NATURAL RESOURCES DEFENSE COUNCIL

May 6, 2011

Michelle Buffington
Stationary Source Division
California Air Resources Board
1001 "I" Street
Sacramento, California 95814

Re: Comments on the Draft LCFS Advisory Panel Workplan, Version 1

Dear Mrs. Buffington,

The Natural Resources Defense Council (NRDC) is pleased to provide comments to ARB regarding the draft work plan being created as part of the LCFS Advisory Panel process. Below are our higher-level comments followed by more specific comments arranged by Topic Area. We thank you for your time and consideration.

In general, we agree with other advisory panel members calling upon ARB to:

- Provide a clear signal to the market that all reasonable measures will be taken, including strengthening the program, to catalyze the low carbon fuels market.
- Signal that weakening of the program's targets would be considered only as a measure of last resort, thereby providing greater certainty to all companies and the public about the LCFS.
- Resist a passive role in the review process that merely examines business-as-usual.
- Take a more active role to ensure all regulated parties and low GHG producers are taking all reasonable measures to comply with the LCFS.
- Focus the review on being solutions-oriented, with the goal of ensuring the program targets are met, creating a more resilient and workable program, and facilitate the planning and responding to major barriers or "bumps-in-the-road" that may arise.

Particularly at a time when California's over-dependency on oil is being felt by all consumers, ARB must stay-the-course in helping move the State to catalyze low-carbon alternatives that can reduce our vulnerability to oil prices.

<u>Topic 1: Progress Against Targets</u>

NRDC agrees with stakeholder comments to:

- Ensure that there is sufficient information and disclosure to understand what is happening in the market, including the total credit balances and deficits.

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- Provide greater certainty to low-carbon fuel producers, regulated parties, and investors that the program will not simply be off-ramped.
- Conducting an extremely forward looking “progress against targets” beyond 2015 is highly speculative and should be treated and considered in a different manner. The LCFS by its very nature is meant to spur additional investment and production that comes on-line at a later date.

Topic 2: Compliance Schedule

ARB should provide the Panel and general public with access to compliance information to understand (1) how much and which alternative fuels are being used and (2) overall credit/deficit balances. ARB can work to aggregate data or remove specific company identifiers to allow for transparency and review.

Topic 3: Lifecycle Assessment

We recommend that ARB works to ensure any updates to lifecycle methodology that result insignificant shifts in carbon-intensity (and thus compliance volumes) does not result in an unintended consequence. One example would be that a methodological change leads to a large reduction in the carbon-intensity of a fuel used for compliance. This would result in a sharp drop in the LCFS credit price, based on a change in accounting practice as opposed to an actual improvement in production process. In these instances, the compliance schedule should be strengthened to hold every producer and regulated party “whole” and keep the LCFS signal consistent.

As a principle, a decrease or increase in carbon-intensity that is due to a change in accounting practices as opposed to actual changes in feedstock or production methods should not change the overall stringency of the program.

Finally, we note that the direct impacts to carbon sequestration and overall GHG emissions from forestry areas or products have not been evaluated and will need to be for the LCFS. Going forward, the SWG will be critical to helping address this issue and creating greater certainty for the program.

Topic 5: Ultralow Carbon Fuels

The availability and use of ultralow carbon fuels is critical to the success of the LCFS. We identify a number of items that appear missing from the draft outline on this topic.

1. We recommend keeping 60% as a guide of where to focus initially, as opposed to a specific limit for a fuels category. Instead, the guiding factor should be whether a particular fuel category has the potential to meaningfully contribute to meeting the standard going forward. ARB should then identify the barriers as well as potential remedies for each of the pathways.

The issue of barriers to specific alternative fuel categories and whether they are "ultra low carbon" are not entirely the same. For example, nearly all the categories listed (cellulosic ethanol, hydrogen, electricity, biodiesel) could potentially have emissions above or below the proposed 60% threshold being considered depending on the method or feedstock. However, those above and below the threshold may fact similar or the same barriers regardless.

2. Also absent from the outline is the issue of the LCFS credit market. NRDC believes that the primary barrier to the issue of whether the LCFS adequately incents ultralow carbon fuels is the lack of a known LCFS credit value. This lack of "price discovery" by the market means no investor or low-carbon fuels producer can price the value of the LCFS program into their projects. ARB must prioritize the development of a credit market and work with "ultra low" carbon fuel providers to create a mechanism that allows them to quantify the value of LCFS credits.

3. Also missing from the outline is discussion on the current uncertainty for ultra-low carbon fuel providers on whether the program will be "off-ramped" as a result of pressure from regulated parties. Providing a strong signal that "off-ramping" from targets will be only used as a measure of last resort, together with assurances of strong enforcement, will provide much needed certainty for companies and investors.

4. In the incentive section, we believe that additional incentives should only be pursued if the LCFS credit market is found to be insufficient for driving additional ultra low carbon fuels and that a future compliance problem is identified. Additional incentives should be applied cautiously since they tend to (1) reduce the overall value of credits, offsetting the overall incentive for all and (2) would result in lower GHG emission reductions without some change in the stringency. Mechanisms that do not lead to distortions should be pursued first. One example of this is to allow ultralow carbon fuel producers that sign long-term production contracts to generate the entire stream of credit value up front. This could potentially help with financing projects since some of the uncertainty regarding future credit value could be diminished.

5. Should ARB consider providing additional incentives to ultra-low carbon fuels, a general set of principles should be established that include:
   - Maintaining the targets and overall GHG emission reductions of the program over the entire period
   - Developing fair and transparent measures to provide those additional incentives such as some volume (or energy) threshold needed to catalyze that particular market
   - Ensuring that these additional incentives are temporary, with clear metrics for off-ramping or cessation of the additional incentives
   - Weighing those additional incentives exclusively or primarily based on GHG emissions performance

6. Sustainability criteria and the recommendations of the SWG should be considered alongside recommendations for incentives for ultralow carbon fuels.

Topic 12: Economics (and Environment)

ARB should add environment to the title since this topic appears to encompass this issue.

With regard to the environment, we recommend that the Sustainability Workgroup (SWG) be provided with similar weight as other workgroups created under the LCFS program. The Advisory Panel can play a useful role by identifying a process to include the eventual SWG recommendations. We recommend adding a question to this section on the process by which the SWG recommendations and sustainability criteria could be incorporated into the program.

Topic 15: Credit Trading Market

As noted above, NRDC strongly supports the creation of a vibrant, credit trading market that allows for companies and the public to calculate the value of the LCFS credit.

We look forward to working with ARB on these particular issues going forward.

Sincerely,

Simon C. Mui

Dr. Simon C. Mui
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