are fewer than twenty refineries remaining in the state.

Alternatively, Kern suggests in lieu of individual compliance demonstrations, that certain exemptions be added to the current approach. Such exemptions could include the following ideas, or any combination thereof.

1. Non-HCICO demonstration exemption: Provide an exemption to refiners that can demonstrated that no crude oil processed during the compliance year exceeded the established baseline carbon intensity.

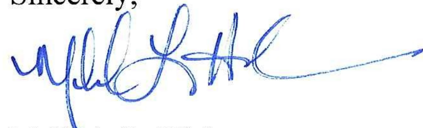
2. Low-volume processor exemption: Provide an exemption to refiners processing less than 5% of the state's total crude capacity from any deficits that would otherwise be incurred by an industry average carbon intensity in excess of the established baseline. The basis for such an exemption lies in that small processors inherently have limited ability to affect the average carbon intensity, but conversely are easily affected by larger refiners' decisions to process HCICO.

3. Low-volume producer exemption: Provide an exemption to refiners producing less than 5% of the state's total primary refined products from any deficits that would otherwise be incurred by an industry average carbon intensity in excess of the established baseline.

For all the reasons detailed above, Kern respectfully reinforces its position that any decision on adopting the proposed amendments be postponed beyond the currently scheduled hearing. There is work to be done to fully assess the impacts of the HCICO amendments as written. Kern proposes that CARB staff work further with industry to develop an approach that provides equal treatment to all refiners, does not unjustly distribute deficits across in the industry penalizing one refiner for another refiner's choices, that does not incentivize refiners to "cheat" because penalties are distributed, and that does not rely on industry averages to demonstrate compliance within an industry with a spectrum of players that spreads far and wide from "average."

Kern appreciates this opportunity to provide comment and we are committed to continue working with Staff throughout this regulatory process.

Sincerely,



Melinda L. Hicks
Manager, Environmental Health and Safety