

**COMMENTS OF MULTIPLE INTERVENORS
REGARDING THE REGIONAL GREENHOUSE GAS
INITIATIVE FINAL AUCTION DESIGN REPORT**

Dated: November 15, 2007

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PRELIMINARY STATEMENT

Pursuant to a solicitation for comments posted by the Staff Working Group on the Regional Greenhouse Gas Initiative website, Multiple Intervenors, an unincorporated association of approximately 50 large industrial, commercial, and institutional end-use energy consumers with facilities throughout New York State, by its attorneys Couch White, LLP, hereby respectfully submits its “Comments of Multiple Intervenors Regarding the Regional Greenhouse Gas Initiative Final Auction Design Report” (“Comments”).

As explained herein, the recommended auction design provided for in the report entitled “Auction Design for Selling CO₂ Emission Allowances under the Regional Greenhouse Gas Initiative – Final Report” (“Final Auction Design Report”) should not be adopted as is. The auction design recommended in the Final Auction Design Report is likely to artificially inflate the clearing price of CO₂ emission allowances (“Allowances”) sold through the Regional Greenhouse Gas Initiative (“RGGI”) cap-and-trade program. Furthermore, given that the clearing price for Allowances will impact the energy prices of consumers in RGGI states, it is critical to protect such consumers from unnecessary energy price increases that will result from a flawed auction design.

CONTACT INFORMATION

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DESCRIPTION OF MULTIPLE INTERVENORS

Multiple Intervenors is an unincorporated association of approximately 50 large industrial, commercial and institutional energy consumers with manufacturing and other facilities located throughout New York State, including the service territories of all of the state's major regulated electric utilities. Formed in 1972, Multiple Intervenors represents its members' interests in regulatory, administrative and legal forums at the national, regional and New York State levels.

Multiple Intervenors has been an active participant in the restructuring of the electric industry on both the federal and New York State levels. In the course of such participation, Multiple Intervenors represents its members' interests in select electric and natural gas utility rate cases and other proceedings before the New York State Public Service Commission ("NYSPSC"). Moreover, Multiple Intervenors represents its members' interests in numerous Federal Energy Regulatory Commission ("FERC") proceedings. Finally, Multiple Intervenors also represents its members' interests before other New York State regulatory agencies and, where necessary, in state and federal courts.

By way of further introduction, Multiple Intervenors also is an active participant in the governance of the New York Independent System Operator, Inc. ("NYISO"). In addition, Multiple Intervenors previously has filed comments as the RGGI initiative has been developed. For example, on May 22, 2006, Multiple Intervenors filed comments with RGGI regarding the Draft Model Rule. Multiple Intervenors has also filed comments with the New York State Department of Environmental Conservation ("DEC")

regarding its Pre-Proposal Rule for implementing RGGI in addition to filing a Joint Statement with other stakeholders regarding DEC's Pre-Proposal Rule.

Multiple Intervenors members support environmental initiatives, and most are leaders in their respective businesses with respect to environmental compliance. However, Multiple Intervenors does have strong concerns about administrative rules, such as RGGI, that may increase energy costs significantly. Large employers in the RGGI states already face severe competitive pressures due to energy prices that afford other regions, and nations, a significant competitive advantage. Accordingly, any measure, such as RGGI, that will further exacerbate the competitive imbalance by increasing energy prices must be scrutinized carefully. This careful analysis must include a thorough review of the proposed auction design because the design of the auction itself can have significant impacts on the price of Allowances resulting therefrom. It is Multiple Intervenors' position that modifications to the auction design recommended by the Final Auction Design Research Report are necessary in order to protect consumers in the RGGI states from unnecessary, and unpredictable, increases in energy prices that will result from an ill-designed auction for Allowances.

