KERN

Kern Oil & Refining Co.
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December 15, 2010

Mr. Kevin Kennedy
Deputy Executive Officer
Office of Climate Change
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Re: Kern Oil & Refining Co. Comments on Air Resources Board Proposed Cap and Trade Regulation

Dear Mr. Kennedy:

Kern Oil & Refining Co. (Kern) is one of only two remaining small refiners in California producing transportation fuels. Kern is the only small refiner in California producing CARB Reformulated Gasoline and Ultra Low Sulfur Diesel. Kern is on record with the Board and continues to advocate for consideration for small refiners.

The two remaining small refiners producing transportation fuels are "family owned," are not publically traded integrated oil companies and do not have upstream crude oil and gas production or downstream marketing and retail stations. Small refiners are clearly being disproportionally and negatively impacted economically by the AB 32 regulations and should be recognized as a distinctive subset of the California refining industry.

Summary of Comments:

Kern has five primary comments for consideration as described below.

1. Full recognition of more efficient, less complex refiners by utilizing the simple barrel output method across the full slate of products. Efficiencies should not be averaged nor reduced in a manner that disadvantages small, less complex facilities to larger, more complex facilities.

2. The idea of full and automatic pass through of allowance costs to consumers is not valid: Under the proposed regulation, there is no certainty that these costs will be passed through to the final consumer. There needs to be a mandated mechanism that creates a linked allowance that is then unquestionably passed through as a separate and distinct invoice line item.

3. Reassess leakage in the refining sector to consider recent imports of transportation fuels. Consider creating subsectors in the refining group that will properly identify leakage advantages that integrated and larger multi-facility refiners have over smaller, non-integrated refiners.

4. Allow only stakeholders to trade in the allowance market. Speculative trading in commodity markets, such as crude oil, has unnecessarily driven costs higher, placing a large economic burden on companies that need to purchase these commodities for their operations. Any speculative price increases in the allowance market will exacerbate leakage and provide additional financial difficulties for stakeholders.

5. Offset limitations should be increased and allowed to be carried over if not used. Increasing protocols and broader use of offsets will help to create more cost competition and a more robust offset market.

Free Allocation Methodology

Kern urges CARB to fully recognize the more energy efficient, less complex refiners by utilizing actual data in the simple barrel output method, across the entire product slate. An energy intensity index approach may represent similar results; however, any manipulation within the index could disadvantage more efficient refiners. Kern is concerned that future efficiency reductions should not be weighted in a manner that rewards prospective efficiency over existing efficiency. It is clear that reductions from an inefficient facility will be easier and less costly to achieve than reductions from a facility that is already incurring costs to operate more efficiently.

Kern supports using a broad base in determining the sector baseline, since leakage would likely occur to less efficient refiners outside of California.

Kern also suggests assigning the refining assistance factor into the high leakage risk category. It may also be necessary to create a subset in the refining sector based on integration and size, in order to prevent large entities from "shuffling carbon efficiencies" among locations to create a carbon advantage within the California Cap and Trade.

Economics of Allowance Costs for Transportation Fuels

CARB has communicated that the intent of the regulation is to pass the allowance costs through to consumers of transportation fuels. Under the proposed rule, there is no certainty that these costs will pass through to the consumer as it is intended. In fact, any costs that are not passed through will provide a particular disadvantage to the small, less integrated refiner. Kern suggests that staff be directed to establish a mechanism to assure that these costs be fully passed through as a separate and distinct invoice line item. This mechanism shall be in the form of a linked allowance utilizing a uniform rate per gallon based on tailpipe carbon emissions, and known in advance.

Allowance Trading

Kern recommends that allowance trading be limited to stakeholders only. Kern is concerned that allowing non-stakeholders to participate in the allowance program will drive costs higher through speculation. Speculators will only be participating in order to make a profit; they do not need to purchase allowances for any other purposes. Stakeholders will participate in the allowance market as part of their business; ***they are required to participate***. Speculators do not have risk associated with non-compliance, while stakeholders can incur significant costs due to non-compliance. Speculators do not necessarily participate in the California economy by providing products for Californians. Stakeholders businesses are located in California.

Offsets

Kern recommends that there be a robust offset market. This will assure cost competitiveness and that the goal of achieving carbon reductions will be accomplished at the lowest cost. To achieve this, it is recommended that CARB increase the offset limit and allow for unused offsets to be carried over to subsequent years. Kern also recommends increasing offset protocols and broader use of offsets in order to spur cooperation of a global nature. Strict limitations of offset quantities and offset protocols (locations) cast a shadow of doubt related to the global nature of this issue.

Other Comments

Kern is concerned about potential excessive penalty amounts (violations accrue per allowance/per day). Kern suggests that there be limitations on daily penalties, while adding any costs that were saved by not complying.

Kern is opposed to the 4:1 allowance penalty. Not only is this a large expense, but it shorts the market of credits. Kern suggests that a 1:1 ratio be used.

Kern recommends that a mandatory review provision be included in the regulation. Leakage review should be conducted yearly while full review should be made at least every three years.

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

Sincerely,

Robert H. Richards
Manager, Environmental Health and Safety