California Council for Environmental and Economic Balance
101 Mission Street, Suite 1440, San Francisco, California 94105
415-512-7890 phone, 415-512-7897 fax, www.cceeb.org

August 18, 2015

Shelby Livingston
Branch Chief, Climate Investments
Air Resources Board
1001 I Street
Sacramento, CA 95814

RE: Cap-and-Trade Auction Proceeds, Funding Guidelines for Agencies that Administer California Climate Investments

Dear Ms. Livingston,

On behalf of the members of the California Council for Environmental and Economic Balance (CCEEB), we wish to provide you with comments on ARB's draft funding guidelines. CCEEB is a non-profit, non-partisan association of business, labor, and public leaders, which advances balanced policies for a strong economy and a healthy environment. Many CCEEB members own or operate facilities regulated under AB 32's "cap," and, as such, provide the funding for California climate investments through the cap-and-trade program. As compliance entities, CCEEB members are responsible for meeting statewide AB 32 GHG reduction targets and have a direct and primary interest in how Greenhouse Gas Reduction Fund (GGRF) monies are spent.

Our chief concern is that we must use these monies wisely and monitor the effectiveness of the program. By maximizing GHG emissions reductions achieved with the limited GGRF funds, California will be able to reach its GHG reduction goals with the least impact to our economy. This is particularly important for medium- and low-income households and small- and medium-sized enterprises because of the extremely regressive nature of energy and transportation costs. Accordingly our key points are:

- Priority should be given to investments that **maximize technologically feasible and cost effective GHG reductions**. This, in turn, maximizes environmental benefits while ensuring fiscal responsibility.
- A process is needed to **ensure appropriate use of funds**.

- A process is needed for the **audit and review of GGRF programs and project investments** in order to determine how successful these have been in achieving GHG reductions.
- ARB must **develop uniform evaluation metrics** and GHG emissions reduction quantification methods in order to inform both investment choices and program review.

We provide detail of each of these points below.

Maximum Technologically Feasible and Cost-Effective GHG Reductions

In our September 15, 2014 comment letter on the interim guidance, CCEEB requested that ARB give priority to investments that maximize technologically feasible and cost effective GHG reductions, as described in AB 32. After reviewing the June 16, 2015 draft funding guidance, we repeat and re-emphasize this comment.

AB 32, as chaptered in Division 25.5 of the Health and Safety Code, makes clear that the overriding regulatory purpose of the law is to achieve the maximum technologically feasible and cost-effective GHG reductions. Ancillary benefits are meant to be achieved "where appropriate," "to the extent feasible," and "where applicable," [1] indicating that these co-benefits are meant to be secondary to the primary goal of maximizing GHG reductions. This directive is repeated in AB 1532 (2012),[2] and is consistent with SB 535 (2012), SB 1018 (2012) and SB 862 (2014).

Unfortunately, the draft funding guidelines are ambiguous and, in some sections, even seem to reverse legislative priorities by directing agencies to merely "reduce GHG emissions," and "maximize economic, environmental, and public health benefits." We note that there is an important distinction between *maximizing* GHG emissions reductions and merely reducing GHGs. **Furthermore, we do not see the term "cost effective" in the document at all.** Given its prominence in the law, we recommend that this be corrected. To partially correct for these reversals in legislative intent, CCEEB recommends that ARB add the following clarifying language to key sections:
[Suggested language is in blue, strikeout is in red]

- Page 11, Section II.F.1 – "All projects funded by the GGRF must maximize technologically feasible and cost-effective GHG reductions ~~reduce GHGs~~…"
- Page 14, Section III.C – "These statutes require that the GGRF allocations be used to facilitate the achievement of the maximum technologically feasible and cost-effective GHG emission reductions…"

[1] See Sections 38562 (b), 38562 (b)(1), 38565, and 38570 (b)(3).
[2] See Section 39712 (b).

