On November 14, 2012, and repeated every quarter through 2020, California will conduct tightly controlled auctions for greenhouse gas (GHG) allowances in a landmark greenhouse gas cap-and-trade program. Compliance with cap-and-trade begins on January 1, 2013, with the first California carbon allowances (CCAs) to be surrendered by regulated entities in 2014. For more information, please contact the authors or visit the California Air Resources Board (CARB) website.

Auction basics

Q. Why is California auctioning allowances?
A. Cap-and-trade is a tool for achieving California’s emission reduction targets and at the start of the program approximately 90% of California carbon allowances (CCAs) will be given away for free to companies. Auctioning CCAs sends a price signal on the value of those emissions and guarantees that all regulated entities, large and small, have access to allowances on an equal footing, reducing the risk that the market becomes dominated by a few players. Furthermore, auctioning CCAs generates proceeds the state can use to achieve further policy goals (such as reducing climate change impacts on disadvantaged communities) that may not be achieved if all allowances are given away for free.

Q. Who can participate in the auction and why participate?
A. Compliance (regulated) and non-compliance entities as well as individuals can participate in the auction as long as they register 30 days prior to auction, meet the financial regulatory requirements and post bid guarantees. Approved offset registries, verification bodies, and offset verifiers are not allowed to hold allowances and thus are not eligible to participate.

A regulated entity might participate if it anticipates needing CCAs to cover its emissions, and believes that purchasing them through the auction will be less costly reducing its emissions. A non-regulated entity may decide to participate if it foresees future regulation. For example, a company that falls just below the emissions threshold could trigger regulation under cap-and-trade if it increases production or loses efficiency. Other non-covered entities, such as brokers, non-profits or individuals may wish to participate in order to purchase, sell, or voluntarily retire emission allowances.
Q. How often will auctions take place?
A. The first auction will take place on November 14th, 2012. Auctions will take place quarterly through 2020. Specifically, they will occur on the 12th business day of the second month of each quarter, every February, May, August and November.iii

Q. What is being sold on November 14, 2012?
A. California will hold two simultaneous auctions on November 14, 2012. One auction will allow entities to purchase allowances that can be used for compliance starting in 2013, (first compliance period and beyond) while the second auction will allow entities to purchase allowances that can be used for compliance starting in 2015 (second compliance period). Bidders may purchase allowances for either auction or both. Approximately 21 million allowances for use in 2013 and 40 million allowances for use in 2015 and beyond will be auctioned during a three hour bidding window.iv

Q. What portion of California allowances are offered for sale at auction?
A. Over the lifetime of the program (2012-2020), the percent of total allowances allocated for free to industrial operators starts at approximately 90% and decreases in the second and third compliance periods (2015-2017 and 2018-2020 respectively). This decrease means that more allowances will be available for sale in future auctions. CARB has contracted with experts to analyze whether more free allowances are needed to prevent against emissions leakage and will update the regulation as needed. 100% of the allowances distributed to Investor Owned Utilities (IOU) will be auctioned with proceeds used to benefit electricity ratepayers. Auctioning of Publicly Owned Utility (POU) allowances is determined by individual POU governing bodies.

Auction Rules

Q. What is the auction format?
A. The allowance auctions will be conducted using a single-round, sealed-bid, uniform-price format. Bids will be submitted electronically using a secure internet-based auction platform. This is the same auction format used by the Regional Greenhouse Gas Initiative (RGGI) cap-and-trade program in the northeastern U.S. Under this format, bidders may not communicate with one another, but may submit multiple confidential bids for a specific quantity of allowances at specific whole US dollar amounts. Each bidder receives the quantity of allowances specified in their winning bids at the uniform settlement price. Allowances are bid and sold in lots of 1,000 units (tons).

Q. How will the final allowance price be determined by the auction?
A. With the uniform-price format, the settlement price is the value of the lowest winning bid. The highest bidder is allocated their requested quantity of allowances first, then the second highest bidder, etc until there are no more allowances. Regardless of original bids, all winning bidders pay the same price (the settlement price), though no bid may be selected below the minimum allowable bid of $10 in 2013. In the event that not all allowances offered for sale are purchased, remaining allowances are offered for sale in the next scheduled auction.
Q. What is the California reserve sale and how does it work?
A. If the final settlement price of the auction exceeds a pre-set level identified in the regulation, CARB will hold a follow-on “reserve” auction six weeks after the close of the second auction, and for each auction thereafter. Reserve sales are allowances sold from the Allowance Price Containment Reserve (APCR). The APCR is composed of allowances held back from auction each year - 1% for 2013-2014, 4% for 2015-2017, and 7% for 2018-2020. Allowances from the APCR are divided into three equal-sized tiers – in 2013, one of these tiers will become available at each of the following prices: $40, $45 and $50 (these prices will increase by 5% annually plus the rate of inflation).

