

CHAPTER 5: HOW DO I BUY, SELL, AND TRADE COMPLIANCE INSTRUMENTS?

This chapter addresses how an entity may buy, sell, or transfer compliance instruments to meet its cap-and-trade compliance obligations. There are five primary ways through which an entity may buy, sell, or transfer compliance instruments:

- Free allocation by ARB.
- Purchase allowances at auction.
- Purchase allowances at a reserve sale.
- Purchase offset credits from other entities.
- Transfer of allowances or offset credits between entities.

The Regulation provides rules for the conduct of auction and reserve sales. Sections 5.1 and 5.2 in this document address those methods for acquiring allowances. Section 5.4 explains the process governing the purchase and transfer of offset credits and allowances between registered entities. The Regulation does not establish a specific venue, such as an exchange, through which compliance instruments must be purchased or sold. It allows the secondary market to establish its own venues subject to ARB's rules governing the reporting of transfers. Section 5.5 addresses the Holding Limit, which is a cap on the number of allowances which may be held by an entity. Finally, the chapter concludes with Sections 5.6 through 5.9, which address regulatory provisions governing the purchase, trading, and retirement of compliance instruments and actions that ARB may take to manage violations of these provisions.

What sections of the Regulation discuss buying and selling compliance instruments?

Regulation Sections 95910–95914 and 95920–95922 include auction schedules, auction participation application requirements, Allowance Price Containment Reserve (APCR) sale requirements, and trading requirements, and provide information on:

- Quarterly auctions, including auction schedule, current and future vintage auctions, and general requirements (Section 95910).

- Auction format and procedures, including bidding, Auction Reserve Price, auction Purchase Limits, and determination of the auction settlement price (Section 95911).
- Auction administration and participant application, including 60-day auction notification, bid guarantees, and auction certification by ARB (Section 95912).
- Reserve sales from the Allowance Price Containment Reserve (APCR), including APCR schedule, reserve tiers, and purchasing (Section 95913).
- Auction participation and limitations, including information disclosure, corporate associations and the Purchase Limit, and consequences for misinforming the Executive Officer (Section 95914).
- Holding Limits, trading allowances in the secondary market, and reporting the transfer of compliance instruments (Sections 95920 and 95921).
- Banking, expiration, and voluntary retirement of compliance instruments (Section 95922).

5.1. How Do I Purchase Allowances at the ARB Auction? (Sections 95910, 95911, and 95912)

ARB will hold four quarterly auctions per year, at which California GHG allowances will be sold. The auction administrator will publish a public auction notice 60 days prior to each auction. Information in the auction notice will include how to submit a bid guarantee, who the bid guarantee is submitted to, and instructions for information needed to return the bid guarantee to bidders. The auction administrator will also conduct webinars, and the auction platform website will provide additional training resources to bidders.

5.1.1. Who is Eligible to Participate in an Auction? (Section 95914)

All registered covered entities and opt-in covered entities are eligible to register as an auction participant. Most voluntarily associated entities (VAEs) are also eligible to purchase allowances at auction. One specific type of VAE that provides clearing services to exchanges cannot participate in auctions; it may only hold compliance instruments temporarily as it settles trades. Approved offset project registries, verification bodies, and offset verifiers are not eligible to participate in auctions because they are not able to hold compliance instruments under the Regulation.

5.1.2. When Will Quarterly Auctions Be Held? (Section 95910)

The first auction was held on November 14, 2012. Beginning in 2013, auctions will be held once each calendar quarter on the twelfth business day of the second month of each calendar quarter (February, May, August, November). Table 5.1 summarizes the auction schedule. The table also provides an explanation of the sources of allowances for each auction. Note that two separate auctions will be held each calendar quarter (February, May, August, November). The Current Auction will offer allowances primarily from the current vintage. The Current Auction may also include allowances from previous vintages that failed to sell at earlier auctions. The Advance Auction will offer allowances from the vintage three years in the future. For example, the Current Auctions taking place in 2013 will offer 2013 vintage allowances, while the Advance

Table 5.1 Timing of Quarterly Current and Future Vintage Auctions	
Timing of Allowance Auctions	Allowances to Be Auctioned
2012	
November 14 – Current Auction	<ul style="list-style-type: none"> One third (1/3) of the 2013 vintage allowances in utility Limited Use Holding Accounts.
November 14 – Advance Auction	<ul style="list-style-type: none"> All (100 percent) of the allowances designated for advance auction from the 2015 budget year.
2013	
February 19 – Current Auction	<ul style="list-style-type: none"> One fourth (1/4) of the 2013 vintage allowances directly allocated by ARB to auction will be offered. 2013 vintage allowances designated for consignment by utilities from their Limited Use Holding Account.
February 19 – Advance Auction	<ul style="list-style-type: none"> One fourth (1/4) of the 2016 vintage allowances designated for Advance Auction.

Auctions in 2013 will offer allowances from the 2016 vintage.

May 16 – Current Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2013 vintage allowances directly allocated by ARB to auction will be offered. • 2013 vintage allowances designated for consignment by utilities from their Limited Use Holding Account. • Unsold allowances from a previous auction, no earlier than two quarters prior, remaining in the Auction Holding Account.
May 16 – Advance Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2016 vintage allowances designated for Advance Auction. • Unsold allowances from a previous auction, no earlier than two quarters prior, remaining in the Auction Holding Account.
August 16 – Current Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2013 vintage allowances directly allocated by ARB to auction will be offered. • 2013 vintage allowances designated for consignment by utilities from their Limited Use Holding Account. • Unsold allowances from a previous auction, no earlier than two quarters prior, remaining in the Auction Holding Account.
August 16 – Advance Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2016 vintage allowances designated for Advance Auction. • Unsold allowances from a previous auction, no earlier than two quarters prior, remaining in the Auction Holding Account.
November 19 – Current Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2013 vintage allowances directly allocated by ARB to auction will be offered. • 2013 vintage allowances designated for consignment by utilities from their Limited Use Holding Account. • Unsold allowances from a previous auction, no earlier than two quarters prior, remaining in the Auction Holding Account.
November 19 – Advance Auction	<ul style="list-style-type: none"> • One fourth (1/4) of the 2016 vintage allowances designated for Advance Auction. • Unsold allowances returned to auction pursuant to Section 95911(f)(3).
Deadline for Consignment	Auction of Consigned Allowances

In 2012, at least 10 days before the November auction.	Allowances designated for consignment must be transferred to the Auction Holding Account.
Beginning in 2013, at least 75 days prior to the regular quarterly auction.	Allowances designated for consignment must be transferred to the Auction Holding Account.

Why are there two separate auctions each quarter?

The separate auctions on the date of the quarterly auction are required because different vintage allowances are offered in the two auctions. The Current Auction will offer allowances issued for the current allowance budget year as well as previous budget years.

The Advance Auction each quarter will offer allowances issued for the budget year three years into the future for sale. In 2013, these allowances will be from the 2016 budget year. An allowance purchased during the Advance Auction cannot be used for compliance obligations incurred before the vintage year. For example, a vintage 2015 allowance purchased in 2012 cannot be used for compliance until 2016 when allowances are first surrendered to cover emissions from 2015.

What are the sources of allowances to be auctioned?

There are several sources of allowance supply for each current and future quarterly auction:

- Allowances from closed, suspended, or revoked accounts.
- Utility consignment of current vintage allowances from their Limited Use Holding Account.
- Allowances from prior auctions where some allowances were unsold.
- Current vintage allowances supplied by ARB.
- Advance vintage allowances supplied by ARB.

How many allowances will be sold at each auction?

Utilities were required to consign one-third (1/3) of the 2013 vintage allowances in their Limited Use Holding Account in 2012 to the November 14, 2012 auction. The Limited Use Holding Account is used for allowances allocated by ARB to utilities. Investor-owned utilities must consign to auction all allowances allocated to them. Publicly owned utilities can request that ARB place allocated allowances directly in their own Compliance Account, in the Compliance Account of an electrical cooperative or Joint

Powers Authority in which the utility is a member, or in their Limited Use Holding Account.

In 2012, the utilities were required to transfer their allowances for consignment from their Limited Use Holding Account to the ARB Auction Holding Account ten days prior to the auction. The remaining 2013 vintage allowances in utility Limited Use Holding Accounts must be transferred for consignment to the Auction Holding Account for sale at one or more of the 2013 quarterly auctions. For allocations received in 2013 and beyond, all of the allowances in Limited Use Holding Accounts must be transferred for consignment to the Auction Holding Account within one year of being received. Beginning with the 2013 auctions, the consignment decision must occur at least 75 days prior to the auction. This requirement allows the auction notice to include the number of allowances to be sold at each auction.

Utility allocations are calculated by multiplying 97.7 million metric tons by the annual cap adjustment factor, as defined in Table 9-2, Section 95891 of the Regulation. Industrial allocations, in contrast, are based on the previous year's reported and verified product data. In the future, utility and industrial allocations will be made on November 1.

After accounting for direct allocations, the remaining annual allowance budget is auctioned by ARB. The auctions will take place quarterly, with one-quarter of the remaining allowance budget being offered at each auction, along with the other allowance sources, as defined above. For the Current Auctions in 2013 and 2014, allowances from utility consignments will constitute the single largest source of allowance supply.

