**BEFORE THE**

**AIR RESOURCES BOARD**

**OF THE**

**STATE OF CALIFORNIA**

**COMMENTS OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA (“SIX CITIES”) REGARDING THE MAY 4, 2012 CAP-AND-TRADE PROGRAM ELECTRICITY WORKSHOP**

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**COMMENTS OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA (“SIX CITIES”) REGARDING THE MAY 4, 2012 CAP-AND-TRADE PROGRAM ELECTRICITY WORKSHOP**

The Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the “Six Cities”) appreciate the opportunity to provide further comments following the May 4, 2012 Cap-and-Trade Program Electricity Workshop conducted by the ARB Staff. As indicated in the remarks by several representatives of the Cities during the workshop, the Six Cities are deeply concerned about the impacts of § 95892(d) of the Cap-and-Trade Regulations, which would prohibit use of allowances allocated under § 95892 to offset directly compliance obligations associated with resources scheduled via the market mechanism administered by the California Independent System Operator Corporation (“CAISO”). The discussion below further explains the Cities’ concerns regarding the application of § 95892(d) and proposes an enhancement to the ARB’s Regulations concerning the allowance auction process that would mitigate those concerns.

**Background on Allocation of Allowances and Use for Direct Offsets**

Section 95892 of the Regulations provides for the allocation of allowances to electrical distribution utilities. The express purpose of the allocated allowances is to benefit the retail ratepayers of the distribution utilities. Section 95892(b)(2) further allows Publicly Owned Electric Utilities (“POUs”), such as the Cities, to utilize their allowances as direct offsets against the compliance obligations for POU resources. However, § 95892(d) prohibits the use of allocated allowances to meet the compliance obligations for electricity “sold” into the CAISO markets. Several POUs challenged the limitations in § 95892(d) when those limitations were added to the Regulations in July, 2011.[[1]](#footnote-2)

**Concerns Arising from the Limitations on Use of Allowances for Direct Offset of Compliance Obligations**

The provision in § 95892(b)(2) that generally allows POUs to utilize allocated allowances as direct offsets to their compliance obligations is based on recognition that: (1) POUs remain vertically-integrated and utilize their resources primarily to meet the needs of their retail customers; (2) most POUs do not participate in energy markets for speculative purposes; and (3) many POUs are relatively small entities with limited staff resources that would be burdened by participation in the complex allowance auction process. *See, e.g.*, Final Statement of Reasons at 342, 687. The Six Cities share all of the characteristics enumerated above.

First, the Six Cities all have long-term resource commitments, and they use their resources to serve the needs of their retail customers. Moreover, most of the POUs’ resources external to California are subject to multi-year contracts with binding take-or-pay (contractual “must-take”) provisions. Because the Six Cities are within the CAISO Balancing Authority Area (“BAA”), they have no ability to arrange for transmission of the output of their resources to their customers except through the CAISO. Under the CAISO market structure, all schedules, whether load, generation, or imports, must be “cleared” (or processed) through the CAISO’s market mechanism as “bids” for supply or demand. Unless applied to net sales to the CAISO, the limitations in § 95892(d) would prevent the Six Cities from using any of their allocated allowances as direct offsets to the compliance obligations associated with their resources.

Requiring the Cities to sell all of their allocated allowances into the auction and procure from the auction all of the allowances needed to meet the compliance obligations for the resources used to serve their customers will impose substantial risks and burdens on the Cities. First, the collateral requirements for participation in the auction will be much greater if the Cities are unable to use their allocated allowances as direct offsets. The volume of allowances that the Cities will be forced to purchase through the auction will be greater by orders of magnitude than the residual number of allowances that the Cities would purchase if they were allowed to use their allocated allowances as direct offsets, and the collateral requirements will be multiplied as a result.

Second, if there is any imbalance of supply and demand in the sequential auction process, the prices at which the Cities are able to sell their allocated allowances may be less than the prices the Cities will have to pay to buy allowances to offset their compliance obligations. The potential for mismatches between auction prices for sales and auction prices for purchases will expose the Cities to the risk of potentially catastrophic revenue shortfalls and defeat the ratepayer protection purpose for the allocated allowances. Even if, over an extended period covered by sequential auctions, the prices received for the allowances sold tend to converge with the prices paid for allowances purchased, temporary price volatility and mismatches between sales and purchase prices could impose an unmanageable cash flow and credit support burden on the Cities.

Third, the Six Cities are relatively small entities, and they have limited staff resources. Moreover, it is contrary to their policies to engage in speculative transactions. Requiring the Cities to manage the full range of risks associated with comprehensive participation in the auctions will impose an unwarranted administrative burden and force the Cities’ Staffs to engage in activities that are outside the scope of their core purpose of providing their customers with reliable electric service at reasonable costs.

