



Potential Updates for Cost Containment in California's Cap-and-Trade Regulation

April 5, 2016

Workshop Materials and Submitting Comments

- This presentation is posted at:
<http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm>
- The presentation webcast is available at:
<http://www.calepa.ca.gov/broadcast/?BDO=1>
- Written comments may be submitted until 5 pm (PDT) on Friday, April 22, 2016, at:
<http://www.arb.ca.gov/cc/capandtrade/meetings/meetings.htm>
- During this workshop, e-mail questions to:
auditorium@calepa.ca.gov

Workshop Agenda

- ▣ Introduction
- ▣ Cost Containment
 - ▣ Evolution of the Existing Reserve Design
 - ▣ Options for Potential Changes to Reserve Design
 - ▣ Questions and Comments
- ▣ Lunch
- ▣ Workshop on Sector-Based Offset Programs

Primary Cost Containment Features

- Multi-year compliance periods
 - Staff has proposed continuing with multi-year compliance periods, while aligning with the CPP
- Ability to bank compliance instruments
 - For any post-2020 program, staff proposes to continue allowing banking of compliance instruments including pre-2021 vintages
- Limited use of offset credits
 - Staff proposes to continue with the 8% quantitative usage limit
 - EJAC has recommended further limiting or removing offsets
http://www.arb.ca.gov/cc/ejac/meetings/041014/final_ejac_recommendations.pdf
- Allowance Price Containment Reserve (Reserve)

Existing Reserve Funding

- Reserve was funded by allocating a specified percentage of allowances from each annual budget between 2013-2020
- Reserve contains over 141.8 million allowances
- Original Reserve size equal to 4% of budgets through 2020
- All Reserve allowances were issued under existing caps
- So far the Reserve has not been used and Market Prices are below the Reserve Tier Prices

Reserve Depletion

- If Reserve were to be depleted
 - Prices could rise to unacceptable levels
 - Administrative intervention in market may occur
- 2010 choice of “Soft” Price Cap reflected concern with depletion risk
- Reserve Tier Prices increase over time with escalation mechanism both to provide investment incentives and reduce the risk of depletion

Reserve Modifications Adopted in 2014

- Augmentation to Reserve:
 - If the Reserve is depleted, then allowances from future vintage years may be purchased at the higher Reserve Tier Price
 - Mechanism limited to 10% of each future annual budget, excluding allowances already placed in the Reserve
- Sales of future vintage allowances would reduce state-owned allowances in future budget years
- Amount available to replenish the Reserve will depend on post-2020 cap design and the allowances themselves would be under the cap

Cost Containment Policy Reviews

- Emissions Market Advisory Committee (EMAC) Findings
 - Larger Reserve could enable lower Reserve tier prices
 - Narrower difference between Reserve Tier and Auction Reserve prices could reduce rewards for market power at end of compliance periods
 - Link:
<http://www.arb.ca.gov/cc/capandtrade/emissionsmarketassessment/priceceiling.pdf>

- Market Simulation Group (MSG) Findings
 - Existing Reserve could be depleted under very specific conditions based on potential emissions shocks
 - Link:
http://www.arb.ca.gov/cc/capandtrade/simulationgroup/msg_final_v25.pdf

Potential Option: Narrow Range Between Auction Reserve and Tier Prices

▣ Provisions

- ▣ Reduce Reserve Tier Prices but otherwise retain existing Reserve structure
- ▣ Eliminate the 5% increase in Reserve Tier Prices to narrow the range between Tier Prices and the Auction Reserve Price
- ▣ Could also consolidate tiers

▣ Advantages

- ▣ Requires only minor regulation changes
- ▣ Reduces incentives for market manipulation

▣ Disadvantages

- ▣ Would raise depletion risk without a source of Reserve replenishment
- ▣ Obscures market price signal
- ▣ Reduces incentives for investments in direct reductions

Potential Option: Future Vintages at a Premium

- Provisions
 - Allow entities to use future vintages for compliance
 - Charge an in-kind premium for use of the option (e.g., 25% of future vintage allowances used)
- Advantages
 - Does not require Reserve Sale events
 - Provides cost containment without requiring market prices to rise to fixed Tier Prices
 - Limits potential returns to market power compared with Reserve system with wide range between Reserve Tier and Auction Reserve Prices
 - Mechanism requires minor CITSS implementation and regulation changes
- Disadvantages
 - Requires a backfill from the Reserve of the borrowings to moderate the rise in future vintage prices
 - Obscures market price signal
 - Reduces incentives for investments in direct reductions if below actual Reserve Price

Seeking Input on Potential Reserve Modifications

- Should the Reserve mechanism be modified?
- If needed, how could the Reserve be enlarged after 2020?
 - If there is a cap adjustment for 2021, should the difference between the adjustment and the cap be placed into the Reserve?
- Should the Auction Reserve Price and Tier Prices be modified to reduce the possible returns to market power? How do we balance this market power concern with the objective of maintaining incentives for emissions reductions?
- Are there other methods of releasing allowances from the Reserve?

Unsold Allowances

- How the auction system deals with undersubscribed auctions
 - No allowances are sold below Auction Reserve Price
 - Mechanism reduces surplus of allowances on secondary market
 - Unsold allowances remain in Auction Holding Account until two consecutive auctions are settled above the Auction Reserve Price
 - Number of previously unsold allowances returned to auction is limited to prevent their return from causing further undersubscribed auctions

- Does the auction system sufficiently address undersubscription?
 - If allowances remain unsold for long periods of time should they be kept for later auction, placed in the Reserve, or retired?
 - Should allowances remaining in the Reserve at the end of 2020 be carried forward or retired?

Additional Information

- Main Cap-and-Trade Program page

<http://www.arb.ca.gov/cc/capandtrade/capandtrade.htm>

Q&A