MEETING

BEFORE THE

CALIFORNIA AIR RESOURCES BOARD

HEARING ROOM

CALIFORNIA AIR RESOURCES BOARD

2020 L STREET

SACRAMENTO, CALIFORNIA

FRIDAY, JULY 29, 1994

8:45 A.M.

Nadine J. Parks
Shorthand Reporter

MEMBERS PRESENT

Jacqueline Schafer, Chairwoman

Brian Bilbray
Eugene Boston
Joseph C. Calhoun
Lynne T. Edgerton
M. Patricia Hilligoss
John Lagarias
Jack C. Parnell
Barbara Riordan
Doug Vagim

Staff:

Jim Boyd, Executive Officer
Mike Scheible, Deputy Executive Officer
Mike Kenny, Chief Counsel

Peter Venturini, Chief, Stationary Source Division
Ron Friesen, Assistant Chief, SSD
Dean Simeroth, Chief, Criteria Pollutants Branch, SSD
John Courtis, Manager, Fuel Section, SSD
Tom Jennings, Staff Counsel, Office of Legal Affairs

Jude Lounsbury, Acting Board Secretary
D. D. Schneider, Office of Legal Affairs
Wendy Pendleton, Secretary
Bill Valdez, Administrative Services Division

I N D E X

INDEX, continued. . .

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PROCEEDINGS

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CHAIRWOMAN SCHAFER: Good morning, ladies and gentlemen, I'd like to call this second day session of the Air Resources Board's July meeting to order, and request the Board Secretary to take the roll.

MS. LOUNSBURY: Bilbray?

Boston?

DR. BOSTON: Here.

MS. LOUNSBURY: Calhoun?

MR. CALHOUN: Here.

MS. LOUNSBURY: Edgerton?

MS. EDGERTON: Here.

MS. LOUNSBURY: Hilligoss?

MAYOR HILLIGOSS: Here.

MS. LOUNSBURY: Lagarias?

MR. LAGARIAS: Here.

MS. LOUNSBURY: Parnell?

MR. PARNELL: Here.

MS. LOUNSBURY: Riordan?

SUPERVISOR RIORDAN: Here.

MS. LOUNSBURY: Vagim?

SUPERVISOR VAGIM: Here.

MS. LOUNSBURY: Wieder?

Chairwoman Schafer.

CHAIRWOMAN SCHAFER: Here.

I believe Supervisor Bilbray is here.

I'd like to remind those of you in the audience who would like to present testimony to the Board on today's agenda item to please sign up with the Board Secretary.

If you have a written statement, please give 20 copies to the Board Secretary.

The item on the agenda today is 94-8-1, a public hearing to consider amendments to the small refiner volume provisions in the regulation limiting the aromatic hydrocarbon content of California motor vehicle diesel fuel.

In 1988, the Air Resources Board adopted regulations limiting the aromatic hydrocarbon and sulfur content of diesel fuel. These rules generally require that the aromatic content of diesel fuel be limited to 10 percent.

Small refiners were provided with a less stringent 20 percent limit to reflect their higher per gallon costs in producing the cleaner fuel, and were provided with a maximum amount of 20 percent fuel that they could produce in any one year.

Because of special provisions in the regulation that allowed small refiners an additional year to comply with both the sulfur and aromatic content limits, the small refiner volume limits for 20 percent aromatic content fuel becomes effective for three small refiners on October 1, 1994.

These three small refiners are Kern Refining, Paramount, and Powerine. These three small refiners are currently meeting the sulfur requirements of the regulation.

Today's proposal deals with the volume provisions for small refiner diesel fuel that the Board set in 1988. The staff has proposed changes that would establish more representative exempt volume limits, delay the effective date of the volume limits from October 1, 1994 to January 1, 1995, and clarify the volume limits for the last quarter of 1994.

These changes are proposed to avoid limitations on production of diesel fuel during a time of historic high demand, and to ensure that the original intent of the Board in adopting the small refiner provisions is met.

The changes will further ensure that the final phase of the reformulated diesel fuel rule is implemented smoothly.

Because of the concerns about how any change in the regulations may affect the competition situation between refiners, I expect that we may well hear divergent views on how the regulation should be modified.

I also note that I took a look at the witness list, and we have a long witness list this morning.

In 1988, the Board understood that the diesel fuel regulations were an essential part of the Air Resources Board's overall strategy to reduce pollutants from motor vehicles. In developing this control measure, staff determined that a 10 percent aromatic limit was technically feasible and would result in substantial emissions reductions in oxides of nitrogen and particulate matter.

However, when determining costs, it soon became apparent that the various sectors of the California refining industry -- small, independent, and large -- would be affected economically to varying degrees.

The higher cost of producing low-aromatic diesel fuel for small refiners compared to larger refiners created concerns over equity and the ability of small refiners to participate in the diesel fuel market.

The Board intended to avoid a regulation that would push small refiners out of the diesel market and would eliminate their contribution to the marketplace.

These concerns over equity and participation in the market led the Board to adopt less stringent standards for small refiners. The proposal before us today does not affect this portion of the rule.

However, in 1988, the Board also sought to limit the impact of small refiner diesel fuel on the environmental benefits of aromatics regulation to the extent possible.

That is why limits were imposed on small refiners' diesel fuel production volumes.

In today's item, we will be considering modifications to how the volume restrictions for small refiners should be set. At this point, I'd like to ask Mr. Boyd to introduce the item and begin the staff's presentation.

Mr. Boyd?

MR. BOYD: Thank you, and good morning, Board members.

I'd like to start this item by just giving a little brief background on what brings us to today's proposal.

I think all of us know that clean diesel is indeed an essential part of California's clean air strategy, and that we indeed need it to meet both the federal and State law requirements.

As you know, clean diesel achieves 70 tons per day reduction in NOx emissions, as well as 20 tons per day in PM10, and 80 tons per day reductions of SOx, sulfur emissions.

And, as you know, in addition, clean diesel fuel reduces toxic compounds that find their way into diesel exhaust. When the Board adopted the regulation in 1988, we recognized, all of us, the limited financial strength of refiners, and accommodated that limited financial strength in the regulation.

In general the diesel regulations, as you know, that large refiners meet the 10 percent aromatic hydrocarbon limit and the small refiners can produce fuel that meets a 20 percent standard. This differential was seen as adequate to level the financial playing field.

However, small refiners can produce 20 percent diesel fuel only up to a calculated production volume cap that we have called the -- or known as the exempt volume.

The intent of this provision was to finally equalize the cost of compliance with the regulations between the small and the large refiners without unduly compromising the air quality benefits of the regulation. In addition, the Board established the exempt volume limit to prevent small refiners from taking advantage of the regulation to expand their market share beyond their historic motor vehicle diesel fuel production level.

Now, over the past year, since passage and implementation of this regulation, small refiners have met with the staff frequently -- and, frankly, it has seemed continuously -- to discuss their concern with the small refiner exemption volume limit.

They believe that the limits in the original regulation are overly restrictive, in that they do not reflect the small refiner's historic ability to produce motor vehicle diesel fuel. They maintain that the result of this approach is not commensurate with the Board's original intent.

So, in April of this year, we held a workshop to discuss the issues raised by the small refiners. Our review of the regulatory requirements and our evaluation of the extensive workshop discussions and our other discussions finally led us to conclude that the small refining sector has changed very significantly since passage of our regulation in 1988.

We further concluded that the methodology recommended by the staff and adopted by the Board in 1988, does not really adequately put into effect the original intent of limiting small refiners to historical levels.

These findings led us to the decision to recommend amendments to the 1988 regulation, and that's what we've brought before you today.

In our view, the amendments proposed do not represent a fundamental change in the original regulation; rather, they are, to some degree, fine-tuning based on these recent findings that I mentioned.

First, the amendments would add a new option, allowing small refiners an alternate method for calculating their exempt volume limit. There are other amendments proposed that would clarify production volumes for the last quarter of 1994, and advance the effective date of exempt volume limit from October 1, '93 to January 1, 1994. I think those dates are in error.

Since the staff report was released, we've continued our discussion of the proposed changes with affected refiners. During this process, we have received additional information on the historical supply and current cost that have convinced once again that additional modest changes to the original proposal should be made. And these will be discussed with you in the staff's proposal.

The amended staff proposal is designed to provide flexibility to small refiners while adhering to the original principles upon which the Board's 1988 rule was based.

In addition, the proposed move of the effective date of the volume limit to a lower fuel demand period is based upon our experience with the October, 1993 rule effected in the State. In other words, we have no intention of ever starting a fuel rule the month of October of any year at any point in time, while any of us is here.

(Laughter.)

SUPERVISOR BILBRAY: Alive.

(Laughter.)

MR. BOYD: It is preferable to implement volume limits in a low demand period rather than in a period that proved to be a high demand period. Even though at the time our intent was to make our rule effective at the same as EPA, we will not be guided by that ever again.

With that introduction, I'll now ask Dean Simeroth to present our proposed amendments and give you additional background on what led us to our recommendation.

Mr. Simeroth, if you would, please.

MR. SIMEROTH: Thank you, Mr. Boyd.

Good morning, Chairwoman Schafer, members of the Board.

Here today, we'll cover why we have the diesel fuel regulations, what they are, what is the small refiners' issue, a description of the proposed regulation amendments to address this issue and their effects.

Why do we need the diesel fuel regulations?

California has severe air quality problems. The ozone air quality standard is violated widely throughout the State. And the State PM10 standard for particulate matter is violated virtually everywhere in the State, except for one county.

Diesel vehicles only constitute approximately four percent of the motor vehicle fleet; but in the 1990 inventory, they contributed 39 percent of the mobile source emissions of oxides of nitrogen, 61 percent of the directly emitted matter from mobile sources, 34 percent of the sulfur dioxide emissions.

Today, with the diesel sulfur regulations in effect, the 34 percent has become six percent.

In terms of the benefits of the diesel fuel regulation, if fully implemented as adopted, we reduce sulfur dioxide emissions by 80 tons per day, particulate -- that is, directly emitted particulate matter, 20 tons per day, oxides of nitrogen by 70 tons a day.

Later, I will present the impact of the staff's proposal on these benefits.

Currently, we estimate that the total capital investments to produce complying diesel fuel are approximately $150 million. This results in an estimated cost per gallon to comply of 6 cents.

The diesel regulations set the sulfur content limit at 500 parts per million by weight for both on- and off-road fuel, aromatic hydrocarbon content limits of 10 percent by volume for large refiners, and 20 percent by volume for small refiners.

The regulation also allows for certification of equivalent alternative formulations for both aromatic limits. We had a general implementation date of October 1st, 1993.

Small refiners had some additional requirements, the production of the 20 volume percent aromatic diesel fuel is limited to 65 percent of a refiner's base year distillate volume. A base year distillate volume was defined and determined as the average of the three highest distillate productions from '83 to '87. One company was allowed base years of '89 to '90, because they were not in operation the previous years.

Finally, a suspension from the regulation was provided for qualifying small refiners to delay the regulation from October 1st, '93 to October 1st, 1994. Three small refiners qualified for the suspension. And, as noted earlier, they are fully complying with the sulfur requirements, but the aromatic hydrocarbon content requirements they will not comply with until October 1st, '94.

The Air Resources Board intent, when originally adopting the small refiner provisions, were to provide fairness and equity to all refining sectors, recognize the small refiners' role in the diesel fuel marketplace; that is, generally, the more competition in the marketplace, the better; and limit the small refiner production of 20 volume percent aromatic diesel fuel to preserve the benefits of the regulation.

In terms of the small refiners' issue here to consider today, is the small refiner exempt volume provision still appropriate in the light of current conditions?

Staff held a workshop on April 21st, 1994, to solicit comments on the smaller refiner issue and used the information to develop the proposals contained in the staff report.

Among others, staff findings were that the California refining sector has changed. Today, there are fewer small refiners producing motor vehicle diesel fuel. Refiners in general utilize capacity, refining capacity, to a greater extent than they did in the early to mid-eighties.

Finally, most distillate produced by small refiners is motor vehicle diesel fuel. And this is addressing the 65 percent distillate volume limitation.

In developing the proposal in the staff report, staff recognized that small refiners produce almost all -- on average, approximately 96 percent of their distillate production is motor vehicle diesel fuel. Staff proposed that refiners could remain subject to current provisions or choose to produce diesel fuel up to 100 percent of their historical distillate production and have that historic distillate production limited.

Subsequent to the release of the staff report, staff evaluated additional information obtained from the California Energy Commission to determine historical operating trends for refiners.

The small refiners provided additional information to show the economic effect of the staff's original proposal. Upon reevaluation of the proposed amendments, staff determined that it is appropriate to modify the original staff proposal.

The key consideration by staff in developing the modified proposal is how refinery operations have changed with time.

Shown here is how refinery operations have changed in the past 10 years in terms of utilization of refinery capacity.

Generally, the overall utilization rate -- that is, the proportion of the capacity that is used -- has increased from about 65 percent in 1983, to over 90 percent in 1992.

However, small refiners have not kept pace, at least through 1992. In 1992 and before, small refiners were either in bankruptcy, suffering frequent periods of nonoperation, or generally operating less efficiently than the industry as an average. That is, they had significantly lower utilization rates.

If small refiners are constrained to utilization rates that existed in 1992 and before, they will be locked into an inefficient mode of operation.

In recognition of how refinery operations have changed and small refiners produce distillate primarily as motor vehicle diesel fuel, we are proposing that the small refiner diesel fuel exempt volume limit provisions be changed so that the small refiner exempt volumes be established through the use of each small refiner's crude capacity, the industry average utilization of crude capacity, approximately 90 percent; each small refiner's ratio of distillate product to crude input; and the average small refiner's diesel fraction of distillate produced.

It should be noted that we're not proposing that the sulfur limit and the 20 percent aromatic standards that are required on October 1st, '94 be delayed.

Small refiners will still have to comply with these limits on October 1st. Staff is proposing to delay the small refiner exempt volume limits to January 1st, 1995, to avoid implementation during the high diesel demand period. We're also proposing to clarify that small refiners can produce 10 volume percent aromatic diesel while producing 20 volume percent aromatic diesel. This is to encourage production of 10 percent complying diesel.

It should be noted that small refiners must -- excuse me. I already said that.

If the current regulation is implemented with no change, small refiners would be allowed to produce approximately 11,000 barrels per day of 20 percent aromatic diesel. Under the staff's modified proposal, this number would become 23,700, approximately, barrels per day.

It's staff's estimate that the average cost for the small refiner compliance 7.5 cents per gallon. To the extent that production cost is higher for small refiners than for the large refiners, the 6 cents indicated earlier in the presentation, the proposal is not a guarantee of a market share for the small refiners.

In terms of the rationale for the staff's proposal, the proposal should correct problems with the current regulation in the proposal and the staff report in determining the small refiner exempt volume.

The proposal does not create an unfair advantage. The proposal reflects a need for refiners to operate at greater efficiency.

In terms of environmental impact of today's proposal, increasing the small refiner volumes -- that is, the 11,000 to the 23,700 -- could reduce emission benefits by up to 3 tons per day oxides of nitrogen and up to six-tenths of one ton per day of directly emitted particulate matter. Also, it needs to be noted that, for the last quarter -- calendar quarter, while we awaiting implementation of the exempt volumes, small refiners would operate at higher levels -- could operate at higher levels in the 23,700.

This would result in a temporary increase or temporary reduction in emission benefits. Emission benefits during this temporary time period of the three months -- the reduction in emission benefits -- excuse me -- during this three-month time period would be 5.8 tons per day of NOx and 1.3 tons per day of particulate matter.

At the end of the -- come January 1st, the end of the three months time period, the numbers shown on the slide would then apply thereafter.

In the staff's view, the economic benefits outweigh the potential adverse environmental effects. The benefits are summarized. The proposal provides an opportunity for small refiners to operate at an efficient level, promotes competition in the marketplace, and would allow independent marketers continued access to their traditional suppliers.

In summary, the staff proposal is that there be no change in the requirement for the small refiners to comply on October 1st, '94, with the 20 volume percent aromatic standard; proposing an increase in the small refiner exempt volume, as discussed today; proposing a delay in implementation of the volume limitation of the small refiners from the high diesel demand period to a low diesel demand period; and clarify the regulation so that we can encourage the production of 10 volume percent complying diesel by small refiners.

In closing, we recommend that the Board adopt the staff's proposal as presented today.

I'd like to add that the staff proposal, as presented, is on the table in the back of the room, the document dated July 29th, 1994. It's two pages. Thank you.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Simeroth.

Do Board members have any questions for staff at this point?

MR. LAGARIAS: I have a question.

CHAIRWOMAN SCHAFER: Yes, Mr. Lagarias.

MR. LAGARIAS: Mr. Simeroth, in that 20 percent aromatics that small refiners are required to produce, does that also include within it any of the 10 percent aromatic fuel that the small refiners are encouraged to produce? Or is that separate?

MR. SIMEROTH: The proposal today would have those two separate, so that they would not be discouraged from producing 10 percent if they could.

MR. LAGARIAS: Well, it seems to me that if you're limiting 20 percent, that everything under that, even 10 percent is part of the 20 percent, because that doesn't give us a cap on the additional fuel.

MR. SIMEROTH: The current regulation reads the way you're describing it, Mr. Lagarias. It would include the 10 percent as part of the 20.

MR. LAGARIAS: Now, wait a minute. Which are you saying? It does include or it doesn't include it?

MR. SIMEROTH: The current regulation, as it is on the books today --

MR. LAGARIAS: Includes it.

MR. SIMEROTH: -- includes the 10 percent as part of their 10 percent volume.

MR. LAGARIAS: And you're proposing to take -- give, in addition to that 20 percent, whatever 10 percent fuel the small refiners produce.

MR. JENNINGS: Mr. Lagarias, perhaps I could clarify the point.

Under the regulation, as it now stands, you look at the diesel fuel coming out, the California motor vehicle diesel fuel coming out of the small refinery starting at the first of the year. And every batch of that is counted against the 20 -- the exempt volume until they reach the ultimate.

What the staff is proposing is a modification, which would allow small refiners to designate batches during that period as being subject to the regular 10 percent aromatics limit rather than the 20 percent aromatics limit.

There would be no increase in the amount of 20 percent aromatics diesel fuel they could produce. And in the regulation on sulfur content in the South Coast Air Basin, the small refiner provisions did have a provision allowing that batch-to-batch designation.

It was taken out of the aromatics regulation to simply matters, but the smaller refiners had said that that could give them more flexibility, but it would not increase the total volume that could be subject to the 20 percent limit.

MR. LAGARIAS: Thank you.

CHAIRWOMAN SCHAFER: Dr. Boston?

DR. BOSTON: Dean, I was unclear. Is that 20 percent allowance unlimited, indefinite? Does it go on forever, or is there a statutory date when it stops?

MR. SIMEROTH: The 20 percent allowance to the -- in terms of the exempt volumes, could go on forever. They can apply each year to renew it.

DR. BOSTON: Didn't the original bill have a limit on when that sunsetted?

MR. SIMEROTH: The independent refiners were allowed a temporary use of the 20 percent provision, and that was sunsetted.

The small refiner provision for the 20 percent originally did not have a sunset.

CHAIRWOMAN SCHAFER: Are there any other questions?

Yes, Mr. Calhoun.

MR. CALHOUN: I believe that the staff report states that there are four small refiners now, and that's down from -- you may have said -- from what number?

MR. SIMEROTH: 14.

MR. CALHOUN: From 14? And that's over a period of how many years? It was 14. How many years --

MR. SIMEROTH: 14 in 1988.

MR. CALHOUN: And it's down to four now; is that correct?

MR. SIMEROTH: Four today producing motor vehicle diesel fuel.

MR. CALHOUN: Thank you.

MR. SIMEROTH: There are other small refiners producing other products, but not diesel

CHAIRWOMAN SCHAFER: Yes, Ms. Edgerton.

MS. EDGERTON: What percent of the diesel market is provided by the small refiners?

MR. SIMEROTH: Approximately 15 percent. The number varies slightly from year to year.

MS. EDGERTON: Did that go down with the reduction in the number of small refiners from 14 to 4? Or did that stay the same?

MR. SIMEROTH: Generally, the volumes supplied by the small refiners have decreased with time. In 1983, the small refiner share of the distillate market was 27 percent. And they're down approximately to 15 percent today.

MS. EDGERTON: You -- thank you. You indicated that there is a particular small refiner's role in the diesel fuel marketplace. What is that role?

MR. SIMEROTH: The information supplied by the small refiners indicate that they primarily serve independent oil marketers and serve accounts directly. And they have no branded outlets, per se. They're supplying the independents, if you want to look at it that way.

MS. EDGERTON: Who do those -- which Californians do those independents then provide diesel to?

MR. SIMEROTH: Unbranded retailers, fleet users, agricultural accounts, trucking firms, construction firms, usually -- in terms of the nonretail outlets, it would be small accounts that usually are not attractive for large refiners to supply.

MS. EDGERTON: Of those end users in California, can you pinpoint a particular sector that uses the most? For example, small farmers, agriculture. Is there some construction? Is there some sector that uniquely uses this supply?

MR. SIMEROTH: I'm not sure that we can say that there's a sector that uniquely uses the supply. The situation is too complex to totally -- to generalize quite that way. You know, some construction outfits will get from Chevron and Shell jobbers as well as they'll get from independent marketers.

Usually, the sector that gets supplied by the independents is one where they're providing a service as well as the product. And they're getting relatively small volumes delivered on site. You're going out to the farm with your truck and delivering the fuel there or going to the construction site and delivering the fuel there type thing.

MS. EDGERTON: Is this a sector of the market which large refiners, through their delivery systems, compete for?

MR. SIMEROTH: Generally, there's competition in this area between the smaller refiners and the large refiners. The independent marketers -- we're sort of talking --

MS. EDGERTON: I realize it's difficult. Sorry. These are very difficult questions.

MR. SIMEROTH: The competition we're talking about is like one level down below the refiners. It's intermediate distributors who are going out competing head to head against each other.

And it's who these intermediate distributors are supplied by --a lot of them are supplied by small refiners, but they are also supplied by major refiners.

MR. BOYD: Ms. Edgerton? Madam Chair, if I might elaborate.

CHAIRWOMAN SCHAFER: Mr. Boyd.

MR. BOYD: Ms. Edgerton, I think you will probably hear today, and you probably have read and heard in the past, that the majors, oil producers, can produce -- when you deal in averages, they can produce -- I'm sure they will say they can produce enough fuel to meet the demand, the historical documented demand in the State of California.

And when you deal in averages, that's pretty easy to see. What our painful experience is, is that the diesel market in California is extremely complex, diverse; it's very geographical, and the transportation system for moving fuels around doesn't necessarily have enough arteries and capillaries to get fuel everywhere it needs to go.

So, the independent marketers are very important and the independent refiners, the small refiners, seem to deal with these people to a very large degree as well as with direct accounts in agricultural, construction, and what have you.

And it's our feeling that, without the combination of the two, we just haven't been able in the past -- even though, on average, you could oversupply the State -- to get the fuel to market without the whole system in place and operating.

And there probably will be witnesses who would attest to that, and we certainly have had that experience in the past. And perhaps the refiners could even speak to it better than we can.

But, in observing, and watching, and listening for quite some time, it does seem to take the sum of all parts to make the system work entirely and to make sure that everyone is supplied. There are certainly areas where small refiners and major refiners go head to head. There's no doubt about that. But there are other areas where it seems that only the smaller refiner provides the supply for a certain geographical area or a certain economic activity in a particular area.

So, it's extremely diverse, complex, and hard to get a handle on, frankly, other than in the aggregate and from experience.

MS. EDGERTON: That's very helpful. Thank you.

And, as is sometimes my wont, I have a followup. What geographic areas -- I mean, I don't want to put you on the spot, because it's a very big State, but is there any -- do you have any sense of what geographical areas tend to wind up unserved?

MR. BOYD: Well, I'll venture my recollection and views, and the staff certainly has a closer hand on this.

Certainly, Northern California seems to have more extreme problems whenever there's a supply difficulty. And some parts of the Central Valley, the San Joaquin Valley, as well, depending upon the ability of pipelines to get adequate fuel to certain spots.

So, we had, during the last crisis, plenty of fuel in total. But we had deficiencies in spots all over the State. And it's the inability of the system to, you know, to totally reach those points, and the need for other alternative ways of getting it to those points that we have seen is quite critical to the, you know, the economic machine that's out there.

MS. EDGERTON: Thank you.

CHAIRWOMAN SCHAFER: Mr. Simeroth, did you want to elaborate?

MR. SIMEROTH: I guess what I could add is -- three small refiners; one is located in Bakersfield -- or actually, two of the four small refiners are located in Bakersfield and two are in the Los Angeles area.

It's no secret there's only three refiners operating in the Bakersfield/Kern County area -- one major and two small refiners. That area could be impacted to some degree.

Probably the most result would be the ability of independent marketers to obtain suppliers. A lot of the independent marketers buy fuel on the spot market. They have no long-term contracts with any particular refinery, and they also tend to buy heavily from the small independent refineries. And how that would be affected would depend upon a lot of things. But, certainly, it would be affected.

CHAIRWOMAN SCHAFER: Are there any other questions for the staff from Board members at this time?

If not, I'd like to begin hearing witnesses, and I'd like to begin with Susan Brown of the California Energy Commission.

Ms. Brown?

MS. BROWN: Good morning.

CHAIRWOMAN SCHAFER: Good morning.

MS. BROWN: My name is Susan Brown. I'm the Deputy Chief for Forecasting for the California Energy Commission.

Our commission is responsible for the State's official forecasts of the supply, depend, and price of electricity, natural gas, petroleum, and other fuels, including diesel fuel.

In addition, we maintain a confidential database under State law, under the provisions of the Petroleum Industry Information Reporting Act. I've been asked today to make a brief presentation on the current capability of our refineries to make and produce low sulfur/low aromatic diesel fuel.