COMMENTS

The auction design recommended by the Final Auction Design Report should not be adopted unless modified as described herein. Modifications to the recommended auction design are required in order to shield consumers in RGGI states from unnecessary energy price increases that will result from a flawed auction design. In order to protect consumers, the final recommended auction design should: (a) not include a reserve price, (b) not include the use of contingency reserve banks for unsold Allowances, and (c) include a

ceiling price, or “circuit breaker”, to guard against unpredictable, and unintended, price increases associated with the roll-out of a novel, untested auction design.

A. The Final Auction Design for Allowances Should Not Include the Use of a Reserve Price

The Final Auction Design Report includes a recommendation to utilize a reserve, or floor, price. The intent of utilizing a reserve price is to prevent Allowances from being sold below a certain price.¹ The use of a reserve price is claimed to be necessary to combat collusive behavior. However, a reserve price also can result in maintaining an artificially high price for Allowances. Because the reserve price could arbitrarily increase the clearing price of Allowances (thus causing further increases to the cost of energy for consumers in RGGI states), the potential cost of this auction feature clearly outweighs any perceived benefit; therefore, the use of a reserve price should be rejected.

In an efficiently operating market for Allowances, it is expected that generators will, over time, implement efficiency and other permanent measures in order to reduce their emissions. This reduction in emissions should produce a lower demand for Allowances. Across the entire market, a lower demand for Allowances creates a larger gap between the total number of Allowances needed by emitting generators and the applicable emissions cap. As this gap increases, the natural market result should be a decrease in price caused by excess supply.

However, a reserve price, which is flawed with respect to its value, would upset these natural market forces. A reserve price, if not properly calculated, would create a

¹ Auction Design for Selling CO₂ Emission Allowances Under the Regional Greenhouse Gas Initiative – Final Report, p. 55, available at http://www.rggi.org/docs/rggi_auction_final.pdf.

floor below which the auction clearing prices cannot fall even if market dynamics dictate a lower price. The result is that market prices will remain artificially inflated at a value above which the market deems as the appropriate value for Allowances. This unnecessary inflation in price ultimately will be borne by consumers in the form of higher energy prices.

RGGI states that choose to sell 100 percent of their available Allowances will be particularly susceptible to the artificial inflation of energy prices. In such states, emitting generators will be required to purchase all the Allowances either from the auction or the secondary market in order to offset their emissions and continue to be able to generate electricity. As noted in the Final Auction Design Report, “the auction price may be expected to mirror closely the price in the secondary market.”²

Where the reserve price arbitrarily inflates the auction price, as described above, then the secondary market will also be expected to mirror such inflated prices for Allowances. In the case of RGGI states that sell 100 percent of their available Allowances, emitting generators must either pay the inflated price for Allowances or they will be unable to produce electricity. If the emitting generator pays the inflated Allowance price in order to produce electricity, it will be required to increase its bid into the deregulated energy markets in order to cover these costs. Ultimately, it is consumers that will bear the burden of this flawed market design in the form of unnecessary additional increases to the cost of energy.

Alternatively, if the emitting generator does not purchase the required Allowances and is thus unable to produce electricity, energy market operators in the RGGI states (i.e. the Independent System Operators and/or Regional Transmission Organizations, collectively referred to as the “ISOs/RTOs”) will be required to rely on more costly non-

² *Id.*, p. 63.

emitting generators in order to meet consumer demand. Again, the result will be higher energy prices for consumers.

Nor can the reserve price be justified on the basis of preventing market manipulation. There are other, more effective measures to protect against collusive behavior by market participants. In fact, the Final Auction Design Report itself concludes that market monitoring “is a way to guard against potential collusion in the allowance market.”³ Unlike a reserve price, market monitoring does not involve the inclusion of arbitrary floor prices that disrupt the otherwise expected market outcomes dictated by the normal trade-off between supply and demand.

Given the potential harm a reserve price poses to the efficient operation of the Allowance market in general, including”: (i) the risk of unnecessary energy price increases to consumers; and (ii) the potential for reliability degradation, and the availability of other, more effective and less disruptive methods to control collusive behavior, it is clear that the potential harm associated with the use of a reserve price far outweighs its benefits. Therefore, the final recommended auction design should not include a reserve price; rather, the stakeholder process should devote greater attention to further defining the type of market monitoring that should be implemented, as well as developing the consequences that will be imposed for improper behavior by market participants.

