



**Comments on  
“Final Report: Auction Design for Selling CO<sub>2</sub> Emission Allowances Under the RGGI”  
15 November 2007**

The Union of Concerned Scientists appreciates the opportunity to submit comments as part of the region's effort to implement the Regional Greenhouse Gas Initiative (RGGI). We appreciate NYSEERDA's and the State Working Group's considerable effort and dedication of resources, including substantial stakeholder involvement, in seeking to design a robust and smoothly functioning market that will achieve RGGI's goals and maximize its value as a model for federal policy. We believe the research team has done a very thorough job and delivered an excellent report and set of recommendations. Our comments are below:

**Auction Format, Frequency, Vintages, and Forward Sale of Allowances**

We support without comment the report's recommendations.

**Reserve Price**

We agree that a reserve price is an essential aspect of any well-functioning auction and particularly support its use in the RGGI Allowance Auctions for the following reasons:

- 1) It reduces the incentive for collusion
- 2) It should be used to reflect social cost of carbon emissions, which is the founding premise of RGGI.
- 3) It would ensure/preserve a minimum level of ongoing incentive for investing in technology to reduce emissions

Discussion: With Congress likely to be still seriously considering federal cap-and-trade legislation as RGGI begins actual implementation (with the first allowance auctions) during 2008, we agree wholeheartedly with statement made by auction design research team leader William Shobe at the November 8<sup>th</sup> stakeholder meeting to the effect that “it is extremely important that RGGI be perceived as a success.” A crucial aspect of that success depends on the market delivering a reasonably consistent price signal – at least, a certain minimum price signal – for CO<sub>2</sub> allowances, especially in the early years of RGGI, when there may be a surplus of allowances available.

In addition, one basis for an auction reserve price is to avoid selling at a price below value to the seller. The July 2007 report of the Northeast Climate Impacts Assessment (NECIA), a collaboration between the Union of Concerned Scientists and more than 50 independent experts from across the country, entitled *Confronting Climate Change in the U.S. Northeast: Science, Impacts, and Solutions*,<sup>1</sup> describes the potential economic and social impacts of climate change on important sectors of the Northeast's economy and character, including agriculture, forests, coastal and marine resources, winter recreation, and public health. While the report does not quantify the cost of those changes, it qualitatively describes the potential costs of the failure of this region, the U.S., and the world to stop the buildup of CO<sub>2</sub> in the atmosphere by mid-century and to have made substantial progress in reducing it by century's end. RGGI's success is an important stepping stone for the enactment of a federal program.

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<sup>1</sup> [www.climatechoices.org/ne](http://www.climatechoices.org/ne)

RGGI's cap and target reductions, established in 2005 based on 2003 data, are understandably modest, and the prices at which allowances are expected to trade – as reflected by the allowance prices used in the modeling of RGGI's economic effects and the \$7 and \$10 thresholds selected for the program's "safety valves" (Stage 1 and Stage 2 trigger events) – are well below the price that most economists believe would truly reflect the cost of emissions to society. The program's greatest value thus lies in demonstrating for a national audience the practical ability of government(s) to implement an effective cap-and-trade program.

**We therefore strongly urge that RGGI begin its auctions in 2008 with an announced reserve price of \$3 per ton/allowance.** This is the upper end of the range used in the economic modeling that showed RGGI having net positive impacts on electricity customer bills (lower bills, even with higher prices) and job creation in the region. In succeeding auctions the reserve price should be set either at that level (adjusted upward in accordance with the rate of interest while also reflecting the increasing social cost of carbon emissions as we learn more about the potential costs of global warming) or at 90% of the spot market price from the preceeding day.

#### **Treatment of Unsold Allowances**

We believe that any allowances unsold at such modest reserve prices should be retired, as it would be confirmation that the allowance cap is too high. If RGGI feels that immediate retirement of unsold allowances is not an option, we support the recommendation that they be placed in a contingency reserve account.

Discussion: however, we recommend that the release of any allowances from the contingency bank should be *in the event that any auction closes above the Stage 2 trigger price (\$10 adjusted for inflation)*. In practice, this would have the practical effect of moderating against the occurrence of a Stage 2 trigger event (but not necessarily a Stage 1 trigger event). The RGGI program was designed with these "safety valves," and we feel that a RGGI allowance market with prices in a range that leads to the occurrence of a Stage 1 trigger event – which only moderately expands the permitted use of offsets – would represent a considerable success. While it is not directly analogous, a provision in the federal Warner-Leiberman bill regarding a prospective "Carbon Markets Efficiency Board" is the basis for our recommendation any such release of allowances from the contingency bank be limited so as to expand the allowance pool slated for offer at the next quarterly auction by no more than 5%.

#### **Openness of Auctions:**

We concur with the recommendation that auctions should be open to anyone, subject to appropriately rigorous bidder pre-qualification and disclosure requirements such as were included in the Commonwealth of Massachusetts' proposed allowance auction regulations. We believe that maximizing participation, along with vigorous oversight and enforcement to prevent market manipulation in both auctions and the secondary market, will best serve the long-run goal of a large, open, transparent, and stable market.

#### **Joint and Uniform Regional Auction**

We believe that those goals would also be best served by joint and uniform regional auctions.

Discussion: Even though it is served by three different power pools, the Northeast's energy market is regional, the allowance market to be established by RGGI is regional, and thus the auctions that will control the rate and price at which new allowances are released into that market should be regional. This would also serve the shared goals among participating state governments, the regulated community, and the general public of maximizing administrative and cost-efficiency in the ongoing implementation and management of RGGI. While we are aware that some RGGI states have indicated they may not be administratively and legally prepared to participate in a first or perhaps even second regional auction that occur(s) in 2008, the regional auction design should include a mechanism for these states' allowances to be included as soon as they reach that point.

### **Market Monitoring**

We concur with the recommendation take advantage of existing market monitoring capabilities and activities by FERC, EPA, the three ISOs, and CFTC. We further encourage RGGI to immediately hire a market monitoring consultant for assistance in designing and implementing - prior to the first auction - criteria and systems for detecting attempts to manipulate prices. RGGI's activities, of course, should not stop at monitoring; it should ensure that enforcement mechanisms and penalties for such activities are defined and publicized. These could range from suspension of privileges to participate in allowance auctions to civil and criminal penalties.

### **Additional Recommendations**

- 1) Improve/Expedite Access to Emissions Information: The time lag in public availability of emissions data from the region's regulated power plants that has contributed to concerns about RGGI's potential overallocation must be remedied as quickly as possible. More timely availability of this information would contribute to the important goal of transparency, in that it constitutes essential information about demand. The European Union ETS experience demonstrates that such lack of information can lead to unnecessary volatility in the market.
- 2) Continue Stakeholder/Public Involvement: RGGI should establish a formal process for ongoing stakeholder and public review and comment on its functioning going forward, just as it has had during its design and implementation stage.
- 3) Quickly address remaining legal questions: We strongly encourage RGGI to devote whatever resources are necessary to put to rest, in very short order, any remaining administrative and legal questions regarding the timely launch of the program, i.e., the announced intention to hold the first allowance auctions by June 2008, which would facilitate price discovery and provide some planning capability for generators with respect to the electricity market.

Thank you very much for your consideration of these comments, and for your and your colleagues' continued efforts to implement this landmark program in a way that is fundamentally effective and fair, and provides a successful model for a solid national program.

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