



**REPORT ON THE SECONDARY MARKET  
FOR RGGI CO<sub>2</sub> ALLOWANCES: THIRD QUARTER 2015**

**Prepared for:**

**RGGI, Inc., on behalf of the RGGI Participating States**

**Prepared By:**



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The Regional Greenhouse Gas Initiative (RGGI) is a cooperative effort of Northeast and Mid-Atlantic states to reduce emissions of carbon dioxide (CO<sub>2</sub>) from the power sector.

RGGI, Inc. is a non-profit corporation created to provide technical and administrative services to the states participating in the Regional Greenhouse Gas Initiative.

### A. INTRODUCTION AND SUMMARY

The primary market for RGGI CO<sub>2</sub> allowances consists mainly of the auctions where allowances are initially sold. Once a CO<sub>2</sub> allowance is purchased in the primary market, it can then be resold in the secondary market. The secondary market for RGGI CO<sub>2</sub> allowances comprises the trading of physical allowances and financial derivatives, such as futures and options contracts.

The secondary market is important for several reasons. First, it gives firms an ability to obtain CO<sub>2</sub> allowances at any time during the three months between the RGGI auctions. Second, it provides firms a way to protect themselves against the potential volatility of future auction clearing prices. Third, it provides price signals that assist firms in making investment decisions in markets affected by the cost of RGGI compliance.

This report provides a summary of activity in the secondary market in the third quarter of 2015 and discusses the results of our market power screens. Several patterns have emerged in this period in the secondary market:

- CO<sub>2</sub> Allowance Prices – CO<sub>2</sub> allowance futures prices averaged \$6.25, up 13 percent from the previous quarter and 28 percent from the third quarter of 2014. These prices ranged between \$5.78 and \$6.20 from July 1 until Auction 29 in early September, then increased rapidly after Auction 29, ending the quarter at approximately \$6.75.
- Secondary Market Activity – Secondary market activity increased significantly from the second quarter of 2015.
  - ✓ The total volume of CO<sub>2</sub> allowance transfers between unaffiliated firms was 25.2 million, up from 15.1 million in the previous quarter and 16.2 million in the third quarter of 2014.
  - ✓ The total volume of trading of RGGI futures listed on ICE was 52.7 million CO<sub>2</sub> allowances in the third quarter of 2015, up from 29.3 million in the previous quarter and 11.2 million in the third quarter of 2014.
- CO<sub>2</sub> Allowance Holdings – Of the 202 million CO<sub>2</sub> allowances in circulation at the end of the third quarter of 2015, compliance entities and their affiliates held approximately 130 million of which an estimated 81 percent were held for compliance purposes.

We evaluate information on the holdings of CO<sub>2</sub> allowances and allowance derivatives as well as the demand for allowances to identify firms that may have acquired a position that raises competitive concerns. In the current study period, we find no evidence of anticompetitive conduct.

## B. BACKGROUND

The secondary market for RGGI CO<sub>2</sub> allowances comprises the trading of physical allowances and financial derivatives, such as futures, forward, and option contracts. A physical allowance trade occurs when the parties to the transaction register the transfer of ownership in RGGI's CO<sub>2</sub> Allowance Tracking System ("COATS"). Financial derivatives include any contracts whereby parties agree to exchange funds and/or allowances at some future date, depending in many cases on factors such as the price of allowances at some future date. Many financial derivatives eventually result in the transfer of physical CO<sub>2</sub> allowances (i.e., the transfer is registered in COATS), but this may occur months or years after the parties enter into a financial transaction. These include the following types of transactions:

- *Futures* – Under these contracts, two parties agree to exchange a fixed number of CO<sub>2</sub> allowances of a certain vintage year at a particular price at a specific point in the future (called the "delivery month"). At the end of the delivery month, the contracted number of CO<sub>2</sub> allowances must be physically transferred to the buyer's account in the COATS registry and funds must be transferred to the seller. The vintage year refers to the compliance year of the CO<sub>2</sub> allowance that is to be transferred. One standard futures contract equals 1,000 RGGI allowances.<sup>1</sup>
- *Forwards* – These are like futures contracts, but a forward contract typically requires that all financial settlement occur at expiration.
- *Call Options* – Call options give the purchaser the option to buy a fixed number of CO<sub>2</sub> allowances of a certain vintage year at a particular strike price at any time prior to the expiration date. For example, suppose a firm holds a call option with \$5 strike price, and December 2015 expiration date. If the price of the corresponding forward contract rose to \$5.75, the firm could exercise the option to buy CO<sub>2</sub> allowances at \$5 and immediately sell them at \$5.75. Alternatively, if the price of the forward contract stayed below \$5, the firm