ARB will supply allowances for the Advance Auctions for allowance vintages from 2015 to 2020. Section 95870(b) requires the Executive Officer to transfer 10 percent of the allowances from the budget years 2015 to 2020 to the Auction Holding Account. Those allowances will be sold pursuant to Section 95910 at advance auctions beginning in 2012. With the exception of the November 14, 2012 auction where all 10 percent of the 2015 vintage allowances were offered, ARB plans to sell one-quarter (1/4) of those allowances per quarterly Advance Auction.

Section 95911(f)(3) requires that when a Current Auction results in unsold allowances, those allowances are redesignated for auction after two consecutive auctions where the settlement price exceeds the Auction Reserve Price. Further, allowances returned to auction can constitute no more than 25 percent of the total allowances available at a quarterly auction. Any unsold allowances from an Advance auction are redesignated for auction during the calendar year of their vintage.

Section 95910(d)(2) requires that allowances from closed accounts (Section 95831(c)), accounts containing allowances in excess of the Holding Limit (Section 95920((b)(5))), or

from suspended or revoked accounts (Section 95921(g)(3)) be consigned to the next auction. Valid ARB offset credits in such accounts shall be retired by the Executive Officer and a like quantity of allowances will be withdrawn from the Auction Holding Account, and those allowances will be consigned to the next auction.

Because of the utility consignment feature, the inability to predict how many allowances will be directly allocated to covered entities, redesignated allowances, and allowances from closed or suspended accounts, ARB will not know the annual budget for the next year's auctions until early November of the previous year. Since the utilities must make their consignment decision no later than 75 days prior to the next quarterly auction, ARB will be able to publicize the number of allowances available at each quarterly auction so that participants can plan their purchases.

5.1.3. Who Administers Each Auction? (Section 95912)

ARB's Executive Officer may designate an Auction Administrator. The Auction Administrator has several duties in administering the auction, including publishing a public notice 60 days in advance of the auction, receiving auction applications from participants, reviewing submitted bids, determining the auction settlement price, and notifying the Executive Officer of the auction results. The Auction Administrator and the financial services administrator are required to treat the information contained in the auction application as confidential business information to the extent permitted by state law.

What is the role of the Financial Services Administrator?

ARB's Executive Officer may designate a financial services administrator to conduct all financial transactions required by the Regulation. The financial services administrator receives and evaluates bid guarantees submitted by auction participants. The financial services administrator notifies winning bidders regarding the number of allowances won and the total payment due. The financial services administrator processes payments for allowances and provides auction proceeds to the state and any entity consigning allowances to auction.

5.1.4. What is the Format of Each Auction? (Section 95911, 95912)

Key Definitions

"Bid guarantee" means a financial guarantee (a letter of credit, for example) submitted by auction participants in advance of a regularly scheduled quarterly allowance auction that guarantees payment for allowances won at auction.

"Auction Reserve Price" means the predetermined minimum price that is the lowest

price at which allowances will be sold at auction.

“Auction settlement price” means the price at which all available allowances in the Auction Holding Account are sold during a regularly scheduled quarterly auction.

This section provides an overview of the auction process, including a brief description of the steps and the bid format as outlined in Sections 95911 and 95912 of the Regulation.

Step 1: *60-Day Public Notice Announcing the Auction*

Section 95912(c) requires the Auction Administrator to publish a Public Notice providing the following information at least 60 days prior to each auction:

- The date and time of the auction.
- Auction application requirements and instructions.
- The form and manner for submitting bids.
- The Auction Reserve Price, below which bids will not be accepted.
- The procedures for conducting the auction.
- The administrative requirements for participation.
- The number of allowances that will be available at each auction, as determined by the Executive Officer.

The first quarter auction notice will include the number of allowances available and the Auction Reserve Price for the calendar year.

Step 2: *Submit Bid Guarantee at Least 12 Days Prior to Auction*

A bid guarantee is a financial security assuring that the bidder cannot default in paying for allowances won at auction. The bid guarantee must be in one or a combination of the following forms:

- Cash in the form of a wire transfer or certified funds, i.e. a bank check or cashier’s check.
- An irrevocable letter of credit issued by a financial institution with a U.S. banking license.
- A bond issued by a financial institution with a U.S. banking license.

Auction participants submit a bid guarantee to the financial services administrator at least 12 days prior to the auction in which they wish to participate. The bid guarantee will be made payable to the financial services administrator and must expire no sooner than 21 days after the date of the auction. The financial services administrator will evaluate the bid guarantee. Once the bid guarantee is found to conform to the regulatory requirements and is accepted by the Executive Officer, the financial services administrator will inform the Auction Administrator of the value of the bid guarantee.

Step 3: *Submit Bids*

Bids can only be submitted during the time the bid window is open on the day of the auction, 10 a.m. to 1 p.m. Pacific Standard Time (or Pacific Daylight Time, when in effect).

Each auction participant will submit a sealed bid to the Auction Administrator. A sealed bid submittal can specify multiple pairs of bid quantities and bid prices; for example, 50,000 allowances at \$22 per allowance and 75,000 allowances at \$15 per allowance. All bidders pay a uniform auction settlement price (see Auction Settlement Price below), and thus bidders are awarded allowances for accepted bids at or above the settlement price. In the example above, a settlement price of \$14 would result in a winning bid quantity of 125,000 allowances at a total cost of \$1,750,000. Bid quantities must be multiples of 1,000 allowances, and bid prices must be in whole dollars and whole cents. Bids are considered binding offers for the purchase of allowances under the rules of the auction.

Step 4: *Ensure Bids Are Above the Auction Reserve Price*

The Regulation specifies that each auction will be conducted with an Auction Reserve Price below which no bids will be accepted. The Auction Administrator will disregard any bids below that price.

In 2012, the Auction Reserve Price is set at \$10 for both the Current and Advance Auctions. The Auction Reserve Price will increase annually from the previous year's level by 5 percent, plus the rate of inflation as measured by the most recent Consumer Price Index for All Urban Consumers. As an example, if inflation was 1 percent, the calculation of the auction reserve price for the 2013 Auction would be $\$10 \times 1.06 = \10.60 .

Section 95911(c)(2) of the Regulation stipulates that ARB will announce the Auction Reserve Price for next year's quarterly auctions on the first business day in December. This information will be announced again on the day of the auction,

before the auction window opens at 10 a.m. PST (or Pacific Daylight Time, if in effect).

Step 5: *The Auction Administrator Evaluates the Bids*

The Auction Administrator will evaluate submitted bids from each bidder, beginning with the highest bid price and proceeding to the lowest bid that is at least equal to the reserve price. Bids and bid quantities must conform to the auction Purchase Limits, the compliance instrument Holding Limits, and the value of the bid guarantee provided by auction participants. Submitted bids that contain bid quantities in excess of the Purchase Limit, the Holding Limit, or the value of the bid guarantee will be rejected in bundles of 1,000 allowances until the bid conforms with the regulatory requirements. Rejected bid quantities will not be considered in determining the settlement price.

Step 6: *Determination of Winning Bidders and Auction Settlement Price*

A basic description of the process for determining winning bidders and the auction settlement price is described below. Section 95911(e) of the Regulation contains a more detailed description.

- Beginning with the highest bid price, bids will be considered in declining order by price.
- The Auction Administrator will sell allowances until the quantity of allowances bid at the next lower price is equal to or larger than the number of allowances still available for sale. This price becomes the auction settlement price paid by all successful bidders.
- Tie bids occur when bidders want to purchase more allowances than are still available at the auction settlement price. Ties are resolved by determining each entity's share of the quantity of allowances bid at the settlement price. Allowances won by each entity are equal to its share times the number of allowances still available, rounding down to whole allowances if necessary. For example, if five bidders each bid for 1,000 allowances and there are 4,000 allowances still available, each bidder would be sold 800 allowances $((1,000/5,000) * 4,000)$.

The reserve price becomes the auction settlement price when all bids are fulfilled and some allowances remain available for sale.

Step 7: *Market Monitoring*

During and after the auction bid window, the Market Monitor will track bids to monitor trends and guard against manipulation.

The Market Monitor will review the conduct of the auction by the Auction Administrator. The Market Monitor will inform ARB whether the Auction Administrator operated the auction according to the Regulation.

The Market Monitor will report its analysis to ARB, which will make the final decision on how to respond to any discrepancy. The responsibility for enforcement of the Regulation lies with the ARB.

Step 8: *Auction Certification*

Following the auction, the Auction Administrator will notify the Executive Officer of the auction results. The Executive Officer will review the Market monitor report, the conduct of the auction by the Auction Administrator, staff auction evaluations, and certify the auction if it met the regulatory requirements.

Step 9: *Financial Settlement*

Following certification of the auction, the Executive Officer will direct the financial services administrator to:

- Notify each winning bidder of the auction settlement price, number of allowances purchased, total purchase cost, and the deadline and method for submitting payment;
- Collect cash payment from winning bidders within seven (7) days of notification of the auction results;
- Use the bid guarantee to cover payment for allowance purchases by any entity that fails to make cash payment within seven (7) days;
- Transfer auction proceeds from the sale of ARB allowances to the Greenhouse Gas Reduction Fund; and
- Distribute auction proceeds to electrical distribution utilities that consigned allowances for auction.

