Local Government Sustainable Energy Coalition

To: Dr. Larry Goulder, Chairman, EAAC
Kevin Kennedy, California Air Resources Board

From: Local Government Sustainable Energy Coalition

Date: November 13, 2009

Subject: **LGSEC Comments to EAAC on Efficiency Windfall**

The Local Government Sustainable Energy Coalition[1] (LGSEC) presents the following description of the "efficiency windfall" challenge to the California Air Resources Board (CARB) and its Economic and Allocation Advisory Committee (EAAC), and offers potential solutions to this issue. The purpose of this document is to constructively contribute to the sound design of California's greenhouse gas (GHG) cap and trade program, align incentives created by cap and trade with local initiatives, and ensure fairness toward entities that help California meet its AB32 GHG reduction targets.

What is efficiency windfall?

The context of this situation is a GHG cap and trade program and the dynamics of energy production and consumption via the electricity grid. Efficiency windfall is the extra allowances held by capped entities in the electric sector because of electricity saving and clean energy initiatives undertaken by non-capped entities. It results because of a disconnect between accounting for GHG emissions under cap and trade on the one hand, and submitting emissions allowances/permits by entities responsible for capped sources in the electric sector on the other. LGSEC characterizes this disconnect by highlighting the following points:

- Electricity saving and clean energy generation projects and programs undertaken by non-capped entities, such as local governments, yield GHG reductions from capped sources in the electric sector, such as power generators or utilities.
- Under cap and trade, each unit of GHG emission (one tonne) that enters the atmosphere from a capped source must have a corresponding permit surrendered on its behalf to demonstrate compliance.

[1] The Local Government Sustainable Energy Coalition includes: the Association of Bay Area Governments, the Association of Monterey Bay Area Governments, the City of Berkeley, the City of Huntington Beach, the City of Irvine, the City of Pleasanton, the City and County of San Francisco, the City of Santa Monica, the County of Los Angeles, the County of Marin, the County of Ventura, the Energy Coalition, the South Bay Cities Council of Governments. Each of these organizations may have different views on elements of these comments.

- Since electricity saving and clean energy projects prevent emissions from entering the atmosphere, capped entities in the electric sector need not submit allowances for the GHG emissions that never occurred.

Due to the GHG reduction created by a local government funded, implemented, and verified electricity saving and clean energy program, entities with capped sources in the electric sector will reap an unearned benefit as they receive surplus allowances to sell, or they are freed from purchasing allowances commensurate with the reductions achieved.

LGSEC notes that unless CARB makes special provisions in its cap and trade program to address the efficiency windfall challenge it will automatically happen. Namely, because of community financing opportunities in California – made possible through AB811 (Levine, 2008) – CARB needs to devise approaches to mitigate this issue.

How to mitigate efficiency windfall?

There are two leading options to address the efficiency windfall challenge, with benefits and drawbacks to both; one of each is provided for each option. With respect to EAAC's report to CARB, LGSEC believes that this issue pertains to methods to allocating allowances and making use of allowance value. Overall, as the cap and trade design process moves forward, LGSEC recommends that CARB take a closer look at ways to mitigate the efficiency windfall challenge.

1. <u>The set-aside approach</u>, which also goes by the name of off-the-top or carve-out. Under this method, CARB would sets aside allowances for the purpose of rewarding energy efficiency or clean energy projects or programs that meet certain criteria. Depending on program rules, non-capped entities that have access to allowance set-asides might either sell them in the "carbon market" to help finance their initiatives or retire them to retain the GHG reduction benefit.

   This method is allowed under the Regional Greenhouse Gas Initiative (RGGI) for voluntary renewable energy purchases (see Model Rule, Section XX-5.3(d)).

   A key benefit of a set-aside approach is that it allows the non-capped entity that caused the GHG reduction to retain the right to claim the reduction to demonstrate that it is meeting a GHG reduction target. For example, if a local government pledges to reduce the GHG emissions under its jurisdiction by a specified amount or percent, then, beginning in 2012 in California when the cap and trade program commences, it must permanently retire an actual GHG permit to substantiate its claim that the electricity saving or clean energy program prevented emissions from entering the atmosphere.

A drawback to a set-aside approach is the potential for high transaction costs to demonstrate that the GHG reduction activity meets CARB's specified criteria.

2. <u>The fund approach</u>, which would consist of revenue collected by CARB (usually from auctioning allowances) to compensate local governments for their initiatives that yield a GHG benefit.

   This method is allowed under RGGI for strategic energy purposes (see Model Rule, Section XX-5.3(b)).

   A benefit of this approach is that it usually has less transaction costs than a set-aside method.

   A drawback of direct payment through a fund approach is that the right to claim the GHG reduction is lost. For example, the GHG reductions associated with a local government energy efficiency program could not be used to help it meet its own GHG target.

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Respectfully submitted,

For THE LOCAL GOVERNMENT SUSTAINABLE ENERGY COALITION

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