



BIG VISION, BOLD ACTION

The mission of the Climate Protection Campaign is to create a positive future for our children and all life by inspiring action in response to the climate crisis. We advance practical, science-based solutions for significant greenhouse gas reductions.

www.climateprotectioncampaign.org

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To: California Air Resources Board (CARB)

Re: Comments on the AB32 Scoping Plan

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Please accept the following comments on the AB32 Draft Scoping Plan on behalf of the Climate Protection Campaign. We appreciate CARB's leadership in implementing AB32 to reduce our state's greenhouse gas emissions. The Scoping Plan is an outline for California's emissions reductions to 2020, and it also sets a course for continued dramatic reductions of 80-100% below current levels by 2050.

The majority of these comments focus on market mechanisms. We recognize that market mechanisms are only one section of the Scoping Plan. The regulatory portion is very important, and by law must precede the market, but the market design has the potential to be either the best or worst part of the state's AB32 implementation. Well-designed market measures can produce the right incentives to reduce GHGs throughout the economy, accomplish reduction goals efficiently, and distribute revenues to assist consumers through the transition. However, if designed improperly, market mechanisms can exacerbate inequities, delay real reductions, subsidize or enrich the largest emitters, and do more harm than good.

The Climate Protection Campaign's previous comments to the ARB advocated for:

- 1) An upstream system
- 2) 100% auction of permits
- 3) Compensating consumers on a per capita basis
- 4) A price floor on allowances (potentially as a carbon fee)

The Draft Scoping Plan mentions several of these concepts and is a good start. We ask CARB to consider the following recommendations for the Final Scoping Plan:

- **Auction 100% of permits, with no phase-in**
- **Consumer compensation is the best use of auction revenues**

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In these comments, we also address LADWP's and other's concerns about auctioning, and we support CARB's proposal for Carbon Fees to help pay for CARB's implementation of AB32, and provide funding sources for clean technologies, green jobs, energy efficiency programs, and more.

- **Auction 100%**

Benefits of auctioning 100% of permits

Auctioning 100% of permits is the easiest allocation method to administer, and when coupled with consumer compensation is the method most likely to accomplish the goals of AB32 with the fairest outcomes. Auctioning is based on the principle that the emissions from the fossil fuel industry and other large emitters should have a price greater than zero, and that price will increase, leading to reductions in emissions, allowing alternatives to become more affordable over time, and providing price incentives toward the conservation and efficiency behavior we want to encourage. As long as pollution is free and has no price, companies externalize those costs onto society.

Auctioning fulfills these Market Advisory Committee (MAC) market design criteria:

- reduces the cost of the program to consumers, especially low-income consumers
- avoids windfall profits where such profits could occur
- avoids perverse incentives that discourage or penalize investments in low-GHG technologies and fuels (including energy efficiency)

Under a 100% auction of permits, purchasers will have an incentive to conduct detailed and accurate emission inventories, and have no incentive to inflate their baselines.

Auctioning 100% automatically rewards early action. Companies that have reduced emissions would need fewer permits. In an upstream auctioned system, the price signal automatically rewards downstream companies that have reduced their need for fuel and electricity. Auctioning is the fairest and least discriminatory approach.

Auctioning 100% from the start discourages lobbying and gaming behavior, because it sends a signal that everyone will be on a level playing field, with no special favors or exemptions to be gained through lobbying or political maneuvering.

The immediate announcement of 100% auctioning in the Scoping Plan would provide the lead-time for large emitters to begin reducing their emissions before the market system takes effect in 2010. One approach to lead-time could consist of a forward market, which allows market players to anticipate costs and spread risk across a market before the system starts. When it starts, 100% auction will be anticipated, and all market players will be on a level-playing field.

Using auction revenues for a consumer dividend or rebate provides compensation to households, and hopefully maintains political support for the emissions cap if higher prices result.

Auctioning 100% facilitates linkage between states in a regional system, and to a future national system.

