

**Comments of Southern California Public Power Authority
on Cap and Trade design issues
to the Market Simulation Group of the University of California Energy Institute
and the California Air Resources Board**

Test the impacts of uneven consignment of allowances to auctions by large utilities

Investor-owned utilities (IOUs), and publicly-owned utilities that are members of the California Independent System Operator, are required to consign all of their allocated allowances to auction (section 95892 of the Cap and Trade Regulation). The proportion of their allowances that they must consign to the November 2012 auction is specified in the regulation: one-third of their allocated 2013 allowances (section 95892(c)(1)). However, there is no rule regarding the proportion of their remaining 2013 allowances that they must consign to each of the four auctions in 2013, or to auctions in future years.

The ARB will freely allocate approximately 90% of allowances in the first compliance period, 2013-2014, leaving only 10% of current vintage allowances for the ARB to auction. Therefore, the large majority of current vintage allowances available to be auctioned in 2013 and 2014 will be the allowances consigned by the large utilities, particularly the IOUs.

If one or more of the IOUs decide (for example) to consign no allowances to the first auctions in 2013, and all of their remaining 2013 allowances to the last auction in 2013, this will have a significant effect on the auctions. Some auctions may have fewer allowances than bids, with a high clearing price, and some may have far more allowances than bids, leading to the auction clearing at the floor price with unsold allowances. The Market Simulation Group should test the possible consequences of such uneven consignment strategies, with a view to determining whether there is a need to constrain consignment patterns.

Test the cost containment potential of double-sided auctions where sellers can establish minimum sale prices

Currently only utilities and the ARB can send allowances to auction, and all sellers at auction must accept the single auction settlement price (section 95910(d)). There is no elasticity of supply in response to demand at the auctions. This may unnecessarily raise the price of allowances. The Market Simulation Group should compare prices obtained under this model with prices obtained in a double-sided auction with the following features:

- All entities (not just certain utilities) are allowed to consign allowances to auction; and
- Entities that do not have an obligation to consign allowances to auction, but choose to do so, are able to set minimum prices at which they will agree to sell each tranche of their allowances at the auction, and are paid as offered rather than paid a single settlement price.

Test the potential to reduce auction over-supply by placing unsold consigned allowances in the consigning entity's holding account

As noted above, the large majority of current vintage allowances available for auction in the first compliance period will be allowances consigned to auction by utilities. As a relatively large number of allowances will be available in the first compliance period it is possible, particularly if economic conditions do not improve, that demand for allowances at the auction floor price may be less than the supply. Allowances that are consigned to auction by utilities and remain unsold at the floor price will be returned to the auction holding account and placed in the next auction (section 95911(f)(4)). This may result in a run of over-supplied auctions.

The Market Simulation Group should test the impact of placing unsold consigned allowances into the consigning entity's holding account instead. This would remove them from the auction pool and give the consigning entity the choice of keeping the allowances for current or future compliance use, or selling the allowances on the secondary market (in which the auction floor price does not apply). This may reduce the chances of having consistently over-supplied auctions in the first compliance period.

Test the effect of reducing bid guarantees for utilities that consign allowances to an auction and bid at that auction

Utilities that consign allowances to auction are, under the current rules, still required to submit a full bid guarantee based on the maximum potential value of their bids (section 95912(i)(2)). However, the financial risk that the bid guarantee is designed to address – a winning bidder not being able to pay for its allowances – is reduced in the case of utilities that stand to receive payments for the allowances they consigned to auction. All allowances a utility consigns to auction will be sold unless the auction clears at the floor price.

The Market Simulation Group should test the theory that there is no increased financial risk to the ARB, but there is a saving in transaction and financing costs, if bid guarantees for utilities that consign allowances to auction are set as follows:

- If a utility submits bids for a number of allowances less than or equal to the number of allowances it consigned (“Consigned Allowances”), the bid guarantee equals the auction floor price multiplied by the total number of allowances in the utility's bid.
- If a utility submits bids for a number of allowances in excess of its Consigned Allowances, the bid guarantee equals the auction floor price multiplied by its Consigned Allowances, plus the maximum value of its bid for allowances in excess of the Consigned Allowances (calculated in accordance with section 95912(i)(2)).