NESTE OIL

11 November 2014

California Air Resources Board
Mike Waugh
Chief, Transportation Fuels Branch
Katrina Sideco
Sent via ksideco@arb.ca.gov

Re: Response to CARB 2014-10-27 Workshop
Proposed Compliance Curves and Cost Containment

Dear Mr. Waugh and Ms. Sideco:

Thank you for the opportunity to provide comments to the California Air Resources Board (CARB) regarding its re-adoption of the Low Carbon Fuel Standard (LCFS). The following comments are respectfully presented to CARB for consideration from Neste Oil US, Inc., a subsidiary of Neste Oil Oyj.

COMPLIANCE CURVE SETTING

Neste Oil strongly supports staff's proposal to keep LCFS compliance at 10% reduction in 2020. The ARB should maintain the downward progress of the compliance curve in a manner as to continue to incentivize low carbon fuel consumption in California. As a result of the "pause" in the compliance curve, California will realize a surplus generation of banked credits. That, coupled with the development of new lower carbon fuels and fuels with increasing carbon impacts compared to original projections, will allow regulated parties to reduce the carbon intensity of California's fuel supply in line with the original compliance curve schedule. Neste Oil believes that these factors leave the program ready for staff to say "giddy up". Of the proposed compliance curves, Neste Oil prefers the original, base case path for the carbon reduction schedule as the preferred approach as it will send the desired market signal, and not further delay implementation and realization of carbon reductions to California fuels.

Neste Oil sees staff’s inability to timely process and approve otherwise complete pathway applications as an obstacle to additional volumes of low-carbon fuels to be open for consumption in California. Timely approvals of pathway applications are vital to California being able to meet its carbon reduction goals. Assuming staff approves new pathways timely and

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does not further deter production and logistic investments in California, the 10% carbon reduction goals on the base case curve are reasonable and achievable.

COST CONTAINMENT

Neste Oil agrees with CARB's assessment that there will be sufficient credits available for future compliance. Therefore, the need to implement a cost containment provision is unnecessary and is unduly burdensome.

A credit price cap does not accomplish the goal of increasing incentives to invest in low-CI fuels. The opposite is true. With a price cap, an investor knows that they will have only a fixed return that is not tied to performance or other market conditions. This would serve as a destabilizing effect on the investment return calculations and will make new investments limited or non-existent.

Assuming a price increase caused by a shortage of credits that caused the price to reach the ceiling, biofuel producers would have a disincentive to produce more low carbon fuels as that would increase the supply and put downward pressure on the credit pricing. A price ceiling might have the unintended effect of causing deliberate credit shortages to maximize the value of the credit.

In the unlikely event that CARB implements a fixed price cap, Neste Oil disagrees that $200/ton is an appropriate maximum value for such carbon credits. The data on which CARB has based its price cap analysis is based on historical market factors that may not continue through 2020. Specifically, low-carbon fuel producers have received value for both the carbon reductions under the LCFS but also additional value for the RIN realized under the federal Renewable Fuel Standard (RFS). Current rulemaking delays by the US EPA have caused significant market disruption and instability to the federal RFS program. It is not unreasonable to anticipate that the RFS program could be further destabilized resulting in greater volatility in the RIN price component. Additionally, over the last several years a large amount of LCFS credits have been generated by the low-carbon, biomass-based diesel fuels. This historical period also included a federal tax credit of $1/gallon for biomass-based diesel fuel blended into transportation fuel. The tax credit expired 31 December 2013 and it remains unclear as to if it will be reinstated or not. It is further possible that the lack of a stable federal tax policy could remove stabilizing market factors and cause significant volatility in the price of low-carbon fuels and corresponding LCFS credits.

To that end, historical evidence indicating a poor likelihood of carbon credit prices increasing above $200/ton should be discounted based on the significant uncertainty that such underlying historical conditions will remain unchanged throughout the duration of this rulemaking period. To that end, Neste Oil recommends that CARB calculate an upper boundary for carbon credits without federal drivers in the pricing components to obtain an accurate range of credit valuation within staff's cost containment goals.

Finally, in the unlikely event that CARB implements a fixed price cap, Neste Oil strongly recommends that such price cap sunset and expire after 2020, at the end of the current rulemaking time period. Staff's calculations about credit availability, by its own admission, end in calendar year 2020. Therefore, it is unclear what the supply and demand relationship regarding carbon credits will be in later years. It is not unrealistic to assume that future carbon reduction requirements would require greater investments in low-carbon fuel production. Greater investments would require greater returns realized via generation of carbon credits. Absent better modeling and projections, it would be inappropriate to set a price boundary for such future years without a full understanding of the economic impacts applicable under those altered conditions.

CONCLUSION

Neste Oil appreciates the opportunity to comment on the re-adoption proposals. Like California, Neste Oil is proud of its continued leadership in producing clean transportation fuel. We look forward to continued participation in the California fuel market and the continued success of the Low Carbon Fuel Standard. Please do not hesitate to contact me if at 713.407.4415 or Dayne.Delahoussaye@NesteOil.com if you have any questions regarding the foregoing.

Respectfully submitted,

NESTE OIL US, INC.

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