NEW FUELS ALLIANCE

January 11, 2010

Mary Nichols, Chair
California Air Resources Board
Headquarters Building
1001 I Street
Sacramento, CA 95812

RE: New Fuels Alliance Comments Regarding AB32 Preliminary Draft Regulation

Dear Chairwoman Nichols,

The New Fuels Alliance (NFA) appreciates the opportunity to provide written comments to the California Air Resources Board (ARB) relative to the Preliminary Draft Regulation (PDR) for AB32 issued on November 24, 2009.

NFA is a national, not-for-profit organization that educates political leaders, regulators, public interest groups, businesses, and the general public about the economic, environmental and other benefits of non-petroleum fuel production and use. Its organizational purpose is to bring together the wide range of groups and sectors that are stakeholders in the development of non-petroleum fuels to build a broad and diverse base of support for a more sustainable fuel-energy future in the United States.

NFA strongly supports the goals outlined in AB32. However, NFA has concerns with certain approaches outlined in the PDR and believes that the inconsistencies contained will be problematic for achieving meaningful carbon reductions and developing advanced biofuel technologies. To that end, NFA offers the following comments for your consideration.

1. PDR Treatment of Biomass is Inconsistent

NFA is concerned with ARB's proposed treatment of biomass as part of the regulation. The PDR makes several proposals in Section 95950 that would require liquid transportation fuel that is derived from biomass to surrender allowances as part of the AB32 cap. Conversely, the PDR does not require electricity derived from biomass to surrender allowances under the program. These two separate approaches to accounting for biogenic carbon are contradictory because biomass is treated one way for one end use and another way for another end use. In other words, a paradoxical situation would be created because biomass that is turned into electrons is not debited for downstream

emissions under the program, but biomass that is converted to liquid transportation fuel is debited.

NFA is aware that the relative climate impact of using biomass depends on certain factors, such as where and how biomass is grown, and that the scientific community is examining this issue. However, it is clear that: (1) creating a double-standard for biomass utilization under AB32 is neither defensible nor consistent from a public policy perspective; and, (2) the presumed "carbon neutrality" of biomass, while debatable depending on how and where the biomass is grown, is nonetheless based on a very real advantage biomass has over fossil fuels in its ability to absorb atmospheric carbon during production. At minimum, ARB's treatment of biomass under the regulation must be consistent across all energy pathways, and recognize the advantage biomass has over fossil fuels in absorbing carbon.

There is also the issue of how an inconsistent policy will affect the marketplace. As with any emerging market or technology, it is critical that policies and regulations are predictable (for investment forecasting) and durable, thereby providing a degree of certainty for producers, investors and other stakeholders. A policy that is inconsistent with regard to biomass, for no apparent reason, will create a market distortion that is not performance-based, and could create major feedstock procurement problems for biofuel producers. For example, the arbitrary and additional regulatory hurdle for biomass-to-fuel companies, created by selectively holding liquid fuels accountable to downstream emissions, would put advanced biofuel producers at a significant disadvantage in terms of securing investment because AB32 would be driving investment to stationary source biomass-firing technologies. While ARB may not have intended for these types of outcomes, the regulation as proposed could stifle the development of new technologies, including advanced biofuels.

2. Calculation of Surrender Obligation for Transportation Fuels Should be Based on Net Carbon Content of Fuel At This Time (Option 1)

The PDR outlines four options in the discussion portion of Section 95950 (p. 40) for transportation fuel to surrender obligations. The first (Option 1) is the only viable solution for ARB to pursue if it intends for AB32 to withstand scientific and legal scrutiny.

The PDR explicitly states in the overview that, *"Covered entities in a cap-and-trade program must account for GHGs they emit"* (p. 6). It is well-recognized that to develop a robust cap and trade program, it is critical that emissions from a particular entity are tradable, transparent and compatible with a market-based accounting system. Employing net carbon content as the baseline accomplishes this necessary goal. However, the inclusion of lifecycle accounting as part of the regulation is inappropriate because its purpose is to compare fuels or products, as opposed to producing an accurate picture of actual emissions released from a specific entity. Furthermore,

lifecycle assessments are based in large measure on industry-wide averages and subjective assumptions made by modelers to fill data gaps. This type of analysis is inconsistent with a cap and trade system, which requires the measurement of physical attributes at a specific facility related to a specific product as the foundation for an accurate, transparent and verifiable market-based carbon accounting program.