The information I'm presenting is based on the confidential PIIRA data, our review of the compliance plans filed with the ARB staff, meetings with individual refiners that we have conducted over the last several weeks with your staff, and a recent telephone survey. So, the information I am providing today I hope will provide a factual context for the decision that your Board will be making.

I want to emphasize some of the points that Mr. Simeroth has made, the first being that the State's refinery out look has changed substantially since the 1980s. And if I can see the first slide, Craig?

Refining capacity has been reduced in large part due to small refinery closures. And since 1982, at least 10 refineries have closed in California. Meanwhile, the demand for petroleum and petroleum products has increased over the last two years, largely due to population gains and as a result of economic growth.

Production at the State's refineries has increased due to higher utilization rates, as shown in this slide, and greater operating efficiencies. Utilization rates during the 1992 to 1993 period went from, on average, 71 percent to 95 percent, approximately, in 1993. I believe your staff was estimating about 90 percent in 1991. So, I believe we're generally consistent.

Distillation capacity -- that is, the capacity to produce crude oil into petroleum products -- has decreased during the same period about 23 percent. But, again, with higher utilization rates, our refineries are still producing sufficient diesel fuel to meet the projected statewide demand.

Next slide, please.

I apologize. This is in your packet, Board members. I think you've got the top half of the slide.

Of the 24 operating refineries in California, 13 are producing diesel fuel to meet the Air Resources Board fuel specifications. Based on our best estimates of current State production, our refineries can produce an average of 167,000 barrels per day of complying fuel.

I think what this shows, if you can read this slide -- and I apologize. It's not very readable for the people in the audience. But of the 13 refineries, as you know, some are operating under variances, and they're indicated by, I believe, the RV on the slide.

Others are making fuel to the alternative formulation, and a third group is making complying diesel fuel meeting the specifications.

Lastly, I just want to comment that the State's refineries have the flexibility to produce more than the average volume that I quoted, the 167,000 barrels per day, during high seasonal demand periods. And based on our estimates and our analysis, we are estimating that about 204,000 barrels per day can be produced during high demand periods.

Next slide.

This point was dramatically demonstrated during the fourth quarter of 1993, when your Board's diesel requirements took effect. The industry produced distillates, which is, incidentally, about 95 percent diesel, at a rate 18 percent higher than the average yearly production.

So, in summary, the refiners are capable of producing diesel to meet California's motor vehicle fuel market, and there is flexibility built in to overproduce during high demand periods.

And with that, I'll close, and ask if there are any questions.

CHAIRWOMAN SCHAFER: Ms. Brown, what share of the drop in capacity to refine over, say, the past ten years is due to the loss of small refiners, and what percent would be due to the fact of the imposition of our diesel regulation makes the yield from a refiner somewhat less?

MS. BROWN: I think that's a very difficult question to -- if you're asking me the reasons why small refineries have closed --

CHAIRWOMAN SCHAFER: No. I was just wanted to know -- you talked about the capacity to refine has gone down, and some of that is due to the loss of small refiners.

MS. BROWN: Uh-huh.

CHAIRWOMAN SCHAFER: But, also, some of it is, I think, due to the fact that the yield from a given refinery, because of the complexity of producing reformulated fuel is also a factor.

MS. BROWN: I'm going to have a difficult time responding to that without doing some further research.

CHAIRWOMAN SCHAFER: Okay. Does the staff, ARB staff?

MR. SIMEROTH: Chairwoman, we don't have that quantified.

CHAIRWOMAN SCHAFER: Okay.

MR. SIMEROTH: We know that, of the smaller refiners who are remaining in business, four are producing, but there are about four others who could have been supplying diesel fuel in the market if our regulations had not been in place. The amount of diesel fuel typically from these refiners -- types of refiners would be very small.

It would be more or less a byproduct from them producing other products that they produce. They're not in business to really produce diesel fuel. That was something that they sold as a byproduct.

A lot of that -- what was a product is now being sold to refineries who are producing complying fuel, and is used as a feedstock into those refineries. So, you can't say it's really off the market. It's getting into the market in different routes.

CHAIRWOMAN SCHAFER: Was there a reduction in the capacity of those refineries, which continued in the market, to produce diesel as a result of the more complex refining requirements?

MR. SIMEROTH: I'd have to --

CHAIRWOMAN SCHAFER: As I understand it, this is going to be an issue in reformulated gasoline. I'm just trying to determine whether it is in diesel. I can't recall.

MR. SIMEROTH: It varied from refinery to refinery. Some refineries actually increased their ability to produce diesel and some had some decreases in their ability to produce diesel.

By and large, none of them really produced less diesel. They're producing less diesel for the California market. The remainder of the diesel was being exported out of State -- Arizona, Nevada, Pacific Northwest, overseas, and so on. Total California production of diesel has remained about the same, except for the impact of some of the smaller refineries closing.

MR. LAGARIAS: Madam Chair?

CHAIRWOMAN SCHAFER: Yes, Mr. Lagarias.

MR. LAGARIAS: Ms. Brown, at a 94 percent utilization rate of the refineries today, they're pretty near up to capacity.

MS. BROWN: That's right.

MR. LAGARIAS: How do they make the increased volume during the high demand period if they're already up to a 94 percent utilization rate?

MS. BROWN: Well, they often shift the slate of products to make more diesel and, say, less of something else, less gasoline, less aviation gas, for example.

MR. LAGARIAS: All right. If one or two of the major or the large refineries were to go down for some reason or other, would the capacity of the industry to produce diesel fuel be impaired so dramatically that it could not meet the peak demand periods?

MS. BROWN: That is obviously a concern with fewer refineries in the market; that if one large refinery -- one of the large refineries that's producing the bulk of the diesel fuel were to go down in an unanticipated outage, that there could be problems. If not producing sufficient quantities, then there might be problems in the distribution system in getting -- and I think we saw some of those --

MR. LAGARIAS: Yes, indeed.

MS. BROWN: -- occurrences, as you know -- I know you know well, Mr. Lagarias -- back in the fall of '93. So, that is a concern.

MR. VENTURINI: Mr. Lagarias, if I may just add to that, one of things that refiners also use to help is inventory. And we, and actually the Energy Commission in cooperation with us, are tracking not only production, but inventories. And when you look at these over time, you see, as inventories drop, then production goes up; as inventories get near the max, the production drops. And the refineries, if they have -- going to have a scheduled downtime, they will tend to increase their inventories to cover that period when they're down.

So, it's a combination of production and their inventories that allow them to get through the peaks that occur.

MR. LAGARIAS: And one last question. When you say 94 percent utilization rate, you're talking about the total refinery; you're not talking about --

MS. BROWN: Yes.

MR. LAGARIAS: -- diesel.

MS. BROWN: I'm talking the total refinery, and I'm giving you a statewide average, which I think, as Mr. Simeroth pointed out, varies from refinery to refinery, depending on the type of refinery, whether it's complex or not.

MR. LAGARIAS: Thank you.

CHAIRWOMAN SCHAFER: Ms. Edgerton?

MS. EDGERTON: I think Mr. Lagarias has raised a very important point.

Let me just make sure that I understood your expert advice on this.

In your opinion and the opinion of the Energy Commission, are these additional -- are the small refiners-- is their volume contribution necessary for a continued economic recovery of California? Do they occupy this rare - I mean a particular corner of the market that's especially essentially? Where do you see them fitting in?

You heard my line of questions before.

MS. BROWN: I did hear your line of questions, and I was listening very carefully to what you were asking.

I think Mr. Simeroth pointed out that the independents and small refiners serve a different market in some cases than the large refiners. The independent oil marketers, I believe, are planning to testify later this morning on that point.

They tend to serve rural areas, lower volume stations, unbranded stations. So, they do have a market niche. Now, whether -- it's a difficult question to predict what'll happen in the marketplace. Again, currently, the number of refineries in the marketplace is fewer than before; however, collectively, they can meet the needs of the State.

The independents are playing a role now. Whether I think the issuance of the variance will determine what role they'll play in the future. . .

MS. EDGERTON: Thank you. I appreciate that. It's very difficult.

MS. BROWN: I understand what you're asking. I'm a little bit at a loss to take a position, not having heard the evidence that I know is going to be presented by parties that follow me. And I think the independent refiners are prepared to make their own case this morning.

MS. EDGERTON: Well, it's a bit of a crystal ball I'm asking you to look into.

MS. BROWN: Yes.

MS. EDGERTON: I appreciate that. And I apologize for that.

MS. BROWN: The market continues to change. There is intense competition at the retail and distribution level, We're going to be watching that. You know, we watch these developments very carefully.

But to predict what continued role the independents will play, I don't have a crystal ball.

MS. EDGERTON: And do I take it that you're here today supporting the adoption of the amendment?

MS. BROWN: Our Commission has not formally taken a position on this issue. I'm here to provide some factual information and evidence for the record to provide an overview and a context for your deliberations.

As a member of the staff, I'm not authorized to take a position on this matter without a vote of three of our Commission. And we have not -- this matter has not been properly put before them.

MS. EDGERTON: Because I know the Energy Commission operates with a charge to secure a diverse energy mix --

MS. BROWN: That's correct.

MS. EDGERTON: -- in the State.

Thank you.

CHAIRWOMAN SCHAFER: Thank you very much. Are there any other questions from Board members for Ms. Brown?

If not, thank you very much.

I'd like now to recognize Mr. Craig Moyer, Western Independent Refiners Association.

Good morning, Mr. Moyer.

MR. MOYER: Good morning, Madam Chairwoman, members of the Board. My name is Craig Moyer. I'm here today representing the Western Independent Refiners Association. I'd like to make three points regarding the elements that were balanced to arrive at the staff proposal presented by Mr. Simeroth this morning.

The first is regarding air quality issues. The second is fairness to all, including the major oil companies. And the third is the needs of smaller -- the remaining small refiners to remain viable. Because this is not just an issue of diesel fuel; this is also an issue of gasoline and the other petroleum products supplied by these small refiners.

If these small refiners don't remain viable, they will not only not produce diesel, they will also not produce reformulated gasoline.

Before I get into those three elements, I'd like to spend a moment to describe how we got there.

In 1988, when I was before your Board on this original rulemaking, there were 14 small refiners. Most of them are now shut down, probably forever. There are only four that currently make diesel fuel. And one of those, Witco, is unique. Witco is unusual as a company and as a refiner. It is a large, multinational conglomerate with access to vast capital, unlike the other small refiners. And it is also unique as a refinery, because it's basically a lube oil operation, not a fuels refinery, and makes only 500 barrels per day of diesel, 500 currently.

When this process began with staff quite some time ago, over a year ago, we had five small refiners that were still planning to make diesel fuel. Fletcher and Golden West have since shut down.

And over that period of time, we've worked, as Jim Boyd mentioned, almost continuously with staff, providing data, providing cost information, providing information on profitability or, in most cases, the lack of profitability, providing LP models showing what different scenarios -- what impacts different scenarios would result in, and the cost to make 10 percent. Because we really tried to find a way -- if we have a longer period of time, can we then make 10 percent equivalent?

And I think we've demonstrated that that, unfortunately, is not a viable option.

Then, staff prepared this proposal, which came out of June 10th, consistent with a narrow interpretation based upon historical production. We came back and said, "Thank you, but, unfortunately, that's not good enough."

We were then charged with answering the question: What is changed? If we're going to go beyond the Board's original intent of the 1988 rulemaking, why? What has changed?

And the answer is in two areas. One, those years were horrible for the remaining small refiners. And I'll talk about that a little bit. And, two, all refiners, large and small refiners both, need to operate at higher utilization rates for reasons that were not apparent during the 1988 rulemaking.

So, we went through more data, more submittals, more planes up and down the coast. I'll be very happy when United gets the lower airfares, so we can shuttle up here and not spend so much money.

And, finally, we're here where we are today to the staff proposal presented this morning. And we support that concept presented in the staff proposal. Crude capacity, utilization, conversion factor of crude to distillate. It hurts; it hurts a lot. And it's going to cut back -- cut back, not increase the markets that small refiners have now. But hopefully, it will be enough to give us volumes adequate so that these remaining small refiners can survive.

I'll come back and niggle on just some proposed modifications to the implementation of the staff's proposal. But let me get into the three elements that I promised that I would talk about, the three balancing items, the three items that we balanced in order to get here.

Start with air quality, because I think that is the charge for your Board and ought to be among the most important elements here.

In 1988, there were 14 small refiners making diesel fuel and now there are only four. In 1988, the staff recommended that small refiner volumes be limited to 55 percent of the '83 to '87 distillate.

At the hearing in 1988, the Board increased that percentage from 55 percent to 65 percent, and then added a provision for Powerine.

Based on the foregoing, we've reviewed this matter with your staff and agreed it would be accurate, but conservative, to say that, in 1988, the Board approved the air quality benefits of this rule, anticipating in excess of 25,000 barrels per day small refiner diesel fuel.

The revised staff proposal, as you saw, would authorize less than 25,000 barrels per day small refiner diesel.

In 1988, it was a struggle. But based upon costs, the importance of small refiners, and other elements, the Board, in 1988, made the policy call that having a separate standard for small refiners was appropriate.

More air quality benefits could have been obtained if all diesel fuel were 10 percent aromatics, but the Board balanced the equities, and concluded that 20 percent small refiner diesel was appropriate.

Because the air quality benefits of this rule were acceptable anticipating 25,000 barrels per day -- indeed, it was considered aggressive at the time -- I submit that for policy purposes, comparing the revised staff proposal with the 1988 rulemaking results in no air quality disbenefit.

Although for CEQA purposes, your board may be required to compare volumes now with the revised proposal, for policy purposes, the amount of 20 percent diesel fuel that would be authorized by the revised staff proposal is less than what was anticipated and deemed acceptable for air quality purposes by this Board in 1988.

Let me make one other brief comment on the air quality impacts, because I understand what it is that this Board does. We've worked on RECLAIM. We've been working very hard on the Federal Implementation Plan, various air quality management plans, and understand the idea that air quality regulations in total are a zero sum game.

But beginning on October 1, 1994, the diesel made by small refiners will be cleaner, because they'll be making 20 percent or equivalent fuel. The revised staff proposal does not worsen air quality.

Let me now turn to the fairness issue. And here I feel a little bit like David talking about a fair fight with Goliath. I don't have a slingshot, but smaller refiners do have a number of things going for them. You'll hear from some of our customers about that later.

But what the small refiners do not have is a price advantage, and they will not gain any price advantage from the revised staff proposal. The cost of producing 20 percent equivalent diesel has been estimated by staff to be 7.5 cents per gallon.

The cost to majors to make 10 percent equivalent is 6 cents per gallon. Accordingly, it is not cheaper, easier, or unfairly competitive for smaller refiners to make 20 percent diesel. It's more expensive than the majors cost. There's no guarantee of any market share then, let alone an increased market share for small refiners.

The only market share issue here is how much of the market will this regulation take away from the small refiners and give to the major oil companies?

It is the market share of small refiners that will be frozen here for eternity at a number lower than the current volumes, not the major oil companies.

And because there's no price advantage to smalls, there's no guarantee that we'll be able to sell even these volumes that will be authorized if you adopt some version of the staff proposal. Nor did the majors have any right to anticipate that they would get more of the small refiners' volume. The same argument on the pools of small refiner diesel fuel that I made with regard to air quality is appropriate here.

The pool that would be provided under the staff proposal is less than what the majors could have anticipated back in 1988. You may hear later today from the major oil companies about the need for certainty. This proposed rule has no direct impact on them.

They can still make as much as they can sell, and their costs are going to be lower than small refiner costs.

Moreover the volumes that we're talking about here could be subject to swing at an individual major oil company during the course of a single week.

The only impact this rule will have on major oil companies now is that the remaining small refiners may well survive in the stated belief of at least one major oil company executive quoted in the Wall Street Journal may not come true (sic).

WIRA and its members are determined not to let the fuels regulations do what the antitrust laws have so far prevented, and leave the marketplace to the mercy of a major oil oligopoly.

Fairness also requires consideration of the consumer. You have in your package a letter from the California Trucking Association eloquently articulating their support for the small refiners' position. Later this morning, you will hear from the California Independent Oil Marketers Association, and a number of independent marketers about their support for us. I ask for yours as well

I'd now like to turn to the third element, and that is a brief description of why this rule modification is so critical to the continued existence of the remaining small refiners, and what has changed since 1988 that justifies, indeed requires your Board to revisit this issue.

It must be stressed that the number of gallons a particular refiner's allowed to produce is key to the overall production costs. The more a refinery produces, the less per gallon it costs, because all related expenses can be spread over a much larger base.

Many of these new costs, reformulated gasoline, process safety management, the myriad other environmental regulations are the same no matter how large the refinery and, therefore, cost small refiners more per barrel than large refiners.

CARB and its staff recognized that small refiners could not possibly meet a 10 percent aromatic hydrocarbon limit and remain in business, resulting in the regulations 20 percent volume limit.

While the idea of tieing it to production may have seemed appropriate at the time, this has turned out to be quite a catastrophe for a number of reasons and not for reasons that could have been anticipated by CARB at the time.

Comments and documents submitted to the Board and staff by Kern, Paramount, Powerine amply demonstrate that the timeframe used to determine their exempt volumes was one of the worst periods in their production history. During all but one of the ten years before 1993, Paramount operated in bankruptcy and was without adequate capital to fund operations.

Powerine did not even operate between 1983 and 1987, and when they did come on line, operated only one crude unit for several years until bringing in the second on line recently.

Moreover, for a five-month period, in 1992 and 1993, Powerine was shut down and reopened only after a change in ownership. During the same timeframe, Kern also operated at less than capacity for economic reasons and sold into a military jet fuel market that no longer exists.

Accordingly, any limit to historical production based on these periods would be inappropriate and untenable for these three small refiners.

But, as the small refiners have demonstrated in their submittals to the Board and staff, it is only in the past few years that they've begun to recover from the 1980s, and it's only by increasing their utilization that they've been able to make this recovery to bring their overall production costs down to what could be considered historical levels.

Interestingly, the same trend has been seen among the large refiners. The chart that Mr. Simeroth put up showing increasing utilization is dramatic indeed. All the refiners have steadily had to increase their crude oil utilization in order to stay in business.

This trend is required, as I say, because of increased costs, many of which were not anticipated, could not have been anticipated during the 1988 rulemaking.

Limiting crude oil throughput unfairly disadvantages small refiners vis-a-vis the large refiners, because the large refiners can continue this trend of increasing their throughput and thus have more barrels over which to spread their costs.

Restricting the amount of throughput as a result of limiting the amount of resulting 20 percent diesel fuel will be further exacerbated when CARB's reformulated gasoline regulations take effect.

Reducing the T-90 of gasoline will necessarily move substantial volumes of hydrocarbons from gasoline into diesel fuel. And if small refiners are limited to historical production, not only would they be unfairly limited to historical crude throughput; but, also, they would have no ability to deal with this impact of the reformulated gasoline regulations, an impact that was not anticipated during the 1988 rulemaking.

In addition, the large refiners' decision to make 10 percent equivalent diesel rather than true 10 percent aromatic content diesel will make it even more costly for small refiners to meet the 20 percent mandate, because many small refiners had planned to buy 10 percent diesel from the large refiners and then mix it with their own 30 -- roughly 30 percent diesel.

An interesting testament to the need for small refiners to produce at 1993 optimum levels comes from the agricultural industry. According to the proposed amendments, increased ozone levels have caused significant loss of agricultural crops throughout California, with some of the most severe losses in the San Joaquin Valley.

And yet, farmers and other off-road motor vehicle diesel users staunchly support the small refiners' proposal. Their support stems from the knowledge that, if the small and independent refiners are regulated out of business, they will have only the large refiner with which to deal, and that means higher prices and less efficient distribution.

With my last few remaining minutes, may I turn to implementation of the revised staff proposal? There are four elements, as described by Mr. Simeroth, that will go into this calculation of the revised staff proposal for calculation of small refiner 20 percent diesel fuel.

Crude capacity, utilization factor, crude to distillate conversion, and the amount that then becomes diesel out of that -- I'd like to focus on that second factor, utilization.

The staff is proposing 90 percent utilization factor. I believe that the proper number would be 100 percent utilization factor. You can see the trend is quite clear. Otherwise, refineries will be tied forever into hamstringing them with a 90 percent utilization. They will never be able to operate at their full capacity, even though all the rest of the refining sector will be allowed to operate at any capacity they wish.

Additionally, the T-90 on gasoline reformulation will dump a lot of hydrocarbons into the diesel market. We will not be able to handle that.

In any event, even if your Board cannot see its way clear to going to a hundred percent, I would urge that it would be more than operate to bring it to 94 or 95 percent, which is the current utilization factor.

Even that ties the hands of the small refiner and says that we will not be able to move beyond the current capacities and current utilization factors, and the major oil companies will, but at least it will give us a few additional barrels. And those additional barrels, I must urge are incredibly significant to the individual small refiners' continued viability and a minimal consequence to the marketplace as a whole.

That concludes my presentation. I guess I should also mentioned that we support also the provision which would allow small refiners to simultaneously sell 10 percent and 20 percent. That's in my written comments. I'm not sure that that will be of any real practical value, because we don't know whether we'll be able to make any 10 percent equivalent. But it seems quite clear that you ought to be-- that the Board ought to include that, encourage that result if it would be possible.

I thank you for your attention, and I'm ready to answer any questions you may have.

CHAIRWOMAN SCHAFER: Thank you, Mr. Moyer. Are there any questions from Board members for Mr. Moyer?

Ms. Edgerton?

MS. EDGERTON: Thank you for your excellent presentation.

I want to go back to the 10 percent/20 percent, just to be sure I understand it. Are you saying -- my understanding is that -- I still may not have this. My understanding is that if the small refiners want to produce the 10 percent, they can do that with no restrictions on the volumes.

MR. MOYER: That is correct. That is not correct under the current proposal. It is correct; that is what staff is proposing today, that they be able to sell both 10 percent and 20 percent simultaneously.

The way it's crafted today, anything that is sold counts towards that 20 percent volume limitation, which discourages the small refiner from finding a way to make some 10 percent equivalent.

Ms. Edgerton, in all honesty, I must tell you that I don't know whether that's going to work, whether it will be feasible technically or practically because, clearly, it will require additional tankage and I don't know whether that's going to work.

But I would not like to be hamstrung from having that flexibility within the individual refineries. Was that responsive?

MS. EDGERTON: Yes. Mr. Moyer, you took a different position from the staff with respect to the air quality effects of this.

MR. MOYER: I don't think so. And I did try to work my -- I have worked these facts through with the staff. I think the difference --

MS. EDGERTON: (Interjecting) Well, now you have to work them through with me, I guess.

MR. MOYER: Well, I think that's appropriate.

MS. EDGERTON: Thank you.

MR. MOYER: Here's the way that we've looked at it. What they were talking about in the air quality disbenefit is for CEQA purposes. You need to look at where we are today, what would happen if there were no change in the rule, and where we are, where we will be if this modification is made.

What I am saying is that there's another way to look at it. And I believe staff will support -- will confirm this. And that is, looking at it from a policy point of view, the air quality benefits that were anticipated by this rule in 1988 versus the air quality of this rule, if you make this revised staff proposal, they're going to be even better, because there are less small refiners producing, and that pool of small refiners diesel will be less than what was anticipated in 1988.

MS. EDGERTON: So, if I understand you right, you're saying the net -- or the overall percentage of the market is smaller -- the 15 percent instead of the 24 percent.

MR. MOYER: Correct.

MS. EDGERTON: So, the air emissions would be gross -- in gross terms less, the polluting air emissions.

MR. MOYER: That's correct.

MS. EDGERTON: That's what you're saying.

MR. MOYER: Less than what was anticipated in the 1988 rulemaking, the air pollution will be less than what was anticipated in the air quality area.

MS. EDGERTON: Because the market's smaller.

MR. MOYER: Because the small refiner market is smaller. The small refiner share of the market was smaller than what was anticipated by the Board in 1988.

MS. EDGERTON: So, based on that, anytime you have a market share that's declining, you have an air pollution benefit.

MR. MOYER: That's one way to look at it.

MS. EDGERTON: That's your argument, isn't it?

MR. MOYER: Well, one could argue that --

MS. EDGERTON: (Interjecting) So, maybe we should try -- are you saying we should --

MR. MOYER: (Interjecting) There were times when I've appeared in front of the Board -- certain boards and heard arguments from people saying, if you really want to get all the air quality benefit that you can you should just regulate us out of existence. But there is something to be balanced.

And my point is I do not believe that your Board, in 1988, had anything else in mind except weighing the very substantial air quality benefits of this rule with the economic viability of a significant sector of the market, and made a policy call back then. And the policy call resulted in a particular number of tons per day of air quality improvement.

And that benefit will not be affected.

MS. EDGERTON: Well, you raise a very important point, in my view, which is the stability, the importance of stability in regulations. And this is -- this is very much involved in our decision today.

Thank you.

CHAIRWOMAN SCHAFER: Mr. Lagarias.

MR. LAGARIAS: Thank you, Madam Chair.

Mr. Moyer, how do you reconcile your statement that whatever utilization rate is adopted will be frozen for all time, when, in the discussions today, the staff has proposed changing the utilization rate from 65 to 85 to 90 percent, and you're even suggesting it ought to go to 94 percent or a hundred percent. How do you reconcile those two statements?

MR. MOYER: I'm not --

MR. LAGARIAS: You made the point that whatever utilization rate the independent oil producers have -- and I strongly support the viability of the independent oil producers' existence -- whatever utilization rate is adopted would be frozen in all time, when we've heard extensive discussions about changing the utilization rate?

MR. MOYER: I see. Because in 1988, we were at 65 percent. That was actually a production rate; that was a conversion rate (sic). We never -- prior to today's staff presentation, there's never been a discussion of utilization of capacity. Everything prior to this has always been tied to production.

And what we're talking about now is tieing it to capacity, and this rule would freeze for all time this -- in the rule a particular utilization number, a capacity number.