- Page 15, Section III.C, first bullet – "~~Reduce~~ Maximize GHG emissions reductions…"
- Page 15, Section III.C, second bullet – "Where appropriate and to the extent feasible, [m]aximize economic, environmental, and public health benefits to the State…"
- Page 15, Section III.D – "GGRF investments need to ~~reduce GHGs~~ maximize GHG reductions based on statutory requirements…"
- Page 21, Section IV.A.1 – reorder first two bullets on page, amend sub-bullets of second bullet to read "…and maximize co-benefits where appropriate and to the extent feasible."

CCEEB agrees with the draft funding guidelines where it states that "[e]ach project supported with GGRF funds must provide real, quantifiable GHG emission reductions…" In order to meaningfully implement the directive to maximize GHG reductions, CCEEB recommends that ARB establish a two-step process whereby administering agencies first quantify expected GHG reductions from proposed projects, and then evaluate ex-post reporting to determine actual GHG reductions achieved. As part of this, the ARB must develop uniform and consistent evaluation metrics and quantification methods. We expand on this need below.

Cost-Effectiveness Needs to Be Part of Project Selection and Review

While one section[3] of the funding guidelines does address the need to prioritize GHG emission reductions, the guidelines completely fail to mention cost effectiveness. CCEEB believes this is contrary to the legislative mandate. More importantly, by ignoring cost effectiveness, programs run the dual risk of missing available GHG reduction opportunities while saddling the economy, consumers, and businesses with unnecessary costs, i.e., it sets up a potential situation of minimum benefit for maximum cost. A third and important reason to include cost effectiveness, both as a priority and as a metric for evaluating results, is that it enables fair accounting and transparency (both worthy goals for government) as well as more robust stakeholder engagement.

Auction revenues are finite from year-to-year, and investment programs are heavily over subscribed, meaning that only a fraction of proposed projects are approved. In simple terms, by prioritizing proposals in terms of maximum cost-effective GHG reductions, the state can ensure the most GHG emissions reductions—along with ancillary environmental and public health benefits—will be achieved for the dollars spent. As ARB staff point out in the 2014 Scoping Plan update, "The strategies we pursue to cut greenhouse gas emissions from our cars, trucks, buses, trains and

[3] Only in Section IV.A.1 do the guidelines mention that GHG reductions should be a priority.

industries can support ongoing efforts to improve air quality up and down the state, especially in our most heavily impacted communities."[4]

Prioritizing projects in terms of cost-effectiveness is also consistent with the legislative intent of AB 32, which seeks to "minimize costs," to the economy,[5] account for "potential adverse effects on small businesses,"[6] and "consider cost-effectiveness"[7]. Direct and indirect costs stemming from cap-and-trade are absorbed by the state economy and the burden is then borne by individual businesses, workers, households, and ratepayers. Direct costs include compliance costs for capped entities and those that must meet direct mandates (e.g. renewable portfolio standard, low carbon fuel standard, and mandatory waste reduction goals); higher energy, fuel, and transportation costs; and higher prices for carbon-intensive goods and services. Indirect costs include leakage of investment and jobs as businesses shift to lower-cost regions outside the state, as well as opportunity costs from investments made towards de-carbonizing industry and energy use.

Achieving reductions through GGRF funds will reduce demand for allowances, meaning consumers and ratepayer will likely see a lower GHG price embedded in the products and energy they consume. Thus, by achieving the maximum number of GHG reductions with limited GGRF funds, California will be able to achieve its GHG reduction goals with the least impact to our economy. As we stated earlier, cost effectiveness has the greatest benefit for low- and medium-income households and small- and medium-sized businesses because of the extremely regressive nature of energy and transportation costs.

For these reasons, **CCEEB strongly recommends that the ARB develop a cost-effectiveness metric**, and that the ARB work with stakeholders to either recommend a range of acceptable costs per unit of GHG emission reductions, or set a minimally acceptable cost per ton. For example, the ARB could develop an index based on allowance prices, or review previously funded projects to demonstrate a range of acceptable costs.

