

Selected Policy Statements & Framework Regarding Allocation of GHG Allowances and Auction/Fee Revenue

California Global Warming Solutions Act of 2006 (AB32)¹

Part 1: GENERAL PROVISIONS

“... investing in the development of innovative and pioneering technologies will assist California in achieving the 2020 statewide limit on emissions of greenhouse gases established by this division and will provide an opportunity for the state to take a global economic and technological leadership role in reducing emissions of greenhouse gases.” (section 38501(e))

Part 4: GREENHOUSE GAS EMISSIONS REDUCTIONS

“The regulations adopted by the state board pursuant to this section shall achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas emissions” (section 38560.5 (c))

“The plan shall identify and make recommendations on ... and potential monetary and nonmonetary incentives for sources and categories of sources that the state board finds are necessary or desirable to facilitate the achievement of the maximum feasible and cost-effective reductions of greenhouse gas emissions by 2020.” (section 38561(b))

“Design the regulations, including distribution of emission allowances where appropriate, in a manner that is equitable, seeks to minimize costs and maximize total benefits to California, and encourages early action to reduce greenhouse gas emissions.” (section 38562(b)(1))

“Ensures that activities undertaken to comply with the regulations do not disproportionately impact low-income communities” (section 38562(b)(2))

“Consider overall societal benefits, including reductions in other air pollutants, diversification of energy sources, and other benefits to the economy, environment, and public health” (section 38562(b)(6))

“Minimize leakage” (section 38562(b)(8))

“The state board shall ensure that the greenhouse gas emission reduction rules, regulations, programs, mechanisms, and incentives under its jurisdiction, where applicable and the extent feasible, direct public and private investment toward the most disadvantaged communities in California and provide an opportunity for small businesses, schools, affordable housing associations, and other community institutions to participate in and benefits from statewide efforts to reduce greenhouse gas emissions.” (section 38565)

PART 5. MARKET-BASED COMPLIANCE MECHANISMS “Maximize additional environmental and economic benefits for California, as appropriate” (Section 38570(b)(3))

¹ <http://www.leginfo.ca.gov/bilinfo.html>, selecting AB32 under the 2005-2006 session

California Air Resources Board scoping plan approved December 2008

(pp.35-36 and pp.69-70)

“Allowances and Revenues

Emission allowances represent a significant economic value whether they are freely allocated or sold through auction. Section E includes a preliminary discussion of some of the options that have been suggested for use of allowance value or revenues. ARB will evaluate the possible uses of allowances or revenues as part of the rulemaking process. One approach would be to dedicate a portion of the allowances for such purposes as rewarding early actions to reduce emissions, providing incentives for local governments and others to promote energy efficiency, better land use planning, and other reduction strategies, and targeting projects to reduce emissions in low-income or disadvantaged communities. This type of dedicated use of allowances is typically referred to as an allowance ‘set-aside.’

The California Public Utilities Commission and the California Energy Commission addressed the question of allocation and auction of allowances in their joint proceeding on implementation of AB 32 for the Electricity and Natural Gas sectors. They have recently released a proposed opinion that recommends to ARB a transition to 100 percent auction for the Electricity sector by 2016.²⁸ The CPUC and CE included in their draft opinion the recommendation that all auction revenues be used for purposes related to AB 32, and all revenue from allowances allocated to the Electricity sector and received by retail providers would be used for the benefit of the Electricity sector to support investments in renewable energy, efficiency, new energy technology, infrastructure, customer bill relief, and other similar programs.

The Market Advisory Committee also recommended the eventual transition to full auction within the cap-and-trade program, noting that a system in which California ultimately auctions all of its emission allowances is consistent with fundamental objectives of cost-effectiveness, fairness and simplicity.²⁸ ARB agrees that a transition to a 100 percent auction is a worthwhile goal for distributing allowances. However a broad set of factors must be considered in evaluating the potential timing of a transition to a full auction including competitiveness, potential for emissions leakage, the effect on regulated vs. unregulated industrial sectors, the overall impact on consumers, and the strategic use of auction revenues.