MR. LAGARIAS: Nameplate rating?

MR. MOYER: Both the nameplate, the factor which would be used for utilization, and the conversion to distillate -- from crude to distillate.

MR. LAGARIAS: I've been involved in the design of plants, and when you get a nameplate rating, if the operator of that plant isn't able to operate his plant substantially above the nameplate rating, he's not satisfied with the plant he's getting.

In fact, your figures on utilization rate point out that plants are operating at 102 percent of nameplate rating.

MR. MOYER: Yes. That's a very good point, and that's why I think it's important that you understand what this first element was is a crude capacity, that's per calendar day, taking that into account.

I think that's a very good point, Mr. Lagarias, and it's one that, you know, we're not going to be able to get to 102 percent if you freeze us at 90. But we'll be able to make it if you take us to 95 or 100 percent.

MR. LAGARIAS: Thank you.

CHAIRWOMAN SCHAFER: Are there any questions from Board -- oh, yes, Supervisor Bilbray.

SUPERVISOR BILBRAY: I was just reminded by my colleague about the fact that there is air pollution benefits to operations being shut down. And the Monterey Air Basin was one of them when Ft. Ord shut down. We were talking about the fact that that needed to be calculated in off emissions that would be lost.

And I think that more than the emission issue here is that our mandate that we watch what the impacts are that we make on the market, and the 14 to 4 number scares the hell out of me, not for the independents' point of view, but I think for both the consumer and the long-term energy and air pollution strategy.

Because I think there is this small percentage of independents that keep the system honest or at least as close to honest. I wouldn't want to ever perceive that the oil business is honest.

(Laughter.)

SUPERVISOR BILBRAY: But I would ask you, when we talk about the cost of production, staff, you gave the numbers between 10 for the large refiners and the 20 percent for the small? Is that the 6 and 7 number?

MR. SIMEROTH: It'd be 6 cents per gallon for the large refineries, as they're operating today.

SUPERVISOR BILBRAY: To produce?

MR. SIMEROTH: To produce the 10 percent or an equivalent to the 10 percent. And 7.5 cents is our estimate what it would cost the small refiners to produce the 20 percent or an equivalent.

So, they're still even at a major disadvantage at the 20 number.

MR. SIMEROTH: Their number's higher, certainly.

SUPERVISOR BILBRAY: Well --

MR. MOYER: If I may comment, Mr. Supervisor?

SUPERVISOR BILBRAY: Yeah, I mean that's what I'm really getting down to is the fact that, you know, we want to make sure that we maintain some level playing field here. And right now, under this plan, I think staff even recognizes that it's not necessarily an even playing field for competition. But you're trying to make it more feasible.

MR. MOYER: That's correct. That's exactly the point that I was trying to make. You may hear today, later today, from some people testifying about this increased market share for small refiners. And it's just not true. There is just no guarantee of any particular market share. Our costs are higher, not lower than theirs.

There's no price advantage as a result of this rule. And I'd like to, just as a general comment, leave you with -- throughout my comments, I have verified and tried to confirm all the facts that I've set out with staff, so that all of these numbers are the same; so that your call is a policy call. And I've done -- I don't necessarily agree with the 7.5 cent per gallon number, but I think that number is actually higher.

But the point is the same. It doesn't matter whether it's 8.5 or 7.5, the staff's -- the conclusion is the same. There's no price advantage. The same thing on the barrels per day. We actually think that the Board anticipated a greater number.

That's not really -- we worked very hard with staff to ensure that we were all working from the same factual base, and then your decision is a policy call, and we hope that it will be the correct one.

SUPERVISOR BILBRAY: Okay. I just think that the numbers speak for themselves, even at that level, and I think that the fact that, if this market is not being served, as being served now by four where it was at 14, we've got people dropping like flies out there that we have a mandate to, at least, be responsive to the market impacts of our regulations. And that's what makes this agency so much more effective as an environmental agency than some others.

So, we just want to make sure that these rules reflect that reality. Thank you, Madam Chair.

CHAIRWOMAN SCHAFER: Thank you very much, Supervisor Bilbray. Ms. Edgerton?

MS. EDGERTON: Well, that's actually correct, because actually, one of the things that I wanted to follow up on was what Mr. Lagarias sort of brought up. But I agree with Supervisor Bilbray that we need to be very sensitive to market competition and to the fairness of our regulations.

Mr. Lagarias touched on a point that is important, and I think that is related to a couple of comments you just made, which is that, today, the small refiners are not competitive -- well, they're not increasing their market share; they're having difficult; they're not going to encroach on the large refiners. Perhaps that's not you -- that's not exactly how you said it, but --

MR. MOYER: I hope I didn't say it exactly like that.

MS. EDGERTON: No, you didn't say it like that. Let's see. What exactly did you say.

Something to the effect that they aren't --

MR. MOYER: My point was simply that there was no guarantee of the small refiners having any particualr market share.

MS. EDGERTON: Okay. That's -- thank you for correcting me. I don't want to put words in your mouth. So, there's no guarantee today.

But the difficulty is that, in 1988, we had a particular market setting where the staff made a decision. Now, at this point in time, we drop in and we have a particular market situation we're looking at. Are we going to drop in again in 1996? I don't think we should be inflexible. By the same token, I have a concern as to some of the points that Mr. Lagarias raised. Well, is it 85 percent? Is it 90? Is it 95 percent? Is it a hundred percent? You know, is this a rolling issue to -- where -- where is a steady course?

MR. MOYER: Perhaps I didn't articulate myself as well in response to Mr. Lagarias as I should have.

This is the first time where any rule indicating, determining, evaluating the 20 percent fuel will be tied to the utilization capacity. In the past, everything has been tied to historical production.

If you let us go to capacity, that's a big difference. And we're very happy with that.

SUPERVISOR BILBRAY: Good point.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Moyer, for your presentation this morning.

I'd now like to recognize Mr. Charles Walz of Texaco.

MR. JENNINGS: Chairwoman Schafer, while Mr. Walz is coming to the podium, I'd like to clarify one additional modification that the staff is proposing that I don't believe was mentioned in the first presentation.

It is included as Item 3 in the handout today. And the proposed modifications to exempt volume the staff is proposing today would be presented as an option to the existing calculation of exempt volume.

And we are proposing that for independent refiners who, under some circumstances, can be subject to the small refiner provisions for October, 1994 through September, 1996, that those small refiners could only use the existing exempt volume provisions and not the proposed new option.

MR. WALZ: Good morning, Board members and Chairwoman Schafer.

My name is Chuck Walz. I'm the Vice President of Refining for Texaco Refining & Marketing.

For a general background the Board members, since we do have a few since our episode last fall (sic), I thought it might be well to indicate that Texaco does have two refineries in the State -- one in Bakersfield, California as well as one in Wilmington, down in Los Angeles.

We currently produce CARB diesel at both facilities. We utilize the 10 percent specification as well as utilizing certification formulations that we developed over the years since the rule was passed. As a matter of fact, we have three such certifications.

We also spent in excess of $25 million in coming into compliance with the regulation that went into effect last fall. We have several -- many serious concerns with the proposals made here today.

And I'd like to go into what those concerns are, if I may. First off, we feel that the revisions appear to be in conflict with California law. By delaying enforcement of the low aromatics diesel regulation or by allowing increased production of 20 percent aromatics diesel, the proposed changes in the low aromatics regulation constitute the relaxation of an environmental standard.

Such discretionary action by the agency is contrary to California clean air statutes and is subject to CEQA review. And one food for thought in reference to the previous testimony that's been given this morning, some small refiners have indeed shut down. But what is the state of their -- or status as we move into the future?

It's entirely possible that they could be restarted depending on what happens in the industry.

Secondly, the California Clean Air Act requires emissions to be reduced by the maximum degree possible as stated in the Health & Safety Code. The proposed revisions are in conflict with that requirement, because emissions from diesel produced by small refiners will not be reduced.

With regard to policy and technical arguments, staff asserted in their report that the proposed revisions will not have an adverse economic impact on businesses. And we strongly argue that point.

Many refiners have been adversely impacted by the special dispensation for small refiners and will continue to be impacted so long as CARB imposes inequality in the market.

Since enforcement of the low aromatic regulation commenced in 1993, the presence of noncomplying variance or exempt diesel in the market has disadvantaged those companies that have complied with the 10 percent aromatics rule through capital investments and very expensive certification programs.

Texaco and probably other companies have been unable to fully recover the substantial investments made to participate in the California diesel market, primarily due to CARB's interference in the market through inequitable treatment of diesel suppliers.

CARB now proposes to provide additional relief to small refiners in the form of further delays in enforcement as well as increased production of higher aromatics diesel fuel.

These proposed revisions will perpetuate the unfair advantage that small refiners have enjoyed in the California diesel market for the past year or since October of last year, as a result of the original one-year delay in enforcement provided in the existing regulation.

During this first year -- that is, from last October to the upcoming October -- of the low aromatics diesel rule, small refiners have accrued significant economic benefit by supplying noncomplying diesel into the CARB low aromatics diesel market without any financial risk from expenditures for capital investment or certification efforts.

And just to give you a sense of the value of that economic benefit, if you use a 6 cent per gallon differential between CARB diesel and EPA diesel, multiply that out on a thousand barrels today, it comes pretty close to a million dollars on a one-year basis. So, for every thousand barrels of -- of diesel that the small refiners have been able to put into the marketplace from October 1, '93 to October 1, '94, they have reaped a $1 million advantage or will have reaped a $1 million advantage for doing nothing.

Yet even in the afterglow of this unprecedented windfall, each refiner has demonstrated little, if any, real progress toward the mandated goal of compliance by October

1, '94. By granting special treatment for small refiners yet again, CARB will reward small refiners for their inaction and will penalize others who have assumed great economic risk to comply with the low aromatics diesel regulation.

This inequity is not justified by any reasonable measure from our viewpoint. CARB justifies the proposed revisions primarily on fears of shortage and market disruption during the peak demand season in the autumn.

There is no basis for this justification for several compelling reasons. The autumn, 1993 diesel experience, as we call it, which apparently forms the basis for the staff's fears, included events which were unlikely to be repeated in 1994. Realignment of supply due to withdrawal from the California market by some refiners -- that includes majors as well as small refiners. The realignment of the distribution system at the terminal level, the rebalancing that took place.

The substantial increase in the federal tax that took effect on October 1st, 1993, was another argument or situation that occurred at the time the rule went into effect.

Uncertainty of supply that existed due to variances that were being granted at the time, and apprehensive consumer response to a broad new regulation.

The problems of 1993 should not reoccur in 1994, because refiners have had one year to fine tune CARB diesel production capacity and the distribution system. We have demonstrated an industry capacity that exceeds peak diesel demand by a substantial margin. And I'll show you some charts on that a little bit later on to -- to give you a better feeling of comfort on that point.

The industry diesel inventory this summer is much higher than in 1993, and can be increased further to accommodate peak demand. I'll also show you a chart on that shortly.

No supply problems have occurred since last autumn, despite demand increased during the peak planning season this spring when significant operating problems occurred. The industry, the system, the rebalancing was able to deal with it.

And, finally, consumers have accepted the regulations and are confident in the industry's ability to comply.

The Board's task, we feel, is to promulgate policy to reduce air emissions. The proposed revisions before you today will immerse the Board into a role of overseeing supply for the diesel market.

That responsibility, we feel, is not in the Board's purview and more appropriately the task of the

California Energy Commission.

The CARB staff report does not propose any changes to the requirements for small refiners to meet the 20 percent aromatic standard. This seems to present a major dilemma for most small refiners, since the proposed revisions do not actually provide real relief to them, only relaxation from the exempt volume limit and enforcement date, both of which may be of dubious value. And I'll explain further my thoughts there.

In statements made at the CARB public workshop held on April 21st, 1994, three of the small refiners revealed that they did not have the capability to produce diesel meeting the 20 percent aromatic standard. The representative of the Western Independent Refiners Association amplified the small refiners' situation further by stating that, and I quote, "Small refiners have no ability to dearomatize diesel now or in the future due to high costs."

And the Board recognized this and assumed that the small refiners would comply through blending or certification.

I do not believe that the Board has assumed anything other than the ultimate compliance with the regulation as adopted in 1988.

Those comments at the public workshop revealed the true nature of this latest request for additional relief. The small refiners seek further delay until a solution on their terms can be developed. Although reliance on purchased low aromatics diesel for blending and/or certification seems to be the course of compliance chosen by the small refiners, they have offered no substantive proof that they will be in compliance within three months, six months, one year, or possibly ever.

This disingenuous performance must not be overlooked when considering these proposed revisions. Sooner or later, the Board must enforce its regulation without further delay.

Texaco believes very strongly that the time is now. We would also urge you during your deliberations today to determine if, indeed, the small refiners will be in a position come this October 1st to meet the 20 percent standard.

We feel this may be only the first step in a course that will take us to a variance proceeding. Because of the 20 percent aromatics limitation, some small refiners may seek variances to continue supplying diesel in California. CARB's proposal does not address this consequence at all, and blithely assumes that each small refiner will be able to produce 20 percent aromatics diesel at the proposed optional volume limit.

This phantom diesel production, after October 1st, 1994, is assumed to be necessary to assure adequate diesel supply this autumn and, in fact, forms the cornerstone for justification of the proposed revisions.

The Board should carefully consider the facts underlying staff's current proposals, and weigh heavily the reality that these revisions accomplish little for small refiners without further relief through variances.

And just in case you haven't been able to get it from what I've said already, Texaco would certainly oppose any variances from the enforcement of the 20 percent aromatics standard by October 1, '94, for the small refiners.

Any variance application filed by small refiners must conform to current regulatory requirements. The regulation specifically states that a variance cannot be granted unless CARB finds that all the minimum prerequisites for any variance from the regulation are met. It is difficult for us to imagine that any of the small refiners could meet all of these minimum requirements.

Each has had nearly six years to implement a compliance plan, yet none has yet achieved compliance. Some of these small refiners find themselves in their current predicament of noncompliance solely because of economic business decisions made to defer significant costs for investment in refinery equipment or for certification of equivalent emission alternative diesel formulations.

Surely, their current situation, based on intentional decisions, is not beyond their reasonable control. After careful review, we believe that the Board or any hearing officer would find no reasonable basis upon which to justify a variance from compliance with the low aromatics diesel regulation for any of the small refiners affected.

The net result of the proposed revisions that you're considering today will not be the salvation of a diesel market purportedly short of fuel, but rather will be the perpetuation in the market of an inherently inferior fuel in terms of diesel exhaust emissions.

If approved by the Board, these proposed revisions will assure an increase in NOx and PM10 for the diesel supplied by each small refiner over the level that would otherwise have occurred if the regulation were not revised to accommodate the small refiners.

Before I make a transition to some data I would like to show on the slides -- and it's basically a review of detail which I believe you've been given -- I would like to comment on the previous testimony with regard to the cost of production for the majors and for the small refiners.

The 6 cent number that you've been provided is a staff number. We're not familiar with the details behind that, but from our company's position, we would argue that our number is substantially higher than that, and have provided staff with that position in many meetings over the course of the last year or more.

In addition, the 7.5 cent number that has been given as a representation for cost of production for the small refiner, it's not clear to us what that is based upon. If it's based on investment and modifying the facilities that they have, it's quite likely that the cost would be much lower if they chose a route of using a certification. The cost of manufacture becomes substantially less.

So, I would, I guess, raise serious concerns over the validity of those numbers for your consideration today without having further background on exactly what they represent.

I would now like to share with you some specific information which illustrates the point that these proposed revisions are neither justified nor necessary to protect the California diesel market.

I believe you've been given a packet of information. Do Board members have that information? It has a cover page on it.

Chairwoman Schafer has a copy.

CHAIRWOMAN SCHAFER: I'm sure everyone has a copy.

MR. WALZ: I'm not sure that the facilities here will allow me to -- to get the full chart on the screen at any one time, but we'll give it a go.

The first slide shows the average demand of 155,000 barrels a day for CARB diesel in the State of California. And that is a number that was taken from the CARB staff report dated June 10th, 1994.

Below that, we show production capability in the State for CARB diesel. These are our assessments, but are our assessments based on testimony given at the October 15th, 1993 hearing when diesel was in very short supply, when it was essential for everyone to be making maximum barrels.

We've shown a major and independent production level of 215,000 barrels a day for Cases A and B. Case A represents the condition as it would be if the rule were left unchanged as it would be -- as it would allow the small refiners to produce 11,100 barrels per day.

The proposed rule that had been on the books had allowed them to go to 16,700; with the modification that was made this week, that number's been changed to 23,700. So, the industry, from our viewpoint, would indicate that they had the capability to produce almost 239,000 barrels a day of fuel, if need be, against a demand of 155,000 barrels.

For that reason, we conclude that the production capacity of major and independent refiners is 40 percent greater than demand and is more than adequate to supply the California market.

If we could go to the next chart, please. The next chart shows that, under current balances -- and these were for the second quarter of this year -- the major and independents were producing at about 142,000; the small refiners were producing at about 21, which said we were producing a total of 163. And that number was allowing inventory in the system to build as I'll show you on a chart here shortly.

But it clearly shows that there was idle capacity of 73,000 barrels a day sitting unused. The State clearly has adequate capability to produce a very high amount of diesel.

You can also see the other cases there, where we could go up to 239,000 barrels a day. That just simply increases the capacity if you allow the independents -- or excuse me -- the small refiners to increase their level to 24,000 barrels a day.

From this chart, we conclude that the average market demand is oversupplied at current production level. Demonstrated CARB diesel capacity for majors and independents far exceeds the small refiner capacity.

And, finally, that the proposed revisions are unnecessary to assure adequate market supply.

The next chart shows data taken from CEC reports on diesel. This is information that's gathered weekly by the Commission, and it really shows very clearly what happened last fall when we were in transition back in the September timeframe -- inventory was down at 1.4 million barrels a day. It was what we considered to be a minimum inventory, obviously by the situation that occurred.

But you can see, since that time, inventory has clearly risen up to around 2, 2.5 million barrels sitting there in inventory in various tanks throughout the State of California.

So, we conclude that the average inventory in -- since the first of the year in the system has been around 2.5 million barrels.

If we go to the next chart and we hypothesize on what might happen this fall and where those barrels might come from, which is really a line of questioning that was going on earlier this morning, as demand increases, the industry has two alternatives to supply that demand. Either (a), increase their production, or (b) take it from inventory.

And for our hypothetical situation here, we've assumed that 50 percent of that increase demand would come from inventory and 50 percent of it would come from increased production.

We've estimated a peak excursion demand of 180,000 barrels a day. That's a guess on our part. You pick your number, but it's probably something less than 200,000. But that's a 25,000 barrel a day increase over what we feel the current level is of 155,000 barrels a day.

If that peak demand rate went on for a period of three weeks, which we feel is typical of what goes on during the fall timeframe, and 50 percent of that peak demand were pulled from inventory, that would deplete inventory by 262,000 barrels, which is about 10 percent off the average inventory in comparison with September, '93 drawdowns when it would have been 37 percent of available inventory.

So, in summary, current inventory is about 1 million barrels higher today than during the October, '93 crisis. Industry is in a much better position to handle peak demand through inventory drawdown this year than in 1993.

And, finally, normal inventory can easily handle peak demand. So, we really feel that having sprint capacity, having barrels sitting on the sideline is not really an issue.

In summary, Texaco opposes the proposed revisions to the low aromatics diesel regulation because the staff recommendation lacks substantial evidence to support a change in the rule.

Secondly, there is no reasonable justification to support such revisions in view of the data I've presented.

Thirdly, the revisions would unfairly discriminate against those refiners which have made investments to comply with the regulation.

And, fourthly, as I started out the discussion here this morning, such revisions appear to be in conflict with the California law as it relates to CEQA review.

I will terminate by -- my presentation this morning by simply asking one final question, and that is, when does a rule become a rule? It's been six years since the rule went into effect. Everyone's had ample time to prepare for it. We continue to go through agonizing discussions, such as this, and we need some certainty. We need some surety. And with every step we take with regard to diesel, it creates a little less confidence in what's going to happen on the gasoline side come 1996.

That concludes my remarks this morning, and I'll be pleased to answer any questions that you might care to ask.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Walz.

(Thereupon, there was a pause in the proceedings to allow the reporter to replenish her stenograph paper.)

CHAIRWOMAN SCHAFER: Mr. Walz, does Texaco also oppose the shift of the effective date from October 1 to January 1, 1995?

MR. WALZ: Yes, we do, because of the situation that I represented up there a moment ago. We feel that between the productive capability that's out there and the inventory, that there is no valid reason for shifting.

CHAIRWOMAN SCHAFER: Thank you. Are there any questions from Board members for Mr. Walz?

Mr. Calhoun.

MR. CALHOUN: Yes. Mr. Walz --

MR. WALZ: Yes, sir.

MR. CALHOUN: -- you heard earlier that the number of small refiners has gone down from 14 to 4. And what has happened to Texaco's market share during this time period?

MR. WALZ: With regard to what product?

MR. LAGARIAS: Diesel.

MR. CALHOUN: The diesel fuel we're talking about here today.

MR. WALZ: I would -- I really don't have a number that I've memorized. I'll give me my gut reaction to that question. But I would say it's probably about the same as it was back in 1988.

MR. CALHOUN: Okay. My next question pertains to the statement that you made regarding the ability of the small refiners to produce the 20 percent aromatic fuel. And you stated that this is really the -- or you suggested that it may be the first step; that the next step may be a request for variances.

MR. WALZ: That's correct.

MR. CALHOUN: What is the factual basis for that statement?

MR. WALZ: The factual basis for?

MR. CALHOUN: For the statement that you suggested that their next step would be a request for variances.

MR. WALZ: It's basis, the quotes I made in my presentation based on information gained in this very room at a public hearing back in April, where they indicated that things were very doubtful in their being able to comply with the 20 percent rule.

And I'm simply, I guess, urging the Board to seek out in testimony this morning some indication as to whether or not that indeed will happen, or all of what we're talking about here this morning is for naught.

MR. CALHOUN: Thank you. No further questions.

MR. LAGARIAS: Madam Chair?

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Calhoun. Mr. Lagarias?

MR. LAGARIAS: The independent oil producers mentioned the fact that they may achieve 20 percent aromatic content by blending with 10 percent aromatic, which apparently they purchase from other sources.

Do you supply 10 percent aromatic to the independent oil producers?

MR. WALZ: We do currently do so, no, sir.

MR. LAGARIAS: In your chart on the impact of proposed revisions to the CARB supply, one of your conclusions was that the demonstrated idle capacity for CARB fuel by the major sources and independents far exceeds that of the small refiner capability.

That's one of your conclusions.

MR. WALZ: Yes, sir.

MR. LAGARIAS: You mean that if, for some reason, if the independent oil refiners disappeared, went out of the market, you'd have no problem supplying the CARB fuel, and you'd like to see them go away?

MR. WALZ: No, sir. That was not the intent --

(Laughter.)

MR. WALZ: -- in putting that -- that was not the intent in putting that in the presentation this morning. It was simply to allay fears or concerns that the Board could possibly have on what might happen.

We're not advocating that. We're not suggesting it. We're not campaigning for it. We're simply trying to suggest that the rule --

MR. LAGARIAS: It wouldn't be a problem if they went away.

MR. WALZ: If there were a problem with supply; that's correct.

MR. LAGARIAS: With supply. Thank you.

CHAIRWOMAN SCHAFER: Mr. Parnell?

MR. PARNELL: I may have misheard or not heard you correctly. It seemed to me early in your testimony you said that Texaco and other large refineries have made significant investments in order to comply with the regulation. And we understand that.

But you also said you haven't been able to recapture that, because of the concessions that have been made to small refineries. There seems to be contained in that the notion that if the small refineries were not given this concession, and they couldn't compete, they would disappear. That would allow you the opportunity to significantly raise price and to recapture those costs.

Is that the notion that you wanted to convey?

MR. WALZ: No, sir. I'm simply saying that, with the capacity that has been demonstrated out there, there is more than adequate supply, way more than adequate supply needed to take care of the market.

MR. PARNELL: I understand the supply issue, but I guess I was a little confused or taken by your comment relative to your ability to recapture your capitalization costs.

MR. WALZ: I was simply making the point that, basically, they have been able to benefit with the substantial increase that the CARB diesel has had over EPA diesel since the rule came into effect; that -- that we have invested substantial money. They have not had to invest money.

And for every -- as I gave you the number earlier, for every thousand barrels a day, they will have collected a million dollars by the end of the year.

MR. PARNELL: Thank you.

CHAIRWOMAN SCHAFER: Ms. Edgerton?

MS. EDGERTON: Thank you for your presentation. It was very helpful.

One of the questions raised by this proposed amendment was addressed by our Executive Officer, Mr. Boyd, in that the experience has been that the supply needs have not typically been satisfied with these -- for diesel in our State, and that --

MR. WALZ: Who haven't?

MS. EDGERTON: Well, if I understood what he was saying, what I was trying to understand was this unique role of the small refiners were. And I think he said that they fill a need in particular geographical areas and particular markets in our State, which has not been fully served or does not appear to have the service of other even large refineries.

In any case, there's been an interruption in supply. And we're all familiar with it. You talked about the "diesel experience."

MR. WALZ: I'd like to comment on that.

MS. EDGERTON: And I'd like for you to comment. That's my question.

MR. WALZ: Texaco, at our Bakersfield facility, we have a very large independent, unbranded business. And, basically, if people have had their credit checked and are willing t o comply with our -- our safety requirements at our truck loading rack, they can come in and generally get unbranded barrels for sale just like they can at some of the small refiners.

Now, I say generally. Last fall, during the crisis, when supply was very tight, we -- and we were hustling, huffing, and puffing to get our facilities in operation to the deadline, we were short on barrels initially. But subsequent to that, we've opened the rack to unbranded distributors and supply many of the same people that will appear before you today no doubt.

So, we do supply into that market.