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<sup>1</sup> More precisely, a futures contract requires parties with an open interest to post financial assurance in an account with the exchange until the contract reaches expiration. The exchange continually withdraws and deposits funds according to changes in the prices of the contracts in which the party has interest. For example, if a firm buys a contract for 1,000 allowances at \$3.50/allowance, the purchasing firm (firm with a long position) must put \$3,500 in an account (or whatever share of the entire liability the exchange requires). If the futures price declines to \$3/allowance, the exchange transfers \$500 from the account of a firm with a long position to the account of a firm with a short position (firm that sold a contract), and the firm with a long position is only required to keep \$3,000 in the account. At the end of the delivery month, allowances are exchanged for funds according to the closing price on the last day of the month.

would let the option expire without exercising it. One standard options contract can be exercised for 1,000 RGGI allowances.

- *Put Options* – Put options are similar to call options but they give the purchaser the option to *sell* a certain number of CO<sub>2</sub> allowances of a particular vintage year at a specified strike price any time prior to the expiration date.

Futures, forward, and option contracts allow firms to manage risks associated with unforeseen swings in commodity prices. Futures and forwards allow firms to lock-in the prices of future purchases or sales. Options allow firms to limit their exposure to price volatility. Call options protect the purchaser if the price of the commodity increases, while put options protect the purchaser if the price of the commodity decreases. Although options provide less certainty than futures and forwards, they usually require less financial security, making them more attractive to some firms.

The terms of futures, forward, and option contracts vary in the degree to which they are standardized. “Exchange-traded” contracts typically have the most standardized provisions, while the term “over-the-counter” (“OTC”) is applied to contracts with less standardized provisions. However, OTC contracts, once entered into, are often settled through a clearinghouse in order to protect the parties from the risk that the counterparty defaults.

The amount of *open interest* is the net amount of futures, forwards, or options that have been traded for a contract with a particular set of specifications (i.e., vintage year, delivery month, etc.), but have not reached the time of delivery, expired, or been exercised. For example, if Firm A sells 100 contracts of a particular type to Firm B, Firm A will have a short position of 100 contracts, Firm B will have a long position of 100 contracts, and the total open interest for the particular type of contract will be 100 contracts. Hence, the total open interest can be determined by summing across all of the long positions of market participants or by summing across all of the short positions.

The volatility of a CO<sub>2</sub> allowance refers to the expected standard deviation of the distribution of allowance prices one year in the future. For example, if the expected value of the price one year in the future is \$1 and the option-implied volatility is 25 percent, this implies that the probability that the price will be within 25 percent of \$1 (i.e., between \$0.75 and \$1.25) is 68.2 percent

assuming that the price is distributed log-normally. Option-implied volatility refers to volatility estimates that are derived by analyzing the price and other terms of an option contract compared with the price of CO<sub>2</sub> allowances.

The category *compliance entities and their affiliates* includes firms that are believed to: (i) have a parent-subsidary relationship with a compliance entity, (ii) be subsidiaries of a parent company that has a large interest in a compliance entity, (iii) have substantial control over the operation of a budget source and/or responsibility for acquiring RGGI allowances to satisfy its compliance obligations.

Allowances held by compliance entities and their affiliates are categorized as *held for compliance purposes* unless a firm holds a number of allowances that exceeds its compliance obligations by a margin that suggests it is also buying for re-sale or some other investment purpose. For such a firm, the portion of its allowances that appear to be held for re-sale or some other investment purpose are excluded from the category *held for compliance purposes*.

### C. SUMMARY OF PRICES

This section summarizes prices in the secondary market for RGGI CO<sub>2</sub> allowances in the third quarter of 2015. Figure 1 summarizes transaction prices in the secondary market for CO<sub>2</sub> allowances, including the prices of allowance transfers registered in COATS<sup>2</sup> and the prices of futures contract trades on the Intercontinental Exchange (“ICE”). Figure 2 summarizes the option-implied (i.e., expected) volatility of RGGI CO<sub>2</sub> allowance prices based on an analysis of the trading of options contracts.<sup>3</sup> Key observations regarding RGGI CO<sub>2</sub> allowance prices:

- Futures prices averaged \$6.25, up 13 percent from the previous quarter and 28 percent from the third quarter of 2014. The prices of ICE futures trades were generally consistent with COATS transfer prices throughout the third quarter. These prices ranged from \$5.78 to \$6.20 from July 1 until Auction 29 in early September and then increased rapidly after Auction 29, ending the quarter at approximately \$6.75.
- The clearing price in Auction 29, held on September 9, was \$6.02, which was consistent with secondary market prices leading up to the auction. The auction clearing price increased 9 percent from Auction 28 (which was held in June).
- Overall, option-implied volatility levels increased slightly from an average of 16 percent in the second quarter to 16.5 percent in the third quarter of 2015.

