THE GREENLINING INSTITUTE

1918 UNIVERSITY AVENUE, 2ND FLOOR BERKELEY, CA 94704
PHONE: (510) 926-4000 FAX: (510) 926-4010 http//www.greenlining.org
Facebook http://www.facebook.com/Greenlining
Twitter http://twitter.com/Greenlining
YouTube http://www.youtube.com/user/Greenlininginstitute

December 9, 2010

California Air Resources Board
1001 I Street
Sacramento, CA 95812

Crucial Modifications are Needed CARB's Proposed CAP-and-Trade Rules.

Dear Chairman Nichols and CARB staff:

The Greenlining Institute would like to commend Chairman Nichols and the Members of the Board for taking a monumental first step in crafting cap-and-trade regulations. While Greenlining supports CARB's broader efforts, we are offering some suggestions on how to improve the proposed regulations and shape CARB's ongoing implementation of a cap-and-trade program.

Protecting low-income households and communities of color and producing economic and asset-building opportunities are the core values that drive Greenlining's efforts. Greenlining supports policies that reduce greenhouse gas emissions, mitigate the public health and environmental impact of climate change, and policies that create jobs and sustainable business growth in underserved communities.

In order for California's cap-and-trade program to be effective, Greenlining believes the CARB's proposal should include the following elements:

1. Greater portion of allowances need to be auctioned to encourage adoption of energy-efficient technologies. Free allowances should only be given to at-risk entities when leakage cannot be prevented through border adjustments.

2. A rigorous methodology should be created before 2012 to assess the need for free allocations and prevent windfall profits for industrial entities.

3. Competitive wholesale energy market should be maintained by the "first deliverer" approach.

4. Auction-generated revenue in the electricity sector should be administered for consumer rebates, energy efficiency development and renewable energy investment in a manner which shields consumers from energy price hikes yet still encourages conservation.

5. A portion of revenue generated in the statewide auction must fund a Community Benefits Fund to help reduce the impact of climate change and provide workforce development programs to support California's growing green jobs sector.

CARB's allocation of free allowances is misguided. Free allowances should only be given to entities when leakage cannot be prevented through border adjustments.

The allocation scheme proposes an initial 90% free allocation allowances for transitional assistance and leakage prevention, and that the need for free allocations will be evaluated on an ongoing basis. CARB anticipates that free allocations will minimize short-term costs to businesses and consumers, while still rewarding businesses that improve energy efficiency or invest in greenhouse gas emission reductions. CARB also expects that free distribution in the program's early years will minimize the potential for industrial sources to shift production to states without an emission cap, particularly for energy-intensive trade-exposed industries.

Greenlining objects to such a large allocation of free allowances. Free allowances will reduce covered entities' incentives to invest in energy-efficiency technologies, and will create undeserved windfall profits for entities. Meanwhile, compliance costs will still be passed onto consumers. While some claim that free allowances will reward early action, a robust auction will maximize incentives for continued investment in clean and efficient technology, and generate revenues that can be reinvested for public benefit. For example, these investments can be used to mitigate instances of economic burden on consumers.

When allowances are distributed primarily through an auction system, the financial incentives can spark the innovation of the most cost-efficient emissions reducing technologies. There are two main advantages to an auction system. First, auctioning more of the allowances provides a clear signal to market participants of the value of an allowance. Furthermore, an allowance mechanism which is predominantly based on auctioning is more transparent than a mechanism based on free allocation.[1]

A clear market signal will encourage California's continued leadership in the green-collar economy. Revenue raised through the auction process can insulate consumers from higher prices and allow us to invest in the infrastructure projects we need to remain competitive.[2]

Greenlining understands that some energy intensive industries face a higher risk of leakage. Leakage, however, can be addressed by more cost-effective methods, such as border adjustment and the first deliverer approaches. The proportion of free allowances is misguided.[3] The industries with both high energy-intensity and substantial trade-exposure represent a very small share of California production. Only a mere fraction of allowance allocations are needed to

[1] Economic and Allocation Advisory Committee, *Allocating Emissions Allowances Under a California Cap-and-Trade Program, Recommendations to the California Air Resources Board and California Environmental Protection Agency*, March 2010 at pg. 14.

[2] *See* EAAC Recommendation at pg. 48.

