

**California Natural Gas Vehicle Coalition
Clean Energy Renewable Fuels
CR&R, Incorporated
Linde LLC
Pacific Ethanol, Inc.
Propel Fuels, Inc.
Republic Services, Inc.
Terrabon, Inc.
TSS Consultants
Waste Management**

February 22, 2012

Carla Peterman, Commissioner
California Energy Commission
1516 Ninth Street
Sacramento, CA 95814-5512

Via Email: c/o Kmcdonne@energy.state.ca.us

Subject: CEC Regulation Title 20 CCR 3103 – AB 118 Funding Restrictions

Dear Commissioner Peterman:

Thank you for the opportunity to further bring our concerns to your attention on the interpretation of Title 20 CCR 3103 (3103 Regulation) regarding funding restrictions applicable to AB 118 grantees. This issue arose as part of the issuance of BioFuels Production Facilities Grant Solicitation (PON-11-601). The PON appears to impose restrictions on grantees such that they may not be able to secure full value of credits earned due to the production of low carbon biofuels. The PON suggests that grantees – who do not otherwise have a compliance obligation to produce alternative biofuels – would have to forgo the value of credits in proportion to the level of grant assistance provided by AB 118 funds.

We urge you to reconsider this provision, as we believe it is contrary to the intent and specific language of AB 118. The language of the solicitation states that if the party:

“... is an obligated party *or has opted in* ... to a credit generating program such as the LCFS or AB 32 initiatives (Note: although not specifically mentioned, does this restriction also apply to the federal Renewable Fuel Standard?), and plans to claim credits generated by the proposed project, then the *applicant will be required to agree to discount the value of those credits at the point of transfer in proportion to the funding received*”. (Emphasis added)

According to the CARB LCFS regulations, the only way a voluntary producer of a low carbon fuel can participate in the LCFS is by “opting in” as a “regulated party”. This is simply convenient terminology used by CARB, but in no way means that an “opt-in” regulated party is required in any way by CARB to produce a low carbon fuel. Such voluntary parties are only “opting in” as a convenient way for CARB to allow for the transaction of LCFS credits under the LCFS program. CARB has specifically clarified in their proposed regulatory amendments to the LCFS that parties that voluntarily opt-in are free to opt-out at any time and still produce low carbon fuel for use in California – provided they are not subject to a compliance obligation under the LCFS. *The CEC also needs to recognize this distinction.*

To our knowledge, this restriction has never been previously applied to any alternative fuel project until proposed for inclusion in the recent biofuels facility PON. As far as we are aware, the interpretation of Title 12 Section 3103 has heretofore always been that it only is applicable to those projects that are “required to be undertaken” pursuant to federal or state law. It is our understanding that CEC AB 118 staff guidance heretofore has always been the same: the funding restrictions only apply to those that are required to be undertaken in order to comply with federal or state law – not those that are voluntarily undertaken to generate and sell low carbon credits (i.e., LCFS or RFS2) to obligated parties.

Imposing such a restriction on voluntary producers of alternative fuels goes far beyond the statutory limitation in AB 118 itself, as modified by AB 109 (Nunez, 2008). H&SC Section 44271 (c) is the statutory basis, authority and reference for Section 3103 of the AB 118 Regulations:

44271 (c) For the purposes of both of the programs created by this chapter, eligible projects do not include those required to be undertaken pursuant to state or federal law, district rules or regulations, memoranda of understanding with a governmental entity, or legally binding agreements or documents. For the purposes of the Alternative and Renewable Fuel and

Vehicle Technology Program, the state board shall advise the commission to ensure the requirements of this subdivision are met.