Allowance allocation and revenue use decisions can greatly affect the equity of a cap and-trade system. Addressing both these issues will be a major part of the rulemaking process. ARB will seek input from a broad range of experts in an open public process regarding the options for allocation and revenue use under consideration by ARB and the

²⁸ Op. Cit. The proposed opinion has not yet been voted on by either the CPUC or the CEC. The Commissions are expected to vote on this proposed opinion before the December Board meeting when the Proposed Scoping Plan will be considered for approval.

WCI Partner jurisdictions. This process will evaluate various mechanisms ARB is considering for allowance distribution and potential uses of allowance value, including the recommendations offered by CPUC and CEC. Issues to be considered will include the appropriate timing and structure of a transition to full auction of allowances, the potential need to harmonize the allocation process regionally for certain sectors subject to interstate competition, and equity across the various sectors here in California.”

“E. Use of Allowances and Revenues

Revenues may be generated from the implementation of various proposed components of the Scoping Plan, including by the use of auctions within a cap-and-trade system or through the imposition of more targeted measures, such as a public goods charge on water. These revenues could be used to support AB 32 requirements for greenhouse gas emissions reductions and associated socio-economic considerations. This section summarizes some of the recommendations and ideas that ARB has received to date. As discussed in the description of the cap-and-trade measure above, ARB will seek input from a broad range of experts in an open public process regarding the options for allocation and revenue use under consideration.

The Economic and Technology Advancement Advisory Committee (ETAAC) recommended the creation of a California Carbon Trust as a possible mechanism for using revenues generated by the program, leveraged with private funds, to further the overall program goals. ETAAC’s recommendation is roughly based on the United Kingdom Carbon Trust. The United Kingdom program was established with public funds, but now functions as a standalone corporation, providing management and consulting services to corporations and small and medium businesses on reducing greenhouse gas emissions. It also funds innovations in carbon reduction technologies. ETAAC recommended the creation of a similar organization that would use revenue from the sale of carbon allowances or from carbon fees to:

- Fund research, development and demonstration projects,
- Help bring promising and high potential technologies through the often challenging early stages of development and get them to market,
- Manage the early carbon market and mitigate price volatility, purchasing credits and selling them or retiring them as needed,
- Dedicate resources to fund projects to achieve AB 32 Environmental Justice goals, or
- Support a green technology workforce training program

The most appropriate use for some of the allowances and revenue generated under AB 32 may be to retain it within or return it to the sector from which it was generated. For example, CEC and CPUC specifically recommended that significant portions of the revenue generated from the electricity sector under a cap-and-trade program be used for the benefit of that sector to support investments in renewable energy, efficiency, new energy technology, infrastructure, customer utility bill relief, and other similar programs. In the case of more targeted revenues from a public goods charge, the intent would be to use the funds for program purposes within the

sector in which it was raised, for example in the water sector. ARB will seek input from a broad range of experts in an open public process, and will work with other agencies, the WCI partner jurisdictions, and stakeholders to consider the options for use of revenues from the AB 32 program.

Possible uses of allowances and of the revenue generated under the program include:

- **Reducing costs of emissions reductions or achieving additional reductions** – Funding energy efficiency and renewable resource development could lower overall costs to consumers and companies, and provide the opportunity to achieve greater emissions reductions than would otherwise be possible. Program revenues could be used to fund programs directly, or create financial incentives for others.
- **Achieving environmental co-benefits** – Criteria and toxic air pollutants create health risks, and some communities bear a disproportionate burden from air pollution. Revenues could be used to enhance greenhouse gas emission reductions that also provide reductions in air and other pollutants that affect public health.
- **Incentives to local governments** – Funding or other incentives to local governments for well-designed land-use planning and infrastructure projects could lead to shorter commutes and encourage walking, bicycling and the use of public transit. Funding of other incentives for local governments could also be used to increase recycling, composting, and to generating renewable energy from anaerobic digestion.
- **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.
- **Climate change adaptation programs** – Climate change will impact natural and human environments. Program revenues could be used to help the state adapt to the effects of climate change which will be detailed in the State's Climate Adaptation Strategy being prepared by the Resources Agency to be completed in early 2009.
- **Subsidies** – Revenues could be used to reduce immediate cost impacts to covered industries required to make substantial upfront capital investments to reduce greenhouse gas emissions.
- **RD&D funding** – Revenues could be used to support research, development, and deployment of green technologies.
- **Worker transition assistance** – Regulating greenhouse gas emissions will probably shift economic growth to some sectors and green technologies and away from higher carbon intensity industries. Worker training programs could help the California labor force be competitive in these new industries.
- **Administration of a greenhouse gas program** – A portion of revenues could be used to underwrite the State's AB 32 programs and operating costs.
- **Direct emission reductions** – Revenues could be used to purchase greenhouse gas reductions for the sole purpose of retirement, providing direct additional