Once auction settlement is complete, the Executive Officer will transfer the allowances purchased into each winning bidder's Holding Account. Allowances may be placed in the winning bidder's Compliance Account if needed to comply with the Holding Limit.

Step 10: *Publish the Auction Results*

The Executive Officer will release the auction results via publication on ARB's website. The following information will be released:

- The legal names of entities qualified to bid.
- The auction settlement price.
- Aggregated or distributional information on purchases with names of the entities withheld.

Additional summary statistics may also be released in the post-auction results report.

5.1.5. *What Are the Requirements if I Want to Participate in an Auction? (Section 95911, 95912)*

- Register with the Compliance Instrument Tracking System Services (CITSS) and establish appropriate accounts prior to the auction.
- Complete an auction participant application with the Auction Administrator at least 30 days prior to the auction date.
- Submit a bid guarantee at least 12 days prior to the auction date.
- Submit one or more bids using the bid protocol specified in the public notice issued by the Auction Administrator.
- Surrender payment for allowances purchased during an auction.

Each step is described in more detail below.

Step 1. *Register with the Cap-and-Trade Program and the Compliance Instrument Tracking System Services*

Auction participants must register with the Cap-and-Trade Program and separately with the Compliance Instrument Tracking System Services (CITSS). Registered entities will have a CITSS General Account Number, which is referred to as a Holding Account in the regulation and this guidance document, and possibly other CITSS account(s). Requirements for CITSS registration are detailed in Sections 95830, 95832, 95833 and 95834 of the Regulation. See Chapter 3 for more information on CITSS and CITSS registration.

Step 2. *Complete an Auction Participant Application (Section 95912(d) and (e))*

An entity must also complete an auction participant application with the Auction Administrator to participate in an auction. Each entity must first register in CITSS because the CITSS account data is used in the auction participant application. Additional auction participant application information will be provided in the 60-day public notice of the auction.

An auction participant application must be completed at least 30 days prior to the auction. ARB encourages auction participants to complete their CITSS registrations as soon as possible and to complete their applications well in advance of the 30-day deadline. ARB's Executive Officer must approve an entity's auction participant application before that entity may participate in an auction. Section 95912 of the Regulation provides more detail regarding this requirement.

Prior to participating in an auction, the Primary Account Representative and Alternate Account Representative that will be authorized to bid on behalf of an entity eligible to participate in the auction must be approved for accounts in CITSS, and the entity must have an entity account in CITSS. Voluntarily associated entities that are participating in the auction as individuals will be required to submit the additional documentation to the Financial Services Administrator, as contained in Appendix A of the Regulation.

Do I need to submit an auction participant application for every auction?

Once an entity's application has been approved, there is no need to reapply unless there has been a material change to the information contained in the approved application, a material change in the entity's Cap-and-Trade Program registration pursuant to Section 95830, or the Executive Officer has made a determination restricting an entity's auction participation pursuant to Section 95914(b). A fact is material if it could influence a decision by the Executive Officer, the Board, or the Board's staff.

The application requires information that ARB needs to correctly apply corporate associations, the Purchase Limit, and the Holding Limit to the acceptance of bids as described in section 95911(e)(3). Other information required by the application is needed for ARB to monitor the auction for potential manipulation.

Further discussion of Section 95914 with respect to prohibited activities is in Section 5.1.9 of this chapter. An entity must inform the Auction Administrator at least 30 days before the auction if there has been a material change to the information. Since much of

the auction participant application information is derived from the CITSS, ARB encourages entities to update their CITSS registration information as soon as possible after a material change occurs.

Example 5.1.5

A material change includes facts including, but not limited to:

- a. Any change in corporate ownership information.
- b. Retaining the services of an advisor regarding bidding strategy or a change in bid advisors.
- c. Any change in a corporate association relationship.

Step 3. *Submit a Bid Guarantee (Section 95912(i))*

As discussed in Section 5.1.4, all registered auction participants are required to provide a bid guarantee to the financial services administrator at least 12 days prior to the auction date.

The Regulation requires the amount of the bid guarantee to be greater than or equal to the maximum value of the bids submitted. Submitted bids that exceed the value of the bidder's bid guarantee will be rejected, in bundles of 1,000 allowances. Only that portion of the bid that exceeds the submitted bid guarantee will be rejected, not the entire bid quantity. Bidders should evaluate their bids or bid schedules as if the bid price for each submitted bid is the auction settlement price. If that bid is accepted, the bidder would win the allowances in that bid, plus any allowances bid for at higher prices. The largest payment obligation from that set of bids is the maximum value of the submitted bids. For example, in Section 5.1.4, the bidder submitted a bid schedule of 50,000 allowances at \$22 and 75,000 allowances at \$15. If the settlement price turns out to be \$22, the entity would owe the financial services administrator \$1,100,000 ($22 * 50,000$); if the settlement price is \$15, the entity would be billed for \$1,875,000 ($15 * 125,000$). For this bid schedule, \$1,875,000 is the maximum value of a set of bids. A bid guarantee greater than or equal to \$1,875,000 would be sufficient for this entity's bid schedule.

This example is not intended to imply that bidders should know exactly their bid schedules at the time the bid guarantee is due. The example does highlight that once a bid guarantee is submitted, the amount of the bid guarantee could constrain bidders on the day of the auction, particularly if the bid guarantee

amount is near the maximum payment obligation implied by a planned bid schedule.

Section 5.1.4 also reviews the regulatory requirements for the types of financial instruments—cash, an irrevocable letter of credit, or a bond—and the Regulation specifies that a combination of those instruments is acceptable. The Regulation also states that if the bid guarantee is needed to complete settlement, the bid guarantee will be used in the following order: cash, an irrevocable letter of credit, and finally, a bond. The bid guarantee must be made payable to the financial services administrator and must expire no sooner than 21 days past the date of the auction.

For those participants bidding in both the Current and Advance Auctions, a bid guarantee is required for each auction. The Regulation allows participants to submit a single bid guarantee rather than two separate guarantees. When the Auction Administrator evaluates submitted bids with respect to the bid guarantee, a single bid guarantee will be evaluated for the Current Auction first, and any remaining balance of the bid guarantee will be applied to the entity's bids in the Advance Auction.

Step 4. Submit a Bid

Most of the regulatory requirements for submitting a bid have been discussed in Section 5.4.1. Additional guidance will be provided in the 60-day public notice from the Auction Administrator. Auction participants should know their auction Purchase Limits (see Section 5.1.6 below) and the allowance Holding Limits (see Section 5.5 of this chapter). Bids in excess of the holding and purchase limits, or of the value of the bid guarantee will be rejected, in bundles of 1,000 allowances, by the excess amount. This evaluation will occur before the Auction Administrator determines the auction settlement price.

Step 5. Surrender Payment

As discussed in Section 5.4.1, after the auction has been certified, the financial services administrator will collect cash payments from winning bidders within seven (7) days of notification of the auction results. Further details, for example, instructions for wiring cash to the financial services administrator, and instructions to be provided by auction participants for the return of any unused portion of the bid guarantee, will be specified in the 60-day public notice.

5.1.6. What is the Auction Purchase Limit? (Section 95911(d))

The Purchase Limit is the maximum number of allowances offered at each quarterly auction that can be purchased by any one entity or group of entities in a direct corporate association. Corporate associations are detailed in Section 95833 of the Regulation (see Chapter 3, Section 3.1 of these guidelines for more information on corporate associations).

The Current Auction Purchase Limit applies to auctions conducted from January 1, 2012, through December 31, 2014. During this time period:

- The Purchase Limit for covered entities and opt-in covered entities is 15 percent of the allowances offered for auction.
- The Purchase Limit for electrical distribution utilities is 40 percent of the allowances offered for auction.
- The Purchase Limit for all other auction participants is four percent of the allowances offered for auction.

The Purchase Limit for all participants in the Advance Auctions conducted each quarter is 25 percent of the allowances offered for auction.

5.1.7. How Does the Auction Purchase Limit Apply to Direct Corporate Associations? (Section 95914(d))

The total of number of allowances purchased by all entities in a direct corporate association must be no larger than the Purchase Limit for the Current or Advance Auction specified in Section 95911(d). Entities in a direct corporate association may allocate shares of the Purchase Limit among themselves. Each entity's Purchase Limit is the entity's share times the auction Purchase Limit assigned to that association. If the allocation is done correctly, the sum of the shares will equal one. For example, if three associated entities decide to equally share the limit, they should allocate one-third to each entity.

If a direct corporate association has entities with a compliance obligation and voluntarily associated entities, the Purchase Limit for the corporate association is 15 percent; the Purchase Limit is 40 percent if the corporate association includes electrical distribution utilities. The total Purchase Limit assigned to all the voluntarily associated entities within the corporate association must be no larger than four (4) percent, with the remainder to be divided among the covered and opt-in covered entities. As an example, if a company has a covered entity with a 15 percent Purchase Limit (such as an oil refinery) as well as a voluntarily associated entity with a 4 percent Purchase Limit (such as a trading desk), then the purchase limit for the covered entity can be between 11 and 15 percent.