Further, the proposed application of lifecycle accounting to only certain energy pathways is inconsistent and non-defensible from a public policy perspective. For example, several of the proposed options create double standards within the regulation. First, as discussed, fuel providers would be uniquely responsible for downstream emissions. Second, requiring surrender allowances for liquid fuels (molecules) and not electricity (electrons) creates a double standard for biomass utilization, as it relates to liquid fuel or power production. Finally, introducing the LCFS as the mechanism for lifecycle accounting under AB32 would mean that bio-refineries would be paying for downstream emissions plus market-mediated effects (in the form of indirect land use change, or iLUC), while fossil fuel refineries would not be paying for market-mediated effects (because they are not enforced against fossil fuels in the LCFS). As such, there would be three sets of inconsistent compliance standards for electrons, molecules and bio-molecules, with biomass-based fuel companies being held to the most cumbersome and stringent regulatory standards. This type of inconsistency violates the fundamental principle of competitive neutrality that is the cornerstone of any performance-based environmental regulation.

Option 1 is appropriate at this time because it is scientifically defensible and maintains consistency across all energy pathways. We are aware of the need to address as many sources of GHG emissions as possible, and NFA is generally supportive of efforts to hold companies accountable for their supply-chain emissions, but we encourage ARB not to distort the fundamental principles of sound public policy to do so.

3. Proposal to Include Lifecycle Emissions via the LCFS with Net Carbon Content Convolutes the Underlying Purpose of AB32

It is important to also consider the ramifications of using the LCFS to determine downstream carbon accounting for fuels as part of the cap and trade program. The LCFS is controversial for reasons that will have a direct bearing on the legal viability of AB32.

The concept of the LCFS, as a performance standard based on a fuel's lifecycle carbon emissions, is generally supported. However, the selective enforcement of indirect effects against land-based fuels only, in the form of an iLUC adder, is controversial. As such, using the LCFS as a carbon accounting metric under the LCFS will likely have the following outcomes:

(1) It will import the "iLUC controversy" into AB32. ARB staff has acknowledged that many elements of the LCFS will be further reviewed

by an expert working group. While this is certainly understandable in a regulation as complex as the LCFS, it does pose challenges in using this regulation as a part of another regulation. There is not consensus that iLUC should be included in a performance-based fuel regulation at this time.

(2) One of the controversial elements of the LCFS is the selective enforcement of indirect effects. All products have indirect effects. For example, an indirect effect of using more natural gas in vehicles could be the impact of pulling natural gas out of power markets and causing more power generation from coal on the margins of world power markets. Yet, to date, the LCFS only enforces indirect effects against biofuels. NFA submitted comments to ARB as part of the LCFS rulemaking and highlighted the fact that the LCFS takes an inconsistent approach to measuring the carbon impacts of different fuels. We believe the LCFS distorts fuel system boundaries and fails to adhere to the International Organization for Standardization (ISO) methodological framework for lifecycle analysis (ISO 14040). Accordingly, it would be inappropriate to employ the use of the LCFS as part of AB32. If the LCFS is used as a carbon accounting metric for cap and trade, AB32 will reflect these inconsistencies, as discussed above.

(3) Debiting any product for an indirect effect is the equivalent of charging them for the direct emissions of another product. For example, iLUC is the impact of biofuels on the margins of the agricultural sector; in basic terms, this means the alleged impact of pushing food and feed production to new land, as predicted by an economic model. As such, iLUC amounts to shifting the carbon impact of Product A to Product B. This concept of "carbon shifting" runs afoul of the basic principles of cap and trade, which is designed to account for actual emissions.

(4) It will create unique and potentially problematic "cross jurisdictional" legal issues. As discussed, unlike direct land use change, indirect land use change charges a domestic biofuel company for the land conversion emissions (predicted by an economic model) of another product in another country (likely food, feed or timber production). NFA encourages ARB to consider the implications of including any provision that penalizes fuels for market-mediated, indirect effects in a cap and trade program. ARB would, in essence, be supporting the notion that a California-based company is responsible for the land conversion actions of another company located in another country, and therefore must buy carbon offsets to account for this behavior. In other words, a U.S. company that develops fuel domestically and from domestic feedstocks would be debited for land conversion that theoretically occurs in a different

country as a result of another company's supply chain. This may be problematic for several legal and jurisdictional reasons.

NFA appreciates your time and consideration and would be pleased to answer any questions you may have about this matter.

Sincerely,

Andrew Schuyler
Regional Director
New Fuels Alliance