greenhouse gas emission reductions. Potential projects, such as afforestation and reforestation, would both sequester CO₂ and provide other environmental benefits.

Many of the potential uses of revenue would help ARB implement the community benefit section of the AB 32 (HSC §38565) which directs the Board, where applicable and to the extent feasible, to ensure that the greenhouse gas emissions reduction program directs public and private investment toward the most disadvantaged communities in California.”

California Advisory Committee Recommendations to CARB:

Environmental Justice Advisory Committee/Economic and Technology Advancement Advisory Committee Joint Letter December 9, 2008 letter

(note: page numbers refer to ETAAC report available at www.etaac.org)

“C. **Allowance Allocation Method** p. 9-3

EJAC endorses the arguments presented against free distribution by “right”, i.e. grandfathering.

D. **Use of Auction Revenues** p. 9-4

EJAC endorses investment in GHG reductions and direct air quality improvements in EJ and other communities. “Co-benefits from emission reduction projects, such as improvements in regional air quality in disadvantaged communities, are important state objectives under AB 32 and should be considered when evaluating overall GHG emission reduction strategies.”²

Market Advisory Committee Report, section 6.1 and others:

http://climatechange.ca.gov/market_advisory_committee/index.html

Economic and Technology Advancement Advisory Committee Report,

section 2A, section 8, and others: <http://www.etaac.org/>

² <http://www.arb.ca.gov/cc/ejac/ejac-etaac%20final%20signed%20letter%20december%2009,%202008.pdf>

Design Recommendations for the WCI Regional Cap-and-Trade Program - September 23, 2008

All partners commit to supporting one or more of the following public purposes that are expected to achieve region-wide benefits through allocation of allowances, distribution of auction revenues, or other means:

- “Energy efficiency and renewable energy incentives and achievement;
- Research, development, demonstrations, and deployment (RDD&D) with particular reference to carbon capture & sequestration (CCS); renewable energy generation, transmission and storage; and energy efficiency;
- Promoting emission reductions and sequestration in agriculture, forestry and other uncapped sources; and
- Human and natural community adaptation to climate change impacts. “

...and “may consider” the following for the remaining value of the allowance budget

- “Reducing consumer impacts, especially for low-income consumers;
- Providing for worker transition and green jobs;
- Achieving emission reductions in communities that experience disproportionate environmental impacts;
- Supporting community-wide efforts funded by local governments to reduce GHG emissions;
- Providing transition assistance to industries;
- Recognizing early actions to reduce emissions; and/or
- Promoting economic efficiency.” (sections 8.2 and 8.3)

“8.7.1. Consistent with applicable state and provincial law, the WCI Partner jurisdictions will auction a minimum of 10% of the allowance budget in the first compliance period beginning in 2012. This minimum percentage will increase to 25% in 2020. The WCI Partner jurisdictions aspire to a higher auction percentage over time, possibly to 100%.
8.7.2. Each WCI Partner jurisdiction has discretion to auction a greater portion of its allowance budget as it sees fit.”

Notes on WCI:

- WCI includes CA plus AZ, MT, NM, OR, UT, WA Manitoba, British Columbia, Ontario, Quebec
- Electricity and industry (inc transportation fuels production) would be included in 2012
- Transportation fuels combustion and smaller residential, commercial, industrial commercial sources would be included in 2015 (section 1, WCI design recommendations)