#### *Prices of CO<sub>2</sub> Allowances and Allowance Derivatives*

Figure 1 summarizes prices in the secondary market during the period. The blue diamonds show the price of ICE futures on days with trading volume. The green triangles show the volume-weighted average prices of physical deliveries registered in COATS on days with transactions when the price was recorded (“COATS transactions”). The red circle shows the clearing price of the CO<sub>2</sub> allowances that were sold in RGGI Auction 29, which was held on September 9.

Figure 1 also shows volume-weighted average prices for each category in the third quarter of 2015 compared to the previous quarter and the third quarter of the previous year. Volume-

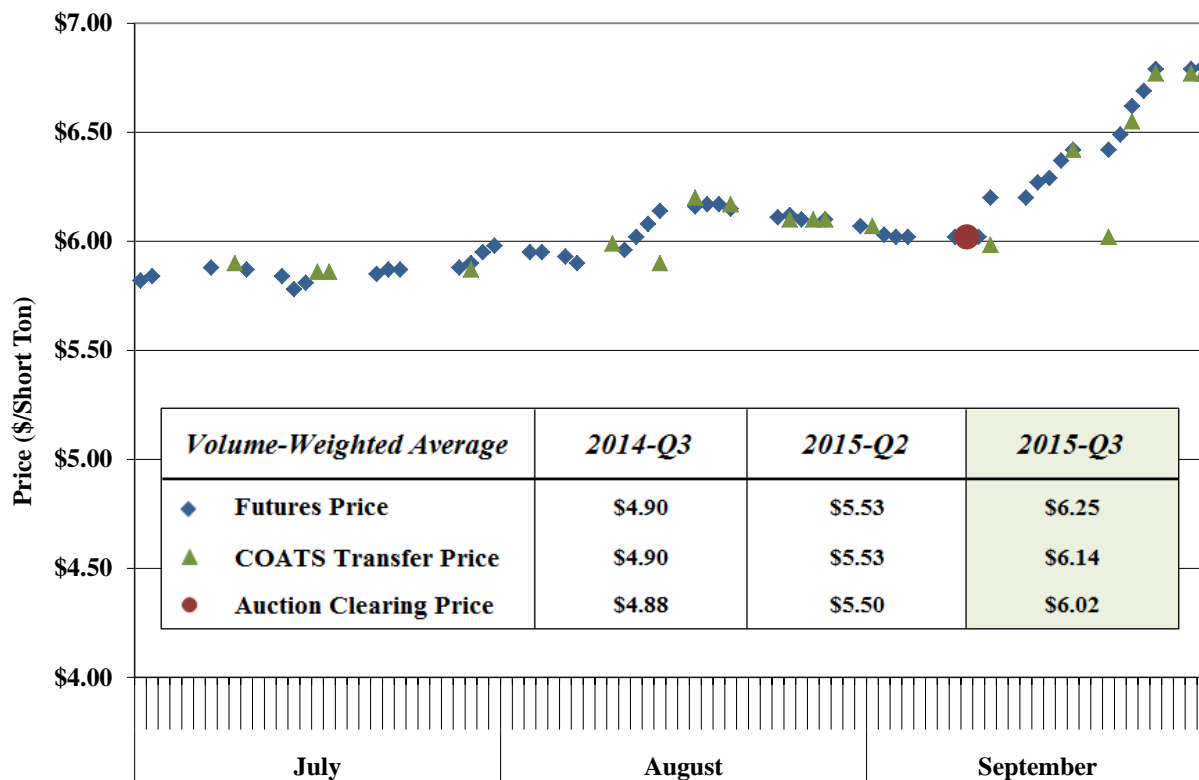
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<sup>2</sup> Parties are required to report the transaction price if there is an underlying financial transaction related to the transfer of allowances between accounts.

