

## Calif. Low Carbon Fuel Standard Price Cap Is A Trade-Off

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On Nov. 21, 2019, the California Air Resources Board adopted a series of amendments to its Low Carbon Fuel Standard, or LCFS, program. The LCFS program is designed to encourage the use of low-carbon transportation fuels, and these amendments are intended to limit compliance costs for regulated parties and diminish any resulting adverse impacts on consumers.

The amendments must still be approved by the Office of Administrative Law. If approved, they will impose a price cap on all LCFS credit transfers. The price cap will limit the price of LCFS credit transfers to the existing Credit Clearance Market price cap of \$200 in 2016 dollars, adjusted for inflation.

Commentators and experts have divergent predictions about the impact of the new price cap. CARB hopes that this price cap will bolster investments by reducing price and regulatory uncertainty, but recognizes that it may also limit anticipated returns on investments.

### LCFS Program History

CARB approved the LCFS program in 2009 under authority granted by the California Global Warming Solutions Act of 2006, A.B. 32, and adopted broad amendments in 2018 to meet a statewide greenhouse gas emissions target codified in S.B. 32.[1]

The LCFS program aims to reduce the carbon intensity of transportation fuels used in the state by 20% by 2030 in order to reduce greenhouse gasses and diversify the states' fuel pool to encourage long-term decarbonization of fuels.[2]

Under this program, regulated parties, including providers of transportation fuels, must demonstrate that the fuels they supply for use in California meet the program's carbon intensity standards, which become more stringent over time. The program uses a credit market to monitor and achieve compliance.

Regulated parties generate credits by supplying fuels with a lower carbon intensity than the annual benchmark, and incur deficits by supplying fuels with higher carbon intensity than the annual



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benchmark.[3] Regulated parties must generate or acquire credits to offset any deficits, and may trade or bank excess credits.[4] These credits can be traded in CARB's CCM or through private transactions.

### **Credit Clearance Markets**

CARB established the CCM to facilitate compliance for regulated parties who have not met their previous year-end obligation.[5] The CCM calls for credits to be pledged for sale, informs regulated parties of the maximum price of credits within the CCM that year, and posts a list of credit buyers and sellers each year.[6]

CARB publishes CCM credit sales, though regulated parties may also conduct private sales outside the CCM. The CCM imposes a price cap of \$200/credit[7] in 2016 dollars, adjusted annually for inflation as determined by the Consumer Price Index.[8] CARB cancelled the CCM in 2017 and 2018, reporting a 100% compliance rate and receiving no credit pledges in 2018.[9]

### **Price Regulation and Trends**

Since the LCFS program went into effect in 2011, credit prices have trended higher and higher even as regulated parties overcomplied and built substantial credit banks for future use.[10] In a 2011 program review report, CARB expressed an intent that the LCFS credit market be efficient, secure and transparent but also noted suggestions that it should take a hands-off approach so as not to unduly influence the market.[11]

2012 regulations imposed reporting requirements and required CARB to publish transaction information,[12] but it was not until the 2015 readoption of the LCFS program that CARB adopted the CCM and imposed a price cap within the CCM to provide a compliance option with cost-containment in case of a tight market.[13]

Regulated parties overcomplied with the LCFS program during its initial years, building credit banks up until the first quarter of 2017, and credit prices steadily rose during that period.[14] CARB reported average credit prices of \$17 in 2012, \$55 in 2013, \$31 in 2014, \$62 in 2015, \$101 in 2016, \$89 in 2017, \$160 in 2018 and \$192 in 2019.[15]

Price dips in 2014 and 2017 are clear, though average annual prices do not reflect some volatility in the market. The 2014 price drop might be ascribed to a 2013 legal challenge that resulted in a stay of the program under which CARB could only enforce 2013 regulatory standards while it remedied California Environmental Quality Act and Administrative Procedure Act defects.[16]

In October 2014, CARB cited low prices as a basis for a price floor[17] that never materialized. Prices recovered but dipped again in 2016; some analysts attributed the 2016 drop to press reports that Gov. Jerry Brown was willing to terminate the LCFS program in exchange for broader industry support for the state's cap-and-trade program.[18]

Nevertheless, credits and trading activity consistently trended up from mid-2017 and reached record levels in 2019, with 1,656 transfers of 14,146,000 credits at an average price of \$192.[19]

### **November 2019 Price Cap Amendment**

On Nov. 21, 2019, CARB approved amendments to the LCFS program that will extend the CCM maximum

price to all credit transactions as part of its cost-containment strategy.[20] The cap is \$200 per credit in 2016 dollars, adjusted for inflation. Under this formulation, CARB set the 2019 CCM price cap at \$213.07. Before this amendment can take effect, both CARB's executive officer and the Office of Administrative Law must give final approval.[21]