A separate metric should be developed for research and development projects, given that total emission reductions from these investments are future-based and more difficult to estimate. We note, however, that current GGRF programs include no funding for research or development of advanced technologies; GGRF funding is only being directed towards deployment of existing, commercially available technologies or near-

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[4] First Update to the Climate Change Scoping Plan: Building on the Framework, May 2014. Page 100. http://www.arb.ca.gov/cc/scopingplan/2013_update/first_update_climate_change_scoping_plan.pdf.
[5] AB 32, Sections 38501 (h) and 38562 (b)(1).
[6] AB 32, Section 38561 (e).
[7] AB 32, Section 38562 (b)(5).

market technologies. This is an important gap that should be addressed in the next three-year investment plan, currently under development.

Ensure Appropriate Use of Funds

The funding guidelines should explain the actions administering agencies and/or the ARB would take to ensure that funds are used as specified in project applications and in accordance with the guidelines and state regulations. CCEEB believes this gap needs to be addressed, and that a verification and enforcement mechanism needs to be put in place. Consequences for misuse of GGRF funds should be clear and effected expeditiously in order to discourage misuse and to shift funding elsewhere.

ARB staff should work with administering agencies and the Attorney General's Office to develop sound verification and enforcement procedures, make these procedures clear to all project applicants, and act to investigate potential situations expediently. Staff could draw from the robust verification and enforcement system already in place to oversee offset projects. We note that climate investments could play a much bigger role in achieving state GHG targets (and will receive many orders of magnitude greater funding), and as such, warrant an equal and appropriate level of oversight and accountability.

Fiscal Audits and Program Review

The draft funding guidelines makes little mention of the how climate investment programs will be audited or reviewed, saying only that, "[a]ll administering agencies are subject to Legislative and Administrative oversight, including audits by the Bureau of State Audits, Department of Finance, other state oversight agencies, or a third-party auditor."[8] Given the size of the GGRF (estimated between $2.2 billion - $2.7 billion for the 2015-2016 fiscal year) and the importance of meeting statewide climate targets, CCEEB believes that developing a much more rigorous and systematic approach to program audits will provide necessary rigor and assurance that the monies are used wisely to meet GHG goals.

CCEEB strongly recommends that ARB commit to facilitating triennial program audits that are scheduled so that audit findings can inform development of the three-year investment plans. This allows transparency for legislative and administration decision makers, as well as public stakeholders, so they can evaluate the success or failure of programs at meeting statutory requirements laid out in AB 32, AB 1532 and SB 535. Most importantly, audits will help ensure accountability for how GGRF monies are spent. Audits should be based on ex-post reporting from approved projects, applying

[8] Ibid, page 9.

the same evaluation metrics and quantification methods used in project selection. Expenditure information should be compiled by the ARB and reported through a portal on the ARB's website. Program audits should include, at a minimum, quantifiable evaluation of: (1) actual GHG emission reductions as compared to estimated reductions, (2) cost per unit of GHG reductions, (3) total funding by region, and (4) total funding by project type. The ARB and administering agencies could assist with evaluation of qualitative metrics, such as which ancillary benefits were achieved, and to what effect.

CCEEB recommends that the State Auditor be primarily responsible for conducting triennial audits; audit costs could be paid for by auction proceeds. The state's independent external auditor provides objective, accurate, and timely evaluations of state and local government activities, and is the only entity given full access by law to all records of state and local agencies, special districts, and school districts. The State Auditor, a gubernatorial appointee, possesses the authority to perform financial, compliance, performance, and contract audits, as directed by statute or as approved by the Joint Legislative Audit Committee. The purpose of the State Auditor is to assure the performance, accountability, transparency, efficiency, and effective management of public funds and government programs and recommend improvements where needed.

Develop Uniform Evaluation Metrics and Quantification Methods

SB 862 (2014) requires the ARB to develop reporting and quantification methods for administering agencies. Furthermore, AB 32 requires that the cap-and-trade program including the offset program, must achieve GHG reductions that are “real, permanent, quantifiable, verifiable, and enforceable by the state board.”[9] CCEEB believes these criteria should be applied equally to climate investments and serve as the basis for the reporting and quantification methods currently under development.

As noted by the Legislative Analyst's Office (LAO) in June, 2014: "Developing longer-term spending plans often makes sense as they can allow state and local agencies to develop longer-term project planning strategies, particularly for capital and infrastructure programs. In the case of cap-and-trade, however, this interest in planning is challenged by the lack of good data on what specific strategies are most successful and cost-effective in reducing GHG emissions. We do not yet know what state-sponsored efforts will be most effective in the near term, and those strategies will likely change in future years as technologies and consumer behavior change."