For the voluntarily associated entity, the Purchase Limit would be between 0 and 4 percent.

The members of the direct corporate association must report the allocation of the Purchase Limit to the Executive Officer by October 1, 2012 if they have chosen to opt-out of account consolidation. They may change the allocation of the Purchase Limit at the time an auction participant application is submitted. This allocation is in effect for the auction for which the application was submitted. Members of a direct corporate association may change their allocation of the Purchase Limit by informing the Executive Officer and the accounts administrator of the change at least 30 days prior to an auction in order for the change to be in effect for that auction.

If the entities in a direct corporate association do not allocate the Purchase Limit among themselves, the Auction Administrator determines which bids from members of the corporate association will be accepted. The Auction Administrator will do this by ranking the bids from highest price to lowest. Bids from members of the direct corporate association will be accepted until the Purchase Limit for the association is met.

In the case of a consolidated account, the Purchase Limit is not allocated among direct corporate associates. Instead, there is one Purchase Limit for the entire consolidated account. However, if an entity in a consolidated account chooses to opt-out pursuant to section 95833(f), then the purchase limit will be distributed between the remaining consolidated account and the opt-out entity.

5.1.8. Can Allowances Be Banked?

Allowances can be “banked” and held, sold, or bought by an entity in a later year than the allowance vintage, i.e., a 2013 vintage allowance can be held in 2014 and subsequent years. Vintage 2013 banked allowances can be used to satisfy a compliance obligation in a later year, such as 2015 or 2016. See Sections 95920(c)(1) and 95922(a) of the Regulation. The converse (“borrowing”) is not permissible, for example, 2015 allowances purchased at an Advance Auction or on the secondary market cannot be used to satisfy an entity’s 2014 compliance obligation.

5.1.9. What Actions Are Prohibited at Auctions? (Section 95912(f) and 95914)

Section 95912(f) says that a registered entity may not communicate information regarding auction participation with any other entity that is not part of a direct corporate association disclosed to ARB. The exceptions are to respond to a request by the Auction Administrator to remediate an auction application, or to an auction advisor as provided for in Section 95914(c)(2).

Section 95914(a) gives the Executive Officer the authority to cancel or restrict a previously approved auction participation application or reject a new application if the Executive Officer determines that an entity has:

- Provided false or misleading facts.
- Withheld material information from its application, as explained in Chapter 5.1.5.
- Violated any part of the auction rules pursuant to subarticle 10 of the Regulation (Sections 95910, 95911, 95912, 95913, and 95914).
- Violated the registration requirements pursuant to subarticle 5 (Sections 95830, 95832–95834).
- Violated the rules governing trading pursuant to subarticle 11 (Section 95920, 95921, and 95922).

If the Executive Officer determines an entity has committed any violation listed above:

- The Executive Officer may instruct the Auction Administrator to cancel a previously approved auction application or to not accept an auction application from the entity.
- The Executive Officer may instruct the Auction Administrator to restrict the auction application approval for any corporate associate of the entity.
- Any cancellation or restriction imposed may be permanent or for a specified number of auctions.
- The cancellation or restriction imposed shall be in addition to any other penalties, fines, and additional remedies available at law.

Other than to an auction advisor or other members of a direct corporate association that are not subject to auction participation or cancellation, an approved auction participant must not release any confidential information related to its auction participation, including:

- Qualification status.
- Bidding strategy.
- Bid price and quantity information.
- Information on the bid guarantee provided to the financial services administrator.

- Other information identified as confidential in the auction application by the Auction Administrator.

ARB recognizes that some entities are required to make public their auction participation and information related to financial commitments, such as allowance purchases. These entities include utilities that are subject to procurement regulation by the California Public Utilities Commission, and publicly owned utilities that are subject to public accountability rules or rules governing participation in projects operated by Joint Powers Agencies (JPA). ARB does not intend section 95914(c) to prevent the publication of information that is required by the laws and regulations governing these entities. See also Section 95833(c) regarding affiliate compliance rules promulgated by state and federal agencies.

Section 95914(c)(1)(A) includes auction participation status in the list of prohibited disclosures. While the public will learn who participated in an auction after the fact, the prohibition reduces the chances that auction participants can signal others of the intent to bid prior to an auction. Such disclosure could inform other entities of the level of demand to be expected at an auction, or be an invitation to discuss collusive bidding strategies.

ARB understands that disclosure of participation may be required of utilities subject to California Public Utilities Commission (CPUC) regulation or under preexisting operational agreements for JPAs or publicly owned utilities involved in joint participation projects. For example, publicly owned utilities that are members of a generation joint venture with other utilities must fund the project, including providing monies to cover a bid guarantee. Likewise, publicly owned utilities that are members of JPAs that have preexisting arrangements regarding the funding of project operations and acquisition of necessary resources (such as natural gas and emissions allowances) must share acquisition strategies among the participants. Other members of the JPA or joint venture will therefore know of the entity's auction participation. Compliance with these disclosure rules does not violate the intent of the existing regulation.

Section 95914(c)(1)(B) includes disclosure of an entity's auction bidding strategy in the list of prohibited disclosures. The prohibition is intended to prevent collusion between bidders. Under the existing regulation, the public will not learn of any entity's bids or amount won after the auction, as they are considered confidential and will not be published in the auction report. Under the single-price, sealed-bid auction format, the public will not learn anything about how participants bid. Except as outlined herein, auction participants cannot disclose this information to anyone, except under the exceptions in section 95914(c)(2) of the Regulation.

ARB is aware of regulations and laws governing utilities that may require sufficient disclosure of bidding strategy to demonstrate prudence in procurement. Compliance with these regulations and laws does not violate the Regulation. Publicly owned utilities should use procedures for joint ventures that do not require consultations on or disclosures of bidding strategy outside of the parameters defined in their preexisting operational agreements.

Section 95914(c)(1)(C) includes disclosure of bid price or bid quantity information in the list of prohibited disclosures. Allowing disclosure would enable collusion between bidders that the sealed-bid auction format attempts to prevent.

The considerations described above for section 95914(c)(1)(B) also apply to 95914(c)(1)(C). Quantities purchased at auctions may be imputed after the auction based on those disclosures, but this situation cannot be prevented and does not involve a release of information prior to the auction.

Section 95914(c)(1)(D) includes disclosure of information on the bid guarantee in the list of prohibited disclosures. This prohibition was included because it could potentially reveal auction bidding strategy. In most cases, there is also no compelling reason for other bidders to know this information. However, ARB understands that utilities, and publicly owned utilities in particular, may be required to provide a public accounting of the total cost of procurement. They may have no practical way to shield this information. For example, in the case of publicly owned utilities, the participants would be required to support the auction participation of the joint venture project. Information may become available to other auction participants who are members of the project through the mechanism that funds the bid guarantee or the auction purchase. However, this disclosure would be of the members' shares of the cost and would not reveal their individual market or auction strategies. Therefore, ARB considers disclosures required through such funding mechanisms to be consistent with the intent of the provision.

Section 95914(c)(1)(E) includes disclosure of information listed as confidential in the auction application in the list of prohibited disclosures. This provision was added to reflect the possibility that some auction participation information may be added to or subtracted from the list of confidential information contained in the auction notice. The list in the auction notice reflects the provisions of the Regulation, but will identify the specific information in the auction participant application that is confidential in nature.

Section 95914(c)(2) is designed to ensure that when one auction participant uses the services of an auction advisor, the auction advisor does not transfer information on the entity's auction participation to another auction participant.

ARB does not require disclosure of an advisor that simply provides advice based on analysis of market conditions and with whom the auction participant does not share

information listed in section 95914(c)(1). ARB requires disclosure of the auction advisor when the auction participant provides information to its advisor on its compliance needs, financial capability, ongoing acquisitions strategies, the value of bid guarantees already posted, and other information listed in section 95914(c)(1) that influence its acquisition strategy.

ARB's primary concern is that an advisor could transfer such information to other entities that may be market participants. Section 95914(c)(2)(A) requires the auction participant to ensure that the auction advisor has adequate protections against prohibited information transfers. Section 95914(c)(2)(B) requires the advisor to acknowledge its responsibility to comply with the prohibitions. Section 95914(c)(2)(C) includes the requirement to disclose the arrangement to ARB.

5.2 How Do I Purchase Allowances from the Allowance Price Containment Reserve? (Section 95913)

Entities can also purchase allowances from the Allowance Price Containment Reserve (APCR). The APCR sale is similar but not identical to quarterly auctions in terms of the sale process and participation. The most important differences are:

- Entities can purchase allowances at a fixed price; it is an allowance sale, not an auction.
- Participation is limited to covered entities and opt-in covered entities.
- Allowances purchased at an APCR sale are deposited directly into an entity's Compliance Account.
- Allowances purchased at an APCR sale are not associated with a particular vintage year.

The Reserve is intended to provide a ready, though limited, supply of allowances to be used for immediate compliance needs. In addition, as the name of the Reserve implies, the Reserve is intended to limit auction and secondary market prices. In contrast to normally auctioned or allocated allowances, reserve allowances cannot be borrowed or banked because they do not have a vintage year. They are a soft price cap, and depositing them directly into compliance accounts ensures that they are used when needed.