<sup>3</sup> The option-implied volatility of a CO<sub>2</sub> allowance refers to the expected standard deviation of the distribution of allowance prices one year in the future.

weighted average prices for the first, second, and third control period CO<sub>2</sub> allowances are shown together.

**Figure 1: Prices in the Secondary Market for RGGI CO<sub>2</sub> Allowances<sup>4</sup>  
July 1 to September 30, 2015**



Key observations regarding CO<sub>2</sub> allowance prices:

- The average transfer price of CO<sub>2</sub> allowances in COATS during the third quarter of 2015 was \$6.14, approximately 11 percent higher than in the previous quarter and 25 percent higher than the third quarter of 2014. At the end of the quarter price levels were approximately \$6.75.
- The prices of ICE futures trades were generally consistent with COATS transfer prices throughout the third quarter. The average futures price of \$6.25 was 13 percent higher than the average price in the previous quarter and 28 percent higher than in the third quarter of 2014. At the end of the quarter price levels were approximately \$6.75.

<sup>4</sup> Sources: Auction clearing prices are available at [www.rggi.org/market/co2\\_auctions/results](http://www.rggi.org/market/co2_auctions/results), ICE futures prices are available at [www.theice.com](http://www.theice.com), and the prices of physical deliveries are based on information in COATS. Futures prices are shown for the prompt month contract settlement price even if the volume traded was for another contract.



- Prices were generally steady in July, rose above \$6.00 after the EPA released the Clean Power Plan Final Rule<sup>5</sup> in early August, and then increased rapidly after Auction 29 (which was held on September 9).
- The clearing price in Auction 29, held on September 9, was \$6.02, which was consistent with secondary market prices leading up to the auction. The auction clearing price increased 9 percent from Auction 28 (which was held in June).

### *Prices of Options for CO<sub>2</sub> Allowances*

The clearing prices of option contracts provide insight about how the market expects the price of the underlying commodity to move in the future. The price of an option depends on two factors: (i) the expected value of the underlying commodity relative to the strike price of the option, and (ii) the expected volatility of the underlying commodity over the period before the expiration date. When call option price decreases coincide with put option price increases, it signals a decrease in the expected price of the underlying commodity. Conversely, when call option prices and put option prices move in the same direction, it signals a change in the expected volatility of the underlying commodity price.

Key observations regarding the pricing of options for CO<sub>2</sub> allowances in the third quarter of 2015:

- Sixty-three option trades (30 put options and 33 call options) were recorded on ICE during the third quarter of 2015, up from 43 trades in the previous quarter.
- The strike prices of the 30 put options traded during the quarter ranged from \$5.25 to \$6.50, while 33 call options were sold at strike prices of \$5.75 to \$8.00. These strike prices provide some indication of the market's expectations for the potential range of variation in allowance prices.
- Sixty percent of the trading volume was for put options, up from just 19 percent in the previous quarter. Put options protect the holder from the risk of downward price movements.

### *Volatility of CO<sub>2</sub> Allowance Prices*

Market-based emissions reduction programs such as RGGI are designed to give firms efficient incentives to reduce or offset emissions. In the short-term, high-emitting generators will operate

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<sup>5</sup> <http://www2.epa.gov/cleanpowerplan/clean-power-plan-existing-power-plants>

less frequently in favor of low-emitting generators. In the long-term, the market will affect the decisions of firms to develop offset projects, retire older inefficient generation, and perform maintenance that increases fuel efficiency and lowers carbon-intensity. Predictable CO<sub>2</sub> allowance prices decrease the risks associated with making long-term investments in reducing CO<sub>2</sub> emissions. Since CO<sub>2</sub> allowance prices can be volatile, the availability of futures and options contracts allows firms to protect themselves from the risks of such investments.

Expected price volatility is affected by elements of the RGGI program that promote allowance price stability. Potential upward price movements are limited by the Cost Containment Reserve (“CCR”), which allows for the sale of a fixed number of allowances in addition to the cap if the auction clearing price reaches the CCR Trigger Price.<sup>6</sup> Potential downward price movements are limited by the Reserve Price, which currently prevents allowances from being sold in the auction at a price below \$2.05 (and is indexed to inflation).

One measure of the volatility of CO<sub>2</sub> allowance prices is known as option-implied volatility, which measures the volatility that is implied by the trading of option contracts for CO<sub>2</sub> allowances. If a firm perceives that CO<sub>2</sub> allowance prices are volatile, the firm may be willing to pay a high price for an option contract that protects it from unforeseen allowance price fluctuations. Likewise, if a firm perceives that CO<sub>2</sub> allowance prices are relatively stable, the firm will be willing to pay relatively little for the same option contract.