MS. EDGERTON: Also, one of the comments -- thank you. One of the comments that you made about the staff's figures with respect to the comparison of the cost to the large refiners versus the small refiners -- the 6 cents versus 7.5 cents, I'm troubled by your comment that your figures did not substantiate -- or are not consistent with what the staff found.

MR. WALZ: No doubt that's an industry average, I would think. And there will be fluctuation from refiner to refiner.

MS. EDGERTON: Uh-huh. I just wanted to give you an opportunity to talk some more if you wanted to tell me what you thought -- what do you think is the correct comparison?

MR. WALZ: Well, I can't speak for what the industry is. I can only speak from Texaco's perspective. And I'd be glad to share that with you in private. But we feel it's of a confidential nature.

MS. EDGERTON: I appreciate that.

MR. WALZ: Other than to say that it is higher than the 6 cents.

MS. EDGERTON: Thank you.

CHAIRWOMAN SCHAFER: Are there other questions from Board members for Mr. Walz at this time?

If not, thank you very much.

MR. BOYD: Madam Chair, might I make a comment or two while Mr. Walz is here?

CHAIRWOMAN SCHAFER: All right.

MR. BOYD: Although his attendance is not totally necessary. I wanted, just for the record, I think, since the staff is giving away so many emission benefits here, I wanted to point out that the staff has not wavered on the aromatic requirement of 20 percent or its effective date.

We feel very strongly about. And that was pivotal decision in our decision to make the rest of the recommendation we've made today. So, I just want to underscore that and any implications that may have for the future.

The other point I wanted to make is perhaps for the benefit of the large number of Board members who weren't here in 1988 when this rule was put into effect. My recollection is that the staff recommended that this rule go into effect January 1st of 1993; that was the 1988 proposal.

But at the Board meeting, the oil companies asked for a delay till October of 1993. I don't recall a discussion, certainly by the oil companies, of the adverse air quality impacts of granting such a delay. And I don't recall myself or the staff challenging on any great basis of an adverse air quality impact, the rationale for the eventual granting of that delay.

So, I think the issue cuts both ways, or the sword cuts both ways, or what have you. But the staff tries to walk the straight and narrow and weave this narrow path between ambient air quality and economic equity.

And it cuts both ways.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Boyd.

Mr. Walz, did you have anything further?

MR. WALZ: I have no comment.

CHAIRWOMAN SCHAFER: All right. Thank you very much for your testimony this morning.

I would now like to take a break for the benefit of our court reporter, and we will resume in five minutes.

Thank you very much.

(Thereupon, there was a brief recess taken.)

CHAIRWOMAN SCHAFER: By my calculation, we have taken about a half an hour per witness on average. And if we do that, we're going to be here till six o'clock. I'm going to lose Board members and probably witnesses, and we may have a quorum problem.

So, I'm going to have to ask witnesses to please try to limit your presentation to 10 minutes. That will give us some time to ask questions. And concentrate on those aspects of your testimony that area different from what has previously been presented to the Board in terms of illuminating our understanding of the effect of the proposed regulation.

Also, I would like to move people around from the original order in which you may have signed up. I'm not sure what exactly that order is, but just so that we can get representation in as fair a way as possible. I'd like to invite the representatives from Kern Oil to come to the podium now, starting with Mr. Eveland, and Mr. Jeffries, Mr. Blackburn, and Mr. Tomerlin, as I understand, are representing Kern and/or independent marketers.

I'd like you to make your presentation as a unit, as a panel, even though we aren't able to empanel you in the seating arrangements here.

I'd like for the Board to hear your testimony and then ask questions of each of you when you're all finished.

MR. EVELAND: Madam Chairwoman and members of the Board, my name is Tom Eveland. I'm Vice President of Government Affairs of Kern Oil and Refining Company. I'll try to be brief, because Kern's position was stated in comments which were faxed to you on Wednesday.

CHAIRWOMAN SCHAFER: Thank you, sir.

MR. EVELAND: I first want to acknowledge and commend the open-door policy that your staff has maintained. I don't remember exactly how many meetings we have had with your staff, but -- on this one issue, but it's been more than a few. And it's refreshing to have an agency that genuinely wants to know and consider our unique circumstances and doesn't treat us small businesses the same as a huge international corporation.

Just one side point. I recall a workshop a year ago, where some of the majors, possibly including Mr. Walz, forecasting that there'd be no shortage in October of '93. So, I'm not sure he and his colleagues are the best forecasters in the world on diesel shortages.

I believe Kern to be unique among California refiners, in that our largest product from a revenue standpoint is diesel fuel. We also produce gasoline and other products, but diesel fuel is our biggest revenue generator by a large margin.

And Kern is located in the heart of California's most dynamic agricultural and trucking area, and diesel fuel is what we're all about.

This rule impacts Kern to a larger degree than probably any other refiner. Kern's had to build a new diesel hydrotreater unit and a sulfur recovery unit from scratch to comply with just the CARB and EPA's sulfur limits. So, we have spent money. These units were not free. And the statement that we've been taking a free ride is just inaccurate.

Kern's working on a formula now to be certified to meet the 20 percent aromatics limit by October 1st. The cost per gallon will exceed the average cost that the large refiners have spent to make their 10 percent equivalent formula fuel.

And your staff has reviewed our actual cost figures to build and operate the new equipment that we have on line and our estimated cost to make the 20 percent certified aromatic fuel.

With our increased capital and operating cost, it's essential for our survival that we run the refinery as efficiently as possible. We're now making nearly the volume which we're limited to by a CARB executive order, which is called a suspension volume. This limit's 7826 barrels a day.

Since we don't have hydrocracking capacity, our percent of diesel yield is pretty well fixed by the type of crudes that we run. Although Kern can make at least the 7800 barrels a day and probably more, there is a minimum production rate below which Kern will have to reduce crude runs and production of other products as well as diesel. And that minimum diesel production rate is 7,000 barrels a day.

Once we're curtailed below that amount, our ability to make any profit or even recover the cost of operation, diminishes rapidly.

Let me repeat that. Our minimum diesel production rate is 7,000 barrels a day. If we go below that, we're not able to run our total refinery and recover the cost of running it. It's very much an issue of incremental cost; the larger the amount, the lower the increment. And it's extremely sensitive to that.

Kern does not sell at retail. It supplies its diesel primarily to independent marketers and direct to consumers, such as farmers, fleet operators, and truck stops, a total of over 70 customers. Some of our diesel is sold through independents to municipal bus companies and other public agencies. Our gasoline and diesel is also used by emergency services in our area. I'm talking about ambulances, fire trucks, and the sort.

If Kern is limited to diesel production below 7,000 barrels a day, we will have to curtail sales of diesel to our independent marketers and direct users and gasoline to those customers and the major oils who lift gasoline at our refinery.

More likely, we'll be put out of business. If the Board chooses not to amend the regulation at all, we'd be left with a diesel limit of only 3595 barrels a day, which would make continued operation impossible.

We can't run the refinery at half capacity. Even if it would run, we couldn't even recover even our fixed costs. And either way, we'd be dead.

As Mr. Moyer of Western Independent Refiners Association mentioned, the small refiners are not asking for an increase in our collective diesel market share over historical levels. We produced at leave 27,000 and some estimates up to 33,000 barrels a day in 1988, and we're not asking for any more than that historical level.

In our own Southern San Joaquin Valley area, the reduction of the small refiner diesel market is dramatic. As we've shared with your staff, in 1983, small refiners held 83 percent of the local market, with majors and large independents holding 17 percent.

By 1988, the large refiners' share had increased from that 17 to 26 percent. And we estimate that at this time, small refiners -- which are Kern and Witco -- market 42 percent of the motor vehicle diesel, with Texaco the other 58 percent.

If the staff's recently revised proposal is adopted, Texaco's share would jump to 64 percent of the local market and assume -- that's assuming that we stay in business, which is not necessarily a good assumption.

Even if our limit is 7,000 that we need, Texaco would pick up to 60 percent of the local market. That's up from 26 percent in 1988.

And, so, I would differ from Mr. Wall's on that point of saying that their market share is about the same. I think, at least in our marketing area, 60 percent or 64 percent is a whole lot more than 26 percent.

Any additional market growth, then, beyond what it is in 1995, when these limits go into effect, would go to Texaco, because Kern and Witco would be forever limited to what you set today.

And I use the word "forever guardedly," as Mr. Lagarias said. I mean, anybody could come back and ask for additional changes. But we believe that this is the time to make these decisions, before this thing is implemented.

Although Kern directly employs only about a hundred people in the Bakersfield area, the fact that we're operating keeps several hundred more people employed supplying goods and services to our company, doing engineering, consulting, and construction for us and marketing our product.

The Office of Economic Research of California Commerce Department has determined that refineries in Kern County have job multiplier of 6.36, meaning that our plant keeps 636 people employed locally, not 100. And Kern's employees are relatively, well-paid skilled workers who contribute more to the economy than their mere numbers would indicate.

They might be able to get another job if Kern went down, but probably not as good a job, and whole local economy would suffer.

Also, since health care is currently on everyone's mind, Kern provides its employees with an excellent health care package and retirement benefits, which probably would not be available elsewhere in the job market.

The staff's recently revised proposal -- this is the one that was announced this morning -- would limit our CARB 20 percent fuel to 6400 barrels a day. And that's according to the staff's estimate. This is obviously better than what was in the June 10th, which was only 5500, and a whole lot better than 3595 if the rule's not changed.

It's not what we need to remain viable, however. We must remain viable to address reformulated gasoline here pretty soon. The staff proposes essentially to limit our capacity utilization to the 1991-92 industry average of 90 percent, while our larger competitors can operate at 100 percent or even more. As Mr. Lagarias said, when you design something, you hope -- and if you have good people -- to be able to achieve that design.

We agree with the staff proposal except for that. If the 90 percent utilization factor were removed, we could produce 7,000 barrels of diesel and utilize our full-rated refinery capacity.

We then would have a chance of remaining profitable. And I say a chance. We're not guaranteed any profits. And this is going into our reformulated gasoline project, where it's extremely critical. And this is what we're requesting -- the revised staff proposal without the 1991-92 utilization factor of 90 percent. And we certainly think 90 percent is low. We think that it's appropriate to allow us utilization of our full capacity. We've talked 95 percent. I think that we're in a critical area here. It doesn't sound like a few percent -- like very many percent, but it's very critical to our operation.

So, that concludes my remarks. I'll be open to any questions.

CHAIRWOMAN SCHAFER: I had a question to start with.

What is the current production at Kern?

MR. EVELAND: We're running pretty close to what the staff set as our maximum level while this rule is suspended, which is 7800 barrels a day of diesel, 7826.

CHAIRWOMAN SCHAFER: What percent of that is your capacity? That represents what percent of your capacity?

MR. EVELAND: That's running basically full. That's basically what we can make.

CHAIRWOMAN SCHAFER: Okay. Thanks very much. Mr. Lagarias?

MR. LAGARIAS: You indicated that the -- we're going to be limiting you to 90 percent, if this regulation is adoption, utilization; whereas, the larger industries can run at 100 percent utilization or greater. But that 90 percent figure was given in exchange for allowing to go to a 20 percent aromatic fuel.

You can certainly go to a hundred percent utilization or greater if you meet the 10 percent aromatic or reformulated fuel. There's no limitations on utilization for complying fuel.

You're correct in that. If we were capable of making the 10 percent or a 10 percent equivalent formula, we would have no limit on our production. But the small refiners -- and in our operation, it was a tremendous capital project, the largest capital project we've ever gone after to desulfurize and remove the sulfur, which is now used in agriculture in our sulfur recovery plant. And we looked at the capital requirements for going lower to a 10 percent aromatic. And it just is not feasible for our size of operation.

MR. LAGARIAS: We recognize that, and that's why the allowance was made for the 20 percent aromatic production. But, as for sulfur, that's a national issue. If anybody's going to stay in business in the diesel fuel in the country, they have to desulfurize. And that affected everyone equally.

MR. EVELAND: That's correct.

MR. LAGARIAS: Thank you.

CHAIRWOMAN SCHAFER: Yes. Supervisor Bilbray.

SUPERVISOR BILBRAY: A question of staff. In the cost of production estimates, the difference between the 6 for large at 10 and the 7.5 for independents at the 20, how much does this gap between the 90 and the 100 percent contribute to the increased cost of production for the independents?

MR. SIMEROTH: Supervisor Bilbray, we tried to look at that, and what they would do with the barrels that they potentially could produce_that would not be allowed under the -- not be allowed under the staff's modified proposal. 7.5 cents does not include that additional cost. We figured the lost value for those barrels would add somewhere around another .4 of a cent to the cost. But, again, that gets into a lot of assumptions of what market can they find for the lost barrels, what's their transportation cost to reach those markets. It gets fairly soft. And the 7.5 is a weighted average for the three refineries.

SUPERVISOR BILBRAY: We're talking about Bakersfield and L.A., right?

MR. SIMEROTH: Bakersfield and L.A., that's correct.

SUPERVISOR BILBRAY: And Bakersfield might be able to access out of State, but L.A.'s not exactly the most perfectly sited location for exporting to Arizona and Nevada.

MR. SIMEROTH: Arizona and Southern Nevada are supplied via pipeline from the Los Angeles area.

SUPERVISOR BILBRAY: Okay.

MR. SIMEROTH: Certainly, Bakersfield, any market they would have to reach would have to be reached via truck.

SUPERVISOR BILBRAY: Those numbers really are pretty, you know, impressing or "depressing," depending on where you're coming from. And I just want to make sure that, when we look at that cap, as we said before, how close to maximum capacity you can generate has a direct relationship to your unit cost. And you're saying it's about four-tenths?

MR. SIMEROTH: Our rough estimate is .4 of a cent.

SUPERVISOR BILBRAY: Now, you say that wasn't included in here. So, it's .4 of a cent above what? The 7.5.

MR. SIMEROTH: That is correct, Supervisor Bilbray.

SUPERVISOR BILBRAY: It's interesting you didn't consider that into the formula.

MR. SIMEROTH: It would round up to probably 8 cents instead of the 7.5.

SUPERVISOR BILBRAY: Thank you.

CHAIRWOMAN SCHAFER: Mr. Eveland, can Kern produce 20 percent aromatic fuel in the fall?

MR. EVELAND: We have a project undergoing, which we plan to have one or more 20 percent fuel certified prior to October 1st.

CHAIRWOMAN SCHAFER: Okay. Does your certainty, I presume, increase if we move the effective date to January 1?

MR. EVELAND: It would.

CHAIRWOMAN SCHAFER: It wouldn't affect 20 percent. Staff just corrected my -- strike the question.

MR. EVELAND: We have a very tight schedule, and we were relying on Southwest Research Institute, which had innumerable problems even making a reference fuel, which took months longer than they had indicated that it would.

Certainly, rolling that date back would give us some breathing room. But I'm not here to ask for additional time at this point.

CHAIRWOMAN SCHAFER: I understand.

Are there any other questions Mr. Eveland at this point? If you'd like to take a seat close to the podium, I'm going to let all the Kern witnesses testify, and there may be some back and forth questions.

MR. EVELAND: These are customers of ours and, et cetera. They're not Kern employees.

CHAIRWOMAN SCHAFER: Okay. Very good.

Mr. Jeffries, if you'd like to go first, that's okay with us.

MR. MARCHBANKS: My name is Pat Marchbanks, and I'm one of Kern's --

CHAIRWOMAN SCHAFER: Mr. Marchbanks with Bruce's Truck Stops.

MR. MARCHBANKS: Correct.

CHAIRWOMAN SCHAFER: Certainly, you may go first.

MR. MARCHBANKS: Thank you. Good morning, Chairwoman Schafer, thank you for letting us speak. My name is Pat Marchbanks, and I'm from Bakersfield, California. And I'm an independent truck stop operator. I'm here today to talk with you all about 20 percent aromatic diesel production and limits.

I'm here also advocating the position of the Western Independent Refiners Association, and the small refineries, and Kern. They are my fuel partners. This issue is critical to them, to me, my employees, their families, my customers, and my community.

The staff has recommended a modified proposal from the current regulations. I personally commend them. I urge you, the Board, to adopt the position outlined by the

Western Independent Refiners Association and Kern in regards to the utilization factors, somewhere between 95 percent and a hundred.

In fairness to all parties concerned in this request, it's reasonable. There's no price advantage to me. This does not take away any barrels from the major oil companies. Rather, it lets people like me continue to purchase my barrels in the independent refining sector.

My business has suffered enough already because of the aromatic issue. Interstate trucking companies are increasing purchases out of State of diesel fuel, and they're limiting purchases in California. Please -- and I say again, please, do not further damage my business.

Be fair. Please adopt the utilization factors somewhere between 95 and 100 percent. I'm here today to try and throw in the human factor. I don't any more prepared statements, but hearing some of the discussions and the questions today, I would like to see if I could take a few more minutes just to answer Ms. Edgerton's questions about customers.

In my rural truck stops, we supply rural school buses. There's school systems with 300 children, and they don't have big tankage, and they're not supplied by majors. They deal at our locations. We're set up for emergency services with the fire department and the National Forest

Service. We've had big fires down in Kern County lately. My locations are open 24 hours. Those are sources for emergency services.

I am an independent. We do a lot of agriculture, not big farming, small farmers. We take care of emergency needs, human error. They've ordered possibly from the Texaco refinery but, for whatever reason, someone forgot to put fuel in their tank, so they ran out.

They can come to the independent side of the market and take care of needs. That's probably only 15 percent of some of the big agricultural needs.

But I'm here to be part of that market. We have jobs. If Kern Refinery, who's my fuel partner, goes out of business in Bakersfield and our home town, those 100 jobs would be lost. As for the Texaco demonstration of the slides, it appears that that production need could be met with those slides. But what about those 100 jobs? You talked earlier about the California economy. Those hundred jobs aren't going to be replaced by anybody else.

Another refinery just turns up a little bit of production and so we -- we're spiraling again.

So, anyway, I'm going to repeat myself and urge you to support this position. And if I can answer any questions, I'd be more than happy to.

CHAIRWOMAN SCHAFER: Thank you very much, Mr.

Marchbanks. Do the Board members have questions for this witness?

Yes, Dr. Boston.

DR. BOSTON: Two questions. Number one, you say that your business was decreased because of the aromatic fuel rule and indicated that out-of-state truckers are not buying from you?

MR. MARCHBANKS: Correct. There are two markets in the retail truck stop business. There's the intrastate business, which is trucking companies that take care of -- and there's the interstate business.

The interstate trucking companies are limiting fuel purchases to 50 gallons in California. They are topping off in border states. The gallonage, retail gallonage from truck stops in California is -- the sales are diminishing. We have been talking with the State Board of Equalization on the taxation issue of this, trying to put issues before them that we've got to do something, because inferior fuel is purchased out of state and burned in our State.

DR. BOSTON: So, they can get all the way into California and back out without refueling?

MR. MARCHBANKS: In the last 100 years, trucking has gone from three miles to the gallon to seven miles. They have aluminum engines. They've made them tighter, and their performance on the engine level is greater. Trucks are lighter. They use aluminum -- their tanks are enlarging. So, yes, they can now take 350 gallons at the border and go a thousand miles.

DR. BOSTON: Those were some of our other regulations that did it to you.

SUPERVISOR BILBRAY: And that's a lot of illusion that got in there. There's perceptions that California fuel causes problems, where our studies show just the opposite. The midwest is a major problem that the cost here in California is so terrible, where you say Utah with some of the most expensive fuel in the country -- but there is a lot of propaganda out there about buying fuel in California.

MR. MARCHBANKS: It's strictly a price issue, not anything about filters or any of that kind of --

SUPERVISOR BILBRAY: Well, there's a whole lot of propaganda that came out of the private industry about our fuel in California, which has hurt the fuel industry here that wasn't based on reality.

I understand, if you would look at our price surveys, you'll see that California's not the highest in the country.

SUPERVISOR RIORDAN: Madam Chairman, if I might.

CHAIRWOMAN SCHAFER: Supervisor Riordan?

SUPERVISOR RIORDAN: And I don't mean to do this to Dr. Boston, to interrupt, but the gentleman is right in what he's saying. And it isn't probably the best of discussions here. We ought to really think about it in another hearing.

But representing some of those areas that sit along the State line, I can tell you what's happening. And they're enticing them with some pretty fancy enticements to buy and load up those trucks just before they cross into California. And it's an interesting issue that really should, I think, at some point in time be discussed by this Board and by the staff.

CHAIRWOMAN SCHAFER: Thank you very much, Supervisor Riordan. Dr. Boston, did you have a set of questions?

DR. BOSTON: I had one other quick question of this witness.

You mentioned that if the refinery, Kern Refinery, was to go down, that it would put you out of business. Couldn't you buy it from Texaco? They said they had plenty of supply there.

MR. MARCHBANKS: If I said that, I was in error. If they close down, their jobs -- I think I could -- the product would be available, according to the statistics in the gallonage and what's in storage, that product probably is and would be available to me to purchase.

I don't know about the fairness of it. Currently, there are branded and unbranded rack prices in Bakersfield for Texaco. And in the past year or two, there have been significant swings in that.

Sometimes those gates have been closed and locked. If Kern went out of business, I don't know how long I could survive if those gates were locked to independents on the unbranded side, you know. It's happened. You know, there have been price spreads between branded and unbranded in the Bakersfield market.

Yes, the product is there. I really believe the gallon numbers are there. But don't be deceived by their availability and the fairness in the distribution of those gallons.

DR. BOSTON: Thank you.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Marchbanks. I would like to assure Supervisor Riordan that the issue that she is concerned about is one that I also share concerns about. And we've done some investigations with the Board of Equalization concerning the sales and trends. And it is not the full picture, but it's interesting to understand your personal experience down in Bakersfield with your company. And I agree it's a question for another day, because there's a lot more out there that we probably do want to look at.

SUPERVISOR RIORDAN: Thank you.

CHAIRWOMAN SCHAFER: Thank you very much.

Mr. Jeffries?

MR. JEFFRIES: Good morning. My name is Wayne Jeffries, President of Jeffries Brothers Petroleum Distributing.

We distribute mainly in the Kern County area. 80 percent of our customers are farmers and agricultural related. The other 20 percent are car lot fuels. As he related to you, emergency vehicles, fire trucks, school buses, et cetera.

We've been in business since 1946. We now employ 27 employees, and our current demand for diesel fuel for our customers is approximately 15,600,000 gallons a month -- I mean, excuse me, a year. It'd be nice.

(Laughter.)

MR. JEFFRIES: A year.

SUPERVISOR BILBRAY: You wish, right?

MR. JEFFRIES: Sorry about that. Our source for diesel is unbranded Texaco, which we have no signed contract with, and Kern Oil & Refinery. Over 30 percent of our diesel we purchase from Kern Oil. Our company relies on Kern's diesel for continued operation.

Many times Texaco has honored, quote, "branded" distributors with no supply for us unbranded distributors.

Without Kern Oil, we would be out of supply to facilitate the crucial needs of farmers.

We desperately need the supplies from Kern Oil. If Kern Oil Refinery is not allowed to increase its output or ceases to operate, that leaves Texaco alone to supply our area.

Let me define competition. It is the efforts of two or more parties acting independently to secure the business of a third party by the offer of the most favorable terms to that party, being us and our customers.

The definition of a monopoly is the exclusive control by one company of service or product.

Speaking on behalf of one of our customers, Mr. Jim Bretol (phonetic), who you've all previously heard testimony from, he could not attend this meeting, because he is right in the middle of harvesting sugar beets. And time is of the essence to the harvest.

Without diesel fuel, his crops would rot in the fields in a matter of days. Also, his produce could not go to market because of the truck transportation needed to get the produce to market without diesel fuel.

He and I agree that what Kern Oil Refinery and what the other independent refiners are asking is not unreasonable, but necessary for continuation of business and secure jobs for all industry related to the farming operations and others.

Without competition of refineries, the price would make farm products in California noncompetitive in the industry. A rule is an established standard, guide, or regulation. There comes a point where rules must stop and people and their survival begin. If you want to keep California competitive in business for all of us, please consider this proposal as a necessity to the survival and future of this great State.

Thank you.

CHAIRWOMAN SCHAFER: Thank you, Mr. Jeffries. Are there questions for Mr. Jeffries from the Board members? Okay. Not at this time. Thank you very much.

Mr. Blackburn? Mr. Vernon Blackburn.

MR. BLACKBURN: Good morning.

CHAIRWOMAN SCHAFER: Good morning.

MR. BLACKBURN: My name is Vernon Blackburn. I'm here today to explain my support for the small refinery proposal to increase the amount of diesel fuel they can sell subject to the 20 percent aromatic hydrocarbon content limit.

I've farmed continuously in the southern end of the San Joaquin Valley near Arvin since 1946. I directly farm about 320 acres of potatoes and carrots. I'm also the managing partner of a potato shed that processes about 800 acres of potatoes per year. I also own and operate a small petroleum jobbership in Arvin since 1969.

My jobbership buys unbranded fuels to supply its farm and business customers. We have over 300 farm, ranch, and business customers. This mix of business gives me a chance to look at both sides of the supply and the user when it comes to fuel.

The way the proposed rule is written now, Kern Oil & Refinery would be forced to severely curtail their production of diesel, which would also reduce other products. To lose Kern's supply of diesel and even gasoline, either partially or completely, would be devastating to the southern end of San Joaquin Valley.

Petroleum jobbers in this area seem to be vulnerable to problems in supply which, in turn, seems to lead to supply (sic) -- the supply of fuel, especially with time.

When the war in the Middle East broke out in early August of 1990, the supply of fuel was extremely tight. On August the 2nd, Texaco refinery in Bakersfield completely cut off my ability to buy gasoline. On August the 3rd, Texaco cut me back on my diesel to 60 percent of what I had purchased in June of 1990.

When red diesel became available on January the 1st, 1994, only Kern Oil had it available. Texaco not only didn't have it available, when they finally did have it available, they initially only allowed sales to branded Texaco jobbers.

