

COMMENTS OF PACE UNIVERSITY LAW SCHOOL ENERGY PROJECT ON  
“THE RGGI PHASE 1 AUCTION DESIGN REPORT (DRAFT)”

15 June 2007

The Pace Energy Project appreciates the enormous progress and considerable effort that has been made by the RGGI Auction Design Team. If we did not appreciate the technical complexity of auction design theory and practice before reading the Phase 1 Report, we certainly did afterwards. We are somewhat knowledgeable, but not expert, on auctions, and are greatly comforted to have several nationally recognized experts on auction design and administration on the Team. We strongly support the Design Team's proposal for an open and transparent process, with as much information publicly available as is possible.

In general, we support the Team's findings and recommendations, and urge also that:

- the process be kept on schedule so that it will be possible for an initial auction of RGGI allowances to be held during the first quarter of 2008;
- all of the RGGI states agree to use the resulting common auction platform and process (realizing that some states may join the auction process late due to varying state timelines for RGGI approval processes);
- RGGI states work together, possibly in cooperation with ISO-NE, NYISO and PJM, to assure that proper market power monitoring and controls are in place to limit and avoid the exercise of market power not only in the auction, but also in the secondary markets for such allowances.

Our specific comments on aspects of the auction discussion and recommendations include:

1. **Auction Methodology.** We defer with confidence to the team's recommendations for the design of the auction—at this time a mixed auction, by vintage, using an English clock with a shootout round for the initial auction of any vintage. Follow-up auctions of allowances for that vintage would be sealed-bid. It will be important to monitor the auctions carefully, not only for attempted market power exercise, but other inefficiencies that might occur. Probably RGGI should take the position from the outset that although the auction design has been carefully developed, the RGGI Regional Organization (RO) will be evaluating and looking for ways to improve the design in future rounds. The Team's conclusion about the importance of keeping the auction open to all buyers seems well justified, and we support it. Concerns have been expressed about the possibility of hoarding by various parties, ranging from Middle Eastern oil interests, through environmentalists, and including generators and other suppliers. We have a deep and abiding respect for the enormous creativity that is brought to bear on any market circumstance in an effort to manipulate prices and make extra money. We are not sure whether the operative phrase is “Where there is a will there is a way” or “Where there is a way there is a will”—both probably. We agree with the Auction Team that the potential for many if not most forms of market power reside in the secondary market independent of the particular auction design.
2. **Quarterly Auctions Commencing Early 2008.** For some time we have advocated holding frequent auctions of allowances and initiating such auctions about a year before the official start of the first RGGI compliance period. This should allow everyone to become familiar with the auction and secondary

markets in a gradual way, including especially the price discovery process. We urge the RGGI Staff Working Group and subsequent RO to press for adherence to this schedule. Clearly, some states will not have completed their rule-making and legislative approval processes by the first quarter of 2008. But several of the larger states, including New York, should be in a position to do so, and that is all that will be needed at that point.

3. **RGGI States Agree to Shared Auction.** There seem to be significant administrative and market efficiency advantages to having all of the RGGI states funnel their allowances through a common auction process. Getting RGGI initiated will have significant administrative challenges without also having different states operating their own separate auction processes with different times, places, rules and so forth that would increase everyone administrative costs while possibly increasing opportunities for camouflaging market power exercise.
4. **Monitoring for Market Power Exercise in Auction and Secondary Markets.** Although there is little indication from previous SO<sub>2</sub> and NO<sub>x</sub> allowance markets of a propensity for market power to exist in such markets, it is critical that the RGGI program address this concern fully and thoroughly. If a cap-and-trade program is going to work for RGGI and eventually nationally and internationally, it must be demonstrably free of significant exercise of market power. There have been enough issues raised already in the European Union program, and RGGI should be able to significantly improve upon that record. We are slightly less concerned about the exercise of market power in the auction than in the secondary market, because the auction can be controlled more easily—as with the shootout provision. The three regional ISO/RTOs have significant experience with monitoring and controlling attempts to affect prices in their wholesale electricity markets. Further, these entities also have privileged, confidential information about all of the electric generators and transmission operators who sell electricity and transmission rights in their regions. One of the main reasons someone might want to affect allowance prices would be in order to affect electricity prices. At the very least, RGGI Staff Working Group and RGGI Regional Organization should coordinate very closely with these regional wholesale electricity organizations. Possibly, these organizations might have an appropriate direct role in monitoring for market abuses with regard to RGGI allowances.
5. **Reservation Prices.** We agree that the RGGI allowance auction needs to utilize a reservation price along with a plan for “how, when and whether” to reintroduce allowances into the auction process if they are held back. We think that such a “reservation and release” plan can not only strengthen the controls against market manipulation, but also provide a more effective long-term price signal for the allowance and offset markets.

Thank you for the opportunity to comment.

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