The following scatter plot reports the option-implied (i.e., expected) volatility of RGGI CO<sub>2</sub> allowance futures contracts, which can be inferred from the trading of options contracts over the last six months.<sup>7</sup> The vertical axis shows the option-implied (expected) volatility of CO<sub>2</sub> allowance futures prices, and the horizontal axis shows the trade date. The figure excludes contracts if the trade date is less than 90 days prior to the expiration date. Excluding these

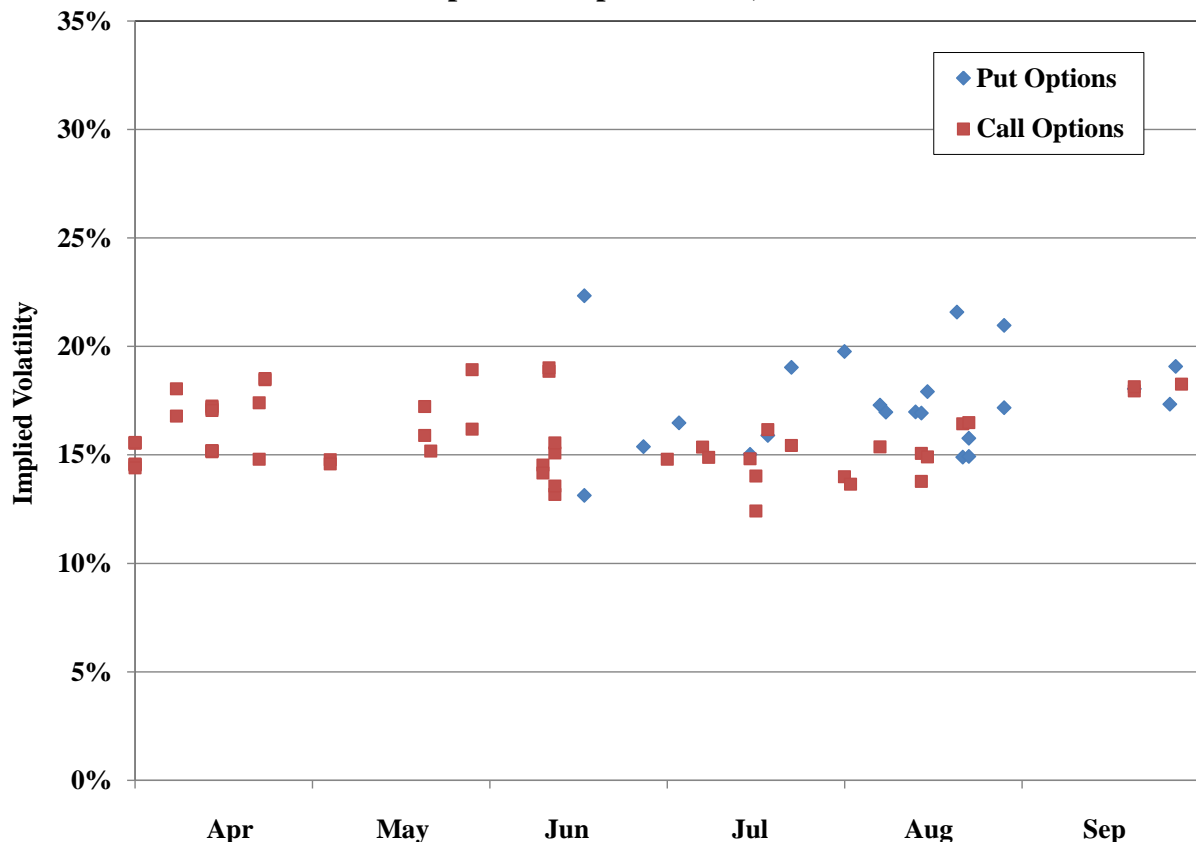
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<sup>6</sup> From 2015 to 2020, the annual withdrawal limit is ten million allowances. Ten million CCR allowances were released in Auction 29 held on September 9<sup>th</sup>. The CCR Trigger price for 2015 is \$6.00 and will rise to \$8.00 in 2016 and \$10.00 in 2017, and it will rise 2.5 percent in each year thereafter.