During all three of these episodes, Kern Oil consistently had fuel available and at a competitive price. The same can't be said of Texaco.

My point to all this is that, in my experience, only Kern Oil seemed to care about me as a customer. It also points out that unforeseen events can easily cause supply and price problems.

Texaco has proven all too often in the past that the unbranded purchaser is the first one they cut off when there is a problem. And we all know there are plenty of problems that can't be helped.

What can be helped is a diesel supply situation in the southern San Joaquin Valley, since there are only two major sources of fuel in this area, Texaco and Kern Oil, it is vital that Kern Oil be allowed to produce more diesel. Only they seem to be able to take care of me, the unbranded purchaser.

Thank you.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Blackburn. Do any of the Board members have questions for Mr. Blackburn at this time?

Thank you very much for coming up today.

And Mr. Tomerlin, are you here?

MR. TOMERLIN: Thank you, Madam Chairman, and Board members, and staff. I'll be very brief in my comments. I'm really having a long day already. A lot of the things I intended to say has been said, and I won't repeat them.

My name is Jim Tomerlin and I work for Cox Petroleum and Transportation. We're located in Bakersfield. We are a family business. We're a family trucking company. We have 100 employees. We have 34 trucks.

In relationship to the small refiners, we do business with all four of them. And the majority of our business is done with Kern Oil, because they're located also in Bakersfield.

Not only are we a customer, as the other gentlemen have spoken, but we're probably a large customer. We use approximately 60,000 gallons of fuel each month. And last year, we did experience some problems of getting it locally. But we had the ability to truck it in. So, we can get fuel. The hard part was paying for it, not getting it. The other side of that coin is Kern Oil is one of our customers.

Of those 34 trucks and 80 drivers, 14 of those trucks are employed hauling crude oil. And that's out from the production site, the tanks that you've seen in the San Joaquin Valley, picking that up in our trucks and delivering it to their facility for processing.

And if this rule goes into effect, as it's been proposed, and a worst-case scenario that Kern Oil does close, that's going to mean 10 to 14 trucks, 25 to 30 drivers are going too be unemployed. And it also means it may have more effect than that, because most of those trucks -- one truck, a new truck costs about $180,000 to put it into service. And most every one of those trucks has some financing still owed to them. So, you've heard a lot about utilization. We're no different. We have to use them, every one, and hope to make enough profit to pay for all of them.

And I just want to say, if we have to shut down 10 of them, that may mean that we'd have to shut them all down. And I want to thank you for your time.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Tomerlin. Do Board members have questions for Mr. Tomerlin?

Do Board members have questions for any of the witnesses from the Kern/Texaco/Bakersfield area at this point in time?

I want to thank you very much. I've had an opportunity to visit both the Texaco refinery and to Bakersfield, and appreciate the trip that you all made up here today, even though I have learned a little bit about your business, it's very interesting to appreciate how many different facets there are and how complex this industry is.

I'd now like to recognize, if he is here, Mr. James Richey of ARCO. Good morning.

MR. RICHEY: Good morning. And I'll also be brief. My name is Jim Richey, and I'm the Environmental Health and Safety Manager for ARCO Products Company in Los Angeles. And I'm here to offer my comments on the proposed regulations being considered, the amendments to those regulations.

ARCO believes that the regulations, as originally written, have been more than fair to the small refiners, because they allow them until October the 1st of this year to reduce the aromatic levels in their motor vehicle fuels, and then permit them to meet a 20 percent aromatics level rather than a 10 percent level.

And, as previously stated, a lot of refiners, including ARCO, have invested millions of dollars -- ARCO over $70 million in equipment to produce diesel fuel containing 10 percent aromatics or its equivalent. Actually, we produce equivalent diesel. We don't produce 10 percent.

We therefore support the ARB's reaffirmation of the October the 1st compliance date for the small refiners to produce 20 percent aromatics content diesel fuel.

We're pleased to see what had been most

distressing about the proposed amendments that were offered on June the 10th, which was the coupling of an increase in the exempt volume of 20 percent aromatics diesel with a limit on the total distillate production, we're pleased that that's been dropped in this modified proposal, which we were informed of this week.

We believe that provision represented a potential precedent setting interference into the free workings of the marketplace, which could have been used by the ARB in the future as a pretext to regulate the volumetrics of other refined products, such as CARB Phase 2 gasoline. So, we're glad that that's -- that proposal is not the one that's being recommended.

However, ARCO is greatly concerned about and opposes the proposed amendments which would allow small refiners to increase the exempt volume of 20 percent aromatics fuel, which they are permitted to produce above that stated in the ARB's current regulations, which are on the books.

Not only is the Board proposing to increase their exempt volume above the 65 percent of total distillate, which is specified in the regulation, the staff's modified proposal, in effect, increases it to over 100 percent. And the arithmetic is simple, because the regulation, as written, limits these small refiners, in aggregate, to about

11,000 barrels per day of 20 percent aromatic diesel production.

The first proposal would have increased that close to 17,000 barrels per day, and the proposal that we're considering today is to increase that to over -- to about 24,000 barrels per day. So, we're going from 11 to 24.

Approving either of these proposals would be going in the wrong direction if the aim is to clean up the air. In fashioning the small refiner provisions to this rule, the ARB stated in its final statement of reasons for that rule that it had, quote, "sought to limit emissions from small refiner diesel fuel to the extent feasible. These limits included imposing a significant cap on small refiner diesel fuel subject to the less stringent 20 percent standard." End quote.

The proposals being considered today obviously go contrary to limiting these emissions. As this Board has acknowledged, when it originally passed this rule and has subsequently reaffirmed as part of the stipulated judgment in a suit brought by ARCO last year -- and I'll quote again. "Primary consideration in the modification of its regulations is to be given to the mandate to attain and maintain ambient air quality by achieving the maximum degree of emission reduction possible from mobile sources." End quote.

Amending the rules to permit more higher polluting 20 percent aromatics diesel fuel to be marketed at the expense at 10 percent equivalent aromatics diesel is in clear contradiction of that stipulation.

With regard to the proposal delaying the imposition of the exempt volume limits until January 1st, 1995, this proposal would allow the small refiners to produce diesel volumes significantly above their current production for three additional months.

We believe this delay is wholly unjustified. The reason cited in the staff report is the concern over potential shortages that might occur during the high demand period of October. And I won't reiterate what has been said previously, but we concur that that should not be a problem, including the fact that the quantity that's being talked about represents only about 6 to 7 percent of the total California diesel supply, and should pose no major supply obstacles, especially if the ARB acts now to reject this proposal, allowing industry to know well in advance and properly plan.

So, in summary, then, I'll make three major points.

One, while ARCO supports the ARB's affirmation of the October the 1st, 1994, implementation of the 20 percent aromatics diesel rule for small refiners, we strongly oppose the option which would allow small refiners to increase production of higher polluting 20 percent aromatics content diesel above the exempt volumes currently specified in the rule.

Two, we also oppose delaying the implementation of existing exempt volume limits for motor vehicle diesel fuels until January the 1st, 1995, for small refiners.

And, three, there has been no compelling reason given for amending the regulation. Further, the changes proposed have nothing to do with improving air quality. And, in fact, in the staff's words, in their June 10th document, quote, "would constitute a significant adverse environmental impact."

Therefore, we believe that this Board should reject these amendments.

And a final point I would add relative to our concern that this will not be the last time this year that the ARB will be asked to address the small refiner diesel issue, we are concerned that these refiners may not be able to meet the 20 percent standard by October the 1st or by January the 1st. And the question is, will they be approaching the Board indirectly through an administrative process requesting variances from meeting the 20 percent rule?

We've both been down this road before, and we believe now is the time for the Board to determine whether you can expect these refiners to be able to comply with the 20 percent standard. And we think the appropriate forum for that discussion is today before the Board members and not in an administrative hearing.

So, we applaud the fact that you are doing that as they come forward. So that concludes my remarks, and I would welcome your questions or comments.

CHAIRWOMAN SCHAFER: Are there any questions for Mr. Richey from the Board members?

Mr. Calhoun.

MR. CALHOUN: Yes, Mr. Richey, I will ask you the same question I asked the gentleman from Texaco. What fact or information do you have to suggest that the small refiners won't be able to meet the compliance date?

MR. RICHEY: Not facts. It's the same comments that were made earlier relative to the workshop that was held earlier in the year, and the quotes that were made from that workshop, where it was stated at that time that -- their intended purpose at that time was to be able to acquire 10 percent fuel and blend to meet the 20 percent standard. And, as I stated previously, we're not making 10 percent fuel. And, so, we don't know whether there will be a problem.

But what bothers us the most is the fact that, historically, the variance process has not been held before you. It's been held before an administrative hearing officer, and you don't necessarily get involved in deliberating that process. So that's -- we want to put that on the table and let it be openly aired today.

MR. CALHOUN: Thank you.

CHAIRWOMAN SCHAFER: Any other questions from Board members?

Ms. Edgerton?

MS. EDGERTON: I just want to say that I agree that ARB should not likely change course, and I think everybody here on the Board agrees. I don't -- I would be very surprised if anybody didn't agree wholeheartedly with that.

Before us today, though, is a regulation which was adopted before many of us joined this Board. And it isn't as if we're coming into establish the whole diesel program.

MR. RICHEY: Right.

MS. EDGERTON: We're coming in, being asked to correct what has been presented as a technical error by the staff with respect to what the volume was -- what volume was appropriate in 1988. So, that's a little bit -- I mean, that puts the context of it differently. We're not -- I don't have before me, even if we wanted to change the whole program, that's not even before us.

So, I just hasten to emphasize that in terms of this proceeding. But I did want to say that I am very sympathetic with your concerns. And I know the stability of the program is vital, and I will agree that the -- and I'm sure everyone else here does -- that our primary consideration is to reduce emissions.

And I think that was the primary consideration in 1988.

MR. RICHEY: Right.

MS. EDGERTON: And that continues as the broad overlay of the program.

MR. RICHEY: Right. If I could respond just briefly.

MS. EDGERTON: I'd love to hear it.

MR. RICHEY: It is true this was debated in 1988. And I would -- I wasn't there. I wasn't at those hearings then, but I would suppose the concept of setting the exemption volumes equivalent to capacity to produce versus historical ability to produce was debated, I would expect, very hotly back then.

And I quoted the word; that the Board weighed those things and decided to set a cap. And, as Mr. Lagarias has said previously, that they didn't cap their -- and even today, they're not -- what they're proposing -- they're not capping their ability to make diesel fuel. They're capping their ability to be exempted from making complying 10 percent aromatic diesel fuel. But they still have the capacity to produce a hundred percent or more of total distillate if they fall back to the 10 percent aromatic standard.

And that was what was weighed back then, and we think that should continue to be very much debated if you're reopening that today.

MS. EDGERTON: Thank you.

CHAIRWOMAN SCHAFER: Any other questions for Mr. Richey? if not, thank you very much for your appearance this morning.

MR. RICHEY: Okay. Thank you.

CHAIRWOMAN SCHAFER: I'd like now to call on Mr. Stan Holm of Mobil.

MR. HOLM: Good morning. I am Stan Holm with Mobil Oil Corporation. Thank you for this opportunity to address the Board on the proposed diesel fuel amendments.

Since you already have detailed written comments stating our opposition and concerns with the amendments, and since most of my points have already been raised, I'll be very brief and use this time just to briefly summarize why Mobil believes the amendments are not necessary and why they are unfair to larger refineries, and why they should not be adopted.

As you know, the net effect of the two proposed amendments would be to increase the small refiner exempt volumes. The increase would be substantial, more than doubling the current exempt volume limits, if I understand the recent changes to the amendments correctly.

Our prime concern with the amendments is that they would further increase the considerable economic advantage extended to small refiners by the regulations. Since CARB diesel continues to be valued in the marketplace above EPA diesel, the increase in the allowable production of a less stringent 20 percent aromatics diesel by the small refiners would provide them with a large economic windfall.

This windfall would come at the expense of air quality and would be unfair to refiners that are required to produce cleaner diesel.

We see no justification for such a drastic action at this point in time. The rationale for the proposed amendments, as put forth in the June 10th staff report, in our opinion, is extremely weak. The rationale for the exempt volume increase that would apply in the fourth quarter of 1994 is to prevent a disruption of diesel supply during the typically high demand harvest season.

The rationale for the other amendments that would permanently increase the exempt volume increase beginning January 1st, 1995, is that it was intended, when the diesel regulations were first adopted back in 1988, that the small refiners be allowed to produce exempt diesel at their historical motor vehicle diesel production volumes.

Apparently, this intent is not quite satisfied by the current exempt volume limits. However, we at Mobil get the feeling that the real motivation behind both of the amendments is to increase the supply of CARB diesel to reduce the chances of a supply shortage or disruption similar to what occurred last fall when the regulations first became effective.

While this concern for a shortage may deserve consideration, we believe it to be unfounded. There simply is no evidence of an impending shortage this fall or in the foreseeable future. I won't repeat the reasons for that. We agree with the reasons stated by other testifiers.

And let me address the premise that the current small refiner exempt volume is somewhat less than their historical diesel production levels and, therefore, the exempt volume limits should be increased.

This was known at the time when the regulations were first adopted. When adopting the regulations, the Board had to balance concerns -- about their concerns about the financial impact of the regulations on the small refiners with the need to maintain fairness to the larger refiners and the need to preserve the air quality benefits of the regulations.

To achieve this balance, exempt volume limits were established. Nothing has really changed since then. There is no reason at this point in time to increase the economic advantage afforded small refiners at the expense of the environment and the larger refiners.

In conclusion, Mobil urges the Board not to adopt the proposed amendments on the ground that they would unfairly increase the economic advantage extended to small refiners, further compromise the air quality benefits of the regulation, and are not justified farm the supply standpoint.

If the Board wishes to relax the regulations to protect against the possibility of a diesel fuel shortage, you should do so in a manner that is fair and equitable for all refiners.

That concludes my remarks. Thanks again for your time.

CHAIRWOMAN SCHAFER: Thank you, Mr. Holm. How much CARB diesel does Mobil market here in California?

MR. HOLM: Right now, we do not market any CARB diesel. We have not produced CARB diesel. However, we do have some efforts underway to quality an alternative diesel blend. It looks optimistic that we're going to be successful. I can't guarantee we're going to be successful in doing that, but it looks optimistic right now. And if we are successful, we should be in a position to produce some this fall.

CHAIRWOMAN SCHAFER: How much diesel was produced by Mobil for the California market prior to the effective date of the CARB diesel rule? Roughly.

MR. HOLM: I'm just going to have to go by, you know, some general knowledge. Mobil is not a large producer of diesel fuel. In fact, if you think -- we're considered a major refiner. But if you think about Mobil in terms of diesel, we're really a small refiner.

And that's why we insist that we have a level playing field here. We're looking at the same situation as the small refiners in terms of what we're going to have to spend and what the market conditions are for us to get into that diesel market.

To more directly answer your question, it was -- I don't know, six to ten thousand barrels a day.

CHAIRWOMAN SCHAFER: So, when we switched over to the CARB diesel, the market here lost that capacity, in effect.

MR. HOLM: Our total diesel production probably hasn't changed much. We've continued to produce EPA quality diesel.

CHAIRWOMAN SCHAFER: But it's not marketed here in

California.

MR. HOLM: Right.

CHAIRWOMAN SCHAFER: Okay. Thank you very much.

Are there any questions from Board members for Mr. Holm?

If not, thank you very much for your appearance today.

I'd like next to recognize Mr. Al Jessel of Chevron.

MR. JESSEL: Thank you, Madam Chairman -- Chairwoman and members of the Board, especially I want to welcome the new members of the Board to a diesel issue.

CHAIRWOMAN SCHAFER: We avoided it as long as possible.

(Laughter.)

MR. JESSEL: The Chairwoman alluded to the amount of time it takes, and I think you're getting a taste of that now.

I represent Chevron U.S.A. Products Company. I'm in the strategic planning business evaluation section, and I want to express our object to the proposals that have been placed before you today.

The proposed changes would allow what we consider to be an inequitable and unintended situation to continue, a situation that is affecting the marketplace today and in a way that is hurting the ability of refiners, such as Chevron, refiners who have invested substantially and in good faith to recoup those investments.

The proposed changes continue an alarming trend begun last fall, a trend that leaves Chevron wondering how committed the ARB is to their rules and how much of this trend will spill over later into the Phase 2 gasoline rules where required investments are an order of magnitude higher.

I'd like to review this trend of what we consider inappropriate market interference with you.

On October 15th, 1993, as a number of the Board members here will remember and probably never forget a hearing that lasted until 10:30 p.m., the Board relaxed the lower aromatics diesel rule to allow low cost, high emissions, high sulfur diesel fuel to be sold to off-road users for a period of 45 days and used subsequently by end users for 120 days in direct competition with true low aromatics diesel fuel or fee paid variance fuel.

This action came even after if it had been clearly demonstrated that the market system was working to bring to an end the unfortunate situation we had last October. On February 14th, 1994, the Executive Officer, without public input, summarily relaxed the rule and allowed this high sulfur fuel to be used by end users until supplies were completely exhausted.

Continuing the trend, on February 7, 1994, the Executive Officer granted Tosco a variance from the low aromatics rule that allowed enormous volumes of lower cost environmentally inferior fuel to reach the market with scant justification and without the compensating variance fee that Chevron and others had to pay as a condition of all other variances granted to date.

This, as you know, resulted in litigation that, unfortunately, never had a chance to be heard in court, let alone be resolved there. But I hope the fact that this matter was litigated conveyed the Board our deepest, deepest concern.

We consider these foregoing actions to have been an invasion into territory that a regulatory agency should, in fairness, stay out of. Once a rule is enacted, it ought to stay intact.

As we have argued over and over in this country, tradition has it, that when the government requires private industry to invest for the public good, government shoulders very little, if any, of the burden for recovering those costs. This is unlike many other countries where government shares in the cost through incentives, such as tax breaks.

While we have become used to this form of buck passing, we may never get used to government interference in the only mechanism we have to recover investment costs, the open market.

In requiring industry to recover the costs of government mandates on its own, government takes an implicit vow not to interfere with the only available mechanism. To be certain, we do not ask that our investment return be guaranteed. We only ask for a fair opportunity to try to recover those costs.

The ARB actions I just mentioned are examples of just the sort off interference we find grossly unfair to those of us who have made good faith investments in response to demands from the public.

We do not think it is too much for us to ask the government to stick to its rules and resist the temptation to manipulate the market through selective relaxations of the rules.

Now, let's talk about the latest attempt to manipulate the market, and that's today's subject.

As you heard, on October 20th, 1993, your staff -- and I'm reading here -- I'm going to pause for a second. You really haven't heard very much about this, and I'm a little bit surprised. So, I'm going to go into a little bit of detail about the history behind this particular problem that we are really deeply disturbed about.

On August 20th, 1993 -- this is prior to the October 1, 1993, compliance date -- your staff, without public input, issued executive orders that suspended ARB's low sulfur rule for three California small refiners, and they're the three refiners, excluding Witco, that are in attendance here today.

As you've heard, this automatically exempted those suspension volumes from the low aromatics rule; in effect, allowing lower cost, higher emissions, low sulfur diesel fuel to compete directly with higher cost, lower emissions, low aromatics diesel fuel.

Let me digress for a second. Your staff is justifying today's proposal in large part upon the Board's intent. Chevron has sympathy with actions that will rectify a situation where the intent of the Board is not being fulfilled.

But the Board's intent must be crystal clear and the policies derived from this intent must be applied uniformly.

In the August 20th, 1993 ARB letters that initially granted exemptions to the small refiners, the Executive Officer said that the Board intended that the amount of noncomplying diesel fuel allowed to be sold under a suspension -- I need to add that would allow that suspension volume to be completely -- sold completely independent of any requirement of the aromatics rule, did not have to meet any tenets of the aromatics rule whatsoever; that that amount allowed to be sold under suspension should be limited to historical production. It makes sense.

So, the refiners could not increase market share at the expense of the environment or of their nonexempted competition.

However, in subsequent letters to the small refiners, one dated October 8th, the Executive Officer. apparently in response to objections from the small refiners, dramatically increased the suspension volumes to the full capacity of the desulfurization units installed regardless of historical production rates and regardless of how much diesel was historically sold in the vehicular market.

Then, on November 1st, the Executive Officer made it possible for small refiners to take full advantage of this dramatic increase by allowing them to purchase intermediate feedstocks to fill out the desulfurization equipment. Thus, the small refiners were in no way limited in production if they were allowed to sell this fuel into the low aromatics market in direct competition with refiners, such as ourselves, who made fully complying 10 percent aromatics fuel or had variances which required us to pay a compensating fee.

They were given the opportunity to install any amount of desulfurization equipment they wanted to, use it to its maximum capacity, and sell the resultant lower cost, higher emissions fuel in direct compensation to refiners, such as Chevron making complying low aromatics fuel.

The staff report makes it quite clear that these small refiners have been taking full advantage of this opportunity that we look upon as more than an exemption. It's nothing sort of a loophole that was abetted by your staff.

The staff report indicates that the small refiners were producing as much as 32,000 barrels per day of suspension fuel in October of last year. And that's just three small refiners -- fully 20 percent of California demand. That's more than Chevron was producing at either of our large California refineries.

What isn't clear, but what's is implied is that fuel was complying low sulfur fuel. Thus, what we may have witnessed is the bizarre spectacle of small refiners being given a one-year exemption from the low suffer rule, a rule that they were, in fact, in compliance with.

Certainly, the Board didn't intend this.

The next impact of granting the suspension seems to have been to give the small refiners more time to comply with the low aromatics rule by a mechanism never contemplated by the Board.

Did the Board intend to reward small refiners that made low sulfur fuel with a year's delay in having to comply with the low aromatics rule? We doubt it.

The small refiners were also allowed to sell this higher emissions, lower cost fuel well in excess of historical production, more than double, judging from the staff report, allowing them to dramatically increase market share at the expense of air quality and at the expense of those refiners who made substantial investments and, as in our case, paid six cents per gallon for the right to sell a very same low sulfur product under variance.

This could not have been the Board's intent with respect to relief for small refiners under the low aromatics rule. I quote from the staff report, page 2, paragraph 2. This is the staff's quotation of the Board's intent.

First, the Board intended to preserve the air quality benefits of the regulation by limiting the volume of diesel fuel meeting the less stringent limits. Second, the Board intended to prevent small refiners from expanding production as a result of the less stringent standard and gaining additional market share from other refiners, particularly those refiners producing a higher quality cleaner burning fuel.

A similar sentiment can be found in both the October, 1988 technical support document and the August 22, 1989, final statement of reasons that accompanied the adoption of the original rule.

Now, the relief in the low aromatics rule that was intended for small refiners was very clearly the higher aromatics limit, 20 percent instead of 10, to meet for the life of the rule. Clearly, there was no intent to exempt an entire year's maximum production from compliance. But that's what the small refiners got and apparently took full advantage of.

The Executive Officer granted the suspension volumes with, in effect, no volume limit, allowed a dramatic increase in small refiner market share -- and these are individual refiners. Small refiners did increase market share. And you've heard testimony that the 14 small refiners that were in existence in 1988 produced a total of so many barrels, and the proposal today would not bring you as many of those barrels of 20 percent fuel.

But, in fact, the individual three small refiners are asking now for that almost entire allocation of 20 percent that would have gone to the 14 small refiners for three. So, those individual refiners can't stand here and tell you they're not increasing market shares as individual refiners.

The granting of the suspension volumes with, in effect, no volume limit, allowed a dramatic increase in small refiner market share of low aromatics diesel fuel, in effect, even though they never made a drop of it, and did this years after the Board made it abundantly -- and that was in the 1988 original adoption; that their preference was to limit the volume of exempted fuel.

We think this action was improper and gave the small refiners a windfall that the Board did not intend and that no one else expected or planned for. And windfall it was.

Recall that at the time staff says the small refiners were producing at nearly their maximum capacity, i.e. last October, prices were the highest in recent history. This action has had a significant effect on the market, representing yet another major intrusion. And because it came at a time of feared shortages, indicates the intent to manipulate.

Today, your staff is proposing that you change the exempt volume limits and the low aromatics rule to conform, as they say, with the Board's intent. However, the staff report does not even begin to explain what was wrong with the original 65 percent rule, which had already been increased from 55 percent in the 1988 proposed rule, presumably at the request of the small refiners.

So, I have to echo what Mr. Richey of ARCO said. There was debate about this very topic at the 1988 rulemaking. And the Board made a decision. The Board established what they thought was going to be the best thing for small refiners at that time to adjust what apparently was an economic disparity and took action, and cast that in the rule.

And refiners, such as Chevron, when we went back to look at the investment, what kind of investment we'd make in this rule, we did that after 1988. We did that in the early nineties. And we made our final decision on -- our final investment in '91 and '92. And this is after some of those small refiners had shut down. So, the market that we had planned on had already -- had already had the small refiners -- the 14, or 11, or 10, or 9 at that time -- had already gone out of the market, and we had made our investment decision based on what we thought was going to be the supply.

And that decision was made well after 1988, and under the light of several small refiners having already shut down.

Well, was the 65 percent rule and -- or the 55 percent rule, whatever you want to call it, was that -- was that really a mistake? I guess I heard the sentiment of one Board member, Ms. Edgerton, I believe, indicate that it might have been a mistake. I haven't heard the staff say it was a mistake.

But if it was a mistake, you know, there's probably a rationale for why that mistake was made, and a good rationale for how to actually rectify it.

The original proposal, not the modified proposal available today, didn't do a very good job of that. It was appeared (sic) -- it appeared to be designed to give a favorable outcome for these small refiners under the current circumstances and really defied any real explanation or any kind of logic progressing from the 65 percent rule to what they were proposing.

And it might provide the reasonable outcome for now, but would it provide a reasonable outcome in all cases? After all, rule changes are intended to be permanent; would have produced a desired result in the future?

