Consumers Union
NONPROFIT PUBLISHER OF CONSUMER REPORTS

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Clerk of the Board, Air Resources Board
1001 I Street
Sacramento, California 95814

Via: http://www.arb.ca.gov/lispub/comm/bclist.php

Re: Comments on Rulemaking to Consider the Adoption of a Proposed California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms Regulation, Including Compliance Offset Protocols

Introduction

Consumers Union of United States, Inc.,[1] publisher of *Consumer Reports*®, submits the following comments in response to the California Air Resources Board (CARB) proposed rule in the above-referenced matter.

Comments

Background

Consumers Union (CU) was an active opponent of Proposition 23 and has advocated for federal climate change efforts to include consumer protections,

[1] Consumers Union of United States, Inc., publisher of *Consumer Reports*®, is a nonprofit membership organization chartered in 1936 to provide consumers with information, education, and counsel about goods, services, health and personal finance. Consumers Union's publications and services have a combined paid circulation of approximately 8.3 million. These publications regularly carry articles on Consumers Union's own product testing; on health, product safety, and marketplace economics; and on legislative, judicial, and regulatory actions that affect consumer welfare. Consumers Union's income is solely derived from the sale of Consumer Reports®, its other publications and services, fees, noncommercial contributions and grants. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

including a consumer rebate or dividend from cap-and-trade revenue. We have considerable reservations that local distribution companies (LDCs), particularly investor-owned utilities (IOUs), can equitably and transparently deliver consumer benefit to ratepayers once allowances have already been provided to them.

CU strongly supports the following components as essential for an equitable, consumer-friendly climate policy: 1) auction of permits, 2) dividend or rebate for consumers, and 3) enhanced energy efficiency and other cost-control measures to keep energy bills affordable, especially for low- to moderate-income households. The first two of these components are implicated in the current proposed rule. The consumer rebate and auction were important components of CU's defense of AB 32 and are essential for consumer acceptance of and support for climate change policies.

The AB 32 Scoping Plan (December 2008) and the Economic and Allocations Advisory Committee (EAAC) recommendations clearly identified the benefits of auctioning permits and using a significant proportion of the revenue as a direct consumer rebate. It is untenable for CARB to now ignore these prior plans and recommendations and abandon them in favor of pro-industry policies.

Recommendations

The proposed cap and trade regulations for electric utilities provide an excessive number of free allowances and an indirect and likely ineffective return of allowance value to consumers. We urge CARB to include the following recommendations in its final regulation:

1) Increase the percentage of allowances auctioned to emitters and utilities.

The California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) recommended to CARB a transition to 100 percent auction for the electricity sector by 2016.[2] It is not entirely clear from CARB's Proposed Rule § 95870(c)(1) and Table 9.2 what percentage is being freely allocated versus auctioned, but it appears to be a far cry from 100 percent by 2016. Although it is less efficient and transparent, it seems reasonable for CARB to start with some free allowances at the outset and increase the auction percentage over time in order to ease anxiety over the transition and allow utilities adequate adjustment time to adjust to new emission constraints. However, for reasons of planning certainty, principles of fairness, consumer protection, and public support, there should be a clear path towards auction and dividend in the electric sector.

While the impact of AB 32 on specific utilities (LDCs) and industries will vary significantly, giving away allowances outright is not the most equitable or efficient mechanism for distributing allowances. Free allocations to emitters decrease the revenue available to be returned directly to consumers, and an efficient allocation system is important for lowering the overall costs of the program. Giving away excessive free allowances creates a windfall for polluters at worst and provides an inefficient allocation at best.[3] In its recommendations to CARB, the Market Advisory Committee (MAC) identified "reducing the cost of the program to

[2] *See* CPUC Final Opinion on Greenhouse Gas Regulatory Strategies, Decision 08-10-037 dated October 16, 2008 at Section 1.5.2, available at http://docs.cpuc.ca.gov/published/FINAL_DECISION/92591.htm.

[3] *See* Government Accountability Office Report GAO-09-950T: Climate Change Policy: Preliminary Observations on Options for Distributing Emissions Allowances and Revenue under a Cap-and-Trade Program at 7-8, available at http://www.gao.gov/new.items/d09950t.pdf.

consumers, especially low-income consumers," and "avoiding windfall profits" as important principles to be followed in the implementation of AB 32, with which CU enthusiastically agrees.[4] Based on these principles, MAC recommended to CARB "that California avoid windfall profits, where they would occur, by limiting the free allocation of allowances."[5] The EAAC report also recognizes that free allocations to emitters should be limited to where emissions leakage is likely to occur and even then, used as a last resort.[6]

If CARB cannot estimate with certainty which entities or end-consumers would be the hardest hit through an auction system, then it is difficult to see how free allocations solve this uncertainty—there will still be winners and losers and the competitive disadvantage of those entities that receive insufficient allocations compared to those that receive a windfall from overallocation will still be present.[7] Free allocations do not solve this problem, but instead, obscure it and make it more difficult to determine the level of allowances that entities actually need and the inequities that arise from the cap-and-trade program.[8]

Not only is an auction system an efficient way to distribute allowances to entities that need them, but it also has important cost efficiencies for consumers of carbon-intensive goods and services. Entities that can reduce emissions at a

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[4] Market Advisory Committee's "Recommendations for Designing a Greenhouse Gas Cap-and-Trade System for California" at 56, available at http://www.energy.ca.gov/2007publications/ARB-1000-2007-007/ARB-1000-2007-007.PDF.