<sup>7</sup> Black’s model for valuing futures options is used to estimate the option-implied volatilities of RGGI allowance futures prices.

contracts reduces variations in implied volatility that are driven by short-term issues such as the timing of the trades within a particular quarter (i.e. around the time of each quarterly auction).

**Figure 2: Option-Implied Volatility of CO<sub>2</sub> Allowance Futures Prices  
April 1 to September 30, 2015**



Observations regarding the option-implied volatility of CO<sub>2</sub> allowance prices:

- In the second quarter of 2015, there were 39 trades where implied volatility ranged between 13 and 22 percent.
- In the third quarter of 2015, there were 37 trades where implied volatility ranged between 12 and 22 percent.
- The average option-implied volatility of put options was 17.5 percent, while the average option-implied volatility of call options was 15.5 percent. Overall, option-implied volatility levels increased slightly from an average of 16 percent in the second quarter to 16.5 percent in the third quarter of 2015.

## D. VOLUMES AND OPEN INTEREST

This section evaluates the volume of COATS transactions (i.e., transfers of CO<sub>2</sub> allowances between unaffiliated parties as recorded in COATS) as well as the volume of trading and the level of open interest in exchange-traded futures and options. Figure 3 examines the volumes of transactions recorded in COATS and of futures trading. Figure 4 summarizes the level of open interest in exchange-traded RGGI futures and option contracts. Figure 5 evaluates the concentration of firms with open interest in exchange-traded RGGI futures and option contracts.

Key observations regarding trading volumes and open interest in the third quarter of 2015:

- The total volume of CO<sub>2</sub> allowance transfers between unaffiliated firms was 25.2 million, up 67 percent from the previous quarter and 56 percent from the third quarter of 2014.
- The total volume of trading of RGGI futures listed on ICE was 52.7 million CO<sub>2</sub> allowances in the third quarter of 2015, an increase of 80 percent from the previous quarter and 373 percent from the third quarter of 2014.
- The open interest in RGGI options increased 23 percent from approximately 57 million at the beginning of the quarter to approximately 70 million at the end of the quarter. This was driven primarily by a 50 percent increase in the open interest of put options.
- Of the 202 million CO<sub>2</sub> allowances in circulation at the end of the third quarter of 2015, compliance entities and their affiliates held approximately 130 million (i.e., 64 percent of allowances in circulation).
- Of the allowances held by compliance entities and their affiliates an estimated 81 percent were held for compliance purposes, while the other 19 percent appeared to be held for re-sale or some other investment purpose.<sup>8</sup>

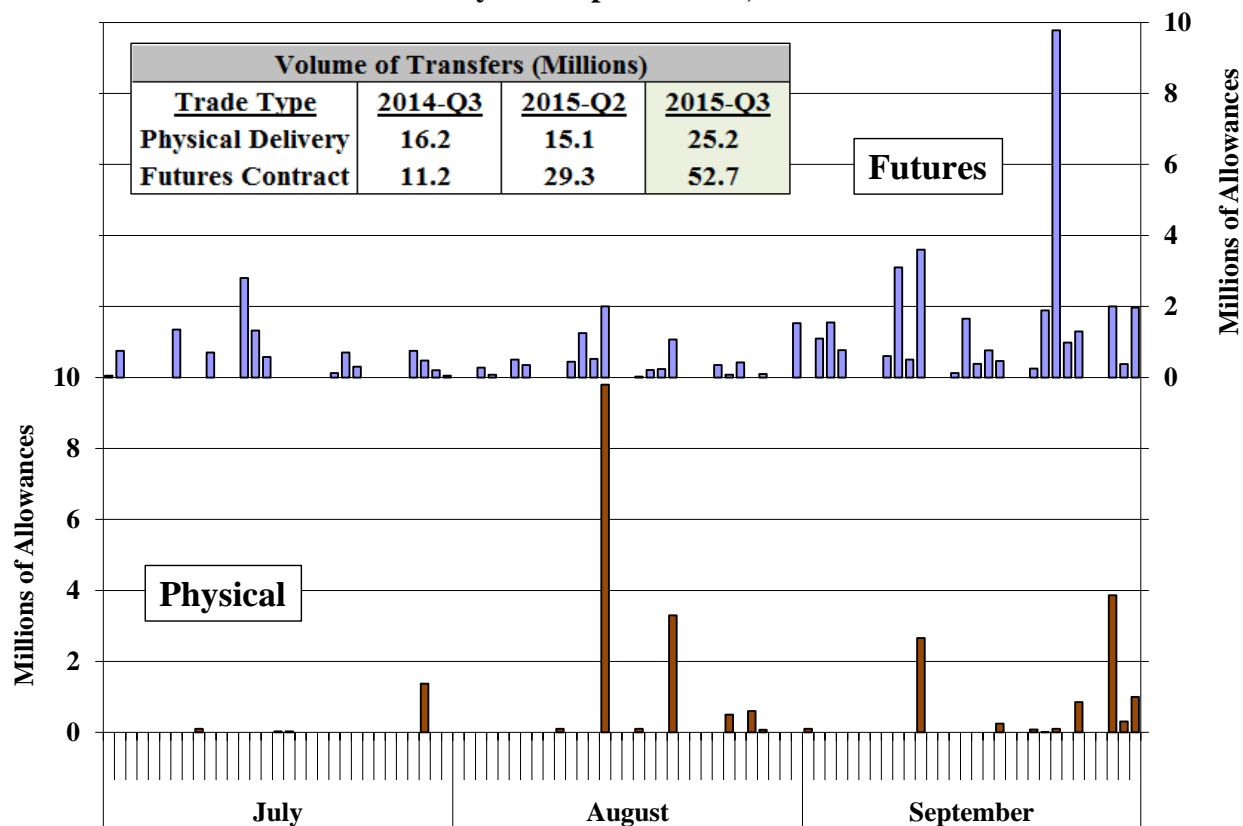
### *Volume of CO<sub>2</sub> Allowance Transfers, Futures, and Options*