Drawbacks of phasing in an auction through grandfathering allowances

We must learn from, and not repeat, the mistakes of previous cap and trade programs such as the South Coast Air District's RECLAIM program, and the European Emissions Trading System (ETS). Those systems gave away emission allowances for free to historic emitters. Free allowances acted as an incentive and subsidy to continue business-as-usual by rewarding historic emitters. Consumers were not protected because companies raised prices anyway due to the uncertainty and opportunity costs related to the value of the permits.

Unlike jumping directly to 100% auctioning, phasing in auctioning encourages gaming behavior for special treatment. Every interest group will claim it deserves free allowances. The allowances are like money, and everyone has a reason why they need it. Announcing a "phase in" in the Scoping Plan encourages large emitters to wait and see, similar to RECLAIM, and to lobby for a more lenient "phase in" (delay) period. During each step of the phase in, opponents of auctioning will complain about escalating costs and petition for waivers, exemptions, or changing the rules. It would be easier to jump directly to 100% auction, rather than have a drawn out process, hopefully avoiding a repeat of CARB's embattled ZEV process, where opponents fight every deadline.

A giveaway of even of 1% of allowances necessitates the creation of a set of bureaucratic procedures, which will be phased out as the auction takes over. This extra administrative burden would use important CARB staff, time, and resources, which would be better used to implement rules resulting in emission reductions. Phasing in auctioning does not reduce emissions, it allows current emitters to defer reduction decisions as long as they are receiving free allowances. Free allowances are a subsidy to the fossil fuel industry.

Free allowances to established companies discriminates against new market entrants, especially renewable energy providers. If coal is currently cheaper than solar, that gap will be extended by the free allowance value given to coal providers or consumers. Each new administrative rule to compensate for this just makes the giveaway more complex.

Consumers will bear the cost under any allocation method, and throughout the phase in. Under a giveaway, consumers receive nothing, while big business receives a handout. People may (correctly) see this as unfair, and be biased against tighter emission caps and other climate policies in the future, if they think it will only enrich the fossil fuel industry at a time when oil is \$140/barrel and gas is about \$4.50/gallon.

Every allowance that is given to large emitters for free reduces the amount of potential auction revenue available for public trust investment or consumer rebates. In a *phased in* system, auction revenues that could otherwise be returned to consumers through a rebate or dividend would be taken from consumers and given, presumably, to large emitters in order to prevent them from feeling the full impact of the carbon price signal. **But allowing large emitters to avoid a price signal defeats the purpose of cap and trade.**

Phasing in auctioning could also complicate linkages between state and regional systems. Large companies or emitters could play each state's market against the other to try to achieve special favors and free allowances, resulting in a "race to the bottom."

- **Addressing LADWP's and other's concerns about auctioning**

The Los Angeles Department of Water and Power (LADWP) and the Southern California Public Power Authority (SCPPA) have submitted comments to CARB, the PUC, and the Market Advisory Committee opposing auctioning, and asking for a phase in or an exemption from having to buy auctioned permits. We understand their concern about anticipated future costs of a carbon market. However, we feel there are strong arguments for auctioning.

We call the two main arguments they have given the "RPS-first" argument, and the "wealth transfer" argument. We discuss and respond to them below.

Rebutting the "RPS-first" argument

The "RPS-first" argument is the claim that they are already paying for renewable energy to meet their RPS requirements, and they need the money that would otherwise go toward purchasing permits to fulfill the RPS. But, **this argument can be rebutted** in the following way: In the RPS, LADWP is purchasing renewable energy, which is the product they provide to their customers. The RPS is separate from an allowance price in the carbon market that equates to the price of marginal emission reductions across industries. The current price for such marginal emissions is zero. The purpose of creating a carbon market is to make that price greater than zero, in order to provide a market incentive to invest in emissions reductions. If there is a carbon price attached to emission reductions, it will become more cost effective for LADWP to invest more, for example, in energy efficiency to reduce their energy load, or to provide solar panels to customers with large peak-energy use.

