April 3, 2012

Ms. Nicole Singh
Regional Greenhouse Gas Initiative Inc.
90 Church St. 4th Floor
New York, NY 10007

IETA COMMENTS ON MACROECONOMIC MODELING AND PROGRAM OPERATIONS IN THE RGGI CAP-AND-TRADE PROGRAM

On behalf of the International Emissions Trading Association (IETA), I am grateful for this opportunity to provide comments on the stakeholder input regarding macroeconomic modeling and program operations, as part of the Regional Greenhouse Gas Initiative (RGGI) 2012 program review. A well-designed cap-and-trade has the potential to drive significant emissions reductions at the lowest cost to the economy. IETA welcomes this opportunity to provide our insight into how to best improve the program during this period.

IETA is dedicated to the establishment of market-based trading systems for greenhouse gas emissions that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our member companies include some of North America's, and the world's, largest energy and industrial corporations—including global leaders in oil, electricity, cement, aluminum, chemicals, paper, and banking; as well as leading firms in the data verification and certification, brokering and trading, offset project development, legal, and consulting industries.

Modeling different scenarios provides the opportunity to better understand the operations of a cap-and-trade program. While models are unable to fully capture the intricacies and complexity of the economy, they allow for greater insight into the key relationships and variables which affect program costs and emissions reductions. IETA believes one of these key relationships is the role of offsets for lowering the costs of compliance through cost-effective emissions reductions outside the capped sector.

Operating a cap-and-trade program requires smoothly functioning auctions, and a tracking system capable of responding to transactions. IETA believes RGGI has performed well in ensuring an orderly and effective auction process, and in establishing a tracking system, RGGI COATS, which does not hinder market activity. Nonetheless, IETA sees opportunity during the program review to address policy options, which can further enhance the efficacy of auctions.

As RGGI examines the results of the IPM macroeconomic modeling presented at the RGGI stakeholder meeting on March 20, and reviews the effectiveness of its program operations, IETA offers some key observations and recommendations which IETA considers key for RGGI's consideration.

1730 Rhode Island Ave. NW, Suite 802
Washington, DC 20036
+ 1 (202) 629-5980

INTEGRATED PLANNING MODEL (IPM) MACROECONOMIC MODELING

The IPM macroeconomic modeling of various policy scenarios by ICF International highlights the critical role for offsets in reducing the costs of reaching an environmental target. ICF created a scenario in which there are no offsets available for compliance, measuring the impacts on the carbon price for RGGI. The result is that allowance prices in the program increase throughout the 2012 to 2020 period. The conclusion of this is clear – providing a sufficient supply of quality offsets is critical for reducing the costs of achieving RGGI's emissions reductions targets.

IETA provided comments to RGGI on February 10, 2012, detailing our recommendations on how to encourage a robust supply of offsets into the RGGI Program[1]. IETA believes that there are structural issues beyond the relative price of allowances and offsets, which have the potential to hinder offset supply. A lower quantity of offsets available for compliance will increase program costs, as the IPM modeling demonstrates.

RGGI currently allows offsets from the following five project types into its cap-and-trade program:

1. Capture or destroy CH_4 from landfills
2. Reduce emissions of SF_6 from electricity transmission and distribution equipment
3. Sequester CO_2 through afforestation
4. Reduce emissions of CO_2 through non-electric end-use energy efficiency in buildings
5. Avoid CH_4 emissions through agricultural manure management operations

IETA continues to argue that, in order to provide sufficient offset supply, RGGI should broaden the suite of offset types available to produce cost-effective emissions reductions. Additionally, offset projects from outside participating states should be allowed, to further increase the scope of emissions reduction possibilities. In particular, including offset methodologies from standards such as the Verified Carbon Standard (VCS) and the American Carbon Registry (ACR), will bolster potential offset supply. Furthermore, these methodologies have been developed in a rigorous manner over a period of years, and therefore maintain high environmental standards.

Beyond efforts to broaden potential supply of credits into the market, RGGI should also consider the offset program infrastructure and its impact on encouraging project developers to invest in emissions reduction activities. For example, offset protocols should evolve over time, taking into consideration innovative approaches for ensuring environmental integrity and improvements to existing methodologies. IETA is concerned that the 'state of the art' nature of offset provisions in RGGI may not be maintained as those provisions have not been updated during the first control period, whereas in other standards and offset mechanisms there is an ongoing process of improving protocols.