5.2.1. Who Is Eligible to Participate in APCR Sales?

Only registered covered entities and opt-in covered entities are eligible to purchase allowances from the APCR sales. Account representatives submitting bids on behalf of

APCR sale participants must meet the same CITSS and auction participation requirements as for quarterly auctions.

5.2.2 How Often Will APCR Sales Occur, and How Many Allowances Will Be Sold?

APCR sales are scheduled on the first California business day six weeks after a quarterly auction. Table 5.2 summarizes the schedule for 2013 and the first sale in 2014. The APCR allowances are taken from each compliance period budget, in the amount of one percent from 2013–2014, four percent from 2015–2017, and finally, seven percent from 2018–2020, per section 95870(a). Given the compliance period budgets, approximately 121.8 million allowances will be available at the first APCR sale on March 8, 2013. Allowances will remain in the Reserve until they are sold.

Table 5.2 Sales Schedule from Allowance Price Containment Reserve

Timing of APCR Sales	Allowances Available for Sale
2013	
March 8	<ul style="list-style-type: none"> • All allowances in the APCR • APCR Tiers – divided into 3 equal-sized tiers
June 27	<ul style="list-style-type: none"> • All allowances in the APCR • APCR Tiers – divided into 3 equal-sized tiers
September 27	<ul style="list-style-type: none"> • All allowances in the APCR • APCR Tiers – divided into 3 equal-sized tiers

December 31	<ul style="list-style-type: none"> All allowances in the APCR APCR Tiers – divided into 3 equal-sized tiers
During 2013 APCR Sales	<ul style="list-style-type: none"> APCR Tier Prices: <ul style="list-style-type: none"> 1st Tier - \$40 per allowance 2nd Tier - \$45 per allowance 3rd Tier - \$50 per allowance
2014	
April 2*	<ul style="list-style-type: none"> All allowances in the APCR APCR Tiers – divided into 3 equal-sized tiers
Beginning 2014, and every year after	<ul style="list-style-type: none"> Increase in Release Price for APCR Tiers: <ul style="list-style-type: none"> Previous year tier prices, plus 5 percent Plus the most recently available 12-month rate of inflation measured by the Consumer Price Index for all urban consumers. <p>Example: 2014 Release Price for APCR Tiers</p> <ul style="list-style-type: none"> 1st Tier = (\$40) *[1.05 + rate of inflation] 2nd Tier = (\$45) *[1.05 + rate of inflation] 3rd Tier = (\$50) *[1.05 + rate of inflation]

5.2.3. Who Will Administer Each APCR Sale?

What is the role of the Reserve Sale Administrator?

As with the quarterly auction, the Executive Officer can serve as the reserve sale administrator or can designate an entity to administer the APCR sale. For California's program, the reserve sale administrator and the Auction Administrator will be the same entity. Four (4) weeks before the sale, the reserve

sale administrator will provide eligible participants with a written notice detailing the number of available allowances and the terms of the sale. The reserve sale administrator will receive the bids and conducts the APCR sale.

What is the role of the Financial Services Administrator?

The financial services administrator conducts all financial transactions required for sales from the APCR. The entity designated by ARB's Executive Officer for the quarterly auctions will also serve as the financial services administration for APCR sales.

5.2.4. What Will Be the Format of Each APCR Sale?

This section provides an overview of the APCR sale process.

Step 1: Creation of APCR Tiers

Prior to the first APCR sale, the Executive Officer will divide the amount of allowances allocated to the APCR into three equal-sized tiers. With approximately 121.8 million allowances total, each tier will have about 40.6 million allowances.

The 2013 APCR Tier prices will be (Section 95913(e)):

- 1st Tier - \$40 per allowance.
- 2nd Tier - \$45 per allowance.
- 3rd Tier - \$50 per allowance.

The tier prices are set to a level that is anticipated to exceed quarterly auction and secondary market prices consistent with the Reserve's intent as a last resort source of allowances.

The APCR Tier prices will increase in each calendar year, starting in 2014, as:

$$\text{APCR tier price} = (\text{previous year's price}) * [(1.05) + (\text{rate of inflation})]$$

where the rate of inflation is measured by the most recently available 12-month Consumer Price Index for all Urban Consumers.

If, for example, the reported Consumer Price Index shows the rate of inflation to have been 2.73 percent, the 1st tier price would be \$43.09 (\$40 * [1.0773]).

Step 2: *Submission of Bid Guarantee*

At least 12 days prior to the scheduled APCR sale, a covered entity or opt-in covered entity that wishes to purchase allowances from the APCR should submit a bid guarantee to the financial services administrator in an amount greater than or equal to the sum of the maximum value of the bids the entity intends to submit. As an example, if an entity intends to submit bids for 15,000 allowances at \$45 and 20,000 allowances at \$40, the APCR sale may result in fulfilling the entity's bid completely. Hence, the sum of the maximum value of the bids is \$1,475,000 ($15,000 * 45 + 20,000 * 40$).

The bid guarantee can be cash, an irrevocable letter of credit or a bond, or some combination of these three financial instruments. The bid guarantee must be made payable to the financial services administrator and must expire no sooner than 21 days past the date of the APCR sale. In the event that an entity is sold allowances and fails to settle in cash, the financial services administrator can use the bid guarantee for settlement. If an entity submits a bid guarantee that is a combination of financial instruments, the bid guarantee will be used in the order of cash, irrevocable letter of credit, and last, a bond. When the bid guarantee conforms to the requirements of the Regulation and is accepted by the Executive Officer, the financial services administrator informs the reserve sale administrator of the value of the bid guarantee.

Step 3: *Submission of Bids*

Entities should submit bids in bundles of 1,000 allowances and at a price equal to one of the three tier prices. Bids for more than one tier are permissible. Entities should be aware that bids should be no larger than the amount of the bid guarantee submitted or the bid will be rejected, in bundles of 1,000. Bid quantities that would exceed the entity's Holding Limit will also be rejected. Bids can be submitted on the day of the sale when the sale window is open, 10 a.m. to 1 p.m. Pacific Standard Time (or Pacific Daylight Time, when in effect).

Step 4: *Purchase Determinations*

The reserve sale administrator will compare the value of the bids against the participant's bid guarantee. The reserve sale administrator will also consider the number of allowances in the entity's account at the start of the sale to determine whether fulfilling the bid would exceed the Holding Limit and Limited Exemption.. In addition, bids that exceed the quantity of allowances in a tier will not be accepted.

Starting with allowances in Tier 1, allowances will be sold to entities that submitted bids to Tier 1. If allowances remain in Tier 1 after all bids to Tier 1 are filled, then to the extent possible the reserve sale administrator will fill bids made to Tier 2 from Tier 1. To accomplish this, the administrator will assign a random number to each bid submitted for Tier 2. The remaining allowances in Tier 1 will be sold to Tier 2 bidders, starting with the bid assigned the lowest random number and proceeding in increasing order of random numbers until all of the allowances in Tier 1 are sold or until all bids have been fulfilled. The remaining bidders in Tier 2, if any, will be sold allowances at the Tier 2 price. This process will be repeated for bids to Tier 3.

Should the sum of bid quantities for Tier 1 exceed the quantity of allowances in Tier 1, each bidder's proportion of the bids submitted shall be computed as the ratio of that bidder's bid quantity relative to all accepted bids for that tier. Allowances sold to each bidder will be the entity's proportion of accepted bids times the number of allowances available in Tier 1, rounded down to the nearest whole allowance. This is the same tiebreaker procedure that is employed in the quarterly auctions.

After completing the sale from Tier 1, the reserve sale administrator will proceed to Tier 2 and subsequently Tier 3, following the procedures outlined in the two paragraphs above as appropriate, until either all the allowances are sold from the APCR or until all accepted bids are filled.

After either fulfilling all submitted bids or selling all allowances in the APCR, the reserve sale administrator will inform the Executive Officer of the sales to each participant.

Step 5: *Resolution of Sales*

The Executive Officer will review the conduct of the sale by the reserve sale administrator and subsequently certify whether the APCR sale meets the requirements of the Regulation. The Executive Officer will conclude the APCR by authorizing the financial services administrator to:

- Notify the APCR participants of their purchases and the total purchase cost.
- Process cash payments from participants and deposit proceeds into the Greenhouse Gas Reduction Fund.
- Use the bid guarantee for those entities that do not settle in cash within seven (7) days of notification of the APCR results. If a combination of

financial instruments have been submitted, the bid guarantee will be used for settlement in the order of cash, an irrevocable letter of credit, and finally, a bond.

- Return any unused portion of the bid guarantee.

Once payments have been deposited into the Greenhouse Gas Reduction Fund, the Executive Officer will transfer the allowances purchased from the APCR Account into each winning bidder's Compliance Account. Finally, the Executive Officer will publish the APCR sale results at www.arb.ca.gov.

5.2.5. What Are the Requirements if I Want to Purchase Allowances at an APCR Sale?

Aside from the restriction that only covered entities and opt-in covered entities can purchase allowances at an APCR sale, the requirements to participate in an APCR sale are similar to the requirements for participating in a Current or Future vintage Auction; see Section 5.1.5 of this chapter. Participants must be registered in CITSS, must complete an application with the reserve sale administrator (or update their application information if needed), submit a bid guarantee, submit a bid, and pay for allowances purchased.