If LADWP is exempt from paying an allowance price, but others, such as PG&E or Chevron are not exempt, then LADWP's electricity will carry an unfairly low price in comparison to the other companies' goods. Should LADWP be given special treatment due to the fact that they are locked into long-term contracts for coal-powered electricity? Chevron is locked into providing gasoline. The more companies are exempted from the carbon price, the less efficient the resulting carbon market will be, and the higher the

overall cost to society. Although LADWP may be trying to protect its ratepayers, it would actually be hurting all Californians.

Rebutting the "wealth transfer" argument

The "wealth transfer" argument is that LADWP and other Southern California public utilities have more coal in their electricity mix than other utilities, therefore they would pay more for permits, but when the revenues are reinvested by the PUC or ARB or other state agency, the revenues will not be returned proportionately to the Southern California ratepayers. LADWP uses this argument to claim that by exempting themselves from an auction, they are "protecting" their ratepayers. In this regard, LADWP and the Mayor of LA sometimes use charged rhetoric that they are protecting "the single working mothers of East LA" by fighting against an auction that would raise electricity rates (quoted in the LA Times and heard at a recent LADWP Board meeting). **But, this argument can be rebutted** as follows: if the State provides a per capita dividend that is equal to all Californians, LADWP and every other business or organization cannot claim they were treated any differently than anyone else. We believe the rebate should be provided directly to consumers instead of to the organization to spend on their behalf. LADWP and others can raise their rates, and will not be put out of business. Higher rates will generally be good for the climate because they will encourage conservation and the profitability of transitioning to renewable energy. We agree the regressive impacts do need to be addressed, and that is why we advocate for the per capita dividend.

One unspoken assumption of LADWP's "wealth transfer" argument against auctioning is that costs will not go up under a giveaway or regulations. Costs will most likely go up under any policy, at least during a transition period. Gasoline and oil prices are already high, and natural gas prices are predicted to go up. Keeping coal prices artificially low does not help anyone in LA, and LADWP does not have a moral authority to oppose an auction simply based on their aggressive (though late in comparison to other utilities) RPS goals. An auction with a consumer dividend will provide the incentives to reduce emissions, and LADWP can expand their programs to protect lower-income ratepayers.

Finally, LADWP may have a large carbon footprint liability, but nationally they are not in the worst shape. Consumers in Wyoming carry a much larger carbon footprint, and several coal-dependent states will have a more difficult time than LADWP. LADWP has a large transmission network, and plentiful renewable energy opportunities for wind, solar, and geothermal, which many coal-dependent utilities in other states lack.

Interestingly, energy costs for coal dependent states are much lower than for states with less coal. Under a carbon cap, they will face the largest price increases, and will say that their customers need low prices. However, in 2005 California paid 12.51 cents per kilowatt hour compared to West Virginia's 6.21 cents per kilowatt hour. West Virginia's electricity mix is 98% coal. LADWP's electricity mix is about 47% coal, so they have only half the liability of West Virginia. Rather than opposing a carbon market, LADWP and others should promote market designs that allow for the market to treat all market players fairly, incentivize emission reductions, and compensate consumers.

- **Consumer compensation is the best use of auction revenues**

Using auction revenues to compensate consumers is based on principles of equity. If California limits statewide emissions under a carbon cap, then every person in California has the right to emit as much carbon under the cap as anyone else. If some people want to emit more, then they need to compensate the others. This can be accomplished by giving an equal share of the cap to every Californian. This is based on the principle that the sky belongs to us all. The distribution of the permits representing emissions under the cap is based on equity. Consumer compensation may be accomplished through a per capita rebate, dividend, or share given to all Californians.

On page 47, the Draft Scoping Plan discusses the use of auction revenues, including:

"Consumer rebates – Utilities and other businesses could use revenues to support and increase rebate programs to customers to offset some of the cost associated with increased investments in renewable resources and to encourage increased energy efficiency.

Direct refund to consumers – Revenue from the program could be recycled directly back to consumers in a variety of forms including per capita dividends, earned income tax credits, or other mechanisms."

