

## Client Alert.

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November 20, 2012

# Sold! High Volume, Low Prices Mark California's First Carbon Allowance Auction

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California's first carbon allowance auction on November 14, 2012 featured plenty of demand but a lower-than-expected closing price, based on results released on Monday by the California Air Resources Board (CARB). California's cap-and-trade program requires that certain regulated entities must acquire a carbon allowance for each metric ton of greenhouse gas they emit in the state beginning in 2013.<sup>1</sup> CARB put up for auction 10% of the allowances issued for the first (2013-14) and second (2015-17) compliance periods at a minimum price of \$10 per allowance. Approximately 75 entities submitted bids.

The auction for 2013 vintage allowances closed at a settlement price of \$10.09 per allowance. (Under the auction's procedures, CARB receives sealed bids electronically, allocates the available allowances starting with the highest bidder, and charges to all winning bidders the lowest price that results in the purchase of allowances.) All 23.1 million allowances offered were sold, and CARB received bids for over three times that many. Bids ranged from \$10 to \$91.13 per allowance, with a median of \$12.96. The Hirfindahl-Hershman Index (HHI), which measures the distribution of the allowances among all winning bidders, was 1133 (out of a possible 10,000 if one bidder had purchased all available allowances). Ninety-seven percent of the allowances sold were purchased by entities with a specific compliance obligation in the cap-and-trade program, while the remaining allowances were presumably purchased by others for trading on the secondary market.

As expected given that California's market represents new and unfamiliar territory, demand was not as high for the auction of 2015 vintage allowances: approximately 5.6 million allowances sold out of 39.5 million offered, or about 14%. Due to the lack of demand, the settlement price ended up being the minimum price of \$10, with bids ranging from \$10 to \$17.25. For these allowances, the HHI index was 1485, and 91% of the allowances sold were purchased by regulated entities.

Many analysts had predicted higher prices ranging from about \$11 to \$15, as carbon futures for California allowances have been trading on secondary markets at around \$12. There is some speculation that prices may have been negatively affected due to the uncertainty created by a recent lawsuit filed by the California Chamber of Commerce challenging CARB's auction authority.<sup>2</sup> CARB chairperson Mary Nichols nonetheless heralded the auction as a success, noting that the electronic auction system functioned smoothly, and that the goal of the auction was not to raise money but to "reduce carbon at a good price for the companies covered." By any measure, this auction represents a significant milestone in the regulation of greenhouse gases in the United States, and the sale of these allowances has generated over \$200 million in revenue for California. With legal challenges pending, the future of California's carbon market will remain uncertain for

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<sup>1</sup> See our prior alert "[California Adopts Historic Cap-and-Trade Program for Greenhouse Gas Emissions.](#)"

<sup>2</sup> See our prior alert "[California Drops Hammer on First Carbon Auction Despite Lawsuit.](#)"

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some time, but the cap-and-trade program for now remains intact. CARB's next auction is scheduled for February 19, 2013.

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Morrison & Foerster's Environment and Energy Group has more than four decades of experience in Clean Air Act and climate change issues, globally, nationally, and in California. Along with our Cleantech Group, we are advising clients on the implementation of AB 32, including CARB's cap-and-trade program, and can provide additional detailed insight or advice upon request.

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