Figure 3 summarizes the volume of transfers of CO<sub>2</sub> allowances between the COATS accounts of unaffiliated firms and the volume of trading of RGGI futures listed on ICE. The figure also shows the volume of transfers in the third quarter of 2015 compared to the previous quarter and

<sup>8</sup> Note, this implies that 52 percent of the 202 million CO<sub>2</sub> allowances in circulation were held for compliance purposes. Section B discusses the criteria used to estimate the share of allowances held for compliance purposes.

to the third quarter of 2014.<sup>9</sup> The volume of futures trading and transfers of CO<sub>2</sub> allowances for each control period are shown together because all CO<sub>2</sub> allowances are essentially interchangeable for compliance purposes.

**Figure 3: Volume of CO<sub>2</sub> Allowance Transfers Between Unaffiliated Parties<sup>10</sup>  
July 1 to September 30, 2015**



Key observations regarding the volume of transfers of CO<sub>2</sub> allowances in COATS between unaffiliated firms:

- The total volume of CO<sub>2</sub> allowance transfers between unaffiliated firms was 25.2 million, up 67 percent from 15.1 million allowances in the previous quarter, and 56 percent from 16.2 million allowances in the third quarter of 2014.

Key observations regarding the volume of trading of RGGI futures and options contracts:

<sup>9</sup> Firms are categorized as affiliated based on available information. As a result, calculations provided in previous reports may be inconsistent with ones in this report when new information becomes available.