We ask CARB to include a study on these options in the Final Scoping Plan.

We believe the single best use of auction revenues is to compensate consumers. The reasons for consumer compensation are: it is based on the equitable ownership of the commons; it protects citizens from higher energy prices; it sustains consumer purchasing power, without which all California businesses and households will suffer; and most importantly, it will create and help maintain political support for a carbon cap over time. Other groups have promoted using auction revenues for other purposes, many of which are supportive of the public interest. However, we feel that those other projects and investments should be made with other revenues derived from carbon fees and reductions in subsidies to the fossil fuel industry.

We were pleased that the Draft Scoping Plan mentions the Congressional Budget Office report on regressivity on page 53. Our preferred method to reduce the regressivity of fuel and electricity price increases is a per capita rebate, dividend, or share. The per capita aspect addresses disproportionate impacts to low-income households (who typically use less fossil fuel), and provides a net gain to lower-emission households in comparison with high-emission households who spend more on fuel than they receive in compensation. Per capita dividends or shares would also reward low-emission households of all incomes. A person with a high emission lifestyle would end up spending more on fuel during the year than the dividend he received. By contrast, a low-emitting person would finish the year with a net income from the dividend. Again, those low-emitting people would generally be lower-income, addressing regressivity.

If revenues raised in an auction are returned to consumers on a per capita basis, this is scalable and can be adopted by other states in the WCI, and eventually a national or international system. If, instead, CARB attempts to meet environmental justice goals by providing certain communities with set-asides (for example, 15% of revenues from an auction set aside for certain communities), this directly accomplishes the goal, but it may be a politicized and contentious process. Other states may have different outcomes depending on their demographics and political clout of disadvantaged communities. Nationally, there will be a patchwork of different policies and set-asides. When different groups achieve more political power, they may seek to change or dismantle the system, similar to the gaming and lobbying problem with giving away allowances instead of auctioning them. A per capita dividend, rebate, or share is a simpler, more transferable, and more inclusive approach.

We encourage CARB to commission a study on consumer compensation. Four possible methods of consumer compensation are: 1) using revenues from an auction of allowances for a cash dividend to consumers (the Sky Trust model similar to the Alaska Permanent Fund, this is now called Cap and Dividend), 2) using revenues to finance a tax break to consumers (similar to the Earned Income Tax Credit), 3) an earmarked credit (such as a coupon for Energy Star appliances, transit passes, or hybrid cars), or 4) distributing a share to consumers representing the emissions (which could be sold to regulated companies in a private market), called Carbon Share. These methods should be studied.

In presenting Cap and Dividend, we are sometimes asked why should “rich” people also get rebates or dividends. The argument is that they are rich and don’t need \$500. If you give them \$500, they will spend it on airfare or something that requires additional fossil fuel consumption. These advocates believe that if there are to be rebates, they should go exclusively to low-income people, or the rebates that do go to middle and upper class people should be “earmarked” to be used only on Energy Star appliances, transit passes, or solar energy systems. There are two reasons why we disagree with this argument. First, the universality of the program makes it transparent and acceptable to everyone. The idea that even the rich get a rebate makes it a societal pact equivalent to Social Security. Second, the rich also “own” a piece of the sky, and therefore they are entitled to their share of the societally created rents on allowances. Wealthy people will still spend more on average than they receive, and the incentive will still be for them to reduce their emissions in order to come out ahead at the end of the year.

In summary, consumer compensation may provide popular political support for further emission reductions, and if done on a per capita basis, would address disproportionate impacts and environmental justice concerns. It is the best use of auction revenues.

More information on consumer compensation may be found at the following websites: www.capanddividend.org, www.carbonshare.org, or www.climateprotectioncampaign.org.