[3] *See* Scott Murtishaw, Adam Langston, and Karen Griffin, *Joint California Public Utilities Commission and California Energy Commission Staff Paper on Options for Allocation of GHG Allowances in the Electricity Sector*, April 2008 at pg. 21

accomplish CARB's leakage prevention goals.[4] Thus, Greenlining urges CARB to closely examine which industries are most at risk, and then only provide free allocations when alternative measures are foreclosed.

In 2015, transportation fuel, commercial and residential industrial combustion, and liquefied petroleum gas fractioners and refiners are scheduled to enter the program. While these entities do not need to submit compliance instruments, they will need to submit emission records to CARB. This provides CARB sufficient time to develop an approach that can prevent leakage without allocating significant amounts of free allowances. For the transportation fuel sector, the covered entity is the supplier of the fuel. CARB acknowledges that this approach is similar to the method similar to the first-deliverer approach, the method used by the electricity sector to determine who has compliance obligation.

Greenlining recommends that allowances be mostly auctioned to these entities, and only be allocated for free when transitional assistance is needed, and border adjustment cannot prevent leakage. Additionally, unlike certain other industries, the public policy justification for free allowances is not present in the application to the fuels sector. Furthermore, with a three-year delay in application, these entities are allowed time to invest in energy-efficient technologies while their emissions are recorded and reported to CARB.

A rigorous methodology must be created before 2012 to assess the need for free allocations and prevent windfall profits for industrial entities.

The current proposal lacks a schedule for reduction of free allocations, and there is no indication that CARB will phase out free allocations. The language remains vague in addressing any assessment methodology that will be used to evaluate at-risk sectors. Greenlining believes that a more specific and transparent assessment process must be developed before the first compliance period begins to effectively measure the need for free allocations.

Industrial sector emitters should be required to submit information on its production cost and revenues to ensure that free allocations do not result in windfall profits for these entities. This will determine whether consumers are actually shielded from spike in energy price as a result of free allocations. To assess whether the free allocations are providing transitional assistance, CARB needs to also assess if entities are indeed using free allowances to invest in energy-efficiency or renewable sources. The information that entities provide will be confidential on an individual level, and be used to compose sector-wide analysis. Entities should be required to submit the information beginning in 2012, and CARB should provide an analysis that evaluates the sector's ability to pass through costs, and make adjustments to prevent leakage.

CARB's proposal stresses the considerable uncertainty in the industrial sector, and therefore it is crucial to develop a rigorous assessment methodology before the cap-and-trade program is implemented in 2012. It is regressive to give away free allocations to protect at-risk entities if consumers, especially low-income households and small businesses, will not be protected against the costs that entities are able to pass through. The best way to protect consumers is to carefully

---

[4] EAAC Recommendation at pg. 64.

measure the need for free allowances, and ensure that entities will not receive undeserved windfall profits.

Competitive wholesale energy markets will be maintained through the "first deliverer" approach.

CARB is proposing to implement a "first deliverer" approach for the electric sector to account for emissions resulting from both power generated in-state and power imported from out-of-state. For imports, the covered entity will be the first entity to deliver power onto the California bulk transmission grid. Electric deliverers include distribution utilities selling at retail and energy marketers brokering at wholesale.

California's own generation resources, which come from mostly natural gas fired and hydroelectric plants, are relatively low-emitting, whereas imported power is relatively high emitting. While much of the electricity consumed is generated from within California's borders, a disproportionate amount of the electricity sector's emissions come from out-of-state generation. This is due to many LDCs having portfolios consisting of high-emitting out-of-state generation sources.[5] Efforts to regulate only in-state sources, which are relatively efficient, would be incredibly expensive and not provide the cost-effective results mandated by AB32. This approach would only result in increased out-of-state power, along with its associated increase in emissions.

The "first deliverer" approach is consistent with the approaches recommended by the Market Advisory Committee, and the Economic Allocation Advisory Committee. This approach will prevent leakage and provides healthy competition between in-state and out-of-state generators. It provides border adjustment to include out-of-state parties, and reduces the need for free allowances. This relieves the economic burden on California state agencies, and will generate revenue to fund low-carbon efficiency and community relief projects. Greenlining suggests that CARB review bordering states' jurisdictions and regulations on generator sources to avoid legal controversies, and only allow free allocations when necessary.