**New Proposed Measures for Mitigating the Burdens Imposed by the § 95892(d) Limitations**

The Six Cities appreciate the ARB Staff’s willingness to explore alternative approaches to mitigating the burdens imposed on the Cities by the § 95892(d) limitations.[[2]](#footnote-3) The Cities have concluded that three relatively modest and interrelated adjustments to the auction process would provide significant relief from those burdens. The Cities ask that ARB Staff consider the following:

1. Allowing entities participating in the auctions to bid as price-takers for purchases of allowances as well as for sales[[3]](#footnote-4);
2. Ensuring that price-taker bids to purchase that are balanced by price-taker consignments to sell clear in each auction; and
3. Allowing allocated allowances consigned for sale on a price-taker basis to serve as collateral for price-taker bids to purchase allowances.

The Six Cities envision that the price-taker option would be available to any entity participating in the auction process, and, therefore, there could be no claim that the price-taker option would confer preferential treatment or an unwarranted advantage on any participant or subset of participants in the auction.

Allowing price-taker bids to purchase allowances as well as to sell them and ensuring that price-taker bids will clear against each other would reduce substantially the financial risks and burdens associated with potential price volatility and imbalances in supply and demand for allowances that the Cities (and many other auction participants) would otherwise face. For example, on the one extreme, if the supply of allowances that is offered for sale into the auction far exceeds the demand for allowances in the auction, then the supply of allowances will be rationed to match the demand. In such instances, the Cities may have their demand for allowances satisfied but fail to receive matching auction proceeds from the sale of consigned allowances due to the rationing of supply. This would cause cash flow issues at a minimum, even if the Cities only intended to be passive participants in the auction to buy back the exact amount of consigned allowances they sold into the auction. On the other extreme, if the demand for allowances far exceeds the supply of allowances in the auction, then the allowances sold will be rationed to match the supply. In such instances, the Cities may be outbid by other purchasers and unable to purchase back the exact amount of consigned allowances they sold into the auction. Either of these two extremes (and potential variants in between) will introduce unacceptable and unmanageable financial risks to the Cities.

Granting the Cities (and any other auction participant that so chooses) the ability to submit balanced price-taker bids for sales and purchases will protect the Cities from the risk of a revenue short-fall that otherwise could occur due to mismatches in either quantity or price or both between the consigned allowances they must offer to sell into the auction and the allowances they may choose to buy from the auction. In addition, allowing the Six Cities (and any others that wish to do so) to participate in the auction as price-takers will reduce the complexity and associated administrative burdens for participating in the auctions. The related suggestion to allow allocated allowances offered into the auction on a price-taker basis to serve as collateral for price-taker purchase bids would reduce the amount of collateral required for participation in the auction, thereby reducing the cost burden that otherwise would be imposed on the market participants who may be both sellers and buyers in the auctions.

**Conclusion**

Adjusting the auction process as described in the preceding section will help to preserve the ratepayer protection purpose for allocated allowances and reduce the financial risks and administrative burdens to the Cities without giving rise to any difference in treatment among

market participants. The Six Cities urge the ARB Staff to give careful consideration to these suggestions and look forward to working with ARB Staff to that end.

Respectfully submitted,

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1. *See, e.g.*, “Comments of the Northern California Power Agency on the 15-Day Revisions for the Proposed Regulation to Implement the California Cap-and-Trade Program,” filed Aug. 11, 2011, at 24; “Southern California Public Power Authority Comment on the Proposed Changes to the Cap and Trade Regulation,” filed Aug. 11, 2011, at 28. [↑](#footnote-ref-2)
2. Representatives of the Six Cities and comments submitted by the Southern California Public Power Authority previously have suggested applying the limitations in § 95892(d) to net sales by POUs into the CAISO markets. The ARB Staff has expressed concerns that applying § 95892(d) to net sales could distort prices in the CAISO markets and give rise to legal challenges. *See, e.g.*, Final Statement of Reasons at 2165-65 and 2168. The Six Cities do not agree that these concerns outweigh the interference with the ratepayer protection purpose for allocated allowances that would occur as a result of the application of the § 95892(d) limitations to all of the Cities’ “transactions” in the CAISO markets. The Six Cities generally Self-Schedule their resources as price-takers in the CAISO markets, represent a very small percentage of the total load in the CAISO BAA, and constitute an even smaller percentage of the supply bids into the CAISO. Given their predominant practice of self-scheduling as price-takers and their relatively small volume of transactions, there is no possibility that “sales” by the Cities could have a significant effect on CAISO clearing prices. Further, the Cities do not understand why application of the § 95892(d) limitations would expand potential legal challenges beyond ones that already exist. Nevertheless, the Six Cities have worked to develop a different approach that does not give rise to the concerns expressed by the ARB Staff. [↑](#footnote-ref-3)
3. The Six Cities understand § 95910(d)(3) of the Regulations to provide that sales of allocated allowances by consignment to the auction process will be price-takers. If that understanding is not correct, the Cities would propose that the price-taker option suggested above apply to both purchases and sales. [↑](#footnote-ref-4)