CCEEB agrees with the LAO's position and strongly believes that cap-and-trade auction revenues should be wisely and strategically invested to maximize GHG emissions reductions at every expenditure level. As we’ve discussed in this letter, at a minimum,

[9] AB 32, Section 38562 (d)(1).

the metrics and quantification methods should evaluate total expected GHG reductions as well as cost effectiveness, expressed as the cost per unit of reduced GHGs adjusted for its global warming potential.[10] To the greatest extent possible, we recommend that metrics and quantification methodologies be uniform and applied consistently across all administering agencies and investment programs so that a fair and standard evaluation can be made. Sharing information on the actual program and project types allows stakeholder engagement. Without it and without metrics, there is no reasonable ability to participate.

The funding guidelines should better describe the process for developing evaluation metrics and quantification methods, particularly in terms of what opportunities exist for public review and comment. To date, ARB's work seems to have occurred with little or no public participation. The funding guidelines should also describe how the quantification methods will be developed. CCEEB asks ARB to (1) release its proposed work plan for public comment, including information on how the quantification methods will be developed, (2) provide a list of consultants and academic experts who are under contract by the ARB to review these methods, (3) schedule a series of public workshops to seek input on any proposed quantification methods before these are finalized and in time for public comments to be meaningfully considered and acted upon, and (4) commit to a public process for updating quantification methods in the future.

Disadvantaged Communities vs. Disadvantaged Households

AB 1532 requires the State, where applicable and to the extent feasible, to direct GGRF investment "toward the most disadvantaged communities *and households* in the state."[11] [Emphasis added.] CCEEB does not believe that these terms are interchangeable, and as such, guidance in Volumes 1 & 2 related to disadvantaged communities erroneously omits <u>any</u> consideration of low-income households located outside those priority communities identified using Cal/EPA's CalEnviroScreen tool. CCEEB sees no reason to discriminate against low-income households outside of the priority communities, especially since these individuals and families – like all Californians – will bear the burden of higher costs for energy, goods, and services.

There are readily available data sets that identify low-income households that could be used for GGRF purposes. For example, the California Alternative Rates for Energy (CARE) Program and the Low Income Home Energy Savings Assistance Program (LIHEAP) establish scaled criteria based on total household income and the number of persons in a household. These criteria are established and overseen by the statutorily convened

[10] Cost effectiveness as defined in AB 32, Section 38505 (d).
[11] AB 1532, Section 39712 (b)(4).

Low Income Oversight Board. A similar statewide data set is available through the Department of Energy's Weatherization Assistance Program.

CCEEB recommends that ARB work with the Department of Community Services, the Department of Housing and Community Development, and the Department of Public Health to identify appropriate household level data. CCEEB also recommends that staff explicitly consider when programs should target disadvantaged communities as compared to disadvantaged households, and provide guidance to administering agencies to clarify when different screens are appropriate. For example, programs meant to improve low-carbon transit service might best be applied at the community level, whereas programs meant to assist households with energy efficiency, weatherization, or clean passenger vehicles might be more equitably targeted at the household or individual level. To the extent possible, low-income *households* should share in the benefits of California climate investments, especially since these Californians will certainly face higher costs due to climate change regulations.

CCEEB appreciates the opportunity to provide these comments on the draft funding guidelines. We will reach out to staff, ARB board members, and other interested parties to further discuss concepts in this letter, particularly the need for verification and enforcement and program audits. We also look forward to engaging with the ARB as it develops evaluation metrics and quantification methods. In the meantime, please contact Kendra Daijogo, CCEEB climate change project manager, should you have immediate questions (kendra_daijogo@gualcogroup.com and 916-441-1392).

Sincerely,

Gerald O. Secundy

cc: Mary Nichols, ARB Chairman
Bill Quinn, CCEEB Vice President
Kendra Daijogo, CCEEB Climate Change Project Manager
Jackson Gualco, CCEEB Consultant