

June 24, 2014

Katrina Sideco  
California Air Resources Board  
Cal/EPA Headquarters Building  
1001 "I" Street  
Sacramento, California 95814



Via email: ksideco@arb.ca.gov

Dear Ms. Sideco:

**Re: Solicitation of Alternatives for Analysis in the LCFS Standardized Regulatory Impact Assessment**

The California Trucking Association (CTA) is pleased to have the opportunity to provide suggestions for alternatives to be evaluated in the economic analysis to be performed by ARB under the requirements of SB 617 and its implementing regulations.

CTA is the second largest trucking organization in the United States, providing comprehensive policy, regulatory and legislative support to our member companies. Our members range from one-truck operators to large international companies providing efficient goods movement. In California, trucking provides 1 out of every 12 jobs in the state.

**Background to CTA Suggested Alternatives**

The Low Carbon Fuel Standard (LCFS) is one of two programs targeted at Carbon emissions, the other being the Cap and Trade program. Because the two programs overlap, in their targeting of transportation emissions, and because the transportation and logistics industries play such a significant role in the state's economy, the LCFS program needs to be evaluated in the context of the economic effects of the Cap and Trade program.

That is, the Cap and Trade program's economic impacts must be expressly identified in the economic analysis so that changes to the LCFS program that relate to its linkage to the Cap and Trade program can be properly assessed for their impacts on the state's transportation and logistics industries and their consequent effects upon consumers.

In that regard, the CTA prepared a study of the joint effect of the LCFS and Cap and Trade programs on the state's transportation and logistics industries through their forecasted effect on retail diesel prices<sup>1</sup>.

The findings of the CTA analysis showed that the combined effect of the LCFS and Cap and Trade programs would add an additional \$2.22/gallon to California diesel prices, increasing retail diesel prices by 50 percent to \$6.69/gallon by 2020. This would cause the average price

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<sup>1</sup> The Impact of the Low Carbon Fuel Standard and Cap and Trade Programs on California Retail Diesel Prices. Stonebridge Associates, Inc. for the California Trucking Association, April 27, 2012. (attached)

difference between California and neighboring states to be \$2.33/gallon, taking into consideration California's \$0.11/gallon higher average diesel tax rate.

Apart from their wider economic consequences, the CTA study concluded that higher diesel prices would make California a less attractive destination for containerized imports from the Pacific Rim and reduce the economic benefits, employment, income and state and local taxes generated in California by that import trade.

The impact of higher retail diesel prices on containerized imports would be magnified by the competitive pressures on California ports due to the pending completion of the Panama Canal expansion project that will double the canal's capacity and magnify by 50 percent containerized import losses due to retail diesel price increases.

The CTA report estimated that between 2015 and 2020, the cumulative impacts of containerized import losses caused by retail diesel price increases could be 616,922 lost jobs, \$68.5 billion in lost state domestic product, \$21.7 billion in lost income and \$5.3 billion in lost state and local taxes.

By comparison California job losses due to the recent recession between 2007 and 2010 were 1,304,600 jobs. The projected cumulative loss of 616,922 jobs, solely due to retail diesel price increases, would equal nearly half the state's total recession-related job losses.

Many of the job losses would be in the logistics industry which is responsible for almost 14 percent of the California economy. The logistics industry contains the industry groups responsible for the shipping, receiving, processing, and storage of goods, and is an important remaining source of middle-class entry jobs.

The California-only diesel price increases would also competitively disadvantage the trucking and warehousing services of California logistics companies and allow out-of-state companies to effortlessly strip away the California industry's commercial transportation business along the state's trade corridors.

The California-only diesel price increases would also impose higher costs on essential California commercial activities which depend upon logistics industry services, such as those that affect the price of food and other essential services.

CTA is emphasizing the joint effects of the two programs because there are policy alternatives available that could reduce the joint costs of the programs and which therefore merit consideration in the economic analysis.

### **Proposed Program Alternatives**

1. Reduce program costs to consumers by permitting unlimited 2-way allowance trading between Cap and Trade and LCFS programs.

Linking programs via allowance trading can reduce the costs of the individual systems by making it possible to shift emission reductions across systems. Just as allowance trading within a

system allows higher-cost emission reductions to be replaced by lower-cost reductions, trading across systems allows higher-cost reductions in one system to be replaced by lower-cost reductions in another.