This approach will also continue to maintain the current competitiveness of the wholesale energy market. The allocation and auction mechanism in the proposed regulation is mindful of the fact that some deliverers of electricity are also retail providers. The proposed mechanism ensures that GHG reductions are accomplished equitably and at the lowest cost to consumers.

It is crucial that auction revenues generated in the electricity sector be administered in a manner consistent with the goals of AB 32.

Under CARB's current proposal, auction revenues from the Electric Utility Sectors must be used for the ratepayer benefits that are consistent with the overall goals of AB 32. Greenlining recommends that bill rebates to be made to low-income households, as suggested by EAAC.[6] This is intended to prevent the percentage reduction in real income for low-income households from being greater than that of other household income groups.

---

[5] *See* EAAC Recommendation at pg. 41.
[6] EAAC Recommendation at pg. 65-70.

It is expected that higher prices resulting from placing a price on carbon will have a regressive impact. As a percentage of their incomes, lower-income households will face larger cost increases than upper-income households. Consistent with the policy goals of AB 32, any mechanism which returns the value of allowances to electricity consumers must take this disproportionate economic impact into account. Greenlining also recognizes the importance of not creating a disincentive for energy conservation. As a result, Greenlining favors the use of separate cash rebates, rather than simple bill discounts. These transfers should be done in a way that accounts for disproportionate impacts, rather than an equal across the board subsidy for all households.

While Greenlining generally supports investments in the development of energy efficiency technologies and renewable energy sources, using remaining allocated allowance values should be done in a manner that is consistent with the joint CPUC/CEC Energy Action Plan. Specifically, investments must be prioritized in terms of cost-effectiveness, with a focus on investments in energy efficiency and demand side resources. This ensures that consumers get the most bang-for-their-buck from the revenues that the electricity sector is receiving on the consumers' behalf.

A meaningful portion of revenue generated in the statewide auction must fund a Community Benefits Fund to help reduce the impact of climate change and provide workforce development programs to support California's growing green jobs sector.

CARB staff recommends creating a fund, using revenue generated in statewide auction that addresses AB 32's goals of protecting communities disproportionately affected by climate change. Greenlining supports CARB staff's recommendation of creating a Community Benefits Fund that will "promote projects that simultaneously reduce GHGs and co-pollutants, finance adaptation/preparedness for climate change health impacts, create improvements to mass transit and land use planning, facilitate natural resource conservation, and support non-utility energy efficiency programs."[7]

Greenlining recommends that CARB to include provisions in the regulation that set aside funding for CBF. The funding will be used to mitigate the impact of climate change and air pollution, improve community health programs, and promote green workforce development programs. CBF should only be available to communities that are disproportionately affected by climate change, and Greenlining will work with CARB to identify the most vulnerable communities. Our multi-ethnic and multi-sector collaboration experience will help CARB reach out to communities effectively.

The creation of a green technology workforce training program to help workers transition to the renewable energy sector is crucial. A significant number of workers from communities of color and low-income communities currently work in high-emitting industries, such as cement plants and refineries. As California shifts toward renewable energy, these workers will need proper training to remain competitive in the job market.

---

[7] Initial Statement of Reasons, General Review of Proposed Cap-and-Trade Program November 2010, at pg. II 29-30

Conclusion

Greenlining's belief, that communities of color, low-income households, and minority-owned businesses need to be at the forefront of all public policy considerations, is consistent with AB 32. AB 32 calls for public and private investment in underserved communities to provide opportunities for small businesses, schools, affordable housing associations, and community organizations to participate and benefit from the economic and environmental opportunities associated with GHGE reduction.

In order for California to truly lead the nation in moving toward a healthy clean-energy economy, climate change policies need to adequately address the concerns of the most vulnerable communities. Because underserved communities bear a disproportionate economic and environmental burden, additional access to resources need to be made available to facilitate transition to a viable and just green economy. Moving beyond the cap-and-trade regulation, Greenlining invites CARB to become an active participant in holding dialogues and other outreach efforts to truly understand the needs of communities of color, low-income households, and minority-owned businesses.

Sincerely,

Orson Aguilar	Samuel S. Kang	C.C. Song	Ryan Young
Executive Director	General Counsel	Green Assets Fellow	Legal Fellow