



Comments on CO<sub>2</sub> Allowance Auction Reserve Price Proposal  
By Pace Energy and Climate Center, Environment Northeast  
and Environmental Advocates of New York  
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The Pace Energy and Climate Center, Environment Northeast and Environmental Advocates of New York appreciate the opportunity to comment on the proposal developed by Professor William Shobe to create and maintain a “current market reserve price” (CMRP) for use as a second, additional reservation price in the RGGI auctions.

Under a properly functioning cap and trade program it would be appropriate and advantageous to have a double reservation price system as has been contemplated by the Regional Greenhouse Gas Initiative. However, given the large amount of allowances available in the market, the market is not sending the appropriate price signals. Until this problem is addressed, establishing a CMRP is premature.

The current “minimum reserve price,” presently set at \$1.89, guards against selling the public’s assets at prices far below their inherent, long-term value. This practice is common in auctions. Things can go wrong in markets, and the “minimum reserve price” protects the seller’s interest. The CMRP, on the other hand, protects more specifically against possible market manipulation at prices above that minimum reserve price.

However, at this time we oppose moving forward with the consideration or adoption of a CMRP for four reasons:

1. There is no need for a CMRP because the severely over-allocated cap has forced the price of RGGI allowances down to the minimum reservation price of \$1.89, and there is no sensible “natural market” cause for that to change until major programmatic changes relating to RGGI’s cap are effected;
2. To which point, scarce RGGI Inc. and State RGGI staff time should be devoted to revising and improving RGGI as a part of the 2012 review with special emphasis upon finding solutions to the extraordinarily challenging problems of an over-allocated cap and the huge number of surplus allowances;
3. RGGI staff time should also be devoted to the examination of other needed RGGI changes that might serve to meet applicable standards for existing resources which EPA may propose pursuant to Section 111(d) of the Clean Air Act;
4. The data upon which Professor Shobe’s analysis is based cover a period during which the market was coming to grips with one fundamental market reality--the massive over-allocation--and moving steadily towards an inevitable market price conclusion—the minimum reserve price. The market data analyzed during this period cannot be reasonably viewed as typical of an allowance market in which there is a binding cap. Dr. Shobe’s conclusions seem *a priori* reasonable—but, unfortunately, have not been tested by relevant data, because there is none yet.

5. Another reason that the data available to Dr. Shobe were of limited value was the unusual and unknowable extent to which the market behavior of buyers and sellers was influenced not by their sense of the “true price,” but by their handicapping whether there would be a federal cap and trade program and, if so, how it would treat the RGGI allowances they were buying and selling. There is always a certain amount of “regulatory risk” associated with environmental emission allowances, but in this case that factor may have been massive.
6. There is a pressing and immediate public interest need with regard to the RGGI reservation price, but it relates to raising the current \$1.89 minimum reserve price to a level that more accurately reflects a reasonable floor price for the long-term value of these public asset allowances had the program operated as intended, designed and agreed to—with a more effective cap on emissions.

In addition, we did have more technical-methodological concerns that we will briefly describe:

1. It is important to update data to ensure that there remains sufficient volume of transactions on a completely consistent basis so that the CMRP could not be manipulated. In doing so it would be important to remember that the several largest compliance entities by the nature of their allowance obligation must eventually hold very large volumes and percentages of the allowances.
2. More analysis should be devoted to the divergence between the COATS filed prices and the secondary market ones, especially since the ratio seemed to grow during the data period covered rather than diminish. This could be harmless, but it might not—and it is important to know which. And, of course, we would want to have that data updated.
3. The report does a good job of discussing the concepts of the true (but unknowable) price and the market indicators of it. The report also does a good job of discussing the relationship of the cost of abating emissions and the price. Were RGGI to err (in our opinion) and proceed now with deployment of a CMRP, it would be crucial to have a thorough understanding of the extent to which the observed price is a function of the varying estimates of “cost of compliance” and the external uncertainties over future relative prices of gas and coal and economic conditions and future environmental-regulatory regimes. As the report states (p. 21), “Uncertainty over the cost of compliance in the short-term had vanished and trading was not necessary to discover this.” So any price is wholly a function of speculation about unknowable and uncontrollable external factors. We would need to know more about what it would mean to have a CMRP in such circumstances.
4. There would need to be further justification of the “80% of the current market price” parameter. Does that mean that the market participants could manipulate the price downward by 20% before this particular protection was triggered? We realize there are other protections against price manipulation, but this is the function that the CMRP is supposed to play. Shouldn’t the acceptable variability zone (the 20%) be a function of historical variability?
5. Although the report correctly points to the natural progression of a new market from early “price hunting” to greater stability, it probably would need to be updated to see to what extent the greater stability of prices is a function of better common understanding and consensus on prices as opposed to the simple reality that the glut of allowances had pinned their price to the floor.

### Summary of Comments

Although we support in a general way the idea of having two parallel reservation prices, we are strenuously opposed to doing so now. Instead, a new, higher minimum reserve price should be instituted as soon as possible to protect the public's financial interest in their public assets. It is exceedingly unlikely that a CMRP would be triggered during this period of monumental over-allocation and existing surpluses held by market participants. We have further methodological concerns but consider them moot given the other reservations with proceeding with developing a CMRP presented here. Therefore, prudent management would seem to dictate that scarce RGGI staff resources be devoted to effecting those vitally needed changes and improvements to the structure of the program as soon as possible. There are significant flaws to be corrected. Also, RGGI may need to be adapted by RGGI staff in order to be used to demonstrate a level of emissions reductions that EPA might require under Section 111(d) of the Clean Air Act.

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