That original staff proposal, I guess, as recognized by the modified proposal coming out, was seriously flawed. Now, staff's modified proposal dated last Wednesday seems more rational, except the equation doesn't seem to work.

The new proposal would actually allow an increase in production beyond any historical level, except for that reached under the sulfur rule suspension. And I refer to page 20 of the staff report -- I'll hold it up here in a second -- which shows the chart, Figure 6, showing what the historical production -- you don't need to see these in detail, but you can certainly see the very level -- here was the original -- this is the original period that was cited by the 1988 rule that the exempt volume was going to be based on.

And then, in 1988 and through pre-October, '93, as staff has labeled the chart, there was a jump. And then, around October 1st, there was an enormous jump as the small refiners began to make the suspension volumes.

Now, one could look at the 1983 through '87 period, which was what was originally designed by the original rule, and say, well, that's the historical production rate. I've heard some rationale to say that that wasn't a fair production rate.

Well, then, why isn't the 1988 through pre-October 1993 production rate a fair production rate for small refiners? And that's -- the numbers indicated by that level was what the proposed option came out to be.

But today's modified proposal increases that amount to somewhere between that and what was allowed under suspension.

And we don't see the rationale why should there be such an increase allowed. It doesn't bear any resemblance to any of the historical periods that make sense, other than the gross production that occurred under suspension.

Clearly, this violates the Board's original intent, and even staff's intent, as stated on page 24 of the report, it would also increase a significant adverse environmental impact, which was mentioned earlier. That's on page 22 of the staff report, if you're following, already identified as a consequence of the original proposal.

The modified proposal only becomes understandable when new intent is invented, such as recognize the role played by small refiners in the diesel marketplace, which I submit was recognized by the Board in '88, when they adopted the rule in the original exemption.

These words, to us, are the smoking gun that provides the staff -- that proves that the staff's intent is to help small refiners influence the marketplace at the expense of the environment and at the expense of complying refiners. We must cry foul.

And I heard another disturbing comment this morning from the Executive Officer, who thought that the State should assure that there was an oversupply of diesel in the State in order to make sure that there was no spot shortage. We find those remarks rather disturbing. Obviously, an oversupply has a great deal to do with the price in the market and seriously limits our ability to recover the investments we made in good faith.

In addition, your staff recommends you delay the imposition of the exempt volume limits, whatever they turn out to be. This would allow the small refiners another three months of production at the outrageous current rate allowed under suspension, albeit at the 20 percent aromatics level.

The rationale is once again the time worn threat of shortage, and I'm not going to take you through that again, over a series of circumstances which occurred once. None of those forces seem to be at work at this point right now. And I just don't see the rationale behind making a decision based on what really is a scare tactic.

These staff proposals, while inappropriate in any context, are especially so in light of the windfall that these same small refiners have received during the past 10 months.

We cannot support handing them another gift right on the heels of the enormous gift they received serendipitously last year. And I have to echo another sentiment that I heard from the Board, and that is when will the requests for relief stop?

There were several in 1988. There were suspension volumes that they were granted last year, and now there's this. When will it ever end? How do refiners like ourselves know how to predict the marketplace if we can't rely on the stability of rules?

The small refiners, because of what they were allowed under suspension, should remain constrained under the original rule, if for no other reason than to reimburse the State's air quality for the damage already done.

You might also -- and here's another digression -- it might be worthwhile to reflect on the US EPA's threat contained in the proposed California Federal Implementation Plan to tighten the State's NOx elsewhere if the low aromatics diesel rules were relaxed.

This could cause Chevron to pay once more for the Board's largesse toward the small refiners. And there's one question you might pose to staff. They've said that the benefit of the rule is so many tons per day in term of NOx. My question would be, is that based on the original 1988 projection of exempt volume or is that based on today's -- or what today's proposal contains? And does that represent the -- does 70 tons per day really represent the credit the State can get in terms of NOx control under the proposed suspension -- excuse me -- proposed exempt volume.

In summary, we see absolutely no need to further mitigate the small refiners' economic challenges of complying with the low aromatics diesel fuel rule, and once again request the Board resist that the temptation to make one more foray into the marketplace.

We strongly urge the Board to reject all of the staff's proposals and leave the rule as is. A rejection on your part would be looked upon by Chevron as a signal that the Board will adhere to its rule after all, and as a reversal of this dangerous trend of weakness and overt market manipulation so far exhibited.

Now, I'm going to add something I wasn't going to say unless I had to.

You've heard a lot this morning from very small businesses and small refiners about the problems that they face in the current regulated environment. Chevron and the other large refiners are no exception to that.

The small refiners and the small business people want you to adopt the attitude that the big guys like us will take care of ourselves. But anyone who's paid the least amount of attention to our industry in the past few years knows that it is in the process of a major restructuring forced, from our viewpoint, by an interaction between government regulations and the intensely competitive nature of our business.

The thousands of jobs -- literally thousands of jobs, just Chevron -- and I know that two of my -- two other large refiners have, within the past several weeks, announced restructurings that's going to cost them thousands of jobs each, also. Thousands of jobs. This is more than all the small refiners employ.

Chevron is now investing about a billion dollars in our two West Coast refineries to make CARB gasoline. The price we paid to get this capital from our corporate financiers was the sale or closure of two other refineries that together employ about 1800 people.

The loss of this investment would spell disaster for Chevron's entire refining and marketing unit. Thousands of Chevron employees could be affected by the ARB's disposition to smooth the market for a few vocal special interests at, what we perceive, our expense.

We hope you think as much of Chevron people as much as you think of others when you consider the effects of your action today.

I also took a bunch of notes on some things that were said here earlier, and I'd like to -- sorry I'm taking so much time, but I would like to rebut a couple of things that you heard.

Let's talk about the price differential. The small refiners have postulated and the staff, I guess, has concurred that -- and I'm assuming that it would be a certified alternative fuel meeting the 20 percent standard that would be a 7.5 cent per gallon cost to the small refiners versus 6 for the majors. I want to point out one thing right now. The market is giving us back about 4 cents per gallon of low aromatics over low sulfur right now. So, if that 6 is right, then somebody is really taking it in the shorts.

And let me also comment on the difference between 7.5 cents and 6 cents a gallon. I think in the original technical support document in 1988, we were talking differences between the small refiners of almost four times. I think the highest number I remember is 57 cents a gallon for small refiners, and the lowest was maybe 11 for large.

That's a very large difference. And that has shrunk suddenly to 1.5, which is one quarter of what the large refiners are purported to cost.

I wonder how real that 1.5 cents a gallon really is. And you heard Mr. Walz from Texaco saying his costs, at least what I understood him to say, are not out of line with that 7.5 cents per gallon. It sounds to me like the small refiners are able to produce a 20 percent alternative at pretty close to the same cost as majors. I don't see any need why they need ore incentive.

One other thing. In the original 1988 hearing and, as expressed in the technical support document, CARB staff had a difficult time trying to figure out what the historical period should be for imposing the 65 percent rule. And one of the reasons that they chose the period they did -- and the period is not, coincidentally, the period that preceded the adoption of the 1988 rule -- and it was stated in the technical support document that one good reason for doing that was to prevent gaming of the system.

If somebody knew that they would be able to take advantage of higher production later on, then they would have an incentive to increase that production.

Well, the staff was concerned about that, and that's one of the reasons why that historical period was chosen. I'll leave it to you to decide whether the system is open to being gamed under today's proposal.

I think I hit most of the other points. I'm amazed. Oh, I need, if I may, confirm one thing. The modified proposal was not noticed with 45 days' advance (sic). I'm assuming that there will be a 15-day comment period? I want to make sure. I haven't heard that expressed yet. The Board should understand that.

CHAIRWOMAN SCHAFER: I usually cover that point before we consider the staff's resolution.

MR. JESSEL: Okay. Thank you. I guess I'll stop there and give you an opportunity to ask --

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Jessel. Could you tell me us again -- I perhaps wasn't listening carefully enough -- what position you have with Chevron?

MR. JESSEL: I'm a planning consultant with the strategic planning and business evaluation unit. I am a fulltime employee. The "consultant" is a misnomer.

CHAIRWOMAN SCHAFER: Okay. Thank you very much. Do any Board members have questions for Mr. Jessel at this time?

Mr. Lagarias and then Supervisor Vagim.

MR. LAGARIAS: I'd just like to hear the Executive Officer comment about the October 8th, 1993, letter to small refiners?

MR. BOYD: Well, we'd have to dig that out and put it in a certain context, Mr. Lagarias.

But let me just give you a little bit of history here. Let me comment that Mr. Jessel and I stood arm and arm and side by side through the disasters of last fall, appearing before the same legislative committees or the same Legislators in their private quarters, trying to make our way through this.

And Chevron got its share of variances. Chevron had its share of upsets and breakdowns, as did Texaco, all of which contributed to why the ARB staff gave variances to hosts of people to keep the supply fairly up with the command that we all saw out there and had nothing to do with anything but that.

And with regard to the Tosco, the other side of the story there is that Tosco forewent its right or its opportunity or privilege to continue to produce 20 percent fuel far into the future. The quid pro quo on the variance was that they would certify a 10 percent fuel and market it in a short period of time. And they did just that. So, the breathers got a very big return on that particular investment. And we got back some of the -- some of the unfortunate public health costs of the crisis period of time.

Everything done by your staff and by the Executive Officer during this period of time, including suspensions, extensions, changes in compliance, was to try to get the supply up to match the historical demand. And that's the only reason therefor.

Also, I think, Mr. Jessel took license with my words today and translated them into subscribing to oversupply. And I hope he doesn't report that to his management, because there'd just be a typical comment of some bureaucrat in Sacramento subscribing to oversupply.

My descriptions this morning were relative to the uniqueness of the California marketplace, the difficulties of the transportation system to reach out and touch all parts of the marketplace, and how -- somehow or another -- the synergism between the large and small refiners in the past has taken care of meeting those needs.

And, as we painfully experienced and learned from history, that when there are deficiencies in one or the other, the marketplace didn't get served. And when the majors had these major upsets that prevented them -- some of them from even coming on line in time to meet the October 1, or really September start date, you know, we were in a world of hurt. And it was very difficult to fill in some of those voids.

And last but not least, a lot of talk about the incredible leadtime people have been given here to meet these regulations and, yet, I am personal witness to a series of meetings over the past several years here in Sacramento between major oil companies -- particularly Chevron -- and management of this organization, as we've gotten closer and closer to the_October, '93 date, questioning whether or not we were going to stick to our guns and keep the rule in place, indicating that they had to know, because they had yet to make their major decision on making the capital investment.

So, I have my own theory that the reason, you know, we -- one of the reasons we didn't get all the blocks on time last fall was perhaps some of the refiners didn't take advantage of all the leadtime and get a fast enough start. And when they tried to crank them up in time for October 1st, we found major mechanical failures occurring in some of the facilities.

So, I don't like to point fingers. We have slogged our way through this thing together, particularly --

I had particularly publicly thanked Chevron for the heroic work that he had done to try to keep everything up and running and to flood the market during the crisis. And we kind of slogged through it together.

But the time has now passed and there's a different view. But everything we did -- variances, extensions, or anything else -- was just to keep the supply barely up with the demand, and to fill the little voids that were being created all over the place, and to address the unfortunate happenstance of having a regulation go into effect during a period of time, which turned out to be a very high ag demand time.

Again, as I said earlier, that's our mistake. We thought the idea of having our regulation start at the same time as the EPA regulation was the right thing to do. That was argued to us, and we concurred with it. And, admittedly, didn't pay attention to what time of the year that really was in California and pay enough attention to the uniqueness of California vis-a-vis the whole federal scene.

So, all of those are factors in why we took all the actions we took to keep the supply up with the very high demand that took place.

MR. LAGARIAS: Thank you.

MR. JESSEL: May I have a chance to say a couple things? I don't want to start an argument between Mr. Boyd and myself. I think there are --

CHAIRWOMAN SCHAFER: Justa moment, please, the reporter needs to change her tape.

(Thereupon, there was a brief pause in the proceedings.)

MR. JESSEL: I have no interest in trying to challenge Mr. Boyd here in public. I agree we did slog through this thing together, and we are very grateful for the way that the ARB did cooperate in a lot of the problems that we had in startup.

But I would like to say one thing, and that is, he didn't mention that everytime we got a variance -- and we got several -- we paid dearly that for that variance in order to make up the difference. The difference was 6 cents a gallon. And that has totaled so far about $9.5 million, which is now sitting in an escrow account, which was originally designed to mitigate the air quality damage that would be done by selling the noncomplying fuel.

So, when I say -- when people say we got a variance and imply that it sounded like we got a break, we don't think we got a break. We had to pay that 6 cents a gallon that your staff says was industry's average cost of production.

CHAIRWOMAN SCHAFER: I believe I did hear that from your testimony earlier.

MR. JESSEL: Thank you. And I think I'll wind it up there, unless there's further questions.

CHAIRWOMAN SCHAFER: Yes, Dr. Boston.

DR. BOSTON: Mr. Jessel, does Chevron have a presence in the San Joaquin Valley? You've heard the testimony earlier; how would you answer some of those supply demands in the southern San Joaquin Valley if something did happen to put the small refiner out of business there?

MR. JESSEL: First of all, let me say that we're not here with the intent to put small refiners out of business. I think the staff and the ARB can choose a rational level of production that they can live with at the 20 percent aromatics rate. We're asking that you not increase that amount beyond some rational number.

So, we don't foresee that this is going to cause a small refiner to go out of business. Even if a small refiner did go out of business -- and, again, that's not why we're here -- the market will take care of it as the market did last October. And when our units got going and other people's units got going and, as Mr. Boyd said, flooded the market -- and you're not coming upon the kind of situation we had last October 1 -- the whole rule, and the EPA rule, and the federal tax increases were all happening at the same time.

The situation just does not exist on the horizon again. So, the market, if a refiner had to cut back, would fill in. I firmly believe that. And we're asking that you, you know, have faith in that mechanism and leave it to us.

DR. BOSTON: Can you give me a real quick education on the difference in making 10 percent aromatic and 20 percent? What's the type of investment needed to get from that stage to 10 percent needed from 20 percent.

MR. JESSEL: You have to answer one question first. And that is, are you talking about a certified alternative against the 10 percent standard versus 20, or a true 10 percent versus a true 20 percent.

DR. BOSTON: 20 percent.

MR. JESSEL: Against a true 20?

DR. BOSTON: Right.

MR. JESSEL: Both would probably require substantial investment in dearomatization. Now, if you compare making a true 10 percent against a certified alternative against a 20 percent standard, the 10 percent would require that substantial investment for dearomatization, but the 20 percent might not. It is possible -- and maybe the gentleman from Kern could confirm, that you could take -- low sulfur fuel now at the current aromatics level -- not change it, add cetane improving additives, and be able to certify against the 20 percent standard.

That would relieve the small refiners of any need to invest the kind of money we've invested in dearomatization. That would leave them only with the investment needed to desulfurize, which they've already made, and leave them only with the extra cost of cetane improver.

DR. BOSTON: Thank you.

CHAIRWOMAN SCHAFER: Supervisor Vagim.

SUPERVISOR VAGIM: Thank you, Madam Chair. Dr. Boston had part of what my question was.

But, in addition, what percentage is your market share? Because much has been made about the unfair advantage. What percentage is your market share now and what was it before the regulation?

MR. JESSEL: That's a hard question to answer. The reason is, most of our fuel is sold to third parties. They're mostly people who contract with Chevron to pick up the fuel. Once they take the fuel, we don't know really who it's sold to, for what purpose.

We didn't know that before the rule; we don't know that now. The only way we could compare market share is if you make the assumption that what we produce is basically what's sold. That is not a good assumption, because much diesel fuel that we produce is shipped out of state. We make a fair amount of low sulfur fuel at our El Segundo refinery, which is exported to the Pacific Northwest where we have obligations to customers there, and to surrounding states.

So, actually, knowing what the market share is is a difficult proposition. Sorry, I don't mean to skirt the question. I know it's an important one, but we have tried to figure that ourselves internally and haven't come up with a good answer.

SUPERVISOR VAGIM: Thank you.

CHAIRWOMAN SCHAFER: Any other questions from Board members for Mr. Jessel? If not, I thank you very much for your testimony this morning.

Is Melissa Chapman of Unocal here? Please, come forward.

MS. CHAPMAN: It might be difficult to make a point that hasn't been made in the last presentation. So, if you hear a repetitive, I apologize for that. I'll try and pick as well as I can.

My name is Melissa Chapman, and I'm a fuels planning engineer for Union Oil Company of California, also known as Unocal.

Before I comment on the proposed revisions to the small refiners' diesel requirements, I want to first express our deep concern that CARB is considering changes to the existing diesel regulation almost a year after its implementation date.

If adopted, this action may have significant implications for the successful implementation of CARB's Phase 2 gasoline regulation.

California refiners are currently spending hundreds of millions of dollars to reconfigure their refineries in order to comply with the Phase 2 regulation. No doubt, many are extremely nervous that the California gasoline market may not allow them to recover the large capital investments required to comply with the regulation.

By continuing to make last-minute revisions to existing fuel regulations, CARB is sending a clear message to California refiners that the regulation on which they are basing their multi-hundred million dollar investments is subject to changes that may endanger those investments.

Concern and uncertainty increase as CARB continues to deviate from a consistent application of the current diesel regulation. CARB must allow the diesel regulation to work in its present form and refrain from upsetting the California fuels market by continuing to propose revisions.

Unocal opposes both of the proposed revisions to the small refiners' diesel regulations. CARB's proposal to allow small refiners to produce 20 volume percent aromatic diesel fuel up to their exempt volume based on the period from 1988 to 1992 is unwarranted from an equity standpoint.

This proposal is also contrary to CARB's stated intent in adopting the small refiner provisions -- to preclude a small refiner from using the less stringent 20 percent standard to increase its market share over that experienced in the period from 1983 to 1987, at the expense of increased emissions.

CARB notes that throughout the staff report that most refiners' production of California -- excuse me -- that small refiners' production of California vehicular diesel fuel in the base years of 1983 to 1987 was substantially greater than the industry average of 65 percent of total California distillate production.

Moreover, CARB states in the staff report that, quote, ". . .the current volume limits for small refiners are substantially less than their base year production of motor vehicle diesel fuel and may actually prevent them from marketing diesel fuel at their historic levels."

It is clear from this statement and the recent release of proposed amendments that the staff knows the actual volume of motor vehicle diesel fuel produced by each small refiner during the 1983 to 1987 base years.

We have asked staff to provide the data used to substantiate this claim; however, we were told that the information was either confidential or not covered by the

Public Records Act.

If the small refiners production of motor vehicle diesel fuel is actually greater than the 65 percent industry average, it may be appropriate to increase their exempt volume to more accurately reflect their 1983 to 1987 base year production.

However, changing the period on which the exempt volume is based in order to reflect a period of overall higher production is completely unwarranted. The original regulation already addresses the potential problem of low production periods during the 1983 to 1987 base years by allowing the exempt volume to be based on the average of the three highest annual production volumes during the five year time period.

Basing exempt volumes on a period of overall higher production clearly allows small refiners to use the less stringent 20 percent standard to increase their market share with a dirtier fuel. It also fails to maintain the fairness and equity of the original regulation relative to the large refiners who invested large amounts of capital and other resources to comply with the stricter standards backed by the understanding that small refiners would not be able to use their less stringent standards to increase their market share over the 1983 to 1987 base period.

Previous testimony has elaborated quite a bit on the advantages that the existing regulation already gives small refiners, so I won't get into that. But we do want to say that this proposal -- if CARB adopts this proposal, it will tilt the playing field even more to the advantage of the small refiner by increasing their exempt volume limit.

Large California refiners have had to scrutinize their investments and upgrades in order ensure a reasonable return on their investments, despite the ever-changing myriad of state and federal regulations.

Small refiners should be expected to do the same. If small refiners have made investments to upgrade their refineries in order to produce volumes of California diesel fuel in excess of their production rates during the 1983 to 1987 base years, they should have done so knowing that they would have to produce either a 10 percent aromatic fuel or a certified alternative formula beyond their exempt volume.

Small refiners' exempt volumes should not be increased at the expense of increased emissions.

CARB also proposes to postpone the effective date of the exempt volume limitation requirement three months, to January 1st of 1995, in order to prevent shortages of diesel fuel during a peak demand period.

Apparently, CARB has determined that there is a risk of supply shortages if the small refiners are held to their exempt volume limitations beginning October 1st of this year.

Again, we have requested data to substantiate this claim, but have been told that it is either confidential or not covered by the Public Records Act.

It is highly unlikely that there will be a supply shortage of diesel fuel in the California market if the three small refiners currently under suspension are held to their current exempt volumes on October 1st of this year.

Excluding small refiners' production, California refiners can produce over 200,000 barrels per day of complying diesel fuel. This is more than enough diesel fuel to satisfy the California market even during a high demand period. In addition, the October 1st, 1994 compliance date neither requires the additional demands of new federal low sulfur regulations nor includes a federal fuel tax increase as did the October 1st, 1993 compliance date.

The diesel market is not under the supply pressures experienced in the fall of 1993 and will not be affected by the small refiners' October 1st compliance date.

CARB also states in the staff report that the extension of the exempt volume limitation effective date is necessary to allow time for market adjustments as distributors and end users look for new fuel suppliers.

Distributors and end users have known since the adoption of CARB's original regulation that small refiners'

20 percent aromatic diesel production will be limited to their historic levels beginning on October 1st of 1994. They have had more than sufficient time to make marketing adjustments and secure fuel from other suppliers. An effective date extension allowing an additional three months to respond to a regulation that has been on the books for over five years is unwarranted.

There's no need to extend the effective date of the small refiners exempt volume limitations.

In summary, Unocal opposes any revision to the existing low aromatics diesel regulation. The California diesel market can be adequately supplied without extending the effective date of the small refiners exempt volume limitations.

Also, any move to allow a small refiner to increase its production of 20 percent aromatic diesel and therefore its market share, relative to the 1983 to 1987 base period, with this dirtier fuel is clearly outside the intent of the original regulation.

It is also unfair to those refiners who invested capital and other resources to fully comply with the environmental intent of the California regulation without the benefit of less stringent provisions.

That's all I have to say. I'm open to any questions.

CHAIRWOMAN SCHAFER: Thank you very much, Ms. Chapman. Are there any questions from Board members? Mr. Calhoun.

MR. CALHOUN: Madam Chairwoman, I guess I'd like to ask the staff a question.

CHAIRWOMAN SCHAFER: Please, go ahead.

MR. CALHOUN: We keep hearing reference to the 65 percent volume. Is the total exempt volume from all the small refiners different from what was originally adopted?

MR. SIMEROTH: Mr. Calhoun, the total exempt volume depends upon the number of small refiners and their historic production rates. So, as the small refiners go out of business or stop producing motor vehicle diesel fuel, the total exempt volume pool will go down.

MR. CALHOUN: I understand that. I guess what I had reference to was at the time when the original regulations were adopted, is the total volume at that time substantially different from what you're proposing today?

MR. SIMEROTH: I'm sorry. I answered the wrong question.

In 1988, when we adopted -- the original staff proposal was 55 percent. At that time, at that 55 percent factor, we estimated tha the exempt volume would be 19,000 barrels with an unknown quantity that Powerine could be expected to produce, because Powerine at that time was shut down, but was expected to come back into operation.

If you take the 19,000 and correct it to 65 percent, assume a reasonable volume production for Powerine, you'd be in the neighborhood of the 25,0000 barrels a day that you heard earlier in the testimony from Mr. Moyer.

MR. CALHOUN: So, in effect, the total exempt volume that you're suggesting here isn't substantially different from the 25,000 barrels based on the original regulation, right?

MR. SIMEROTH: Mr. Calhoun, that'd be correct when you make all the corrections to calculate that number.

MR. CALHOUN: So, then, I guess the question I'd ask you, Ms. Chapman, is the concern that you expressed about fairness -- did Union Oil Company make its decision based on the original 28, 26,000, 25,000 barrels, or based on a moving market, what you thought the market would be?

MS. CHAPMAN: Well, I think, you know, there was a series of decisions that were made. And each time, the market was looked at, and who were the players in that market. And each time, we looked at the volume that each specific small refiner was able to make and the market that each ne of those small refiners was serving.

So, I agree or I understand that the total volume has not changed, but if you looked at the volume that each small refiner is allowed to make, that has changed considerably.

MR. CALHOUN: Thank you.

CHAIRWOMAN SCHAFER: Thank you, Mr. Calhoun. Are there any questions from Board members for Ms. Chapman? Yes, Ms. Edgerton.

MS. EDGERTON: I just wanted to thank you for your excellent presentation.

MS. CHAPMAN: Thank you.

CHAIRWOMAN SCHAFER: Thank you very much.

I'd like now to recognize Carolyn Green of Ultramar.

Good afternoon.

MS. GREEN: Good afternoon, Chairwoman Schafer, members of the Board. My name is Carolyn Green. I am the Director of Government and Public Affairs for Ultramar, Inc.

Unlike many of the people you've heard before you, we are not a small refiner and we are not a major refiner. We are an independent, and that puts us in a unique position, because right now, we are the only independent refiner in California subject to this rule, particularly the 20 percent provisions.

You do have our written testimony in front of you. The only item I particularly want to call to your attention in my oral remarks is the fact that, when the exempt volumes were determined back in 1988, the production and sales in

California were taken into account.

The proposal does not do that now. So, what you really have is the potential for a refiner who may have ben exporting some of their product, now to use their entire California capacity for use in California.

And then they could expand their capacity to export additional amounts, which could, in some instances, result in their exceeding historical volumes in California. And we think that that is something that was unintended in the staff's proposal. We don't think the staff proposal is appropriate anyway, but there is that potential.

The other comments that I would like to make are really to point out that it seems that this debate is centered around keeping an industry, i.e. the small refiners, whole.

