January 5, 2010

***Via email to*:** eaac@calepa.ca.gov

Economic and Allocation Advisory Committee (EAAC)
1001 I Street
Sacramento, CA 95814

Re: Criteria for use of Allowance Value

Dear EAAC:

We applaud the Committee's identification of four AB 32-inspired criteria to guide its recommendations on allocating allowance value: cost-effectiveness, environmental effectiveness, fairness, and simplicity. We also note with encouragement the Committee's increased incorporation of these criteria into the report as reflected in the latest draft (released Jan. 2, 2010). We are concerned, however, that the use and application of the criteria remains inconsistent.

The more that the Committee can give CARB and other readers a clear sense of how it weighed the alternative uses of allowance value, the more valuable the Committee's thought processes and ultimate recommendations will be in shaping CARB's cap and trade regulations. To better integrate the criteria into the final report, we urge the Committee to make the following three changes:

1. **Clarify that environmental effectiveness is a key criterion in evaluating all alternative uses of allowance value.**

In both the Introduction (chapter 1.5) and Recommendations (chapter 6.1.1) sections of the current draft, the Committee identifies four fundamental criteria: cost-effectiveness, fairness, environmental effectiveness, and simplicity. Yet, in Chapter 5.2.4, which discusses how CARB should evaluate investment alternatives, the Committee suggests only three criteria: cost-effectiveness, fairness, and accountability and transparency. For both consistency and clarity, we urge the Committee to recommend the same set of criteria to evaluate *all* alternative uses of allowance value, rather than using one set of criteria for three out of four alternatives, and a different set of criteria for the fourth. While "accountability and transparency" may well encompass the rationale underlying "simplicity," we urge the Committee to be consistent in its use of terms.

In particular, we are very concerned about the absence of "environmental effectiveness" from the list of criteria in Chapter 5.2.4. As the Committee makes clear in Chapter 1.5 and 6.1.1, environmental effectiveness is a distinct and critical criterion, rooted in AB 32's mandate to maximize environmental benefits and reduce co-pollutants. Leaving it out or attempting to subsume it in the phrase "various external benefits" within the well-recognized category of "cost-effectiveness" at best risks mischaracterizing the Committee's intentions in the eyes of policymakers and the public. At worst, it could undermine the prospects of financing investments with significant environmental upsides. We urge the Committee to make clear that "environmental effectiveness" is a criterion against which all alternative uses of allowance value should be evaluated.

2. Systematically compare the alternative uses of allowance value against each of the four criteria.

Chapter 4.1 outlines the four main alternative uses of allowance value (prevention of adverse impacts, financing of investments, dividends to the public, and tax rate reduction). Part of the discussion under each alternative invokes one or more of the four overarching criteria as a supporting rationale, but the application of the criteria is neither consistent nor complete. For example, the discussion on dividends highlights fairness considerations, but does not address how well dividending fares under the other three criteria. On the other hand, the report recognizes that investing allowance value is justified from both a fairness and cost-effective standpoint. Although the report discusses each of the main alternatives more fully in Chapter 5, we encourage the Committee to give a balanced summary of the merits of each proposed use of allowance value in Chapter 4.1. Readers that may be less likely to delve deeply into the report should have a clear overview of the strengths, and drawbacks, of each alternative.

3. Apply the criteria to the potential investments discussed in Chapter 5.2.2.

In addition to the broader comparison of the main alternative uses of allowance value in Chapter 4, we encourage the Committee to briefly address how each of the potential investments identified in Chapter 5.2.2 stacks up under the four criteria. Currently, only the section on disadvantaged communities makes this connection. We recommend the Committee build on this approach and summarize the fit between each potential investment and each of the relevant criteria. Given that the report does not make specific recommendations on which investments to fund with allowance value, any additional insight the Committee can provide will add considerable value to the difficult task awaiting CARB and the proposed Advisory Board.

We believe that revising the draft to systematically apply the criteria to all proposed uses of allowance value will more effectively convey to readers the process that the Committee went through, and will better assist CARB in formulating and justifying its regulations on use of allowance value.

Thank you for considering our input.

Sincerely,

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Natural Resources Defense Council

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