The primary goal of linkage is to achieve the same level of emissions reductions at a lower cost. If the price of allowances in the other system is lower than the price of allowances in the first system, then participants have an incentive to purchase allowances from the other system until prices are equalized in the two systems, resulting in net cost savings. In principle, by increasing and diversifying the number of buyers and sellers in a carbon market, linkage can provide the dual benefits of increasing liquidity and reducing price volatility<sup>2</sup>

2. Reduce program costs to consumers by allowing the use of allowance offsets in the LCFS program at the rate of 8 percent, just as is allowed in the Cap and Trade program.

The LCFS program doesn't currently allow the use of offsets, although there is a proposal to allow refiners to earn allowances for improving the energy efficiency of their refineries. However, the purpose of offsets is to lower the cost of complying with carbon limits and it is not clear that the costs of reducing emissions from refining for a specific refiner will reduce the overall cost to consumers.

That is why it is important to allow the use of offsets and specify that they be purchased from an offset market in which an official certification regime is in place for measuring and verifying emission reductions. One concern regarding climate change policy is unequal prices of carbon which can cause local economic damage, via leakage, if production flows to regions or industries that have a lower price of carbon—unless carbon, in the form of offsets, can be purchased from that area, effectively equalizing the price.

3. Lower the cost to consumers for reducing carbon in fuels by discontinuing the LCFS program and relying solely on the Cap and Trade program. Or, alternatively do not include transportation fuels under the Cap in the Cap and Trade program.

Layering the LCFS program on top of the Cap and Trade program causes far more costly emission reductions associated with reduced gasoline consumption than would be encouraged through either the LCFS or the Cap and Trade system on its own. Importantly, these reductions will be more costly than opportunities in other sectors covered by the cap. As a result, the interaction of the two policies increases the cost to California's economy associated with meeting its emissions target, relative to implementing only the LCFS or only the cap-and-trade system within the transportation sector.

Stavins<sup>3</sup> uses a numerical example to illuminate the impacts of combining the LCFS with the Cap and Trade program. He concludes that reduced gasoline consumption that cost more per ton

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<sup>2</sup>Robert N. Stavins, Linkage of Greenhouse Gas Emissions Trading Systems: Learning from Experience. Discussion Paper ES 2013-02, Harvard Project on Climate Agreements, Belfer Center for Science and International Affairs, Harvard Kennedy School, November 2013. With M. Ranson.

<sup>3</sup> Robert N. Stavins, Comments on the Recommendations of the Market Advisory Committee to the California Air Resources Board, "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California. June 15, 2007.

than reduction opportunities that would still remain untapped in other sectors covered by the Cap-and-Trade system, would be an unnecessary increase in aggregate costs for what is achieved and that imposing both regulations on the transportation sector would increase the social cost of achieving California's climate policy goals.

4. The economic alternative to be assessed here is the cost savings for consumers of a program change to anticipatorily reduce the program's annual requirements to conform them to expected supplies. This would require adopting procedures, comparable to those employed by EPA, setting annual alternative fuels requirements for the LCFS based upon annual forecasts of alternative fuels availability.

Under the Clean Air Act (CAA), as amended by the Energy Independence and Security Act of 2007, the US Environmental Protection Agency (EPA) is required, each year, to set the annual standards for the Renewable Fuel Standard program (RFS). Reflecting lower gasoline consumption and the failure of the biofuels industry to develop as anticipated, EPA is again proposing to reduce the advanced biofuel and total renewable fuel standards for 2014.

The proposed standards reflect EPA's updated production projections, which are informed by extensive engagement with industry and a thorough assessment of the biofuels market. The reduction from the statutory levels is intended to put the program on a manageable trajectory while still allowing for growth in advanced and total renewable fuels over time.

Based on an assessment of the available volumes of cellulosic biofuels, EPA is proposing to set the cellulosic biofuel standard at 17 million gallons for 2014, less than 1 percent of the statutory 2014 CAA target of 1.75 billion gallons.

Recently the court ruled that EPA's could not set biofuel mandates higher than EIA's production estimates to promote biofuel development. The Court ruled that, although an overall goal of the RFS was to promote development of renewable fuels, the provision specifying EPA could adjust the cellulosic volumes was put in place to correct for production shortfalls, not to promote biofuel development.

