# LOW CARBON FUEL STANDARD

## Low Carbon Fuel Standard Overview

The California Global Warming Solutions Act of 2006 (aka Assembly Bill 32 or "AB 32") mandates a reduction in California statewide greenhouse gas (GHG) emissions to 1990 levels by 2020. The Low Carbon Fuel Standard (LCFS) is one of the primary Emission Reduction Measures promulgated by the California Air Resources Board (ARB) to achieve AB 32's 2020 target. It is expected to contribute approximately 20% of the required statewide GHG reductions under AB 32.

The LCFS focuses on the transportation sector and requires a 10% reduction in the carbon intensity (CI) of gasoline and diesel from 2010 levels by 2020, with CI targets designed to become more stringent each year. The CI of fuels, expressed as grams of $CO_2e$ per megajoule, is calculated across the full lifecycle of transportation fuels (i.e., well-to-wheel) and includes all GHG emissions associated with producing, distributing, and using the fuel.

## Who is regulated by the LCFS?

- Typically, a producer within California or the importer of a refined/final product constitutes the Regulated Party.
- Suppliers of low-carbon fuels (e.g., electricity, biofuels, natural gas) can "opt-in" to Regulated Party status and generate LCFS credits that can be sold to another party that needs them for compliance.

## How does one comply?

Each Regulated Party must ensure that the overall CI score for its fuel pool at least meets the annual target for the given year. Excess CI reductions from one type of fuel can be used to compensate for insufficient reductions in another fuel. A fuel that has a CI below the target for a given year will generate LCFS credits on a volumetric basis (i.e., the more low CI fuel one sells, the more credits one generates). Conversely, a fuel with a CI above the target will generate deficits, also on a volumetric basis. Each LCFS credit represents one metric tonne of $CO_2e$ avoided and each deficit represents one metric tonne of $CO_2e$ added – both as measured against the pertinent year's CI target.

In each annual compliance period, a Regulated Party must balance its deficits with credits. The banking of surplus LCFS credits is allowed and credits do not expire due to passage of time. A negative balance for a calendar year that persists until April of the next year results in the Regulated Party being out of compliance. Regulated entities can comply by:

1. Lowering the CI of their fuels (e.g., via efficiency improvements anywhere in the lifecycle, blending lower carbon fuels); and/or
2. Purchasing LCFS credits from other Regulated Parties.

The LCFS also imposes recordkeeping requirements (e.g., retention of Product Transfer Documents) and quarterly reporting requirements that must be followed to remain in compliance.

LATHAM & WATKINS LLP IETA

Revised April 2015 | For more information, contact northamerica@ieta.org or Joshua T. Bledsoe at joshua.bledsoe@lw.com

# LOW CARBON FUEL STANDARD

## Relationship with Cap-and-Trade Program

While the LCFS has surficial similarities to ARB's other carbon trading regime, the Cap-and-Trade Program (e.g., both trade in increments of one metric tonne of CO2e), the two operate separately. Among other key differences, the two regimes: (1) establish distinct compliance instruments that are non-fungible across programs; (2) use different compliance instrument tracking systems; (3) require different registrations; and (4) have different rules regarding trading confidentiality. Entities covered by the LCFS and the Cap-and-Trade Program need to comply with both regimes, and cannot use over-compliance in one program to compensate for under-compliance in the other.

## What's next for the LCFS?

The LCFS has been challenged in both California state court and US federal court, and ARB largely has been successful defending the Program. However, due to procedural errors committed by ARB during the initial adoption of the LCFS regulations, the CI targets have been frozen at 2013 levels. ARB presently is attempting to cure these procedural flaws by readopting the Program. Concurrently, ARB also is overhauling many aspects of the LCFS, including but not limited to credit cost containment, credit invalidation procedures, and enforcement of violations.

ARB anticipates extending the LCFS beyond the scheduled 2020 sunset date, just as with the other AB 32 Emission Reduction Measures it implements. Finally, ARB has expressed interest in linking the LCFS with similar programs in Oregon, Washington, and British Columbia.



LATHAM & WATKINS LLP

IETA