It is our belief that this statutory restriction was never intended to apply to voluntary producers of low carbon fuels – whom are doing so without any obligation or mandate by a government agency. We believe this statutory restriction was intended to apply to only those parties that are required to produce alternative fuels, such as through the Low Carbon Fuel Standard (LCFS), the federal renewable fuel standard (RFS2), or Greenhouse Gas programs, such as California's Cap and Trade Program. In the case of the LCFS, this statutory provision would appear to be only applicable to producers of fuels that have a higher carbon intensity than the target goal of the LCFS – they are mandatory regulated parties. These parties, typically petroleum fuel producers, have an obligation to lower the carbon intensity of fuels they produce or purchase credits from other parties that produce low carbon fuels and have credits to sell. AB 118 grantees that voluntarily produce a fuel under no obligation to a government entity to do -- and can sell credits to mandatory regulated party-- should not be subject to such restrictions.

It is certainly our belief that this restriction was never intended to apply to parties who voluntarily develop alternative fuels. To do so would be counter to the very goals of the program: to stimulate the production of low carbon alternative fuels. Limiting the value of credits available to voluntary producers of such fuels would remove a significant financial incentive to produce alternative fuels. This would play directly into the hands of those who are opposed to programs such as the LCFS and, potentially, the federal Renewable Fuel Standard (RFS2) - and would lead to a diminished capability to produce alternative low carbon fuels.

The CEC's 3103 regulation must be interpreted differently or modified to allow voluntary alternative fuel producers to have full access to incentive programs such as the LCFS and RFS2. We believe it is possible to interpret 3103 in a way that is different from what the CEC staff proposed in the recent biofuels PON (see attached highlighted commentary on Section 3103):

- Regulation 3103 uses the term "may" rather than "shall", thus the requirement proportionally restricting credits could be interpreted as a permissive discretionary authority of the C-- that does not have be applied to voluntary producers of alternative fuels.
- Subdivision (b) of 3103 is specifically referenced in subdivision (a) regarding the production of excess credits by a mandatory regulated party (i.e., petroleum fuel producer under the LCFS). The language in (a) refers to (b) as a means to restrict the ability of a mandatory regulated party ability to secure the maximum value of fuel credits under programs such as LCFS or

RFS2. We believe the proper way to interpret subdivision (b) is as an extension of (a) rather than a stand-alone subdivision.

The production of biofuels at a commercial scale is economically challenging, particularly when producing biomethane that must compete against the wholesale price of fossil natural gas that is currently less than \$2.50/MMBTU – a 10-year low. Most industry experts agree that this low price is likely to be with us for many years to come due to the availability of North American natural gas. We are not aware of any technology that produces commercial scale biomethane or renewable natural gas for anything close to this price. The cost of commercial production of biomethane can be 2-3 times the price of fossil natural gas.

While the AB 118 grant program is essential to make low carbon biofuels commercially available, access to other incentive programs -- such as the state's low carbon fuel standard (LCFS) and the federal Renewable Fuel Standard (RFS2) -- are absolutely necessary to make the economics work. Without access to these supplementary revenue sources, it is virtually impossible to make these projects work at a commercial scale. If the CEC continues to impose funding restrictions in the manner that appears to be outlined in the solicitation, no commercial scale projects will ever be developed if it access is restricted to supplementary funding provided by the LCFS, the RFS2 and other incentive programs. The AB 118 program will be relegated only to provide funding for small scale RD&D and pilot scale projects – NOT commercial scale alternative fuel projects.

The undersigned parties strongly request that the CEC not impose this funding restriction on parties that are voluntarily opting-in to the LCFS or RFS2 for purposes of generating and transacting LCFS or RFS2 credits. The PON funding restriction, consistent the language of AB 118 should only be on parties that are required to comply with the LCFS (H&SC 44271(c)). *We further request that the CEC continue to interpret Section 3103 in a manner consistent with this approach, or amend Section 3103 such that it does not impose such a restriction on voluntary producers of alternative low carbon fuels.*

Please contact any one of the undersigned parties if you have any questions or require further information.

Sincerely,

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Attachment: Section 3103 Funding Restriction Text and Comments

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