Furthermore, IETA disagrees with the quantitative usage limits on offsets, as this unnecessarily restricts the options available for compliance and raises program costs. Program and entity-usage limits would create uncertainty for offset project developers and investors with long-term planning horizons. Ideally, the total supply for offsets should be decided by market participants through price signals, rather than pre-determined in the program rules. This would create a situation in which

[1] Full submission available at:
http://www.rggi.org/docs/ProgramReview/StakeholderComments/SC021012_IETA.pdf

private actors are given the greatest amount of flexibility to achieve real emissions reductions at the lowest economic cost.

The IPM modeling demonstrates that offsets, when used to the maximum prescribed in the current regulations, reduce costs substantially in comparison to a case where offsets are not available for compliance. IETA recommends policy that enables the most cost-effective emissions reductions to be available for compliance, thereby increasing the effectiveness of the program. Introducing the structural reforms outlined above, and detailed in our previous comments to RGGI, will reduce program costs by ensuring a sufficient and robust quantity of offsets are available to participants in the RGGI carbon market.

PROGRAM OPERATIONS: CO2 ALLOWANCE AUCTION OPERATIONS

Auction purchase limits

RGGI currently restricts the number of allowances an associated entity can purchase to 25 percent of the CO2 allowances offered for sale in that auction. Individual participants have reached this limit on five occasions in the first control period[2]. The use of auction purchase limits can have the unintended consequences of both restricting liquidity and creating an unlevel playing field between entities.. This could increase the potential for price manipulation and price spikes by limiting a company's ability to sit an auction out if prices are excessively high in that particular auction. In addition, such companies would have limited ability to buy allowances to sell in the secondary market, which could further reduce liquidity. Finally, this policy could create a situation where some compliance entities are forced to purchase allowances in the secondary market instead of at auction—likely with a markup reflecting the sellers' leverage in the market.

As RGGI considers different policy scenarios and the effects on allowance demand by covered entities, IETA suggests that the auction purchase limit should be eliminated or revised upwards, particularly *if* a growth in allowance demand is expected. It is essential that covered entities are able to implement their compliance strategies without restrictions on the number of allowances available to them at auctions, and this becomes more important as expected allowance demand increases.

Auction Frequency

Currently, the RGGI program provides for quarterly auctions, which is suitable given current allowance demand in the primary market. However, in programs with increased demand, more frequent auctions are a method for increasing price discovery. This can be seen in the management of carbon market auctions in other jurisdictions. For example, the European Union requires that all auctions be conducted weekly or more frequently, commencing in 2013. In high demand allowance markets, infrequent auctions can create price volatility and prices spike in anticipation of upcoming auctions. Holding more auctions smoothes this volatility by permitting more frequent transactions to take place. Additionally, price discovery is a key component to a functioning marketplace, and therefore if more auctions take place then more accurate price signals are transmitted.

[2] RGGI Program Operations Review, page 3, available: http://www.rggi.org/docs/ProgramReview/March20/Program-Operations-Review_030212.pdf

If RGGI were to encounter a scenario in which there was robust allowance demand growth, then it would aid market efficiency to introduce more frequent auctions. IETA recommends that RGGI take this under consideration when anticipating future allowance demand in the RGGI program.

CONCLUDING REMARKS

In summary, IETA believes that the critical lesson to be drawn from the March 20 2012 stakeholder meeting is that policies and regulations which encourage the deployment of offsets will reduce the costs of achieving RGGI's emissions reduction targets. RGGI, and participating states, should consider this during the program review and seek to enhance potential offset supply by taking the measures IETA has outlined in these comments. Additionally, there are policy improvements in the auction design which will increase market efficiency and enhance price signals to market participants.

Once again, on behalf of IETA and our member companies, I would like to thank you for your attention to these comments. Please do not hesitate to contact either myself, or Anthony Mansell (Mansell@ieta.org) with questions.

Sincerely,

Henry Derwent

Henry Derwent
President and CEO