September 13, 2018

Sam Wade, Branch Chief
Transportation Fuels Branch
California Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Comments on SB1383 Pilot Financial Mechanism

Dear Mr. Wade:

California Bioenergy LLC appreciates the work ARB has done in developing a conceptual pilot financial mechanism ("FM") to reduce the economic uncertainty associated with the value of LCFS credits. We want to thank you for the opportunity to submit comments and to work with you and other stakeholders to craft a successful program.

As discussed, a FM is critical to bring in nonrecourse debt. Banks we anticipate, based on historic discussions, will not accept the revenue risks of the LCFS and RIN programs. A financial mechanism, with a floor price in excess of established debt service coverage ratios solves this problem.

Since interest rates for debt are substantially lower than the returns sought by equity, the levels needed for the FM floor price are lowered. An ability to fund a project substantially with debt will also increase the number of projects that are developed, since project developers will need to raise a lower amount of equity capital. This will be important for both dairy and nondairy projects. To be direct, it will also mean a greater portion of project returns will go to project owners and farmers (for us project owners and farmers are combined) versus leaving the community. It will also result in greater project control by these entities, who will be hands on and likely the best to management them.

Another key role of a FM is to ensure long-term project operations. As studied, in the dairy sector the LCFS and RIN credit programs account for approximately 95% of current revenues. A precipitous drop could put operating projects at risk. Traditional equity investors will close down a project that is no longer financially viable. With substantial state financial contributions and given the climate goals and urgency, it is key to build projects that will remain operating for decades.

Thus it would be best to have a FM in place for many years. It is important to point out that the level of the FM floor price goes down over time. First the FM should be high enough to pay off debt and equity (which will be a smaller amount with a debt contribution). However, once debt is paid off the FM floor price simply needs to exceed operating costs (including necessary ongoing capital reinvestments to secure long-term operations).

As a result, we suggest the proposal to end the program after ten years is modified. It may have two or three stages: a floor price during a ten-year debt term and a price after the debt term. A modification may be a floor price for the first five years (helping secure an equity return), followed by a five-year period to pay off the balance of debt, followed by a second ten-year lower floor rate to cover operating costs.

Under a confidentiality agreement if ARB is interested we are pleased to disclose our estimates of O&M costs, debt service, capital reinvestments, and other relevant costs. We suspect competitors will similarly be comfortable sharing these numbers.

Based on our internal discussions after our call we have a handful of suggestions of next steps. To increase the chance that a program is developed, we think it would be very helpful for ARB to make a recommendation on the program approach. To get to that point for the dairy pilot FM we would suggest a small, focused working group with a handful of developers. We have worked constructively with competitors on this topic and other topics and believe all parties would benefit.

A few key CalBio recommendations follow.

1. We support the inclusion of RINs in the FM as well as the price of natural gas. RINs contribute substantially to project success. This inclusion should greatly decrease the likelihood of falling below the FM floor price as long as the RIN program continues.

2. A creative proposal was put forward to turn to private insurers to provide guarantees following an initial level of guarantee from the state. An advantage of a FM working group would be to enter into discussions with private insurers and see if it is available. Per AJW's analysis, this may greatly decrease the annual capital allocations by the state.

3. ARB suggested three state agencies to administer the program: the State Treasurer (CPFTA or CAEATFA), CEC, and CDFA. (ARB excluded itself based on a concern over a

potential conflict of interest.) We would recommend ARB selecting the agency and having them as part of the focused working group. This agency could take on such roles as running multiple estimates of the costs to the state based on different approaches and securing proposals from private insurers. The team will need good modeling resources.

4. The CfD and put option proposals are potentially complex programs. It would be terrific if we could simplify the approach at least for the dairy sector. At this point we recommend an option/insurance approach. In addition, knowing the strike price (floor price) and option/premium cost each year, may make it easier both to enter into and to manage the program.

5. We would very likely be willing to pay an annual cost for participation in a program. Our willingness to pay will of course reflect the cost and the floor price/insurance guarantee. We may also want to look at an upfront annual cost and potentially a second payment after year end if the credit prices exceed a certain level - thereby furthering the reserves in the state coffers. The project owner would have an annual commitment, and we would suggest that the owner doesn't have the ability to cancel participation based on market conditions. This will decrease the upfront costs and may increase the total amounts brought in by the state. The annual commitment will also help secure long-term project operations.

6. There is a focus in the white paper on competitive solicitations to get to the most economic price. Given the absence of experience, project owners will only have estimates based on financial models. It may be best to review economics with multiple developers and set a pricing program. It would be a mistake to have program pricing based on poorly thought out modeling or aggressive bets.

7. It is very important for a project to know it will be able to secure access to the FM. This in turn enables the developer to bring in bank, equity, grants - in other words to complete the capital formation. Needing to enter a competitive solicitation could slow development down substantially. It would be ideal for projects that have reached a certain level of project readiness, to be able to enter a queue and know that they will have access to the program until allocated funds have run out.

8. The level of project readiness needs to be defined to prevent projects that are not substantially advanced from holding back viable projects. This would be a good topic for various parties to discuss. The importance of the queue and queue rules will also reflect the amount of state funding. For example, (i) entry into the queue

may require Lease and Feedstock agreements and advanced permitting; (ii) holding one's place in the queue may reflect start of construction by a certain date and subsequently reaching COD (excluding external delays) by a certain date. An escrow payment may or may not be a helpful component. It could potentially be a pre-payment of the first year's premium/option price. An approach similar to one outlined here may make more sense than a fixed two year start date per the ARB presentation. Project owners will want to start as soon as possible (which will be easier for add-ons to existing clusters). Delays beyond two years should be accepted both to accommodate external delays and to decrease bankers' expected conservative approach; we need them to feel certain that good projects will return their capital.

9. The white paper raised the topic of integrating grant winners. This is important if the funding option/insurance price is competitively defined. If it isn't, but rather a fixed price, it will also be important to take grant awards into account based on amount of funds in the FM program. We don't want financed or even built projects to take the available capacity. Built projects should perhaps be limited to participation in the second ten-year period, to help insure long-term project viability.

An important issue that is out of our scope is developing a dairy pilot program that can be expanded for other LCFS credit generating sectors.

We would like to thank ARB staff for the opportunity to comment, and we look forward to working together with you and the broader industry on the financial mechanism and other aspects of the LCFS program.

Sincerely,

Neil Black
President