5.2.6. What Is the Purchasing Limit for APCR Purchases?

The APCR sale is a sale, not an auction. No Purchase Limit applies to APCR purchases. However, the number of allowances an entity could buy must be within the amount of the combined Holding Limit and Limited Exemption.

5.2.7. What Actions Are Prohibited at APCR Sales?

Actions that are prohibited in the quarterly auctions are also prohibited at APCR sales. See Section 5.1.8 of this chapter for discussion.

5.3 How Do I Purchase ARB Offset Credits?

Purchasing offset credits is similar to purchasing allowances. See Section 5.4 below for information on how to transfer compliance instruments between entities.

Unlike allowances, offset credits are not allocated or sold by ARB. Instead, they are created through offset projects that are developed by third parties. These projects reduce emissions in uncapped sources, for which they receive compliance offset credits that can be sold to entities participating in the cap-and-trade program. More information about offset credits can be found in Chapter 6.

While the Holding Limit does not apply to ARB offset credits, offsets cannot represent more than 8 percent of compliance instruments surrendered to meet a compliance obligation.

5.4 What Are the Process and Requirements for Trading Compliance Instruments (Section 95921)?

Covered sources may acquire allowances and offset credits via the secondary market, i.e., buying and selling allowances or offsets outside of the auction format. This can be through an exchange or through an over-the-counter trade between two parties. ARB's only involvement in such transactions is in the reporting of a change in the ownership of allowances. The term "transaction" means an understanding among registered entities to transfer the control of an allowance or ARB offset credit from one entity to another, either immediately or at a later date.

Not all secondary market transactions will result in a change of control. For example, derivatives contracts may involve financial settlement terms instead of the transfer of compliance instruments. The contract itself may be traded after its origination, perhaps several times. The Regulation is written so that these types of contractual arrangements must be reported to ARB only when the contract results in physical delivery of the compliance instruments to a new owner.

5.4.1 What Is a Transfer Request (Section 95921(a) and (b))?

In CITSS, a transfer of allowances or offset credits from one owner to another must be reported through a "transfer request" submitted by an authorized account representative to the accounts administrator. The transfer request is necessary to register a transfer of compliance instruments between account holders in the tracking system.

All compliance instruments, whether emission allowances or offset credits, are identified by unique serial numbers within CITSS. The transfer of a compliance instrument means the removal of the serial number of a compliance instrument from one account and placement into another account. The serial numbers are not available to account holders, and CITSS will "move" the serial numbers to execute the transfer.

5.4.2 What Is the Process for Transferring Compliance Instruments Between Parties? (Section 95921(a))

A transfer request must be submitted to the accounts administrator by two authorized account representatives of the account initiating the transfer (the "source" account.) The transfer request must be confirmed by an account representative of the account that will receive the compliance instruments (the "destination" account). All transfers of

compliance instruments must be completed with the accounts administrator within three (3) calendar days of the initial submission of the transfer request. The

- Step 1:* The process is initiated by submission of a transfer request in CITSS by either a primary account representative or an alternate account representative for the source account entity submitting a transfer request to the CITSS account administrator.
- Step 2:* A different account representative for the source account must confirm the transfer request within two (2) days of the initial submission of the transfer request.
- Step 3:* A primary account representative or an alternate account representative for the destination account must confirm the transfer request to the CITSS accounts administrator within the time remaining of the three (3)-day window that begins when the initial transfer request is submitted.
- Step 4:* If the Executive Officer makes a determination that the transfer request and the transaction for which the transfer request is submitted meets the regulatory requirements, the Executive Officer will instruct the accounts administrator to transfer the serial numbers of the compliance instruments purchased into the buyer's Holding Account or Exchange Clearing Holding Account.

Entities engaged in a transaction will be in violation and may be subject to penalties if the above process is completed more than three days after the initial transfer request is submitted or if the initial submission of the transfer request is submitted more than three days after the settlement date of the transaction.

There are two instances in which a transfer request confirmation by an account representative of the destination account is not required under the Regulation (Section 95921(a)(2)). The first includes transfers initiated by the Executive Officer. The second case involves an entity that wishes to transfer compliance instruments from its CITSS Holding Account to its Compliance Account. The transfer is completed once an account representative submits the transfer request and a different account representative approves the transfer request.

How do I enter the information required for a transfer request (Section 95921(b))?

The account representative submitting a transfer request does not need to enter all of the information required by section 95921(b). CITSS will supply some of the information based on the responses the account representative makes to prompts on the "Propose

Transfer” form in CITSS. This section explains the information the account representative must supply and which information CITSS will supply.

When an account representative logs into CITSS to submit a transfer request, CITSS will automatically place the account number for the source account and the name of the account representative into the transfer request.

When a second account representative for the source account approves the submission of the transfer request, CITSS will enter the name of that representative into the transfer request.

The account representative initiating the transfer must enter the account number and Entity Reference Code number for the destination account. CITSS then informs the account representatives of the destination account of the transfer request submission.

The account representative initiating the transfer must enter the quantity of compliance instruments to be transferred.

Section 95921(b)(6) requires entities to report the price of the compliance instruments being transferred, but there are exceptions. Reporting a price is not required for transfers to entities with a direct corporate association or to an entity’s own compliance account. It is also not required for transfers from limited use holding accounts, since those involve transfers to the Auction Account which is under control of the Executive Officer.

The representative initiating the request must also enter whether the price is denominated in U.S. dollars.

The price reported for spot purchases and forward contracts is the average price paid for the compliance instruments in each transfer conducted under a single contract. For futures contracts, which may be traded multiple times, the price reported should be the price reported by the exchange or its clearing entity. The account representative for the destination account cannot change the information entered into CITSS by the representative for the source account, so the account representative for the source account must enter the appropriate price.

ARB staff expects that most transaction agreements will involve a specific price for compliance instruments being transferred. Contracts that specify an aggregate payment or a basis for payment for compliance instruments transferred will yield either a price or an average value, which can be entered into CITSS transfer request. ARB is aware that some contracts may result in transfers of compliance instruments without an explicit price. For example, contracts between electric generators and utilities may make utilities responsible for supplying the compliance instruments for power they purchase under

contract. There will be no price available for this transfer because the generator does not make a payment to the utility for the compliance instruments. In this case, the utility may enter zero as ARB will already have the price for the utility's purchase of the compliance instruments, from the transfer request that initially placed the instruments in the utility's account. Other cases include contracts in which compliance instruments are transferred along with or in return for bundles of goods and services, with no basis for calculating payment for the compliance instruments. ARB will allow parties to these types of contracts to enter a price of zero rather than impute a value based on the bundles of goods and services involved.

Utility contracts which transfer allowances to generators may take the form of forward contracts, which do not fall under the prohibition against beneficial holdings as described in Section 5.7.1 of this chapter of the guidance. Allowances held in a utility's holding accounts count against the holding limit, but the utility can meet its forward contract commitments within the holding limit by:

- Using staggered transfer dates for different contracts;
- Using forward procurement contracts with delivery dates close to the date the utility must make a transfer; or
- Transferring allowances for its own compliance to its compliance account.

Sections 95921(b)(4) and (5) require the account representative initiating the transfer to supply information about the transaction agreement for which the transfer request is submitted. First, the account representative must enter the date of the transaction agreement. Second, the account representative must enter the actual or expected settlement date, if that date is not the same as the date of the transaction agreement. The expected settlement date would be the date by which the terms of the contract are expected to be met. For agreements in which completing the transfer request is the final act of settlement, the date the transfer request is initiated will suffice. For example, for a simple forward contract, the date the contract is signed is the date of the transaction agreement, while the date on which compliance instruments must be transferred is the expected settlement date. Some contracts may call for multiple transfers over the life of the agreement or involve additional terms, such as financial payments. In these cases, the expected settlement date would be the end date of the contract, or, in the case of an exchange-traded contract, the final day of trading of the contract. The CITSS form also contains two optional fields that request information on the transaction agreement for which the transfer request is submitted. These fields are the type of contract for the

transaction agreement and trading venue. CITSS provides choices using two pull-down menus.

Pursuant to section 95921(b), upon request by the Executive Officer the entities that are party to the transfer request will be required to provide documentation about the transaction to ARB.

5.4.3 How Is a Deficient Transfer Request Remedied? (Section 95921(c))?

A transfer request may be deemed deficient before the transfer is registered into CITSS or after the transfer is recorded by the accounts administrator. In both instances, the deficiency must be remedied, but the process differs in the two cases.

If the accounts administrator observes a deficiency in a transfer request before the transfer is registered into CITSS, the accounts administrator will notify both entities and ARB's Executive Officer. The entities can resubmit the request with the deficiency corrected, but this must occur within the three (3)-day window that started with the initial transfer request submission. If the deficiency cannot be corrected within the three (3)-day window, entities may withdraw the request or submit a new transfer request in place of the initial deficient request. However, failure to complete the transfer request within the initial three-day limit is a violation, and penalties as mentioned in Section 95921(a)(3) may apply.

