SB1383 Pilot Financial Mechanism – Administrative Credit Support

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As an alternative to the CfD and Put Option, CARB could provide the financial risk mitigation for dairy-related projects required by SB1383 by issuing administrative credits. This Administrative Credit Support (ACS) program could support project financial models by establishing a bias in the market for dairy biogas projects that would significantly reduce the financial risk without requiring additional funds to be allocated by the state government.

How it works:

- CARB would publish a floor price for LCFS credits along with a lowest covered price that would apply to all dairy-related projects. The floor price would be in effect for multiple years to provide stability for financing projects.
- At the end of each quarter, if the average credit price for the quarter is below the floor price, each project would receive additional administrative credits to make up the shortfall. The number of carbon credits that the project generated in that quarter would determine the number of administrative credits they receive.

  EQ1: *Number of Credits Generated* x (*Floor Price – Quarter Average Price*) = *Shortfall*
  EQ2: *Number of Administrative Credits = Shortfall / Quarter Average Price*

- The lowest covered price would be defined as a dollar value per credit that would cap the number of administrative credits that would be issued. Administrative credits would be issued to cover up to the dollar value of the average price for the quarter below the floor price.
  EQ3: If *Lowest Covered Price > Quarter Average Price* Then
  Number of Administrative Credits = Shortfall / Lowest Covered Price

Example:

- CARB establishes the Floor Price = $125 and the Lowest Covered Price = $50. Project generates 2,000 LCFS credits per quarter.

  Quarter #1: Average Quarter Price = **$130**
    - No administrative credits are issued.
    - Credit Revenue = 2,000 x $130 = **$260,000**

  Quarter #2: Average Quarter Price = **$110**
    - EQ1: Shortfall = 2,000 x ($125 - $110) = 2,000 x $15 = $30,000
    - EQ2: Administrative Credits = $30,000 / $110 = 273
    - Credit Revenue = (2,000 + 273) x $110 = **$250,030**

Quarter #3: Average Quarter Price = **$40**

- EQ1: Shortfall = 2,000 x ($125 - $40) = 2,000 x $85 = $170,000
- EQ3: Administrative Credits = $170,000 / $50 = 3,400
- Credit Revenue = (2,000 + 3,400) x $40 = **$216,000**

Pros:

- Reduces project financial risk without requiring any new government funding.
- Does not require a separate administrator; CARB can administer the ACS as part of the LCFS program.
- Parameters of the ACS program are stable and known up front. Without the need for a reverse auction pricing mechanism or allocation of limited state funds, projects can be developed without concern for being priced out of coverage or shut out due to lack of funds. There is also no dependence on the program timeline to achieve certainty.
- Project developers can purchase policies from private insurers to augment the ACS if needed. These policies should be available at a reduced price due to the lower risk profile.

Cons:

- Value of Administrative Credits is determined by the market at the time of issue. The financial assurance provided by the program will still have some price volatility risk.
  - Developers can purchase additional insurance from the private market if they need to address this level of risk.
- Manipulates the market by issuing more credits when prices are low, further eroding the value of the credits.
  - This impact is mitigated by the small portion of the overall LCFS credit market represented by dairy biogas projects, and by the Lowest Covered Price. Using 2,000 credits per quarter as a standard size dairy project and the numbers from the examples, the maximum number of credits issued would be 13,600 per year. With an annual market size of 10,000,000 credits, 50 dairies in the worst case scenario would add <7% additional credits to the market. The LCFS credit market is expected to grow over time as carbon targets are reduced, decreasing the potential impact of each dairy project.
- Program is not scalable to support other types of biogas or renewable fuel projects.
  - This is a market manipulation to favor dairy projects. The program could stop accepting new dairy projects at any time if the focus were to shift to other types of projects.