Although CARB published an illustrated compliance scenario in support of its 2018 LCFS amendments that showed credit prices fluctuating between \$115 and \$135[22] between 2019 and 2030 under (then proposed and now effective) strengthened carbon intensity reduction targets, it also expressed concern about credit prices in directing staff "to monitor the cost containment provisions of the Low Carbon Fuel Standard."[23]

In fact, credit trades in November 2019 reached \$210,[24] and CARB's 2019 economic analysis shows credit prices settling at the new \$200 price cap before declining in 2022.[25] In one economic analysis, CARB estimates that this price cap might contain and reduce revenues from credit sales by \$2.9 billion (in 2016 dollars) between 2020 and 2030.[26] Nonetheless, CARB expects that added stability will benefit businesses and mitigate resulting economic disincentives.

This pending price cap has not taken effect, and credit prices are hovering below the expected cap. In the last week of 2019, CARB reported an average price of \$197 per credit, with some credits selling for \$209,[27] and sales in the first weeks of 2020 ranged from \$145.75 to \$208.05 with an average price of \$196.[28]

Some analysts and consultants familiar with the matter expect that credit prices will rise to the price cap and stay there for the foreseeable future as carbon intensity reduction targets become more difficult to meet and annual deficits eat into existing credit banks.[29] Others believe that potential increases in electric vehicle adoption alleviate pressure on the credit market and reduce prices.

Even others express concern that the price cap might be ineffective — one public comment noted that regulated parties may evade the price cap in certain fuel transactions and thus render the cap illusory. Nonetheless, credit prices continue to trend up, and CARB's proposed price cap may soon cabin credit prices.

### **The Price Cap Creates Regulatory Certainty at the Cost of Limiting Potential Upside**

While experts and analysts differ on the impact of the cap with respect to credit prices, the price cap creates an element of regulatory certainty that is much needed for the LCFS program. The LCFS program is still a new program, and its future has been subject to extensive speculation, which had an impact on the credit price in the past.

With the program's extension through 2030, CARB imposed a price cap in an effort to ensure a stable credit market and to cap compliance costs that might otherwise adversely affect California consumers and erode both public and industry support for LCFS. This price cap is expected to cabin prices and therefore avoid unreasonable compliance costs for regulated parties that typically generate deficits.

However, the price cap will also limit the potential upside of investments in low carbon intensity fuel production facilities and risks devaluing existing investments that anticipated higher returns based on rising credit prices.

Nonetheless, the amendment injects certainty into the market just as prices started to approach the

CCM market cap — CARB is limiting and clarifying compliance costs that will in part strengthen the LCFS program against potential failures and loss of public confidence. This should provide assurance to regulated parties of the outlook of the LCFS program through 2030.

## Conclusion

CARB believes that this credit price cap will inject certainty in the LCFS market. It is not without controversy — some expect that the amendment may be ineffective or discourage investment by capping credit revenues and investment returns.

Nevertheless, CARB believes that its most recent amendments should stabilize the LCFS market (helping to preserve the program) and encourage investment in low-carbon alternative fuels and emission reduction projects while limiting economic consequences on consumers.

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[1] Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons, at I-1 (Oct. 1, 2019).

[2] *Id.*

[3] *Id.*

[4] *Id.* at I-2.

[5] Cal. Air Res. Bd., Low Carbon Fuel Standard Credit Clearance Market (CCM) (May 16, 2019), <https://ww3.arb.ca.gov/fuels/lcfs/reportingtool/ccm.htm> (last accessed Jan. 20, 2020).

[6] Cal. Air Res. Bd., LCFS Credit Clearance Market (CCM) Timeline (2018), <https://ww3.arb.ca.gov/fuels/lcfs/reportingtool/ccmtimeline2018.pdf> (last accessed Jan. 20, 2020).

[7] A credit reflects one metric ton of carbon dioxide-equivalent (MTCO<sub>2e</sub>).

[8] Cal. Code Regs. tit. 17, §95485(c)(3)(C) (2020).

[9] Cal. Air Res. Bd., 2017 LCFS Compliance Information and Credit Clearance Market Information 1, [https://ww3.arb.ca.gov/fuels/lcfs/ccm\\_050918.pdf](https://ww3.arb.ca.gov/fuels/lcfs/ccm_050918.pdf) (last accessed Jan. 20, 2020); Cal. Air Res. Bd., 2018 LCFS Compliance Information and Credit Clearance Market Information 1, [https://ww3.arb.ca.gov/fuels/lcfs/2018compliance-ccm\\_051519.pdf](https://ww3.arb.ca.gov/fuels/lcfs/2018compliance-ccm_051519.pdf) (last accessed Jan. 20, 2020).

