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The Property Tax Firm

Expert Opinion

Impact of AB 32 on the California Motor Fuels Market

Background

In 2006, California passed the first ever legislation mandating caps on greenhouse gas ("GHG") emissions for industry. AB 32, the Global Warming Solutions Act, created a statewide cap on GHG emissions and required the state to return to 1990 emission levels by 2020. Implementation of rules and market mechanisms began in early 2012.

In addition, AB 32 created a Low Carbon Fuel Standard ("LCFS") requiring a 10 percent reduction in the carbon intensity of fuels by 2020. The LCFS requires producers of gasoline and diesel to reduce the carbon intensity ("CI") of those fuels sold in California. The phased-in compliance schedule starts with a 0.25 percent reduction in 2011 and increases to 10 percent in 2020. Although a California court determined that this standard is unconstitutional in January 2012, the California Air Resources Board ("CARB") has appealed the decision.

These regulations primarily target the producers of gasoline and diesel, who are required to meet each year's standard by blending low carbon biofuels into refined products, selling low carbon biofuels directly (including electricity and hydrogen), and buying CI credits to comply with the standards.

Oil refineries, chemical plants, steel mills, coal-fired power generation plants, paper mills, and cement plants will face the greatest impact from potential GHG emission legislation.

California refineries face regulatory challenges from AB 32 and LCFS

> "Refineries are the largest energy using industry in California and the most energy intensive industry in the United States. After Texas and Louisiana, California has the largest petroleum refining industry in the country."[1]

A 2012 study by The Boston Consulting Group[2] discussed the key impacts of AB 32 on California's oil refineries. Among the effects discussed, the study noted potential for:

- Restriction on types of crude oil that can be processed by the refineries
- Increased exports of large volume of refined products

POPP HUTCHESON ANNOUNCES

Popp Hutcheson PLLC proudly announces Gilbert Davila, Mike Mims, Kevin Sullivan, Missy Ramirez, and Sebastian Rodrigano as the newest members of the Popp Hutcheson CMI Team.

PROPERTY TAX SCOREBOARD

Popp Hutcheson PLLC representerd several oil and gas producers in the Eagle Ford Shale and Permian Basin. The Popp Hutcheson team developed a property tax strategy that resulted in an assessed value reduction in excess of 25% from the noticed value for our clients in 2012.

- Increase in the price of electricity and natural gas
- California refined products to be supplied by imports from Asia
- Closures of several California refineries due to negative cash flow from operations
- Increased manufacturing costs, as refineries will have to purchase carbon credits on the open market to comply with AB 32 regulations

[1] *Profile of the Petroleum Refining Industry in California, Energy Analysis Department – Environmental Energy Technologies Department. March 2004.*

[2] *Impact of AB 32 – Summary of key findings, The Boston Consulting Group. June 18, 2012.*

Implementation of the LCFS could result in additional closures of California refineries as a result of increased operating costs, lack of demand for refined products and increased supply of biofuels.

Starting in 2010, several California refinery owners began putting refining assets up for sale with the strategic forecast that the California refining sector is going to suffer over much of the decade ahead, struggling with significant stay in business investment, government regulation, overcapacity and low refining profitability.

The negative impact of AB 32 on California refineries was confirmed on August 2012 when Tesoro Corporation announced it will acquire the 266,000 barrel per day Carson refinery from BP for $50 million, less than 5 percent of replacement cost.

Summary

One thing is clear: complying with AB 32, including the LCFS and the cap-and-trade programs, will result in increased compliance costs for California refiners, increased capital expenditures, increased operating costs, and additional operating restrictions. It will inevitably lead to an increase in the cost and decreases in the demand for the refined products produced for the California motor fuels market. The impacts of AB 32 must be carefully analyzed and considered when developing opinions of value for refineries that participate in the California motor fuels market.

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