Similarly, although the LCFS program goal is a 10 percent reduction in carbon content by 2020, it is not at all certain that this goal can be achieved. However, there is no provision for modifying the goals of the program in such an event. The current proposal is to hold regulated parties responsible for the economic burden of securing supplies even if none are available. This requires expenditures which bring no environmental benefit but add to the costs which consumer will pay in the fuel prices.

CEQA requires alternatives to achieve the program's objectives. That assumes that the program's objectives are feasible. However, the program's objectives/targets were specified in an Executive Order that provided no demonstration that the program's objectives were feasible<sup>4</sup>.

In the event that the supply of required alternative fuels is not available, regulated parties who would be otherwise responsible for purchasing alternative fuels should not be held responsible

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<sup>4</sup> Executive Order S-01-074.

for purchasing administrative credits or incurring indebtedness for a program which is arguably infeasible.

The economic alternative to be assessed here is the cost savings for consumers of a program change to anticipatorily reduce the program's requirements to conform annual requirements to expected supplies.

5. Assess the alternative of removing diesel from the LCFS program.

The economic assessment should review whether it makes sense to continue to include diesel fuel in the LCFS program.

Diesel GHG emission reductions that would result from the LCFS would be only 1.7 percent of all recommended GHG reduction measures. Yet, retaining the minor participation of diesel in the LCFS program raises the prospects of the significant economic damage and the hundreds of thousands of lost jobs that could be caused by retail diesel price increases.

The assessment of this alternative should take into consideration the carbon reduction benefits that would be expected to accrue from the already required upgraded truck emission system requirements and associated enhanced fuel efficiency.

6. Evaluate the alternative of imposing a carbon tax to replace the LCFS and Cap and Trade programs.

Many observers claim that a carbon tax would be a far more efficient and therefore lower cost method for reducing carbon emissions. This regulatory approach should be assessed as an alternative.

7. Assess the alternative of imposing LCFS and/or Cap and Trade program costs at the fuel pump as tax-exempt regulatory surcharges.

ARB should consider requesting that the Legislature require that the LCFS and Cap and Trade program costs ARB imposes on the costs of fuels be reflected in the retail prices of transportation fuel in the form of tax-exempt, per-gallon surcharges in the same manner that other state and federal fees and excise taxes are currently posted and imposed.

This would prevent these regulatory costs from being included in refiners' fuels costs and thereby being magnified in their impact by being themselves taxed. ARB-imposed LCFS costs have a 17 percent higher impact at the retail level, when included in the wholesale cost of fuel, compared to had they been imposed as tax-exempt surcharges<sup>5</sup>.

Imposing program costs in the form of tax-exempt surcharges would also avoid the competitive effects created by differences in companies' capacity to absorb program costs without engaging in extraordinary measures that might adversely affect California fuels markets.

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<sup>5</sup> Stonebridge Associates, Inc., The Impact of the Low Carbon Fuel Standard and Cap and Trade Programs on California Retail Diesel Prices. Prepared for the California Trucking Association, April 2012.

Also, requiring that ARB's LCFS and Cap and Trade program costs be imposed in the form of tax-exempt surcharges would create greater transparency for the public and Legislature regarding the costs of ARB GHG reduction programs, especially as revenues from those programs are considered for future spending.

The fact that the establishment of such a tax-exempt regulatory surcharge would require legislative action should not disqualify this alternative from assessment. Feasible alternatives need not exclusively rely upon the authority of ARB.

### **Alternatives Related to the Basic Economic Analysis Required Under SB 617**

For reasons that are unclear, ARB has not made public the key program details it proposes to use in the program's SB 617 economic analysis. These details include:

- Forecasted alternative and conventional fuel prices
- Forecasted carbon intensity premiums
- Forecasted alternative fuel supplies
- Annual carbon intensity targets
- Any other significant program changes that are not yet public but are essential to assessing the program.

This lack of transparency creates the problem of proposing analytic alternatives prior to the availability of the assumptions that ARB proposes to use to demonstrate the program's feasibility. ARB perpetuated a similar type of approach during the 2012 Program review by withholding its economic analysis until the end of the review period, denying the Advisory Board the opportunity to review its economic analysis, especially its price impact assessment.

