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Comments Regarding LCFS Workshop held on October 27, 2014

Element Markets, LLC (“EM”) appreciates the opportunity to comment on ARB Staff’s proposals for cost containment and compliance scenarios under efforts to reauthorize the Low Carbon Fuel Standard (LCFS) regulation.

Element Markets is approaching ARB with comments not only as a producer of LCFS credits, but also as one of the largest participants in the United States in all environmental commodities. We have a unique perspective based on our experience in Emissions, Renewable Energy Credits, Renewable Fuels, and Greenhouse Gas markets, where we have seen the effect of changing compliance mandates and cost containment.

The outline of our position is below, but to summarize our position, we strongly oppose any change to the compliance curve unless taken lock-step with cost containment.

Compliance Scenarios

During the October 27, 2014 workshop held by ARB Staff on proposed compliance scenarios and cost containment (referred to as the “Workshop” hereinafter), three alternative compliance curves for achieving the 2020 emission reduction goal were presented. These compliance curve alternatives represent different rates at which carbon intensity (“CI”) reduction needs to be achieved by regulated parties.

We believe that progressive CI reduction requirements contribute to the LCFS program’s efficiency in incentivizing renewable fuel development in the State of California; however, EM recognizes the need for refining the compliance schedule as part of the re-adoption of the LCFS program. We applaud ARB’s approach of soliciting stakeholder feedback on this important issue, but **we disagree with any changes to the compliance curve unless a reduction in the compliance curve is done lock-step with cost containment.** EM believes that the “Base Case” remains an acceptable solution that puts California on the right path for reaching its carbon reduction goals. Decreasing requirements now will only further reduce the impact of the regulations while the LCFS market is experiencing some of the lowest prices we have seen since the advent of the LCFS program. Making a further cut will have a detrimental effect on the market likely driving prices down below \$10/tonne and causing the creation of credits only from “business as usual” activities.

Our other concern about the reduction of the compliance curve, not taken in conjunction with cost containment, is that it will cause the market to remain well oversupplied through 2021, and ARB will



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only meet the 10% reduction in 2020 through a faux composition of some limited reductions plus a tidal wave of banked credits that will only trade at hugely suppressed prices.

For example, as seen in the data released by ARB regarding the effect the compliance scenarios have on banked credit volumes¹, potentially choosing to adapt the “More Gradual Path” would result in the residual banked credits by 2020 being 47.4% of all deficits generated that year. The fact that by the end of the initial compliance period enough credits would be left to cover almost half of the excess annual carbon emissions means that the gradual approach would effectively result in failing the goals set out in the LCFS program. The actual development of a low-carbon fuel industry in the State of California is only achieved if in the long run all annual deficits under the LCFS program equal credit generation – with a reasonable amount of credits banked by stakeholders for assurance of continued compliance and market stability. However, it is EM’s opinion that the excess of banked credits potentially realized by the “More Gradual Path” is harmful to renewable fuel development and the LCFS program as a whole. Based on the above, **EM expresses its grave concerns regarding the “More Gradual Path” compliance scenario** and respectfully advises ARB Staff against the implementation of such policy.

Cost Containment Provisions

Necessity of a Price Floor

EM appreciates ARB Staff’s thorough analysis and consideration of implementing a LCFS credit price floor. As expressed in our previous comments, EM is in support of this measure and would like to provide comments on the key talking points presented by ARB Staff during the Workshop. It is our opinion that ARB Staff has a very good understanding of the benefits of introducing a price floor as stimulation of investments, improvement of investor confidence and long-term planning benefits are all positive effects of the price floor mentioned in ARB Staff’s presentation.