Q. Why are future allowances sold? Can entities bank credits?
A. Allowances for future years are sold to ensure that entities with long planning horizons have the opportunity to secure compliance with the regulation early into the program. In combination with the use of a quarterly market, selling future allowances helps prevent a bidder from “shocking” the market with an unexpected large jump in demand for allowances. In addition to selling future allowances, the program rules also allow entities to buy and hold emission allowances until they are needed for future compliance obligations. Holding limits on the number of allowances an entity can retain prevent allowance hoarding.

Auction safeguards

Q. What has CARB done to ensure the integrity of the auction?
A. CARB has taken several steps to ensure proper oversight and security to prevent gaming and illegal market manipulation. The program requires (1) secure program registration; (2) enforced holding and purchase limits; and (3) a centralized allowance tracking system where all compliance instruments, allowances or offset credits, will exist.\textsuperscript{v}

CARB has also contracted with an independent Market Monitor, Monitoring Analytics, LLC to monitor, detect and report any issues related to the auctions, reserve sales and secondary markets. Monitoring Analytics currently operates oversight of the PJM electricity market in the Northeast. CARB and the Market Monitor will review all auction results and financial settlements will not be processed until CARB has certified the auction results. In this role the market monitor acts as a watchdog over the program as a whole. Any questionable behavior is subject to further investigation and prosecution by state enforcement officials.

Q. What types of market simulations or practices have been conducted?
A. CARB organized a practice auction on August 30, 2012 to test the online auction platform and enable users to get familiar with the bidding process. No money or allowances were exchanged during the practice auction as it was designed only to introduce participants to the auction registration and financial services processes and procedures as well as the mechanics of submitting a bid.

CARB has engaged the University of California and other private consultants to perform market simulations. These market simulations are responsible for creating models and running experiments based on the market structure and market rules of California's program. These activities will be used to identify opportunities for program improvement, including identification of market rules that might lead to market disruptions or inefficiencies.\textsuperscript{vi}
After the auction

Q. What auction results will be made publicly available?
A. Auction results will be available to the public in a report that includes (1) the auction settlement price; (2) list of qualified bidders; (3) number of allowances sold at auction, (4) ratio of total quantity of allowances bid to total allowances available for sale and (5) total percent of allowances purchased by compliance entities. Once CARB has certified the auction, results will be posted to both the ARB website and the WCI Auction Platform website. vii

Q. If a compliance entity does not win any bids, how else can allowances be obtained?
A. Compliance entities can obtain allowances through future quarterly auctions or reserve sales held by CARB. Alternatively, entities will be able to buy allowances from other entities that are selling excess, through secondary markets or through purchase of approved offsets. No more than 8% of an entity’s compliance obligation can be met with offsets.

Q. How likely is it that the results of the first auction are reflective of results of future auctions?
A. Since trading activity in the California market is still in its infancy, it is possible that the results of the first auction will not be predictive of long term market dynamics. Differences between the November 2012 auction and future auction may include differences in the settlement price, percent of allowances purchased and number of entities registered.

Q. What will happen to the money that is raised through the auction?
A. All proceeds from the auction of non-utility allowances will go into the GHG Reduction Account. Auction proceeds will be appropriated in accordance with legislation, including the state budget, AB 1532 and SB 535. By law, money raised from the auction will be invested in ways to further the goals of AB32, funding solutions that allow us to reduce pollution, increase clean energy generation, keep energy prices down or lessen the impacts of global warming. Twenty-five percent of proceeds are required to be used in ways that benefit disadvantaged communities.

Q. What is the best resource for additional information on the auction?
A. The Auction Platform allows the public to view and download auction results, see the auctions calendar and other resources. It is available at https://www.wci-auction.org. General information about the program can be found at the Air Resources Board Climate Change Program website at: http://www.arb.ca.gov/cc/cc.htm.

Environmental Defense Fund and the auction - EDF’s role in the auction is focused solely on the successful implementation of California’s cap-and-trade program. EDF participated in the practice auction and has attended all CARB training meetings related to the auction. EDF is committed to understanding and communicating information about the auction process to ensure the program works seamlessly and effectively.

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iii 17 California Code of Regulations §95910
vii http://www.arb.ca.gov/cc/capandtrade/auction/auction.htm and https://www.wci-auction.org/