- **Other funding sources for cleantech, green jobs, etc.**

Page 47 of the Draft Scoping Plan, cited above, describes potential uses of auction revenue, including subsidies to industries, research & development of new technologies, job transition assistance, adaptation, planting trees, and more. CARB will probably receive comments from other advocacy groups stating that the funds should be used exclusively for public goods such as low-carbon technology research and development, public transit, weatherization, or energy efficiency. Many states already have public goods charges for energy efficiency. There are many subsidies for renewable energy, including tax breaks and rebates. We believe that rather than coming from auction revenues, the best funding sources for these public goods are carbon fees and redirecting the subsidies currently going toward fossil fuel producers.

The Scoping Plan mentions a Carbon Trust that invests in clean technologies and research and development, an idea promoted in the ETAAC Report. The private sector should be the main funder of the Carbon Trust. This can be accomplished through targeted fees or other incentives.

Auction revenues should be reserved specifically to compensate consumers for higher fuel and electricity prices.

- **Support for immediate implementation of carbon fees**

We support CARB's proposal in the Draft Scoping Plan for a set of carbon fees. We believe these fees can co-exist alongside an auctioned permit system such as Cap and Dividend. The fees do not replace an auctioned permit system. The revenues from such fees should help cover CARB's administrative costs to implement AB32, and to raise revenues to invest in the public goods mentioned above, allowing auction revenues to be reserved for consumer compensation.

- **Other design elements for a capped carbon market**

Some of the following design elements have been mentioned in previous Climate Protection Campaign comments, and are summarized here.

An upstream system

An upstream system is the most comprehensive, and requires the least amount of administration from CARB. Although some people believe a system must focus on facilities, an upstream system could also encompass transportation fuels. The point of regulation for transportation fuels could be at the Terminal Rack.

The WCI must allow for States to Buyback or Buydown the allocations

It is important not to penalize California for making further reductions than the regional cap. In other words, if California makes steep reductions, then another state in the WCI should not be allowed to generate more emissions. This could be accomplished by allow-

ing the state or actors within the state to withhold, buy back, buy down, or retire allowances.

Regarding a Western States regional system, perhaps allocations would be given to the States to auction, and revenues would be recycled to consumers at the state level through the State Income Tax system. This would be simpler than creating a regional revenue stream with awkward politics.

Include transportation

It is best to include transportation in the carbon market at the beginning. It will be harder to include it later, and the design of the system should assume from the beginning that transportation will be included.

Limit offsets

Offsets should be limited as a percent of the program, and also limited by geography to prevent “hot spots.” Offsets can allow reductions in sectors not covered by the cap to have a market value, but should not substitute for permits. Additionality has been problematic in current offset programs. Also, forward accounting is problematic (counting 20 years of reductions in advance all at once), and the forestry sector has issues. Scientists predict increased wildfire in the West, and all those carbon offsets could go up in smoke. The current Northern California fires are a warning.

California’s Market Advisory Committee suggested that **performance standards for offsets** are necessary. One offset category in the Agriculture sector could be biodigesters at dairies. The Straus Family Creamery in Marin County, CA has a biodigester which is an example of a project that reduces greenhouse gas emissions from cows, provides renewable energy, and can provide an additional revenue source for the dairy industry. We do not feel that CDM credits are acceptable for California or the WCI. The CDM lacks the necessary accountability, and there are horror stories about Chinese factories selling millions of dollars of CDM credits and using proceeds to fund coal fired power plants. All offsets, especially out-of-state offsets, should be limited.

Price floor for permits

We have encouraged a price floor reserve price for allowances as a design element for a Cap and Auction system. It can be implemented through a carbon fee that rises over time. This reduces low-end price volatility, and can help companies justify long term capital investments in low-carbon technologies.

Unlike our support for a price floor, we are cautious about a price ceiling, which may inhibit companies from receiving a price signal.

Finally, we were pleased to see CARB mention its close working relationship with local air districts in the development and enforcement of regulations to implement the Scoping Plan. The air districts and local governments will be important partners in developing, monitoring, and enforcing AB32.

Thank you for your consideration.

Sincerely,

Mike Sandler
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Executive Director