Assuming, arguendo, that the final recommended auction design does include a reserve price, then Multiple Intervenors submits that additional work must be completed regarding the methodology for setting such a reserve price. Any final auction design including a reserve price should include detailed information about the methodology for

³ *Id.*, p. 42.

calculating the reserve price. Specifically, the Staff Working Group should utilize the stakeholder process to develop the necessary standards, information, and other details required to define and document a clear methodology for calculating a reserve price.

B. The Final Auction Design for Allowances Should Not Recommend the Use of Contingency Reserve Banks

Like the proposed recommendation to utilize a reserve price, the recommendation of the Final Auction Design Report regarding the use of contingency reserve banks for the handling of unsold Allowances should be rejected because the risks associated with such an auction design feature far outweigh its benefits. A contingency bank withholds available Allowances from the auction until certain circumstances occur (e.g. exceeding the first offset trigger price). This withholding of Allowances would reduce the available supply of Allowances and cause artificial upward pressure on auction clearing prices.

As was demonstrated by the comments of Northeast Suppliers in response to the Phase I Auction Design Report, there is, on average, a very narrow gap between the actual available Allowances in the RGGI states and the actual emissions of CO₂ by generators in such states.⁴ This narrow gap indicates that there is likely to be a high demand for available Allowances by emitting generators. The effect of utilizing a contingency bank for any unsold Allowances, therefore, would unnecessarily tighten supply in a high demand market. The natural market response to tight supply accompanied by high demand would be

⁴ Comments of the Northeast Suppliers on the Auction Design Phase I Research Report, p. 2, available at http://www.rggi.org/docs/ne_suppliers_6_28_07.pdf.

an increase to the clearing price of Allowances in the auction. Ultimately, it will be the consumers that bear the cost of this increase through increases in the price of energy.

This inflationary effect of allowing a contingency reserve bank is further magnified if such a design element is utilized in conjunction with a reserve price. As described in the previous section, a reserve price sets a value below which Allowances will not be sold. Therefore, the reserve price, which is potentially at odds with what the market deems as the appropriate value for Allowances, can create unsold Allowances that then would be removed from the overall available supply, thus creating an even tighter margin between supply and demand. The result would be artificial upward pressure on the clearing price of Allowances, all due to auction design elements that are not necessary.⁵

As described above, the utilization of a contingency reserve bank potentially will have a significant inflationary impact on the price of Allowances. Such potential only grows with the consideration of other factors such as relatively tight supply of Allowances and the participation of entities that may seek to retire Allowances. Ultimately, it is the consumers in the RGGI states that will pay for such an auction design flaw in the form of higher energy prices. The more reasonable approach to the treatment of unsold Allowances is to simply roll them into the next auction, thereby avoiding the arbitrary tightening of supply caused by a contingency reserve bank. In any event, the proposed use of a contingency reserve bank should be rejected.

⁵ The supply side of the Allowance market may also be reduced by market participants who purchase Allowances in order to “retire” them. Participants that purchase Allowances to retire them will not re-sell such Allowances through the secondary market. Therefore, each Allowance purchased by such a participant equates to one less Allowance being available to emitting generators (i.e., a decrease in supply).

C. The Final Auction Design Should Include a Ceiling Price or Circuit Breaker in Order to Protect Consumers

As noted in the Final Auction Design Report, one of the purposes of RGGI is to implement the “first cap-and-trade program for greenhouse gas emissions within the United States.”⁶ The Final Auction Design Report also notes that “because the supply of CO₂ allowances in the RGGI region is fixed, the price of allowances will be more volatile than would the price for a good for which the supply could respond to changes in price.”⁷ In other words, the Allowance auction will be groundbreaking, with all of the uncertainties associated with such a transformation. Energy consumers in the RGGI states simply cannot afford to shoulder all the risk associated with this grand experiment; the stakes are too high. Accordingly, Multiple Intervenors submits that the final auction design must incorporate a ceiling price, or circuit breaker, in order to protect consumers against the significant energy price increases that could result from this novel experiment.

