

**Comments of the Western Power Trading Forum
to the California Air Resources Board on Auction Design and Enforcement
in the Cap and Trade System**

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The Western Power Trading Forum¹ (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (ARB) on issues related to auction design and enforcement under a cap and trade program raised during the March 23rd stakeholder workshop. On the questions related to auction design, WPTF encourages ARB to look to some of the model design and rules established by the Regional Greenhouse Gas Initiative. While WPTF does not endorse all element of the RGGI auction design (such as the use of a price floor) we believe that on-balance it is a simple, straight-forward model that enjoys broad support from stakeholders. WPTF also supports the use of strict penalties for failing to surrender sufficient allowances or offsets to cover emissions.

Our comments on specific questions raised during the March 23rd meeting are provided below. We look forward to providing additional input on these and other issues as the design of the cap and trade program emerges.

Auction Design Issues

- ***Should entities participating in the auction be required to provide financial assurance of their ability to pay for purchase of allowances?***

WPTF supports a requirement that entities be required to demonstrate their financial solvency as a condition for participating in auctions. We suggest that ARB provide entities with a range of options for demonstrating financial assurance.

- ***Should participation in the auction be limited to entities with compliance obligations?***

WPTF considers that the participation of many buyers and many sellers is a criterion for well-functioning markets. There should not be any restrictions on which entities may participate in the auctions or secondary GHG markets. Allowing market intermediaries to participate in the market will increase market liquidity and ultimately reduce the transaction costs of trading. Further, because a first deliverer approach will be used in the California system, it will be difficult – if not impossible – to determine a priori which entities will have a compliance obligation, since a myriad of different entities, including financial organizations and marketers, regularly deliver power in the California energy markets. Concerns about market manipulation should be addressed through an appropriate market oversight body, not by barring these entities from the market

¹ WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 60 members participating in power markets within the WCI member states and provinces, as well as other markets across the United States.

- ***What information regarding the auction and participants should be disclosed publicly? Information on bidders and whether the bidder is a capped entity? Auction prices and volumes, in aggregate or by sale?***

WPTF considers that the timely public disclosure of information on auction clearing prices and total (aggregate) volume will be essential for price discovery and ensuring transparency of the market conditions. WPTF believes that the information contained in RGGI's market monitor report is useful and appropriate. While we do not see a need for public disclosure of the volumes of individual sales, we can support such disclosure provided that bidder information is kept anonymous. WPTF opposes disclosure of information on individual bidders.

- ***Should purchase limits be established?***

WPTF supports the use of purchase limits on auction participants for individual auctions, provided that auction frequency is at least quarterly. Purchase limits should be set as a percentage of the total auction volume, e.g. 25% as in RGGI.

- ***How frequently should auctions be held?***

WPTF considers that auctions should be held quarterly. This is the frequency adopted in RGGI and it appears to be working well.

- ***Bidding rules: Sealed vs. open bids? Single vs. multiple clearing prices? Number of bidding rounds?***

WPTF recommends that the auction bidding rules should be simple and straightforward. We support the model used by RGGI: a single round, single clearing price auction, using sealed bids.

- ***Reserve bid price?***

WPTF opposes the establishment of price floors or caps and therefore opposes use of a reserve bid price. A main argument for the use of cap-and-trade is precisely that policy makers do not need to take a view on price. Policy makers establish the emission reduction goals that the cap-and-trade system is intended to deliver and the market determines the price at which those goals (the cap) will be met. From these basic principles, it does follow that the price, in the absence of market failure, cannot be too low, or too high. The price will be what is needed to clear the market, particularly in the short-term.

Enforcement

WPTF considers that capped entities within the GHG trading system should be subject to strict penalties for failure to surrender sufficient allowances and/or offset credits to cover emissions. Payment of the penalty should not discharge the non-compliant entity's obligation to make the environment whole.

Additionally, WPTF considers that capped entities be provided an opportunity to respond to any non-compliance allegation. ARB should adopt a protocol by which entities with reported non-compliance can review and comment on the allegations. Before penalties are assessed, both ARB and the entity would benefit from sharing of information and confirmation of the non-compliance.

- ***Should the penalty be significantly higher than the allowance price to deter non-compliance?***

Yes. WPTF believes that compliance penalties should be set relative to and higher than the market allowance price (e.g. 1.5 times the allowance price for each ton in excess of surrendered allowances) so as not to incentivize non-compliance.

- ***Should the penalty amount be fixed, variable or up to ARB's discretion?***

The penalty should be assessed at a fixed rate, relative to market allowance prices.

- ***Should the penalty be denominated in dollars or allowances?***

WPTF is concerned that denomination of the penalty in allowances will increase overall demand for allowances, and thus allowances prices. On the other hand, it may be administratively simpler for ARB and capped entities if the penalty were denominated in allowances.

For this reason, WPTF recommends that individual non-compliance entities be allowed to choose whether to pay the financial penalty or surrender allowances. In the case that an entity chooses to pay a financial penalty, the state would use a portion of the penalty to purchase and retire allowances or offsets equivalent to the quantity of excess emissions of the non-compliant entities to ensure that the environment is made whole.