[10] See Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons, at I-4 (Oct. 1, 2019).

[11] Cal. Air Res. Bd., Low Carbon Fuel Standard 2011 Program Review Report 161–63 (Dec. 8, 2011), [https://ww3.arb.ca.gov/fuels/lcfs/workgroups/advisorypanel/20111208\\_lcfs%20program%20review%20report\\_final.pdf](https://ww3.arb.ca.gov/fuels/lcfs/workgroups/advisorypanel/20111208_lcfs%20program%20review%20report_final.pdf) (last accessed Jan. 20, 2020).

[12] Cal. Code Regs. tit. 17, §95488(e)–(d) (2012).

[13] Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons, at II-6 (Dec. 2014).

[14] Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons, at I-4 (Oct. 1, 2019) (Q1 of 2017 reported the credit bank shrinking for the first time since 2011).

[15] Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for December 2019 (Jan. 14, 2020), <https://ww3.arb.ca.gov/fuels/lcfs/credit/Dec%202019%20-%20Monthly%20Credit%20Transfer%20Activity.pdf> (last accessed Jan. 20, 2020); Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for December 2016 (Jan. 10, 2017), [https://ww3.arb.ca.gov/fuels/lcfs/credit/20170110\\_deccreditreport.pdf](https://ww3.arb.ca.gov/fuels/lcfs/credit/20170110_deccreditreport.pdf) (last accessed Jan. 20, 2020); Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for January 2015 (Feb. 10, 2015), [https://ww3.arb.ca.gov/fuels/lcfs/credit/20150210\\_jancreditreport.pdf](https://ww3.arb.ca.gov/fuels/lcfs/credit/20150210_jancreditreport.pdf) (last accessed Jan. 20, 2020).

[16] See *POET, LLC v. State Air Res. Bd.*, 218 Cal. App. 4th 681, 767 (Cal. Ct. App. 2013).

[17] Cal. Air Res. Bd., Workshop on Low Carbon Fuel Standard: Proposed Compliance Curves and Cost Compliance Provision 20 (Oct. 27, 2014), [https://ww3.arb.ca.gov/fuels/lcfs/lcfs\\_meetings/lcfs\\_compliance\\_curves\\_and\\_cost\\_containment\\_10232014\\_handouts.pdf](https://ww3.arb.ca.gov/fuels/lcfs/lcfs_meetings/lcfs_compliance_curves_and_cost_containment_10232014_handouts.pdf) (last accessed Jan. 20, 2020).

[18] See Stillwater Associates, LCFS Credit Price: What’s behind the nose dive? (Aug. 9, 2016), <https://stillwaterassociates.com/lcfs-credit-price-whats-behind-the-nose-dive> (last accessed Jan. 20, 2020).

[19] Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for December 2019 (Jan. 14, 2020), <https://ww3.arb.ca.gov/fuels/lcfs/credit/Dec%202019%20-%20Monthly%20Credit%20Transfer%20Activity.pdf> (last accessed Jan. 20, 2020).

[20] See Cal. Air Res. Bd., Resolution 19-27 (Nov. 21, 2019); Cal. Air Res. Bd., Initial Statement of Reasons, Appendix A at 26 (Oct. 1, 2019).

[21] See Cal. Air Res. Bd., Resolution 19-27 at 5 (Nov. 21, 2019).

[22] Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons at EX-10 (Mar. 6, 2018).

[23] Cal. Air Res. Bd., Resolution 18-34, at 8 (September 27, 2018).

[24] Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for November 2019, at 1 (Dec. 10, 2019).

[25] Cal. Air Res. Bd., Staff Report: Initial Statement of Reasons, Appendix B, at B-5 (Oct. 1, 2019).

[26] Id. at B-9.

[27] Cal. Air Res. Bd., Monthly LCFS Credit Transfer Activity Report for December 2019 (Jan. 14, 2020) (showing prices below the 2019 CCM cap of \$213.07).

[28] Cal. Air Res. Bd., Weekly LCFS Credit Transfer Activity Reports (Jan. 14, 2020), <https://ww3.arb.ca.gov/fuels/lcfs/credit/lrtweeklycreditreports.htm> (last accessed Jan. 20, 2020); Cal. Air Res. Bd., Weekly Credit Activity Log, <https://ww3.arb.ca.gov/fuels/lcfs/credit/Weekly%20LCFS%20Credit%20Activity%20%28upto%2012%20January,%202020%29.xlsx> (last accessed Jan. 20, 2020).

[29] Data Dashboard, Cal. Air Res. Bd. (Dec. 31, 2019), <https://ww3.arb.ca.gov/fuels/lcfs/dashboard/dashboard.htm> (last accessed Jan. 15, 2020) (illustrating rising credit prices and declining credit bank).