Uncertainty in a marketplace often manifests in unexpected behavior. In the case of the RGGI Allowance auction, this uncertainty may lead emitting generators to place an inflated value on Allowances in order to ensure that they obtain their needed number of Allowances in the near term, rather than relying on a nascent secondary market or subsequent auctions that may include uncertain price outcomes. Such action by emitting generators, which is wholly plausible and understandable with the development of a new market, could significantly increase the auction clearing price for Allowances.

⁶ Supra n. 1, p. 5.

⁷ Supra n. 1, p. 54.

In addition to uncertainty of generator bidding, there are the issues of tight supply as described in the previous section that will result not only from the narrow margin between the available Allowances in RGGI states and historic emissions by emitting generators,⁸ but also from the participation of entities in the marketplace (whether the auction or the secondary market) that effectively will remove Allowances from the otherwise available supply. These unpredictably perilous conditions are exacerbated if coupled with flawed auction designs such as a reserve price and/or the utilization of contingency reserve banks. Overall, the potential risks are too great to implement such an auction without a mechanism to protect consumers from significant increases to energy prices.

Importantly, there is no downside to imposing a ceiling price, or circuit breaker, on the auction results. In recent testimony before Congress, Governor Eliot Spitzer said:

The cost of allowance, just like the cost of fuel, will be built into the generators' electricity prices, but our modeling shows that these impacts will be negligible. For a typical New York residential customer (using 750 KWh per month), the projected increase in wholesale electricity prices in 2015 translates into a monthly retail bill increase of about 0.7 percent or \$0.78. thus, although some have argued that greenhouse gas controls are too costly for consumers, our modeling has shown otherwise. We can and must absorb these modest costs to reduce our greenhouse gas emissions – because the costs to our society of catastrophic global climate change will be far higher.

Finally, proceeds from the initial sale of allowances will be used to expand energy efficiency and renewable energy, especially for low-income consumers. Meeting our energy needs through efficiency and renewables reduces carbon dioxide emissions

⁸ Supra n. 4.

from the electricity sector and makes achieving the RGGI cap more likely and less expensive.⁹

Clearly, New York officials explicitly anticipate “negligible” consumer impacts from the auction and, implicitly, anticipate that, at those anticipated cost levels, the yield will be sufficient to meet the State’s energy efficiency and renewable energy goals. Accordingly, a ceiling price, or circuit breaker, should be adopted so that the auction price can go up to, but not exceed, levels that will yield “negligible” consumer impacts.

Given the novelty of the Allowance auction and the potential for unanticipated, and unacceptable, results, a ceiling, or circuit breaker, price should be included in order to provide critical protection for consumers. Without a ceiling price, or circuit breaker, all of the considerable risk inherent in the new auction process will be backstopped by energy consumers that cannot afford additional, unpredictable price increases. In short, opening the auction without a ceiling, or circuit breaker, price would be irrational and imprudent.

Multiple Intervenors submits that the protection of consumers is paramount given the uncertainties, potential tight supply, and auction design flaws that may affect the auction process. Furthermore, Multiple Intervenors recommends that the Staff Working Group utilize the stakeholder process to develop the necessary standards, information, and other details necessary to define and document a clear methodology for calculating such a ceiling, or circuit breaker, price.

⁹ Testimony of New York Governor Eliot Spitzer Before a Hearing of the U.S. House of Representatives Select Committee on Energy Independence and Global Warming, p. 3, available at <http://globalwarming.house.gov/tools/assets/files/0206.pdf>.

CONCLUSION

Based on the foregoing, Multiple Intervenors respectfully submits that the auction design recommended by the Final Auction Design Report should not be adopted unless modified as described herein in order to ensure adequate protection against significant increases in the cost of energy to consumers in the RGGI states.

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