California Amends Its Low Carbon Fuel Standard (“LCFS”)

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California caps LCFS credit prices.

Pressing forward with its efforts to address climate change, the California Air Resources Board (“CARB”) finalized amendments to its innovative LCFS. To add stability to the credit market, the amendments constrain LCFS credit costs by establishing a hard price cap of $200 in 2016 dollars on credit transactions. They also allow a limited amount of credit borrowing if there are insufficient credits to meet annual compliance obligations. The amendments, which are effective July 1, 2020, seek to stabilize the LCFS market and ensure its continued support by capping the cost of LCFS credits.

Background

The LCFS requires regulated entities, such as producers or importers of fuel, to ensure that fuels supplied in California meet ever-decreasing carbon intensity (“CI”) targets or to procure and surrender credits to CARB reflecting the difference between the CI target and what they supplied to the state. These entities can buy LCFS credits in the market or in the CARB-administered Credit Clearance Market (“CCM”), which is intended to offer cost-controlled credits if there is a market shortage. Since the LCFS’s inception, observers have often predicted that deficits will exceed credit generation, resulting in increased LCFS credit prices.

In 2018, CARB directed its staff to monitor the CCM’s cost containment provisions and, as needed, technical adjustments to the program. Today’s rule is result of staff’s analysis and reflects the agency’s interest in continuing public support for the program by limiting potential fuel price spikes.

The LCFS price cap and CARB’s response to opposition.

The amendment caps LCFS credit transfers at $200 in 2016 US dollars, adjusted for inflation, with the maximum credit price going into effect starting June 1 of every year. How CARB will enforce this cap for sales or transfers that occur outside the CCM is unclear, meaning entities structuring sales or transfers of credits must carefully consider how those sales or transfers are detailed and costs are allocated in those sales or transfers.

Multiple stakeholders opposed extension of the price cap to all LCFS credit transactions. Parties noted that the CCM already provided cost-restricted compliance credits and that a hard cap does not provide flexibility, especially where other governments may increase compliance penalties above California's proposed price cap. However, CARB determined that the maximum credit price is sufficiently large to incentivize investment in low carbon fuel projects, noting recent investment projects undertaken when prices were below the cap.

The amendments also require additional oversight of regulated entities and provides more certainty to purchasers of CCM credits.

Regulated entities with a credit deficit for two consecutive years must submit a compliance plan by August 31 of the second year describing how the party intends to maintain compliance with the LCFS. Once approved, the entity must then submit an annual implementation plan for a five-year period starting the calendar year after the plan was approved. These implementation reports will be made public on CARB's website if the entity's annual credit shortage in any given year is greater than the annual credit shortage.

CARB will also not remove invalid credits from entities that purchased the credits on the CCM. This removes any uncertainty for regulated entities that purchase credits through the CCM.

CARB hopes to spur additional electric vehicle infrastructure.

The amendments allow CARB to borrow up to 10 million LCFS credits and distribute these credits to California utilities in return for pledging these credits for sale into the CCM. The revenue generated from this sale will be used to build electrification infrastructure in poor and disadvantaged communities.

The amendments also reallocate certain credits generated from residential electric vehicle charging infrastructure to the Clean Fuels Reward ("CFR") program, which offsets the cost on new light-duty electric vehicle purchases or leases in California.

Potential effects and what to watch.

Companies investing in low carbon fuels may consider the potential costs and benefits associated with the revised LCFS regulation. CARB estimates its changes will lower low carbon fuel producer revenues by $3.2 billion over 10 years, but that the price cap will solidify the program and ensure its continuation.

CARB's actions could also affect Oregon's Clean Fuel Program and other, similar programs that other states are considering. By creating new clean energy markets, these rule amendments are important to regulated parties and investors to understand the stability and future prices of these innovative environmental credits. King & Spalding lawyers are involved in all aspects of the LCFS and the effect of these amendments on the market.

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