But the reality that you're talking about is that you are looking at a volume that was produced by 13 or 14 refiners. And now what you're being asked to do is give three refiners that entire amount. And at least two of those refiners are direct competitors of Ultramar. We are not like a lot of the other major refiners. We do sell in the independent market. And, in fact, our historical volumes are the same or smaller than the suspended volumes.

For example, Paramount's suspended volume is 11,700 barrels a day, which is approximately the same as our historical production.

Powerine's suspended volume is 15,600 barrels a day, which is larger than our capacity, not just our historic production -- our capacity. So, what you're looking at here for us in particular is an opportunity for us to lose market when we're playing by the rules. Somehow, we don't understand the equity there, and we would like you to look at that issue. And we agree with the other speakers that there is no reason for the changes that staff is requesting.

Thank you very much.

CHAIRWOMAN SCHAFER: Thank you, Ms. Green. Are there any questions from Board members?

Yes, Mr. Lagarias.

MR. LAGARIAS: Ms. Green, you are pointing that the small refiners shrank from 13 to about 3 as a result of their decision to go out of the diesel market.

MS. GREEN: No, they did not shrink from 13 to 3 as a result of their decision to go out of the diesel market. They shrank from 13 to 3 as a result of other market issues. Diesel may have been one of them, but they shrank because of their plants were not technically -- technologically advanced. Their operations may not have been efficient. There are a whole host of reasons. It's not just the diesel issue.

MR. LAGARIAS: Thank you. I stand corrected.

But at the same time, some of the majors also, for whatever reasons, left the diesel market as well. Is this not correct?

MS. GREEN: That's absolutely right. And they're not asking you to make adjustments to take that into account.

MR. LAGARIAS: Where do you think their market share ought to go from those major ones? Do you think that ought to be -- if you're making the point that the independents -- remaining independents are asking for the quantity we identified for independents, then the same argument can be made that the majors should be taken over, which they would if they could, that market share of the diesel that the major -- those major companies left. Isn't this not so?

MS. GREEN: They are not asking you to give them that market share. They're doing what they need to do within the context of the existing rule. And that's the issue here.

MR. LAGARIAS: Well, it was market share that was brought up. What do you think should be done with a market share of those organizations that no longer supply the diesel market?

MS. GREEN: What we are saying is that the Air

Resources Board ought to be regulating air quality. They ought not to be regulating the market. And that's being asked to do. You're being asked to regulate the market, which we think is inappropriate for this body to do that.

An earlier speaker said that the overall fuel market is the purview of the California Energy Commission. Why not have them go there?

MR. LAGARIAS: I agree that our primary charge is to maintain and improve air quality; at the same time, we have to consider equity issues in doing that. And we are in a dilemma, and we tread very cautiously when we look at anything that affects the marketplace.

But our primary concern is to improve air quality.

CHAIRWOMAN SCHAFER: Are there other questions for Ms. Green? Yes, Ms. Edgerton.

MS. EDGERTON: I just got your written comments as I sat down this morning, and I've been listening to some other folks. And I just wanted to understand better why Ultramar, from what you say, since the volume is -- why, as a technical matter -- you just don't quality as a small refiner, but --

MS. GREEN: No.

MS. EDGERTON: Where do you fit? I still don't --

MS. GREEN: Two issues. One, the technical issue is in the way the exempt volumes are being defined. One was based on California production for sale in California. Now, what it's being based on is overall production capacity.

It's not looking at what volumes may have been, in fact, exported out of California. So, you're not looking at the same potential volumes now. That's the issue we raised.

But beyond that, whether or not these provisions would advantage Ultramar, we philosophically oppose changing the rules of the game in midstream. It sends an ominous signal that you an come in and chip away at the outside of a rule until, at some point, you have no rule and we have no certainty, and everybody gets more cynical about the process.

MS. EDGERTON: Ms. Green, you, with your considerable experience -- I happen to know of it, because we're both in the Los Angeles area and I know of your experience -- I would be very interested in your view -- obviously, you've given this a lot of thought from your company's point of view. Air pollution regulations, which you were with the South Coast for some time and know that very well, and some of the consequences of economic burdens on how they fall with different -- on different industries.

What would you -- where do you think consideration of the economic effect on the small business should fit in the consideration of a regulation? I'm asking you personally, because I have a lot of respect for your experience. You've been in private and public sector.

MS. GREEN: I think there are two places. One is when the rule is adopted, it ought to take into account cost-effectiveness of the rule and the differential cost-effectiveness of imposing the same requirements on a large or a small business. Because it may -- it may, in fact, be different.

Secondly, it ought to take into account ability to pay, and that's -- because no matter how cost-effective it is, it may put someone out of business. And that is one of the considerations that your Board takes into account when adopting a rule or regulation. It certainly was one of the important aspects of the South Coast's process.

And, then, later on, when you're looking at the way the rule is working in fact, there may be, based on new information, there may be some -- some justification in making some minor adjustments, to the extent that that rule itself is causing the concerns.

But we have here are so many factors that are influencing what's happening in the small refiner market, that staff has not made a case that this rule specifically is the cause of the woes that you're being asked to address.

And, so, I'm just not sure that there's a real problem that this rule is solving.

And that's what our -- one of the things that our testimony said. What is the problem here? What's the real problem that you're attempting to solve? You've heard a number of people cite different issues, because it's not clear.

CHAIRWOMAN SCHAFER: Are there any other questions from Board members for Ms. Green?

Yes, Mr. Parnell.

MR. PARNELL: Well, of the staff. If I understand, the exempt volume under the prior regulation was "X," 25 million barrels, or whatever that number was. There were then 14 independent refiners. Today, there are four. And we're redistributing that among them. Am I misunderstanding something here?

That seems to be a real distortion if that's occurring.

MR. SCHEIBLE: No. When the Board adopted the rule, at that time, when you pooled all the barrels produced by the small refiners, and you figured out the exempt volume, and you anticipated Powerine coming back on line, you calculated something in excess of 25,000 barrels of fuel at 20 percent could be made under the regulation.

And that did not accrue to the industry. It simply is the total of all the individual pieces. So, at that point, the Board decided that it was willing to give up the environmental benefits of 10 percent fuel for that volume had all those refiners stayed in business and produced.

So, today, what we have is a situation where many of those refiners are no longer in business; therefore, they no longer can use their allocation. And if we increase the allocation for the remaining refiners, we still won't go above the level that the Board originally contemplated might occur had all those stayed in place.

And we don't view any action we're taking here as allocating market share or whatever. We're trying to figure out what's the right level to allow the refiners to reasonably operate at and compete in the marketplace.

MR. PARNELL: Thank you for that. But the effect of, even though our eye was on environmental effect -- and what you say is true with respect to environmental, the bottom line is that the effect of what will be done is a redistribution of that volume to three or four, which was historically 14. And then, with respect to the other comment that was made that's a concern to me, that this has no -- is not addressing the issue of fuel sold in California.

That seems --

MR. SCHEIBLE: With respect to the fuel sold in California, of the three small refiners and what they have reported historically to the California Energy Commission is that they don't show any exports. And we'd have to go back and verify that. But they basically, for those three actors, it appears that almost all of the fuel that they produced in the diesel market was sold in the California market and was not counted as an export.

In terms of what the final market share will be, I think we found out that the suspension volume, for example, in a time of shortage, when -- in October -- the small refiners produced at close to their suspension volumes. Once the shortage was over in November-December, their volumes dropped down.

So, the fact that they have a certain allocation of 20 percent fuel doesn't mean that they will be successful in selling that amount of fuel. It just means that, if they are successful in selling fuel, they can sell that amount -- up to that amount at 20 percent.

If we restrict it at a lower level, it means that they can sell much less than the production that they've been able to achieve even before the rule went into effect at 20 percent. And then they will either have to market outside the State or find a way to produce 10 percent or 10 percent equivalent fuel.

CHAIRWOMAN SCHAFER: Supervisor Bilbray.

SUPERVISOR BILBRAY: I think we've got to recognize, too, the earlier testimony, that the baselines on certain companies were artificially low because of the economic problems. So, as we get into this situation, you had, you know, you had a grossly depressed economic situation as a baseline, and then -- which probably contributed to some degree, either indirectly, in this whole configuration of why we end up with what we've got now and the number of operators.

So, I think this thing sort of balances itself out when looked at from the economic point of view, because the environmental may be there, but you obviously have an artificially low baseline that we originally projected on, because we weren't aware that there were certain economic factors that had driven that price -- I mean those numbers just so far down at that time. Thank you.

MR. LAGARIAS: Madam Chair?

MS. GREEN: I do have one question, and that is related to the comments about being able to market a 20 percent fuel.

If a small refiner is not able to produce a 20 percent actual or equivalent fuel by October 1 of '94, and this -- these amendments are adopted, would they then seek a variance for their exempt volumes now or that much higher volume?

CHAIRWOMAN SCHAFER: I don't believe I can answer that question. I don't know that the staff can project an answer to that question.

MS. GREEN: Well, the --

CHAIRWOMAN SCHAFER: But I can understand why you would have it in mind. I just don't think we can resolve that today.

MS. GREEN: Well, that's a real concern, because then what some of the other speakers have alluded to is exactly what winds up happening. You have even greater volumes of noncompliant (sic) fuel on the market, and kind of in anticipation of some questions. It is very difficult. It is not a straight process or straight extrapolation to produce 20 percent fuel, especially a 20 percent certified as opposed to a 10 percent.

There are differences in fuel. There are -- it's almost impossible to find blendstocks, et cetera. We have not certified a 20 percent fuel yet. We have spent probably half a million dollars so far developing reference fuels, and candidate fuels, and testing them, et cetera.

So, based on our personal experience, it is going to be difficult to certify a fuel. And, so, the question of what happens in terms of a variance and -- what you're really talking about -- in terms of volumes that are out there on the market that don't comply with either a 10 percent or a 20 percent, is a real issue from our perspective.

We will not be in the market until we certify a 20 percent fuel, and because we're playing by the rules. And we think everyone else should, too.

CHAIRWOMAN SCHAFER: Mr. Calhoun.

MR. CALHOUN: May I ask the staff to comment on that? The point that Ms. Green made is that, in the vent that some of the small refiners could not meet the production date and sought a variance, would the variance be limited to what is currently on the books or this proposed volume change?

MR. KENNY: It's difficult to specifically respond to the question, other than to simply say that the small refiners who are not in compliance on that particular date would obviously have the right to apply for a variance.

But the resolution of that particular variance, in terms of the -- whether it was given or any conditions associated with it being given, would be dependent upon the individual facts that were associated with the application.

CHAIRWOMAN SCHAFER: Ms. Edgerton?

MS. EDGERTON: This is related, actually, to the question I wanted to ask.

You and a number of the large oil companies have raised a concern about the precedent this would set with respect to the stability of the reformulated gas specifications we've set for 1966.

MS. GREEN: '96.

MS. EDGERTON: 1996. 1966 was a good year, but I actually do know it has passed.

Is the kind of scenario that you just painted the kind of thing you're worried about? Can you be more specific? I can think of some things that are analogs. But what is specifically -- as specific as you can be -- the worry about what this -- what message this sends about the reformulated gas specifications? Because they're two different sets of regulations.

MS. GREEN: The specific worry is that people will do two things; one, just keep carping at the regulation -- not necessarily at its heart, but at its arm and its leg. And, at some point, you have a useless body that can't function, one.

Secondly, though, the concern is that people will make business decisions to place the odds and not make those investments that they need to make because they're gambling on you bailing them out by relaxing something here or there until the net effect is that you've gutted the regulatory process.

CHAIRWOMAN SCHAFER: Thank you very much, Ms. Green, for your presentation today.

MS. GREEN: Thank you.

CHAIRWOMAN SCHAFER: Mr. Lagarias, you had a question for staff?

MR. LAGARIAS: Yes. This question of allowing the independent refiners to have market a 20 percent cap aromatic fuel, one of the issues is how long is that going to go on? Is that going on in perpetuity or what's the story?

Now, as I understand it, some of the alternative reformulated diesel fuels to meet the 10 percent limit actually exceed a 20 percent aromatic fuel content; is this correct? Or may exceed.

MR. SIMEROTH: Mr. Lagarias, some of the formulations do exceed. I can't go into the details, because they're asked to be asked to be held confidential.

MR. LAGARIAS: Well, if that's the case, wouldn't it make sense to look at how the independent producers can make an alternative reformulated diesel fuel that may exceed a 20 percent content, but be in compliance with our 10 percent fuel regulation? Sometime in the future, could you look into that so that we can sunset or eliminate this disparity between the 20 percent aromatic content allowed the independent producers and the 10 percent, or reformulated fuel formulation, that the larger producers have to meet?

MR. VENTURINI: Mr. Lagarias, if it's your desire and the Board's ultimate desire that we look at some appropriate time at whether or not, in essence, a sunset provision should be applied, I think we would certainly be willing to conduct that analysis. And over the next few years, the small refiners will be dealing with what they're going to do to comply with the reform regulations, and we'll have much better information on what their situation is in that regard as well.

MR. LAGARIAS: Thank you.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Lagarias.

As I think is already evident, I intend to continue to hear witnesses, with the hope to try to conclude prior to the time that Board members need to depart.

I would like next to recognize Mr.Glenn Lingle of Paramount.

MR. LINGLE: Madam Chairman, ladies and gentlemen, my name is Glenn Lingle. I'm president of Paramount Petroleum. We also have in the audience the owner and chief executive officer of Paramount Petroleum.

You've asked many people today that's come to this podium what do you do with the corporation that you're speaking for.

The reason I'm here and the reason that the presidents of all three of the independent refiners are present is not the fact that we will have a restructuring or some other matter. If we cannot resolve this issue to what we think is a fair and equitable solution, you will not have to worry about most of us being around to talk to you much longer.

So, we think this is extremely important. I have some very competent people that work for me. But we wanted to make sure that we got the very best representation to the Board as possible to give you our side of the story.

I've heard a lot of comments. Ms. Green made some very good points. I would like to address a few of them in bullet points. I'm not going to get specific.

I think most people here should understand that when we talk about giving the independents a break and giving them this, giving them that, you all have -- as of now, if we want to look at this as a monetary value, the Board has not given the independents one thing. We're here today asking for volume so that playing field is level, and we have a right to compete for the diesel market in the State of California.

That's what the bottom line comes down to. Individually and collectively, we have spent more money, on an average, to get to where we are today to try to comply with 20 percent aromatic equivalent diesel than the majors have in marketing 10 percent aromatic equivalent diesel.

Therefore, we are not asking for a subsidy. We're not asking for anything else. We're asking just level the playing field.

Most of ladies and gentlemen do not understand the workings of a refinery. I've heard many of my counterparts in the business from ARCO, and Texaco, and Chevron talk about that they have 215,000 barrels of diesel available to make CARB diesel with. They show our little numbers down there, possible 11,000, possible 16,000, possible 23,000.

The other side of the coin, and if we could discuss this -- we're not going to get into it, but to the gentleman, if we had a -- for instance, ARCO L.A. refinery that's in the same situation today that the Wells (phonetic) Texaco refinery's in; is Chevron going to make 90,000 barrels of diesel that they say they can make, or are they going to get out and make that -- taking their units and their refinery and converting that to 90,000 barrels of gasoline to opt in, because ARCO couldn't supply their market (sic)?

A lot of people have a lot of capacity, especially majors. They have units that are high pressure hydrocrackers. By doing this, they make low aromatic diesel stocks, and they can swing their barrel around dramatically between gasoline, jet fuels, and diesel. Independents do not have the luxury of having this type of scheme for our refineries.

Ms. Green of Ultramar made the statement that they put their money where their mouth is; that they spent up to half a million dollars testing. We passed a half a million dollars a half a year ago in testing. We're not only testing, we're developing an additive package that we think is going to be revolutionary to the hydrocarbon market in the United States and the world, not only the State of California.

It not only reduces NOx, CO, and the rest of it, it reduces everything. It looks good. We expect, unequivocally, to have our diesel certified before October 1. We've been working on this very diligently now for over 15 months. We have not put off and defrayed costs or anything else waiting to see if we can get in here and convince the staff of CARB, will you give us another free ride.

I've been president of Paramount Petroleum now for nearly eight years. During that eight-year period, we've been out of bankruptcy two and a half -- two. During that period of time, it started in 1989, December, in bankruptcy, right out of bankruptcy. I started squeezing enough money to start making the necessary modification to our refinery so that we could qualify for the suspension volumes that we got in 1993-94. We spent literally millions of dollars squeezed out of a Chapter 11 budget to comply with these things.

I wish that I -- I have worked for majors, by the way. I was a refining expert for the Kingdom of Saudi Arabia for 12 years, built six grassroot refineries in Saudi Arabia, the best in the world. I know the major side. I've had the purse so full you couldn't pick it up.

On the business side, you get much more -- much more down to earth and you run leaner and meaner to survive.

I wish we had the luxury -- as the gentleman from Chevron says, "We got to restructure." And you look at Amoco says they're restructuring. Texaco says they're restructuring. All this tells me is they got so many people they can make money despite theirselves.

We're down to 200-and-some people running a 46,000 barrel a day refinery on about seven, eight different feedstocks. And that's lean and mean.

The last point is -- I want to make here is that-- I don't want to take up a lot of time. Paramount Petroleum, in 1988, in 1989, our fixed and variable costs were approximately $3.00. That's supposed to be confidential, but we're going to put that out. Since then, we have drove that down dramatically, because we have asked of our employees to do two jobs or a job and a half. We've got to survive in a market that's bitter. They have responded by doing that. We haven't put on enough people to tell you. We've had to add a few in the environmental section just to keep up with the paper work.

What's killing us is our cost is gone up 50 percent to maintain the same level of payments we must make for process safety management, for RECLAIM program, for Rule 2281, for Rule CCR 2282, for Clean Air Act amended in 1990. I'm spending -- one-third of my budget now is not fixed or variable, because each year I have to add in these other pieces that's above and beyond and put out special effort to do it. And the only way I can do it is take that piece of equipment down there and run it to its maximum capability. We thank the staff. They have been open.

We have supplied them tons of data. I've heard many people question the costs here today. If they've got any different numbers, I'd like to look at them, because we've dug through everything we could think of.

What I'm telling you is they've worked hard and they've worked diligently, and we think they've come up with the best suggestion I think they can do. We thank them for it. And we thank the Board for the time and energy to listen to us.

But I'm telling you we cannot survive if you don't give us the same type of deal, a right to compete, running our equipment at a hundred percent as the majors can.

I know the majors' making 10 percent, and we make a 20. But I have paid more money, and more time, and more effort to get to this 20 percent than the majors have to get to their 10. Level the playing field and you'll keep three independent refiners.

Thank you very much.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Lingle. Do Board members have questions for Mr. Lingle?

SUPERVISOR VAGIM: Madam Chair?

CHAIRWOMAN SCHAFER: Yes, Supervisor Vagim.

SUPERVISOR VAGIM: Yes. The supply seems to be the biggest issue at this particular point. Can you speak to the supply, particularly in the areas where there doesn't seem to be a heavy influence on the majors -- from the majors?

MR. LINGLE: Paramount. I can't speak for Paramount. I can't speak for the others. We find that our supply issue goes -- a heavy percentage of it goes out to customers that are going south towards San Diego into the farming area, down in that area, and into the Imperial Valley. We're about the closest thing around. Powerine's over there, but they seem to have maybe a little -- and he's going to speak here in a minute, and he can address that.

But we see a lot of our customers coming in. And during the last year perceived diesel crisis -- it caused a lot of upset. It shouldn't have happened. But we got a lot of customers out of the San Joaquin Valley, also. We think that most of our customers, most all of our customers are independents, small independents. Our credit standards and the rest of it, we don't have as high as the Chevrons, and the ARCOs, and other people. And people can come in and qualify to get terms with us better than they can from majors generally.

SUPERVISOR VAGIM: Well, one of the issues, though, that was laid out by the smaller refiners and their folks that spoke and supported their point of view was the fact that there are areas where there's a supply crisis.

MR. LINGLE: It is.

SUPERVISOR VAGIM: And this is really to fill the gap of that supply problem.

MR. LINGLE: If you'd drive through Sacramento -- I'll say Sacramento; I haven't driven through it that much. But I can take you to L.A., and I'd drive you 20 blocks. I'll show you four different independent suppliers. Every one of them had their costs down from 3 to 6 cents under any major in town. If these four independent suppliers vanish, those costs on those majors -- I can't say they're going to raise them, but I know that they're not there because the independents decided they'd just be three or four cents cheaper.

There's always a balance. And people -- I have learned in my lifetime -- I've been in this business 26 years, been all over the world many times. I find if you give people a chance, they want to make a good return on their investment. And it seems the better return they get, they feel like they should get a better return on the investment. And all of us would like to have investments that bring back every six months a return. That's a good return on investment. And we can't do it, unfortunately, because we have competition out there that keeps us from getting that type of return.

SUPERVISOR VAGIM: Yeah, when we speak to price. But I'm talking about supply. And they're interrelated.

MR. LINGLE: That is the same thing.

SUPERVISOR VAGIM: Okay. I know they're interrelated. But the fact of it is, no matter what the price is, if the fuel isn't available, that's a whole different animal.

MR. LINGLE: Fuel is available. It's going to be like this gentleman farmer here today who spoke. It doesn't matter any difference what anything else is -- he's going to lose his crop. It's going to rot in the field. He's not going to have stuff to run his tractors with. That's why we had people driving from the middle of San Joaquin and from Frisco to Paramount Petroleum, which is a long drive to get a truckload of diesel back last October, November.

SUPERVISOR VAGIM: One of the issues that they're pointing out is that they would protect that by having the ability to produce --

MR. LINGLE: (Interjecting) That's right. If we wasn't there, they wouldn't have got the diesel.

SUPERVISOR VAGIM: Okay. But what they're saying is that, if they don't have the ability to elevate that, that crisis could happen again.

MR. LINGLE: Absolutely. I agree. I know that the majors --

SUPERVISOR VAGIM: Wait. Now you're kind of speaking for the modification, though, is what I'm saying. I mean, the modification is allowing more fuel supply.

MR. LINGLE: That's what I'm asking for more.

SUPERVISOR VAGIM: But you're an independent, and you're saying you want to have an even playing field.

MR. LINGLE: It is an even playing field. The even playing field is 20 plus 10. We put the money out; they put the money out. We put the effort out; they put the effort out.

SUPERVISOR VAGIM: So, you don't have a problem with the rule right now, then.

MR. LINGLE: No. What they have -- what they have suggested, I've said they've done very good work. I think, and the only thing that I'm asking for is we're allowed to make a hundred percent of our production in 20, and the majors make a hundred percent of 10.

SUPERVISOR VAGIM: I see. So, you want the independents to be in that group.

MR. LINGLE: That's right.

SUPERVISOR VAGIM: I see.

MR. LINGLE: That's level. I've spent as much money as they have or more.

SUPERVISOR VAGIM: Well, you make a point. Thank you.

MR. LINGLE: Any other questions? Thank you very much.

CHAIRWOMAN SCHAFER: No, thank you very much, Mr. Lingle.

And, finally -- well, actually, there's two more witnesses. Mr. Gualtieri of Powerine Oil. Are you here Mr. Gualtieri?

MR. GUALTIERI: Good afternoon, Madam Chairwoman, members of the Board. I've been changing my presentation to cut it down. I changed morning to afternoon. And I thought I might even have to change it to evening.

My name is Al Gualtieri. I'm president of Powerine Oil Company, which operates a 49,500 barrel per day refinery in Santa Fe Springs.

The special provisions for the small refiners in the current regulation may have seemed appropriate at the time the regulation was adopted in 1988. But in retrospect, these provisions would have allowed Powerine and the other small refiners -- would not have allowed us to remain competitive. It is very clear today that these provisions did not work; since the regulation, as it is now written, would restrict the operation of the Powerine refinery and make our business uneconomical.

When the original regulation was adopted, no one here in Sacramento on the Board, on the staff, and certainly in the refining industry had any ideas of the magnitude of the changes that would have to be made in the refining industry to comply with all the regulations affecting not only the fuel quality, but compliance with the numerous environmental, safety, and health regulations that have been adopted in recent years by various agencies.

These changes have required all of us in the industry to make very large capital investments and the production costs for all of the refineries, large and small, have increased significantly.

You've already heard from the large refining companies that they, to remain economical, have been going through major restructuring programs in their companies, including significant reductions in their organizations, as well as closing down or selling off what, in my view, is some of their less efficient refining operations.

As a small refiner, we did not have another facilities to dispose of, and our organization, which has always been very lean, we did not have the staff reductions to try to reduce our operating costs.

The one change that all refineries, both large and small, have experienced recently to make us more economically viable is that all refineries today are running at their optimal capacity utilization.

As we speak and, as you saw earlier, the refining industry is now operating at well above a 90 percent capacity utilization rate. These changes in the industry have happened because of the large capital investment requirements and the high operating costs that refiners are faced with today.

The only way refiners, large and small, can be economically viable is to operate at heir optimal capacity utilization.

The diesel fuel regulation adopted in 1988, could not have anticipated these changes; and, therefore, these changes were not given consideration when the regulation was adopted. Powerine and other small refiners have been meeting with the CARB staff for the past year to ask them to consider changing the regulation to allow the small refiners to have an exempt volume based on each refiner's diesel production capacity when it is operating at its optimal capacity utilization rate.

To restrict Powerine and the other small refiners to historical diesel production in a period when these refineries were operating at 20 to 30 percent below their optimal rate, would cause our refineries to operate uneconomically, which has the very real potential of closing our businesses.

At a time when California is trying to recover from a very deep recession, the loss of these small refiners to the economy would be significant. Powerine alone employs over 400 people in its refinery operation, plus another hundred contractor personnel. And the loss of these jobs in Southern California would be a significant loss to the economy.