[5] *Id.*

[6] *See* Economic and Allocation Advisory Committee's "Allocating Emissions Allowances Under a California Cap-and-Trade Program" dated March 2010 at 63, available at http://climatechange.ca.gov/eaac/documents/eaac_reports/2010-03-22_EAAC_Allocation_Report_Final.pdf.

[7] *See* Congressional Budget Office Analysis: "An Evaluation of Cap-and-Trade Programs for Reducing U.S. Carbon Emissions, June 2001," at Chapter 2 Box 3, available at http://www.cbo.gov/doc.cfm?index=2876&type=0&sequence=3.

[8] *Id.* (identifying regressivity of cap and trade program that does not provide relief to low-income households).

lower cost than purchasing allowances will make these improvements instead of purchasing additional allowances. Consumers benefit from this market efficiency that drives the lowest-cost emission reductions.

CARB recognizes that under its proposed rule, some IOUs will have extra allowances to auction in a secondary market. Consumers Union feels strongly that, particularly in the case of IOUs, it would be more efficient to auction these allowances in the first place and return most of the revenue directly to consumers. An LDC pass-through requires close regulation and detailed analysis of each LDC's proposal to ensure the value of allowances is actually passed through to consumers. Even under vigilant oversight, determining the value of "free" allowances and what counts as "consumer benefit" is not as transparent as issuing direct rebates and may not be sufficient to counteract the regressivity of pricing carbon.

Provided that rebates or dividends are a large percentage of allowance revenue and are distributed fairly, most consumers, particularly low- and middle-income consumers will be not significantly worse off under the new program, and many may be better off.[9] Principles of fairness may require additional rebates to account for particularly large differences in regional impacts. Providing additional or larger rebates for consumers most impacted by the new program will provide more transparent, and likely larger, relief than providing free allowances to the LDCs and hoping the benefit will trickle down in an equitable manner. Ultimately, the auction and dividend method of distributing allowances is the most

[9] *See* EAAC report at 56-58.

transparent and reliable method for delivering ratepayer relief from the cap-and-trade program. However, given the uncertainties in initiating a new program, a mixture of free and auctioned allowances may still benefit ratepayers, as long as the path to full auction is clearly laid out. CU strongly urges CARB to formulate a clear path to full auction by 2016, as recommended by the CPUC and CEC.

2) Provide residential ratepayers a direct rebate through lump-sum payments.

Auctioning allowances and returning a large portion of the auction revenues directly to consumers are essential for ratepayer protection. However, CARB's current proposal does not dedicate sufficient revenue to direct consumer rebates nor adequately ensure consumers will actually receive the benefits promised them under the proposal. Equal rebate checks for residential ratepayers (or at least equal within a LDC service area) are essential to ensure basic fairness of the program and to protect low- and middle-income ratepayers from potential increases to electricity prices. The EAAC report explicitly recommended dividends (possibly combined with tax cuts) as the majority use of allowance value because dividends best serve the twin objectives of fairness and economic efficiency.

CARB's utility sector plan includes provisions for a secondary market for excess allowances distributed to utilities. Section 95892 directs utilities to use excess allowance value "to reduce the costs of AB 32 policies on their ratepayers," for "ratepayer benefit" and "for protection of electricity customers and for other AB 32 purposes." As outlined in the first recommendation above, CU ardently supports a direct consumer rebate as opposed to an LDC-pass through. However, if CARB insists on routing consumer benefit through LDCs, Consumers Union strongly believes that a direct consumer rebate or "lump-sum transfer" should be the only allowable use of these funds.

The AB 32 Scoping Plan (December 2008) is filled with excellent recommendations for cost-effective efficiency programs and standards, weatherization efforts, smart growth planning, and renewable energy research and deployment. Many of these worthy efforts will also help defray energy costs for consumers and are excellent options for use of allowance revenue. Support for such programs should be allocated in a transparent, competitive and efficient process, however, and not be opaquely routed through LDCs.

Cost-effective efficiency programs and other uses of the allowances that may "benefit ratepayers" that are administered by IOUs are not the best use of allowances. IOUs are often obligated to conduct such programs irrespective of the AB 32 program; the substitution effect may occur, with the result that IOUs do the same level of efficiency programs with no added benefit for ratepayers that are supposed to be provided by AB 32. Such substitutions are difficult to identify, and other failures of transparency are entirely plausible if utilities are given leeway on "ratepayer benefit." Theoretically, the CPUC could prevent such abuses, but it is much cleaner and more transparent to provide the entire allowance auction value directly to consumers in a lump sum and then keep efficiency and other programs separately addressed through independent allowance allocation (in the case of non-IOU recipients) or ratemaking or other CPUC proceedings (in the case of IOU-sponsored programs).

In addition, many consumers will not realize the significance of the on-bill rebate unless it is clearly identified as a reduction. A separate dividend check would be the clearest and fairest option for consumers, even if such a check is included in the same envelope as the electricity bill. A lump-sum payment will preserve the economic signals intended to reduce energy use and emissions while helping consumers afford increasing energy bills.

Conclusion

For the above reasons, Consumers Union urges CARB to consider these recommendations in its implementation of AB 32. We appreciate CARB's hard work and tireless efforts to ensure climate change policy benefit the state's citizens and its environment and hope that it makes special efforts to ensure fairness to consumers throughout this process.

Respectfully Submitted,

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