We would like to take this opportunity to emphasize the importance of the above mentioned benefits gained from a price floor and believe that these advantages by far surpass any difficulties in practical implementation or potential adverse effects the measure might have. EM also recognizes that it is hard to gauge these “soft” benefits (that are difficult to directly quantify) and objectively compare them with other number-values involved in the re-adoption decision-making process; however, we respectfully urge ARB Staff to keep the importance of these “hidden” advantages in mind when evaluating the necessity of a price floor. As a leading environmental credit marketer and renewable fuel developer, EM has considerable experience in identifying the key criteria for the development of successful renewable fuel deployment. Based on our experience earned through cooperation with various shareholders of both the fossil and renewable fuel sector, we are able to state with confidence that the ability to reliably establish a consistent, guaranteed minimum future revenue stream from the sale of environmental commodities is a factor that may very well become the deciding point in an investor’s decision for development of renewable fuel applications. Accordingly, we believe that the adoption of a price floor is of key importance to achieving the goals set for the California renewable fuel industry.

¹http://www.arb.ca.gov/fuels/lcfs/lcfs_meetings/102714compliancecurves.xlsx; retrieved 11/9/2014



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According to ARB Staff's analysis, the inherent inaccuracies involved in defining a level for the price floor may lead to potential negative outcomes of the application of this instrument. We again would like to direct ARB Staff's attention to the fact that the existence of a price floor may be more important than the level itself. While below we provide additional comments on what we believe the best approach for applying the price floor is, we have confidence that ARB Staff is able to set the price floor at a level where its advantages overshadow any potential drawbacks.

During the Workshop, ARB Staff also asked for comment on whether a price floor would be necessary if the LCFS is working as planned. In our opinion, how often (if ever) the price floor is reached does not necessarily determine the success of its adoption. As mentioned in the above, the majority of benefits of a price floor are created by its existence. Its level – while an important factor – may of course contribute to these, but as long as it is a reasonable value, it does not need to be set at the exact optimum in order to yield the expected benefits. Accordingly, in EM's opinion, the price floor will greatly contribute to the LCFS "working as planned" regardless of its relation to current credit pricing.

Proposals for Setting and Implementing a Price Floor

EM agrees that the practical implementation of a price floor is a task that needs to be approached carefully and diligently. Being an active member of the LCFS credit marketplace, we recognize the difficulties and restrictions caused by the mandatory reporting of credit prices in the LRT. As an alternative, we suggest allowing - under predetermined conditions - LCFS credits to be sold into the California Carbon Allowance ("CCAs") market created by AB32. This solution would not create unnecessary administrative hurdles in LCFS credit trading and neither would it necessitate ARB collecting any funds from program participants. Instead, a controlled, one-way transfer opportunity from the LCFS into CCAs, which is an established and stable market, would create a reliable price floor for LCFS credit prices through the existing price floor of the CCAs market (current price floor for 2014 is set at \$11.94, which increases at CPI + 5% annually).

Being that the GHG reductions under AB32 take into consideration both LCFS and Cap and Trade mechanisms, some linkage between the programs should be warranted especially if it supports the ability for investment within the vehicle fuel sector.

Linkage of Cost Containment and Compliance Scenarios

As previously communicated by EM, we believe that both the modification of compliance curves and application of cost containment mechanisms (for both capping and flooring of prices) have great impact on the LCFS program and should not be isolated. Indeed, **it is our belief that the optimal application of both these instruments may be achieved only by applying a comprehensive approach that ensures that maximum benefits to the LCFS program are provided by their synergy.**

Based on our experience, we believe ARB should leave the compliance curve that currently exists in place and only reduce the compliance curve in the event that a cost containment trigger is hit. For example, ARB may change the compliance curve for the year in which a cost containment price is hit for three (3) consecutive months. So, if in 2017 prices of LCFS credits hit \$200/tonne, then the compliance curve for 2017 only will be reduced to the Straight Line proposed scenario. Only if prices then continue



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to rise to \$400/tonne would the compliance curve for 2017 be reduced to the “More Gradual Path”. Each annual period will reset and be adjusted only if the cost containment prices are hit on average over the three (3) month period.

On behalf of EM, I would like to thank you for the consideration of our comments, and I would be happy to make myself available for a follow-up phone call or meeting.

Kindest Regards,

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