If the accounts administrator finds a deficiency in a transfer request after the transfer is registered into CITSS, the accounts administrator will notify both entities and ARB's Executive Officer. The entities have five (5) business days following notification from the accounts administrator to correct the deficiency. If the entities fail to correct the deficiency within that time, the Executive Officer may direct the accounts administrator to reverse the transfer.

5.4.4 What Are the Requirements for Exchange Clearing Holding Account Transfers? (Section 95921(d))?

Compliance instruments can be transferred for clearing purposes to voluntarily associated entities through Exchange Clearing Holding Accounts. In this case, a transfer request should list the Exchange Clearing Holding Account as the destination account. All compliance instruments received by an Exchange Clearing Holding Account must be transferred to one or more destination accounts within five (5) business days of receipt. Unlike the transfer request process in Section 95921(a), a transfer to or from an Exchange Clearing Holding Account does not require confirmation by an account representative of the destination account. Also unlike Section 95921(a), a request to transfer compliance instruments from an Exchange Clearing Holding Account

does not require confirmation by a second account representative of the source account.

5.4.5. What Are the Transaction Record Requirements for Entities with Exchange Clearing Holding Accounts? (Section 95921(h))

Entities with Exchange Clearing Holding Accounts are required to provide transaction records to ARB within 10 calendar days of a request from the Executive Officer. In addition, transaction records with the data required in 95921(b)—specifically, Holding Account numbers for the source and destination accounts—must be kept for 10 years. Holders of Exchange Clearing Holding Accounts are not required to include the transaction date, settlement date, or compliance instrument price in transfer requests submitted to the accounts administrator.

5.5 Is There a Limit for the Quantity of Allowances an Entity May Hold (Section 95920(a)-(g))?

The Regulation specifies a Holding Limit as the maximum number of GHG allowances that may be held by any one entity or jointly held by a group of entities with a direct corporate association. The Holding Limit applies any time an entity acquires allowances. The Regulation imposes two distinct Holding Limits on allowances according to their vintage.

The Holding Limit sets a cap on the number of allowances that may be held in the Holding Account of any covered entity, opt-in covered entity, or voluntarily associated entity. There is a Limited Exemption for allowances held in Compliance Accounts, discussed below; in most cases, the allowances in Compliance Accounts do not count against the Holding Limit.

The Holding Limit does not apply to allowances held in a Limited Use Holding Account or Exchange Clearing Holding Account.

5.5.1. What Is the Holding Limit for the Current Year Compliance Obligation? (Section 95921(c)-(d))

The Holding Limit for the current compliance year applies to all current vintage allowances and any earlier vintage allowances that can be used to satisfy the entity's compliance obligation. For example, in 2015, this would include all 2015 allowances, including any 2015 allowances that were purchased in the 2012 advance auction, and 2013 or 2014 allowances. Allowances purchased at an APCR sale are deposited directly into Compliance Accounts and are exempt if all allowances in the entity's Compliance Account are exempt. Table 5.3 shows the Holding Limit quantity of

allowances with discussion below the table to explain the allowance quantities in the table.

Table 5.3 Holding Limits

Year	Current Compliance Year Allowances (millions)	Future Vintage Allowances (millions)	
		Allowance Vintage	Holding Limit Quantity
2012	5.9450	2015	11.7375
2013	5.9450	2015	11.7375
		2016	11.4350
2014	5.8675	2015	11.7375
		2016	11.4350
		2017	11.1350
First Compliance Period Ends			
2015	11.7375	2016	11.4350
		2017	11.1350
		2018	10.8325
2016	11.4350	2017	11.1350
		2018	10.8325
		2019	10.5325
2017	11.1350	2018	10.8325
		2019	10.5325
		2020	10.2300
Second Compliance Period Ends			
2018	10.8325	2019	10.5325
		2020	10.2300
2019	10.5325	2020	10.2300
2020	10.2300	Not Applicable*	Not Applicable*
Third Compliance Period Ends – *Because allowance budgets have only been established through 2020, the table shows no future vintages past that year.			

What is the Limited Exemption to the Holding Limit?

The Limited Exemption allows an entity to exclude allowances from the Holding Limit Calculation is equal to the annual emissions from the entity's most recent emissions data report that has received a positive or qualified positive emissions data verification statement. If the quantity of allowances held in the entity's Compliance Account exceeds the specified Limited Exemption, the allowances exceeding the Limited Exemption will be counted as allowances subject to the current compliance year Holding Limit.

In any year that ARB has assigned emissions to an entity in the absence of a positive or qualified positive emissions data report, the assigned emissions levels will be used to determine the Limited Exemption.

Does the Limited Exemption Change Each Year?

Starting with 2013, the Limited Exemption increases each year on October 1 by the amount of emissions in the most recent emissions data report during that year.

The Limited Exemption is subject to periodic reductions associated with the end of a compliance period. Specifically, on December 31 of the calendar year following the end of a compliance period, the Limited Exemption will be reduced by the sum of an entity's compliance obligation during that compliance period.

The Limited Exemption is also affected by the change in the scope of the program. For the first compliance period, the reported emissions or assigned emissions used to determine the Limited Exemption includes only emissions associated with the scope of the program for the first compliance period. In 2015, reported or assigned emissions will include the emissions associated with the change in program scope that occurs in 2015, and this will affect the quantity of allowances eligible for the Limited Exemption. Given the change in scope, on January 1, 2015, the Limited Exemption will be increased by the amount of emissions in the emissions report received in 2014 but not yet included in the Limited Exemption.

Can the Limited Exemption Be Increased Temporarily?

ARB recognizes that covered sources will have plant upgrades, new facilities, and plant retirements that will affect emissions before verified emissions data is reported on September 1 each year. Entities can request a temporary increase in the Limited Exemption to allow them to purchase additional allowances without exceeding the Holding Limit. The process, detailed in section 95920(d)(3) starts with a petition from an

entity to the Executive Officer, before October 1 of any year. The petition should provide evidence demonstrating an increase in emissions relative to the previous year and request a temporary increase in the Limited Exemption. The temporary increase would be valid until verified emissions data for that year is available. The amount of the increase in emissions must be at least 250,000 metric tons CO₂e on an annualized basis. The Executive Officer will evaluate the submitted request to determine if an adjustment is needed. Should an adjustment be granted, the Limited Exemption will be increased immediately by the amount determined by the Executive Officer. The temporary increase granted will be replaced by verified emissions data when it is received for that year, and the Executive Officer shall use the verified emissions data to calculate the Limited Exemption.

Determining Your Holding Limit

Entities can calculate the maximum number of allowances they can hold using the following example and using the values from Table 5-3:

$$\text{Holding Limit Plus Limited Exemption} = 5,945,000 + [\text{Limited Exemption} - \text{allowances in the Compliance Account}]$$

If an entity's Limited Exemption is equal to 4,000,000 metric tons and it holds 1,000,000 allowances in its Compliance Account:

$$\text{Holding Limit Plus Limited Exemption} = 5,945,000 + [4,000,000 - 1,000,000] = 8,945,000 \text{ allowances.}$$

If an entity's Compliance Account balance is 4,500,000 allowances:

$$\text{Holding Limit Plus Limited Exemption} = 5,945,000 + [4,000,000 - 4,500,000] = 5,445,000.$$

Section 95912(j)(3) allows the Executive Officer to transfer allowances won in an auction to an entity's Holding Account or its Compliance Account as needed to facilitate compliance with the Holding Limit.

Entities can hold more allowances in their Compliance Account than allowed under the limited exemption, but this practice will not increase the entity's holding limit.

5.5.2. What Is the Holding Limit for Future Vintage Allowances? (Section 95920(e))

There is a second Holding Limit that applies to each vintage of future vintage allowances. For example, if the current year is 2013, the Holding Limit would apply separately to 2015 and 2016 vintage allowances purchased at advance auctions in 2012 and 2013.

The Holding Limit for future vintage allowances is determined by the following formula:

$$\text{Holding Limit} = 0.1 * \text{Base} + 0.025(\text{Annual Allowance Budget} - \text{Base}),$$

where the Base is equal to 25 million metric tons of CO₂e and the Annual Allowance Budget is the quantity of California GHG allowances issued for the vintage year.

At the start of a calendar year, the most recent future vintage allowances become current compliance year allowances and are no longer subject to the future vintage Holding Limit. The current vintage Holding Limit would now apply to those allowances. For example, at the beginning of 2015, 2015 allowances become subject to the Holding Limit for the 2015 compliance obligation.

5.5.3. How Does the Holding Limit Apply to Direct Corporate Associations? (Section 95920(f))

The decision made by members of a direct corporate association on account consolidation will affect the how the Holding Limit applies. Entities in a direct corporate association may have a consolidated account, which means that they have pooled their allowances, Holding Limits, and Purchase Limits in order to have a single account, allowing for efficiencies in the administration of that account. Thus, for a direct corporate association with a consolidated account, there is one Holding Limit for all associated entities.

If a member of a direct corporate association opts out of a consolidated CITSS account, the opt-out entity and the entities with a consolidated account must allocate shares of the Holding Limit among themselves. The sum of the shares of the Holding Limit should sum to one (1). For example, a corporate association with three members could allocate one-third of the limit to each member.

