Comments of the Western Power Trading Forum

to the California Air Resources Board

on Potential Changes to the Cap-and -Trade Program

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The Western Power Trading Forum[1] (WPTF) appreciates the opportunity to provide input to the California Air Resources Board (CARB) on its consideration of amendments to the cap-and-trade program. Our comments below address some of the issues raised at the joint workshop with Quebec on November 16th.

Choice of Pool from which to remove allowances for pre-2030 program reductions.

WPTF appreciate the analyses presented by UC Davis on projected allowance prices under CARB's proposed program budget reductions. While that analysis is helpful in assessing the appropriate the level of budget reduction prior to 2030, and provides insight into the implications of taking the pre 2030 budget reductions entirely from the supply available for auction and allocation versus taking some of the reduction from the APCR and price ceiling supply, it is not yet complete. Given the need for CARB to evaluate the price ceiling, and presumably the APCR price tiers, in light of the social cost of carbon as required by AB398, we request that staff provide analysis and options for these price points before making a proposal on the choice of pool from which to remove allowances. the choice of pool from which to remove allowances.

Auction Supply Adjustment Mechanism

Staff indicate that they are considering a mechanism whereby the supply of allowances made available in the quarterly auctions would be tied to the settlement price. As we understand this option, the supply at any given auction would be reduced if the auction clearing price would be below a pre-determined dollar amount. This mechanism is intended to provide additional price support above the level of the price floor for the year. Such a design mechanism may be desirable in programs, such as RGGI, that are plagued by low allowance prices due to lax program caps, but this is not the case in California. To date, auction clearing prices under the linked California-Quebec programs have consistently been well above the price floors and are forecast to remain high under all of CARB's future scenarios. Additionally, the program already has a mechanism to withhold supply of allowances from the market if an auction clearing price is below the price floor.

WPTF is also concerned that the addition of an auction supply adjustment mechanism could add uncertainty which could cause price volatility. Under today's program, market participants have a reasonable understanding of the supply of allowances, which in turn provides predictability about future prices. This predictability around future supply and prices is important for market participants' ability to make decisions about investment in GHG mitigation, and to plan for acquisition of allowances for compliance purposes.

For these reasons, WPTF does not support the addition of an auction adjustment mechanism.

Cost Containment

As CARB notes, to date the Allowance Price Containment Reserve (APCR) has not been accessed. However, the UC Davis analysis suggests the program may not be so fortunate in the future. At this point, WPTF does not see a need to change the overall framework for the APCR and price ceiling. However, there may be a need to adjust the overall volume of the APCR and may be a need to consider the supply of APCR allowances tier 1 and tier 2 prices in light of the 2030 budget reductions and post

[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 80 members participating in power markets within California and elsewhere across the United States.

2030 trajectory. Again, we look forward to CARB's further analyses shedding light on these questions, before providing specific comment.

Finally, while not specifically covered in the presentation, a question was raised to Quebec during the workshop about offsets. WPTF considers a continued role for offsets as a compliance instrument to be important for cost containment and urges CARB to evaluate the economic impact of increasing offset limits after 2030, particularly in light of potential carbon dioxide removal projects.

Holding Limits

The ability of entities to bank allowances under the cap and trade program in and of itself acts as a cost containment mechanism, as it allows entities to plan for program compliance and hedge against future allowance prices increases. Because the programs allowance holding limit sets the upper boundary on entities' ability to bank allowances, it is important to set this limit appropriately. Reasonable holding limits also help to reduce price volatility and increase market liquidity as the number of allowances declines over time.

The holding limit for any given year is currently set relative to the program budget for that year; as program budgets shrink, the holding limit shrinks. WPTF supports this general approach, as well as maintaining the limited exemption for allowances in an entity's compliance account. However, given that CARB will be adjusting the program caps for the pre 2030 period below those currently set in the regulation, WPTF recommends that CARB modify the formula by adjusting the 'base' or the multiplier so that the year-on-year reduction in the holding limit declines at a lower rate than currently. However, This will help to ensure that entities who have diligently planned for their future compliance are not unduly harmed by the reductions in program budgets. We request that CARB staff evaluate options for adjusting the holding limit formula and provide a proposal to stakeholders at a future meeting.

Other market rules

At the November 16th workshop, staff raised the possibility of changes to market rules to 'enhance liquidity and price volatility' and specifically questioned whether banking provisions should be modified. The ability to bank allowances is an important tool both for compliance management and price hedging. Reducing volatility and maintaining the steadily increasing price signal incentivizes earlier investment in emissions reductions.

Additionally, we are not aware of any incidents of gaming or other inappropriate behavior that would suggest that modification of the banking provisions is necessary to protect the market, nor seen any analysis that suggests that banking by entities is negatively impacting liquidity. Rather, banking creates an additional supply of allowances which can respond to high allowance prices to support market liquidity and stabilize prices as programs budgets decline. Any changes to these provisions, in particular, application of a duration limit to currently banked allowances could undermine market confidence in the program. Lastly, staff note that there has been a steady increase in market participants over time. The large number of market participants in and of itself helps to ensure the liquidity of the market. For these reasons, WPTF opposes any modifications that would limit entities' ability to bank allowances.