The facility that Powerine constructed in 1993 to produce a lower aromatic diesel fuel, contrary to what you heard from some of the larger refiner representatives here, required an investment of our company of over $7 million. Our diesel fuel processing unit can only produce a 20 aromatic volume percent diesel fuel at the present time. We are not in a position to make more investment in our diesel manufacturing facilities to produce a lower aromatic diesel fuel, because all of our resources at this time are committed to producing reformulated gasoline to come into compliance with process safety management, the RECLAIM regulations in Southern California, and a lot of other compliance projects that have to be met because of agency rule changes in our industry.

If we cannot sell our diesel fuel in California, we will have to reduce our production or capacity utilization. We do not have the opportunity to move our diesel fuel into other marketplaces outside of California. We do not have a retail marketing network, which would allow us to sell our diesel fuel, even though it meets EPA quality specifications, in the surrounding states.

We don't have the capability to export our diesel fuel to markets outside of the region. Whatever diesel fuel we manufacture will have to be sold in the California marketplace.

If our operation is restricted in its CARB diesel fuel production to the volume contained in the current regulation, the company would have to reduce its production to the volume contained in the regulation, and the production of the overall refinery would be significantly affected to the point that our operation would not longer be economically viable.

Over the past year, we have provided the CARB staff information on our operating costs, our capital investments, our capacity utilization, or historical diesel fuel production in order to convince the staff that a different methodology for determining the exempt volume is more appropriate than the provisions in the current regulation.

The proposals before the Board today certainly go a long way toward achieving what Powerine believes is a fair and equitable change to the regulation. I do want the Board to know, however, that these changes will still have a restriction effect on Powerine's operation and cause us some economic penalty. We would have liked to have seen a higher capacity utilization factor than the one that is proposed.

Recently, our sales of CARB diesel have averaged over 13,000 barrels a day during periods when the market was not being -- the demand on the marketplace was not being met by the production capability of the industry. Under the CARB proposals today, our exempt volume will be reduced to a very much lower volume than what our production capacity has been during the past year. So, there will be an economic penalty to our company.

However, Powerine does support these amendments, since they are certainly an improvement over the current situation for the company, and they will afford our company an opportunity to remain competitive and economically viable as a California small refining company.

The increase in volume being proposed for the exempt volume of diesel fuel for Powerine and the other small refiners does not provide us with any kind of a competitive edge compared to the larger refining companies.

We're not guaranteed any market share. We're simply afforded an opportunity to compete in the California marketplace, and nothing is being changed as far as that competition is concerned.

We, as a small refinery, continue to have to deal with the economy of scale effect that occurs in our industry. As a small refinery, we are always investing on a per barrel basis, and our operating costs are much higher on a per barrel basis than the costs for the larger refining company.

For these reasons, granting us a higher exempt volume by adopting these proposals does not give us a competitive edge compared to the larger refining companies. It simply gives us an opportunity to remain competitive and economically viable in the California marketplace.

One last point that I know has been raised by some of the larger refining company representatives here today, Powerine is in a position today to produce a 20 percent aromatic diesel fuel, and we will be producing a 20 percent aromatic diesel fuel on October 1, 1994.

Thank you for the opportunity to make this presentation to you today.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Gualtieri.

Are there questions from Board members for Mr. Gualtieri? If not, thank you very much for your patience in appearing so late in the day.

I also understand Evelyn Parker-Gibson of CIOMA is here to make a presentation. Would you like to come forward now?

MS. PARKER-GIBSON: Thank you very much for the opportunity to comment on the proposed amendments to the small refiner volume limits for protection of diesel fuel.

My name is Evelyn Gibson, and I'm the regulatory affairs director for the California Independent Oil Marketers, CIOMA is probably how you've heard of us most often.

CIOMA represents approximately 500 petroleum distributors who operate throughout the State. Diesel's an extremely important part of their businesses. Most of them sell to commercial, agricultural, or governmental users of diesel fuel.

And Mr. Jeffries, who spoke earlier today, is one of our members. He gave you a pretty accurate picture of what they do.

Given the importance of this product to our members, CIOMA has an intense concern about sufficient supplies of diesel being available when and where they're needed.

To have a sufficient supply, we believe that oil refiners who are currently producing diesel in the California market must continue to produce it. Furthermore, they must produce diesel in the quantities that they're currently producing. Without all of these suppliers producing at the capacity -- at that capacity, supply and distribution problems are inevitable. They may not happen all at once. They might not happen in the predictable way, but they will happen periodically.

The critical question we think today that you need to address is how concentrated do you want the diesel supply in the California market to become?

The small refiners who are the subject of these proposed amendments are a key part of the supply picture. Without their presence, our members would not be able to supply all of their customers' diesel demands. Certainly, the large and independent refiners produce a substantial and needed quantity of the State's diesel supply, but small refiners frequently are the marketers' only source for diesel in some of the rural regions of the State and when disruptions occur at the larger refineries and force a stop in production.

And I think what Mr. Jeffries referred to earlier today is a good example. During the diesel crisis, when he went to Texaco to get his unbranded supply, he wasn't able to get it. So, he had to go to Kern and get more. And as Mr. Lingle also alluded to, many of the San Joaquin independent marketers ended up driving to Los Angeles or all the way to Sacramento just to pick up fuel and ship it back down to the San Joaquin Valley in order to fill the needs of those customers.

We have only to look at the introduction of the low aromatic diesel regulation in October, 1993, to see how fragile the balance between diesel supply and demand is, and to realize how important these small refiners are to ensuring adequate supply or in filling gaps between supply and demand in emergency situations.

We support the proposed amendments that will enable these small refiners to continue making quantities of diesel above the original limit.

CIOMA is very much concerned that either -- that the proposed amendments still will, however, force small marketers to make production choices that will take needed gallons out of California and move them to other states, or that will force them to shut down entirely.

Therefore, we're urging the California Air Resources Board to allow these small refiners to produce up to a 95 percent utilization rate, which I think is somewhere equivalent to that 25,000 barrels per day figure that we've been talking about all day. My figures could be wrong on that.

It is important to note that, since the adoption of the regulations, as we've also talked at length about, we've lost 10 small refiners here in California. And that loss has been substantial.

Our marketers have relationships with many different kinds of suppliers. And when one of them goes out, it's often some period of time before they can develop another relationship with another supplier to take their place and to get the fuel that they need to serve their customers on an expedient basis.

These regulations were not adopted with the intent of concentrating refining to only a handful of large and independent refiners, with a few small refiners remaining. But that has been the inadvertent result.

California can't afford further concentration of petroleum refining and continue to have an adequate balance between supply and demand. We must acknowledge the investments that these remaining small refiners have made to make cleaner fuels, efforts that they have made at great cost and a substantial business risk, and allow them to remain competitive by making 25,000 barrels per day or that

95 percent utilization rate, whichever is the most appropriate figure to cite.

There is also another issue that hasn't really been discussed very much today that will affect supply and that we're very much concerned about. When production of reformulated gasoline begins, large and independent refiners may be forced to choose production of gasoline over production of diesel. For large refiners in particular, diesel production has traditionally been a byproduct of gasoline production.

The refining process for diesel has become more complex with the implementation of the low aromatic diesel regulation. And it now competes with gasoline for some refinery processes.

As gasoline production also becomes more complex under the reformulated gasoline regulations, some refiners may reduce their diesel production levels in order to make the amounts of gasoline they really have to make.

This is a forced choice between -- this forced choice between making gasoline or diesel will affect the remaining independent refiner. We also consider Tosco -- even though they're now really sort of acting as a large refiner, they also are an independent refiner of sorts. And they, too, will be forced to make this kind of decision -- gasoline or diesel -- which is the product they can best afford to make?

Since both of these independent refiners have a retail -- have retail branded gasoline stations that they must supply with gasoline, they will have to devote some refinery capacity -- not significant refinery capacity -- to making gasoline.

This gasoline production could come at the sacrifice of diesel production. And if you remember from October, these two independents were often the fill-in factor. They were the two who would make the gallonage of diesel that needed -- was needed to keep the supply and demand balanced.

Without them making sufficient supplies of diesel, if they choose to make more gasoline because of their refinery configuration, then you only have the small refiners left to fill the diesel demand. And that's a really critical thing that you need to weigh.

This is not a stagnant regulation, just a single thing that you're doing. This is one of a whole spectrum of regulations that you're doing to affect how fuel is made in California. And it will certainly have a big impact on the industry overall.

Again, we need these small refiners who primarily make only distillate products, mostly diesel, to remain operational at their highest capacity to keep diesel supplies and prices stable.

The variances that were issues during the emergency shortages of the last -- last fall may not work if you don't have the small refiners here, and if the other refineries, who are producing both gasoline and diesel, are forced to make decisions where they focus more on gasoline rather than gasoline and diesel production at the same time.

Undoubtedly, the first comment or question -- and we've heard it ad nauseam today -- is the fairness issue and whether or not you're giving the small refiners some kind of an unfair advantage.

CIOMA challenges any of the refiners in this room to say that they suffered last October or during the entire fall. I don't think any of them can claim that they actually had a bad period of return on their investment during that shortage of fuel when prices went very high.

Even when the small refiners were producing 32,000 barrels a day of diesel and whatever other distillate products they make, large and independent refiners increased their market share to the point where at times they turned away unbranded marketers, even though those marketers had long-term supply contracts -- or not exactly contracts, but relationships with those refiners.

If these small refiners have an increased market share at this point, it is the result of increased demand or absorption of the market share held by the small refiners that are no longer producing fuel. These refiners have not taken market share away from the other large and independent refiners here in California and would not if they were allowed to continue making a 95 percent utilization rate.

The other issue that's been addressed at length is the public health impact. CIOMA believes that allowing these small refiners to make both increased barrels of diesel and other distillate products will not compromise the public health benefits of the low aromatic diesel regulation.

The original limits set for small refiners allowed approximately 33,000 barrels per day. I think my figures are off, given what Mr. Simeroth said. But at any rate, what they're asking for is no different than what that segment of the industry would have been making had those other 10 refineries, small independent refineries, remained in production.

At this time, CIOMA believes that the economic impact of limiting small refiners to production levels that will force them to either sell substantial amounts of diesel out of state or to even cease production entirely outweighs the minimal public health impact of allowing these increased production levels of 20 percent aromatic diesel.

And I would like to sort of echo Mr. Lagarias' comment about the alternative formulas that many of the large refiners are making now -- some of those, we understand, are above the 20 percent aromatic limit. So, there is some question about whether they're actually at a same level as some of these small refiners would be once they start making the 20 percent aromatic diesel.

There are a couple of other points. Some of the other speakers brought up the fact that this October is not last October. Well, it isn't. They are different situations. But all of the factors that were present to create a shortage last year could also be present this year. First of all, with regard to inventory levels, I think, if you will recall, most of the large refiners assured you that they had plenty of inventory in October, '93.

We continued to question whether or not those inventory levels were going to be sufficient to meet the demand, especially given all of the things that were happening in October.

When push came to shove and October finally rolled around, because of turnarounds or whatever factors there were, those inventory levels were not sufficient to carry on filling the demand during the period of that introduction of the low aromatic regulation.

I don't think you can depend on inventory right now. It's like taking a snapshot of the market at this moment and saying, okay, what works right now is going to work for the next 10 months. That's not necessarily true. There's a lot of change. Reformulated gas regulations alone are a major change and will shift many aspects of the entire fuel market -- that includes production, product mix, distribution, and storage, and definitely, supply.

So, you need to think about what's coming up down the road, both from EPA and from CARB, and when those things will start before you determine that the picture today looks great; you've got enough inventory to take care of the demand.

Secondly, one of the speakers referred to withdrawal of refiners from certain markets. If you see small refiners withdrawing from various markets -- and in Mr. Lingle's case where he's fueling the Imperial Valley is a good case. That's an area where there aren't a lot of suppliers down there. And if you have one pull out, it will make a significant difference.

Small refiners very easily, as you've just been told, could go out of business simply because they can't afford to produce at half ration. They have to go full force or they either close, or they send their product out of state and take it out of the California distribution.

Secondly -- or another point that was brought up was redistribution at terminals. Some terminals -- large refiners decided not to continue to offer fuel at during October, '93. We don't have any assurance at this point that they're not going to do the same thing. As I said, reformulated gas sort of shifts everything. It affects capacity, it affects the pipelines and whether or not they can actually handle all these products.

And there may be some decisions made by some refiners where they will decide only to offer reformulated gas rather than diesel at certain terminals.

So, we don't now for sure at this point that there will be all of the people at all of the terminals that they currently are.

Thirdly, they referred to excise tax increase and other things that were going on. There is an excise tax increase that's coming. It's not coming this October, but it's coming in January -- sorry, July 1, 1995, if Senate Bill 840 passes. And that is a State excise tax.

So, again, you're going to have some disruption, maybe not this year, but it could very well be in 1995. And if you don't have all of your suppliers there, you're going to have problems.

Also, this year, in October, there will be a change in the EPA/IRS dyeing requirement, so there could be some confusion in some discomfort in the market during that transition. Although it is a softer transition than just a drop-dead date.

(Laughter.)

MS. PARKER-GIBSON: And, lastly, you still have apprehensive consumers, both consumers at our end of the market and consumers who are our customers. Nobody's really sure what's going to happen with reformulated gas, and with diesel, and with all of the changes that are going on both on a federal level and a state level.

I don't think you can be assured that the way the market looks today is going to be a sufficient picture for tomorrow.

That's why we're hoping that you'll take the action to keep these refiners in the mix. We need everybody who's making fuel to stay.

We don't need a reduction or a concentration of production of fuel.

Thank you very much for the opportunity to speak.

CHAIRWOMAN SCHAFER: Thank you very much, Ms. Parker-Gibson.

Are there any questions from Board members for this witness?

If not, I want to thank you very much for appearing again today.

I would like to have a short break now. We will make preparations to close the record thereafter and consider a resolution. Five minutes.

(Thereupon, a recess was taken.)

CHAIRWOMAN SCHAFER: At this point, I'd like to ask the staff, for the record, to summarize those written comments that the Board may have received by individuals, but who were unable to testify at this hearing.

Were there any in that category?

MR. FRIESEN: There are two letters that we need to enter into the record. The first is from the Exxon Company, requesting the Board reject both the staff's proposal in the staff report as well as the staff's modified proposal, indicating that both proposals would substantially increase emissions of NOx and particulate matter, and that they are counter to the Board's charge to reduce motor vehicle emissions and improve air quality.

And denying the proposed amendments would return the small refiners to the volume limits established by the original regulation and correct the economic distortion created by the executive order.

In summary, they propose the amendments may also undermine the Board's desire for a smooth implementation of the upcoming Phase 2 gasoline requirements.

The other letter that needs to be entered into the record is from the California Trucking Association. They are in support of the small refiners' proposal to increase the amount of diesel fuel subject to the 20 percent aromatic hydrocarbon content limit. And they f eel that small refiners would ensure price stability and adequate regional supplies.

CHAIRWOMAN SCHAFER: You want to get a little closer to the microphone?

MR. FRIESEN: Yes.

CHAIRWOMAN SCHAFER: And slow down the rpm a little.

MR. FRIESEN: All right. The California Trucking Association feels that the four small refiners that are remaining in the market need to be able to produce at levels at the marketplace and allow the small refiners to cover their operating costs.

The rule currently mandates a return to operations at utilization rates they feel are too low to be competitive in today's market, and that the result to fuel users in a market dominated by two or three big producers would cause a real possibility of shortages and new price spikes and, therefore, they urge adoption of the staff proposal.

CHAIRWOMAN SCHAFER: That's the California Trucking Association?

MR. FRIESEN: Yes, that's correct.

CHAIRWOMAN SCHAFER: Thank you.

All right. Mr. Boyd, does the staff have any further comments? Obviously, a number of complex issues have arisen here this afternoon.

Are there any that need to be addressed? Some that occurred to me, and I would specifically ask that you, as you handle these, to identify one or two of the legal ones that I heard raised -- one concerning CEQA and one concerning our legal authority to take into account economic concerns in these regulations.

MR. BOYD: Those are the very two issues that I had in mind, Madam Chair. I'd like to ask the legal staff to make some comments on both those points, if they would, please.

MR. KENNY: I'd be happy to respond to those. With regard to CEQA, what CEQA requires is that for any proposal that is being presented to the Board, that we identify the environmental impacts associated with that proposal.

In this particular situation, the staff has identified an emissions impact associated with the potential passage of this proposal. And those were the NOx and the particulate matter increases.

To the extent that there are environmental impacts associated with the proposal, the Board then has an obligation to look at whether or not there are any alternatives or mitigation measures which could be utilized to carry out the proposal.

The staff has looked at whether or not there are any environmental mitigation measures or any alternatives that would carry out the intent of providing for an economic revival fueled from the small suppliers and has been unable to identify any alternatives or mitigation measures.

What that then requires is that the Board, if it does adopt this particular proposal, that it engage in a statement of overriding considerations, identifying in the record what those considerations are for why it's adopting this particular proposal, despite the fact that there are environmental consequences associated with it.

What we have done is prepared the resolution with the overriding considerations in mind. And the overriding considerations are specified in the resolution on pages 3 through 5.

In addition to that, there was a question with regard to the Board's authority to consider the effects on the economy of this State of any adoption of a regulation.

The Health & Safety Code specifically provides for fuel regulations, in fact, that the economy of the State is to be considered in the adoption of regulations. And that is found at Section 43013 of the Health & Safety Code.

CHAIRWOMAN SCHAFER: Thank you very much.

Mr. Boyd, are there any other comments that the staff believes might be helpful to the Board as we consider this resolution?

MR. BOYD: I have just -- a lot's been said today, and I don't want to take advantage of the Board or the audience to say much more. But one point I do want to make for the entire audience -- I know the Board has heard this many times from me before, and I know how they feel.

There's a lot of concerns about the State and the status of the economy of California. And I want the members of the audience to rest assured that the staff is as concerned as are they, all of them, about the status of the California economy.

Our charge is protecting the public's health, and we also are to be concerned with the economy. And there's nobody who recognizes more than we do, some of us who've been here a long time, the importance of a strong, healthy economy in this State. A strong, healthy economy equals and yields a strong and healthy environmental program. And without one, you don't have the other.

And so, we, in no way, are looking to put the majors, or the small, or the independent refiners in harm's way any more than we'd want to put our own organization in harm's way.

Again, as indicated yesterday, we try to weave our way down the middle and find the best we can get in terms of striving to meeting the public health goals of the State, while assuring that there's an economy here and surviving to provide the engine that we need.

And, as the economy grows, we do better, and we want it to survive.

And all the parts of that giant engine -- agriculture, construction, the refinery, the oil businesses, the small independents, et cetera, they're all part of that huge complex that has to survive. And the recommendation we've made to you, as you can see, doesn't seem in the eyes of anybody to meet particular needs. It doesn't go far enough as far as some are concerned, and it certainly goes two far as far as others are concerned.

I don't want to use the old trite statement about nobody likes it, so it must be right, but I would recommend the staff recommendation still, after even hearing everything today, as the best course we see available under the given situation.

And recognizing in 1988, the Board did make a policy decision relative to a differential between small refiners and large refiners and, even at that point in time, made the decision in recognition of the fact that this 20 percent was in perpetuity.

I know that's a concern to many people. And certainly, it's the prerogative of the Board to address, readdress that, or what have you. But in that context, we've given you a recommendation that we feel is the fairest to all concerned, while still keeping in mind the breathers of the State.

That concludes my comments.

CHAIRWOMAN SCHAFER: Thank you very much, Mr. Boyd.

At this point, I would now like to close the record on this agenda item; however, note that the record will be reopened when the 15-day notice of public availability is issued. Written or oral comments received after this hearing date, but before the 15-day notice is issued will not be accepted as part of the official record on this agenda item.

When the record is reopened for a 15-day comment period, the public may submit written comments on the proposed changes, which will be considered and responded to in the final statement of reasons for this regulation.

Just a reminder, at this point, if Board members have had ex parte communications, this would be the time to put them on the record.

Hearing none, I believe that you have a resolution before you. Would anyone care to make a motion?

MR. LAGARIAS: Madam Chair?

CHAIRWOMAN SCHAFER: Yes, Mr. Lagarias.

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MR. LAGARIAS: Madam Chair?

CHAIRWOMAN SCHAFER: Yes, Mr. Lagarias.

MR. LAGARIAS: I move adoption of Resolution 94-52 with a couple of comments.

CHAIRWOMAN SCHAFER: Do I hear a second?

SUPERVISOR RIORDAN: Second the motion.

CHAIRWOMAN SCHAFER: A motion has been made and seconded.

Mr. Lagarias.

MR. LAGARIAS: These are just generalizations. I've heard the independent producers will be meeting the deadline proposed in the resolution for achieving 20 percent compliance fuel.

I would request that, if any requests for variances from this, since I've heard they would meet it, do come up, that the staff makes sure that the record of this proceedings be a part of any such variance discussions.

And, secondly, I've heard, too, that some of the compliance fuel, the 10 percent alternative compliance fuel, does have a very high aromatic content. I would like to see the staff continue to monitor this performance. And if, indeed, it appears that a compliance fuel of higher than 20 percent aromatics can be developed within the staff's estimate of reasonable performance, that at some time in the future, they come back to see if we would change that exempt fuel.

And, hopefully, don't bring it back before the reformulated gasoline issue is on record and we have an indication of its performance.

CHAIRWOMAN SCHAFER: Very good. Is there any other discussion from members of the Board? Mr. Calhoun.

MR. CALHOUN: Yes. In connection with what Mr. Lagarias mentioned a few moments ago about the possibility of variances being sought, perhaps the record should also include a suggestion that there be a mitigation fee in the event that someone should request a variance in order to sort of expedite them getting off of the variance.

CHAIRWOMAN SCHAFER: Is that a feature in the current regulation, Counsel?

MR. KENNY: The current regulation doesn't specifically provide for a variance fee, but it does provide for other conditions as determined by the Executive Officer.

In the variances that were issued last year, that particular provision was used to impose variance fees on just about all of the variances that were issued by the Executive Officer.

MR. CALHOUN: Okay. Fine.

CHAIRWOMAN SCHAFER: Thank you. Any other discussion among Board members?

Yes, Supervisor Vagim.

SUPERVISOR VAGIM: Thank you, Madam Chair.

I just want to make sure that I have this right.

On page 4 in the resolution, it shows on the bottom, where, "The amendments approved herein will result in a 20 percent aromatic hydrocarbon diesel. . .lawfully supplied by refiners by approximately 24,000 barrels a day during the fourth quarter of '94 and by approximately 12,800 barrels a day starting January 1," is that in addition to the 24,700, or is that mutually exclusive figures?

MR. JENNINGS: That's the increase.

SUPERVISOR VAGIM: So, the first 24,700, then an additional twelve-eight?

MR. JENNINGS: The first 24,700 represents the increase over the current exempt volume levels --

SUPERVISOR VAGIM: Right.

MR. JENNINGS: -- but only for the fourth quarter of 1994.

SUPERVISOR VAGIM: Right. And then it goes back to twelve-eight?

MR. JENNINGS: Well, it goes back to a level where the increase over the existing volumes would then be 12,800.

SUPERVISOR VAGIM: Okay.

Just to wrap up my comments, if I may --

CHAIRWOMAN SCHAFER: Yes, certainly. Supervisor Vagim.

SUPERVISOR VAGIM: -- Madam Chair.

I'm going to support the resolution with a couple of caveat statements that I think we ought to be watching for, and that is the fact that January 1, 1996 is coming, and the independents do have to make a heavy decision, as some have testified that they may have equal problems in the diesel arena as a small manufacturer.

And I hope we'd be cognizant to that. Because, if indeed, they -- if they run into the same problems, I think you -- if supply is the issue, then we ought to look at the whole regime of those who have the small -- if an independent is indeed skidding toward a smaller size plant, but doesn't make a small category, I think -- I would hope we were cognizant to those issues.

CHAIRWOMAN SCHAFER: Very good. Any other comments or notes from members of the Board?

Ms. Edgerton?

MS. EDGERTON: In the event -- I would just like to suggest that, in the event that this does go forward, that it would be appropriate, if we're extending these -- if we do extend these opportunities to the small refiners, that the staff look at the possibility of sunsetting this at some point and reporting back to the Board.

Thank you.

CHAIRWOMAN SCHAFER: If there are no other comments, I'd just like to make one short one. Although our main job is to be concerned about the environment and to do everything that we can to improve the air quality in this State, we do have responsibilities to look at economic impacts.

I don't like playing God or even Adam Smith, which, in my book, is pretty close to a deity in these matters. It's not always a comfortable situation for us, because there are a number of issues involved when you try to be equitable.

However, I think it is our responsibility to act in a reasonable way here. I think that the staff proposal is a reasonable proposal under the current situation, and I'm prepared to support the resolution as well.

Will the Board Secretary please call the roll?

MS. LOUNSBURY: Boston?

DR. BOSTON: Yes.

MS. LOUNSBURY: Calhoun?

MR. CALHOUN: Yes.

MS. LOUNSBURY: Edgerton?

MS. EDGERTON: No.

MS. LOUNSBURY: Lagarias?

MR. LAGARIAS: Yes.

MS. LOUNSBURY: Parnell?

MR. PARNELL: Yes.

MS. LOUNSBURY: Riordan?

SUPERVISOR RIORDAN: Aye.

MS. LOUNSBURY: Vagim?

SUPERVISOR VAGIM: Aye.

MS. LOUNSBURY: Chairwoman Schafer?

CHAIRWOMAN SCHAFER: Aye.

MS. LOUNSBURY: Resolution 94-52 passes 7-1.

CHAIRWOMAN SCHAFER: Thank you very much.

I will note that there is a 15-day comment period for this item. And, Mr. Boyd, if there is no further business before the Board today --

MR. BOYD: There is no further business, Madam Chair.

CHAIRWOMAN SCHAFER: -- I will adjourn, and wish you all a good weekend.

(Thereupon, the meeting was adjourned at 2:15 p.m.)

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