The shares of the Holding Limit for each entity in a direct corporate association is provided to the accounts administrator by the primary account representative or the alternate account representative of each entity at the time the entity registers in CITSS. The shares provided in the account registration application remain in effect until the primary account representative or alternate account representative of each entity informs the accounts administrator of a change in the allocation of the Holding Limit among the direct corporate associates.

Similar to the Holding Limit, the Limited Exemption applies to a direct corporate association according to the degree of consolidation. Entities which fully consolidate their accounts pool their Limited Exemptions, resulting in a single number applied to their consolidated account. Opt-out entities, on the other hand, remove their share of the Limited Exemption from the pool. This results in a small Limited Exemption for the

entity choosing to opt out, and a large Limited Exemption representing those entities which consolidate their accounts. Finally, in the case of no consolidation, each entity has a separate Limited Exemption, as if they were entirely independent of each other.

5.5.4. What Is the Holding Limit for APCR Purchases? (Section 95920(c)(1)(B))

Allowances purchased in an APCR sale are placed in an entity's Compliance Account and thus would be subject to the Holding Limit and Limited Exemption.

5.5.5. Are Allowances Transferred from Exchange Clearing Holding Accounts Included in the Holding Limit? (Section 95920(b)(3))

Allowances transferred from an Exchange Clearing Holding Account will be counted against the Holding Limit of the destination account listed in the transfer request at the time the transfer is confirmed.

5.5.6. What Happens if a Violation of the Holding Limit Occurs? (Section 95920(b)(4-6))

The Executive Officer shall refuse to approve a transfer request that has not been recorded in the tracking system if approval would result in a violation of the entity's Holding Limit, based on the information available at the time the transfer request is submitted. If a violation of the Holding Limit is found after a transfer request has been recorded, the accounts administrator will notify the entity and the Executive officer. The entity will have five (5) days to bring its account balances within the Holding Limit. If the entity has not done so within five (5) days, the Executive Officer can transfer excess allowances to the Auction Holding Account, where the allowances will be sold at the next scheduled quarterly auction. The same process applies if the Holding Limit violation occurs at the beginning of the calendar year when future vintage allowances become current vintage allowances.

Penalties may also be imposed if an entity exceeds the Holding Limit or if a transfer request is filed or approved that would violate the Holding Limit, when approval by the Executive Officer results from other violations, such as fraud, provision of false information, or failure to make disclosures of corporate associations. For example, suppose the Executive Officer approves a transfer request between two entities that failed to disclose a direct corporate association. Penalties could be assessed on transfers that violate the Holding Limit. The Executive Officer may assess penalties based on a transfer request that is filed, but not approved, if the evaluation of the transfer requests leads to the detection of other violations.

5.6 What Actions Are Prohibited Regarding Purchasing ARB Offset Credits?

Due to their unique qualities, ARB offset credits are subject to certain purchasing restrictions that are different from those relevant to allowances. When purchasing offset credits, it is important to ensure that they have not been retired, surrendered for compliance, or used for mitigation in another emissions reduction program, such as a voluntary carbon offsetting program.

A certain number of ARB offset credits derived from forestry protocols are placed into a Forest Buffer Account to provide insurance against unintentional reversal. ARB offset credits in these accounts may not be purchased or sold.

Finally, offset credits that have been invalidated for any reason may not be purchased or sold. Please see Chapter 6 for more information on ARB offset credits.

5.7. What Are the Restrictions on Trading and How Are They Enforced? (Section 95921(f))

For the market to function well, participants must be confident that trading is conducted honestly and without manipulation. To that end, the Regulation places various limitations—both general and specific—on trading behavior. The Regulation prohibits any trading involving:

- Any manipulative or deceptive device.
- A corner or attempt to corner the market for a compliance instrument.
- Fraud or an attempt to defraud any other entity.
- A false, misleading, or inaccurate report concerning information or conditions that affects or tends to affect the price of a compliance instrument.
- An application, report, statement, or document required to be filed pursuant to these regulations which is false or misleading with respect to a material fact, or which omits a material fact necessary to make the contents therein not misleading.
- Any trick, scheme, or artifice to falsify or conceal a material fact, including use of any false statements or representations, written or oral, or documents made by or provided to an entity on or through which transactions in compliance instruments occur, are settled, or are cleared.

Additional general prohibitions on trading include, but are not limited to the following:

- Failure to complete the transfer request in the required amount of time.
- An entity cannot acquire allowances and hold them in its own Holding Account on behalf of another entity.

5.7.1. Can an Entity Hold Allowances in Its Holding Account on Behalf of Another Entity? (Section 95921(f)(1))

The Regulation prohibits an entity from acquiring and holding allowances in its holding account in which another entity has an ownership interest or over which another entity can exert control over their disposition. This prohibition on an entity holding allowances on behalf of another entity is only intended to apply to instances where the other entity has an actual ownership interest in the allowances and/or can exert control over their disposition while they are still in the holding entity's account. It does not apply to transactions such as forward contracts, in which one entity promises to deliver a quantity of instruments at a future date. A forward contract does not allow a purchaser to gain an ownership interest in or control over allowances until they are transferred to the purchaser's account at the time of delivery. The contractual obligation to deliver may be met using compliance instruments the seller already has or through new purchases or other contract deliveries. Thus, contracting for delivery of allowances at a future time would not be considered holding allowances on behalf of another entity. Holding allowances to deliver under a forward contract commitment would also not be considered holding allowances on behalf of another entity.

In addition to standardized forward contracts such as futures or options, ARB expects that some entities will sign contracts to regularly transfer allowances to another party. Several variations on this type of contract have been described to ARB by entities in the electricity sector. ARB views these contracts as essentially no different than forward contracts and, accordingly, they will not be barred by the Regulation, so long as the contract does not (1) give the ultimate recipient control of compliance instruments while they are still in the account of the entity from which they will be received, and (2) does not recognize any ownership interest by the ultimate recipient in the compliance instruments while they are still in such entity's account.

Finally, the prohibition on acquiring and holding allowances on behalf of another entity does not apply to allowances transferred between members of a direct corporate association. ARB acknowledges that entities sharing a direct corporate association may opt-out of consolidation, but nevertheless choose to conduct all purchases on behalf of the corporate association through one or more particular entities, with the expectation that the purchasing entity will later transfer those allowances to another corporate associate for the latter's use in satisfying a compliance obligation. The prohibition on acquiring and holding allowances on behalf of another entity is intended in part to avoid

circumvention of the auction purchase limit and holding limit, which already apply to the entire group of entities sharing a direct corporate association on a combined basis. Accordingly, acquiring and holding allowances for later transfer to another member of a direct corporate association shall not be deemed by ARB to violate the Regulation.

Utility contracts that transfer allowances to generators may take the form of forward contracts, which do not fall under the prohibition against beneficial holdings. Allowances held in a utility's holding account do count against the holding limit, but the utility can meet its forward commitments within the holding limit by:

- Using staggered transfer dates for different contracts.
- Using forward procurement contracts with delivery dates close to the date the utility must make a transfer.
- Making frequent transfers.
- Transferring allowances for its own compliance to its compliance account.

5.8 What Restrictions Can ARB Implement for Entities That Violate Provisions of the Regulation? (Section 95921(g))

If any registered entity violates any of the provisions specified in the Regulation, ARB may do **any or all** of the following:

- Reduce the number of compliance instruments an entity may have in its Holding Account below the amount allowed by the Holding Limit, pursuant to Section 95920.
- Increase the annual surrender obligation for an entity to a percentage of its emissions above the 30 percent obligation, pursuant to Section 95855.
- Suspend or revoke the registration of entities registered, pursuant to Section 95830. A revocation or suspension of registration requires that the entity must sell or voluntarily retire all compliance instruments in its Holding Account within 30 days of revocation. If the entity fails to sell or voluntarily retire all compliance instruments in its Holding Account within 30 days, the accounts administrator will transfer the remaining instruments into the Auction Holding Account for sale at auction on behalf of the entity, pursuant to Section 95910(d).
- Limit or prohibit transfers in or out of the entity's Holding Account.
- Take other enforcement actions that may result in the imposition of penalties pursuant to section 96013.

5.9. What Is the Process for Compliance Instrument Retirement? (Section 95922)

Compliance instruments are retired in CITSS through the following multi-step process:

1. A covered entity or opt-in covered entity requests a transfer of compliance instruments from their Holding Account to their compliance account. The Executive Officer fulfills that request.
2. When the compliance obligation is due, a covered entity must have sufficient compliance instruments in the compliance account to cover their obligation. The Executive Officer then transfers those compliance instruments to a holding account known as the Retirement Account. Once in the Retirement Account, compliance instruments cannot be transferred and are effectively retired.
3. The Executive Officer records the serial numbers of the retired instruments to a publicly available Permanent Retirement Registry.

To voluntarily retire a compliance instrument, an entity registered in conformance with Section 95830 submits a transaction report to the accounts administrator requesting a transfer of compliance instruments to a Retirement Account. The information in the transactions report must include the entity's account number, the amount of the compliance instruments, and list the ARB Retirement Account as the destination of the compliance instruments.

5.10. How Is the Trading of Compliance Instruments Tracked?

See Chapter 3; Section 3.5 on the Compliance Instrument Tracking System Services (CITSS).