Therefore CTA wishes to ensure, as much as possible, that ARB does not use the specious assumptions and methodologies of its previous economic analyses that helped ARB conclude that the LCFS was effectively a costless regulatory regime. Issues of specific concern include:

- Pricing of Compliance Scenarios: Costs of including alternative fuels
    - The price forecasts ARB developed and used did not include any CI premiums or factors reflecting RIN prices for different alternative fuels.
    - All the ARB compliance scenarios showed comparable overall price impacts because the amount of alternative fuels used to achieve the diesel contribution to overall compliance was limited to 20 percent of diesel demand.
    - The 20 percent restriction on alternative fuels also constrained the cost impacts associated with latter year requirements for low CI-alternatives.
    - ARB LCFS program price impact forecasts were for "wholesale" prices, reflecting only the cost to refiners of biofuels, and did not estimate retail costs which would include the effects of federal, state and local taxes.
7. Assumptions regarding the cost and amount of alternative fuels that would not be attributable to the LCFS because they would be required under the federal RFS2 program.

- Assumption 1: The RFS2 supply and cost assumptions used in the last program evaluation of the LCFS by ARB reflect its incorrect claim that RFS2 supplies of specific alternative fuels would be those associated with California-sized proportions of RFS2 requirements. Those costs for those supplies were assumed to not be attributable to the LCFS because they would be required under the RFS2 rule. However, the RFS2 is a nationwide program that allows refiners to comply wherever in the U.S. they choose. Companies that have a national presence will be able to comply with the RFS2 through any of the facilities they operate. This is an advantage for companies that have refining facilities located near sources of biofuel production. LCFS costs are those imposed in addition to costs associated with meeting RFS2 requirements. RFS2 requirements and costs are based upon the extent that refiners choose to meet their national RFS2 requirements in California.
- Assumption 2: ARB also calculated RFS2 supplies and costs using unmodified statutory RFS2 requirements, which at the time, for example, required 10.5 billion gallons of cellulosic diesel production by 2020. The proposed 2014 target for cellulosic fuel is 17 million gallons.
- Adoption by ARB of these two assumptions systematically underestimated LCFS program costs by attributing enormous amounts of alternative fuels costs to the RFS 2 instead of to the LCFS<sup>6</sup>.

### **Alternative Forecasts**

CTA would like the following forecasts to be used in the economic analysis as alternatives to the forecasts that ARB will propose to use.

- TRANSPORTATION FUEL PRICE CASES AND DEMAND SCENARIOS: Inputs and Methods for the 2011 Integrated Energy Policy Report, FEBRUARY 2011 CEC-600-2011-001.
- The CEC Cost Analysis is described in the Excel spreadsheet CEC 2011-23-14 Biofuel values, which is attached to this letter.
- The CEC LCFS analysis which is described in the Excel spreadsheet 2011-11-16\_Summary\_of\_November\_14\_Workshop\_LCFS\_Compliance\_Analysis which is also attached to this letter.

### **Issues of Particular Concern to the Trucking Industry**

CTA's own study, mentioned several times, examined the impacts of increased retail diesel costs on imports via California ports, especially in connection with the expansion of the Panama Canal. This analysis depended upon modal elasticity analyses<sup>7</sup> commissioned by the Southern California Association of Governments that assessed the relative sensitivity of domestic and

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<sup>6</sup> ARB refused to release the Excel spreadsheets it used to calculate RFS2 and LCFS costs.

<sup>7</sup> Port and Modal Elasticity Study, Phase II, Robert C. Leachman, Leachman & Associates LLC for the Southern California Association of Governments, September 7, 2010.

international shippers to increases in port-related costs, such as the California-only diesel price increases identified in the study.

The CTA analyses identified a significant impact of these fuel price increases that ramified through the economy, appearing in the form of reduced economic activity, lost jobs and lower local and state taxes. This is the type of analysis that the SB 617 regulations promulgated by the Department of Finance had in mind.

The California trucking industry is extremely vulnerable to California-only increases in the cost of diesel fuel. The ARB's economic analysis needs to take a realistic look at this issue and incorporate the sensitivities that CTA employed in its study.

We appreciate your interest in our concerns and look forward to collaborating with ARB in its renewal of the LCFS.

Sincerely,

A handwritten signature in cursive script that reads "Eric Sauer".

Eric Sauer  
Vice President of Policy and Government Relations  
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