

To: RGGI Staff Working Group, rggicomm@gw.dec.state.ny.us

From: Constellation Energy Group, Inc.

Re: Comments on the Recommendations in the RGGI Phase II Auction Research Report

Date: November 15, 2007

Constellation Energy Group, Inc ("Constellation") appreciates the opportunity to provide preliminary comments on the *Auction Design for Selling CO₂ Emission Allowances Under the Regional Greenhouse Gas Initiative (RGGI): Final Report*. Constellation recognizes the efforts of the study team to evaluate the multitude of auction platform design options. Overall, Constellation believes that any auction platform should be open and transparent to encourage liquidity and provide credible price discovery to the market. Constellation finds many of the study's recommendations to be sound elements of such an auction platform and supports many of the recommendations in the study, though a few raise some questions and concerns. Of greatest concern is the recommendation for a reserve price. Below are Constellation's thoughts on the specific proposals; however, before addressing the recommendations, Constellation would like to offer an additional comment not discussed in the study.

In order to fine tune the auction design, Constellation urges RGGI to conduct a live, practice auction or auctions with the representatives from entities expected to participant in the actual auctions. These sessions will offer platform designers, administrators and participants critical information about how the auctions are likely to perform in a real-world setting prior to the release of official allowances into the market. Given that for the first time, auctions will be the method to distribute 100 percent or close to 100 percent of the allowances to the market, a "test-run(s)" could be key to the success of the program's launch.

Comments on Specific Study Recommendations

1. **Uniform-price auction format:** Constellation is familiar with this auction structure in power auctions and has no objection to this format.
2. **Single-round, sealed-bid format:** Constellation finds a single, sealed-bid format to be an acceptable approach for the auction. However, the resolution of auction ties should be on a pro-rated basis as in other emissions auction platforms rather than by a random process.
3. **Separate auctions for different vintages:** Constellation agrees that each budget year should be its own vintage and that each vintage should be auctioned separately.
4. **Quarterly auctions:** Quarterly auctions are an acceptable interval for auctions. Periodic auctions will be useful for price discovery, in particular in the early years of the market. RGGI may consider reviewing the number of auctions held in future years to evaluate whether fewer auctions would be sufficient. For instance, after five years of market function, semi-annual auctions may be sufficient to distribute vintages. Fewer auctions reduce the administrative costs of conducting and participating in auctions; however, this should be balanced against the stability and maturity of the market when the move to fewer auctions is made.



5. **Future allowances:** Constellation agrees that the distribution of allowances in advance of their vintage is critical to compliance planning and business decision-making. Four years is a sufficient period of time.
6. **Reserve price:** Constellation opposes the use of a reserve price. Constellation understands the desire to limit potential collusion during the auction process. However, it is unclear whether setting a reserve price will, in any way, prevent or limit potential collusion. Instead, designing the auction to be an open and transparent process governed by strictly enforced anti-collusion and anti-manipulation rules will be the most effective means of preventing collusion. A reserve price, on the other hand, may have a significant influence on the market price produced from the auction, thereby distorting the price of carbon derived from the auction process. Among Constellation's concerns are the following:
 - A situation wherein a significant quantity of allowances remain unsold due to the reserve price being higher than bid prices could erode liquidity in the secondary market;
 - The reserve price could act as a barrier to entry for non-compliance participants who may be critical to providing sufficient liquidity to the market;
 - A reserve price could harm price discovery by not allowing the market price to reflect the true valuation of allowances by auction participants. This could potentially increase volatility in the secondary market due to the artificial price point established by the reserve price; and,
 - The methodology of determining the reserve price could limit participation in the secondary market prior to auctions or create incentives for unintended activities in anticipation of reserve price setting.

Constellation believes that the market should set allowance prices.

7. **Unsold allowances:** Among Constellation's concerns about a reserve price, is the potential to create unsold allowances to be either taken out of the market or have their market entry delayed. Such regulatory interventions are contrary to market stability and perpetuate regulatory uncertainty, in particular when interventions occur before the market has fully developed. If a reserve price is enacted, the method to handle unsold allowances must be clearly known by participants before the auction occurs.
8. **Lot-size:** Constellation finds that 1,000-allowance lots seem like a reasonable size for the auctions.
9. **Open-auctions:** As mentioned in the introduction, Constellation believes open auctions are essential. The limit of 33% for any one entity to purchase in an auction should be more fully evaluated because of its connection to other structural aspects of the auction platform, such as disclosure of beneficial ownership. Any limit imposed must not restrict a covered entity's ability to secure enough allowances to comply. For instance, if any state chooses to run a separate auction, the market dynamics will change substantially and could impose unreasonable restrictions on a state's covered entities.
10. **Accepted bids:** All participants must be financially qualified to cover winning bids and accepted bids must be binding contract obligations.
11. **Joint and uniform auction:** Constellation strongly encourages all the RGGI states to participate in a centralized auction regime to support RGGI allowances as a consistent currency across the member states and to avoid the added administrative costs, among other challenges, that a multi-auction schedule would present.

12. **Market monitoring:** Constellation supports monitoring of the auction process and coordination with relevant agencies and entities. This process should be well defined with clear rules and enforcement paths to an ultimate, sanctioned authority.
13. **Beneficial ownership:** Constellation has concerns about the disclosure of beneficial ownership information in regards to its potential impact to discourage market participation and to distort the market. If it is essential for market monitors to have beneficial ownership information to identify purchases in excess of auction rules (for instance, the 33 percent limit imposition), then the disclosure and evaluation of such information must not go beyond that limited use.
14. **Auction information:** Constellation strongly believes in the importance of market transparency. In addition to disclosure of the auction clearing price, the identities of winning bidders and the quantity of allowances obtained by each winning bid, Constellation would like actual bid prices by each auction participant and information on losing bidders also be required to be disclosed.
15. **Statement of intent:** Constellation has no objection in principal to the concept of participants signing a “statement of intent.” However, any such statement will need to be reviewed by counsel. To that end, Constellation recommends that any proposed statement be circulated for consideration and review by counsel prior to its official use.
16. **Evaluation:** Constellation supports proper oversight and on-going evaluation of the program. However, the program must be clear and stable over a long time horizon to reduce uncertainty for businesses and for consumers and to help ensure sufficient, timely investment. This will require discipline and patience to allow those policies to work as intended, without interference.

Thank you for the opportunity to offer these comments. Constellation has been a participant in the RGGI stakeholder process from its early stages and looks forward to continued involvement in the process.