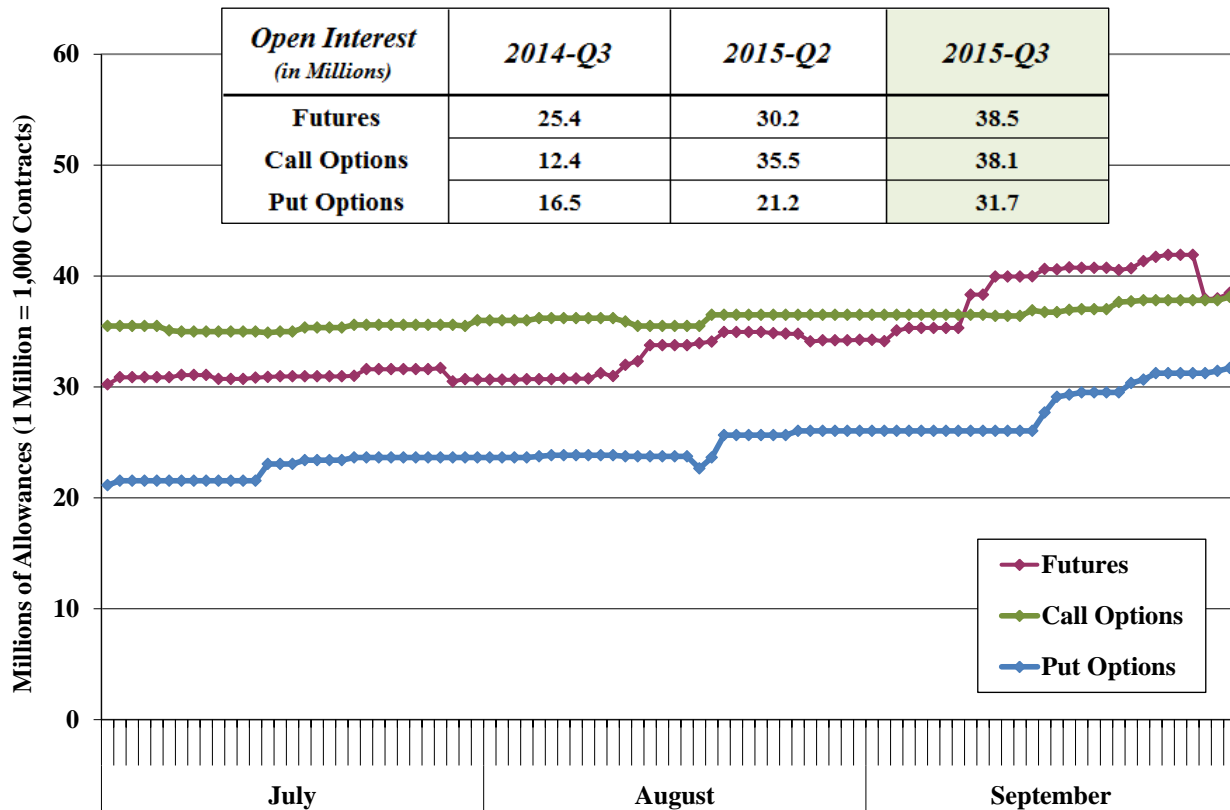
<sup>10</sup> Source: CO<sub>2</sub> allowance transfers are based on information in COATS.

- The total volume of trading of RGGI futures listed on ICE was 52.7 million CO<sub>2</sub> allowances in the third quarter of 2015, an increase of 80 percent from the previous quarter and up 373 percent from the third quarter of 2014.
- Approximately 23 percent of the volume of trading of futures listed on ICE during the third quarter of 2015 was for contracts that expired during the quarter. An additional 57 percent of the volume of trading was for contracts that will expire in December 2015.
- Sixty-three option trades were recorded on ICE during the third quarter of 2015, up from 43 trades in the previous quarter. Seventy-two percent of the volume was for contracts with December 2015 expiration and 20 percent was for contracts with December 2016. Sixty percent of the trading volume was for put options, up from just 19 percent in the previous quarter.
- The total volume of options traded in the third quarter of 2015 was for 29.9 million CO<sub>2</sub> allowances, which was an increase from 26.8 million in the previous quarter.

***Open Interest in Exchange-Traded RGGI Futures and Options***

Figure 4 summarizes the level of open interest in exchange-traded futures and options listed on the ICE during the third quarter of 2015. The red line shows the level of open interest in futures contracts. The green line shows the level of open interest in call options. The blue line shows the level of open interest in put options.

**Figure 4: Open Interest in RGGI Futures and Options  
July 1 to September 30, 2015**



Key observations regarding the level of open interest in RGGI futures and options:

- The total open interest in RGGI futures increased throughout the period, reached a high of 41.9 million on September 27, and then dropped to 38.5 million just before the end of the quarter.
- The open interest in RGGI put options increased 50 percent from 21.2 million at the end of the second quarter to 31.7 million at the end of the third quarter of 2015.
- The open interest in RGGI call options increased 7 percent from 35.5 million at the end of the second quarter to 38.1 million at the end of the third quarter of 2015.

***Concentration of Open Interest***

Additional information about the trading of futures, forwards, and options is available in the weekly Commitments of Traders (“COT”) reports, which are published by the Commodity

Futures Trading Commission (“CFTC”)<sup>11,12</sup> for each week when greater than 20 firms have reportable positions in a particular product.

Figure 5 summarizes the concentration of open interest in 2015 vintage ICE futures and options contracts. The figure reports the net long positions in three categories: (i) the four firms with the largest long positions (see “Top 4 Firms”), (ii) the four firms with the largest long positions not including the Top 4 (see “Next 4 Firms”), and (iii) all other long positions. The figure also reports the net short positions in three categories: (i) the four firms with the largest short positions (see “Top 4 Firms”), (ii) the four firms with the largest short positions not including the Top 4 (see “Next 4 Firms”), and (iii) all other short positions.

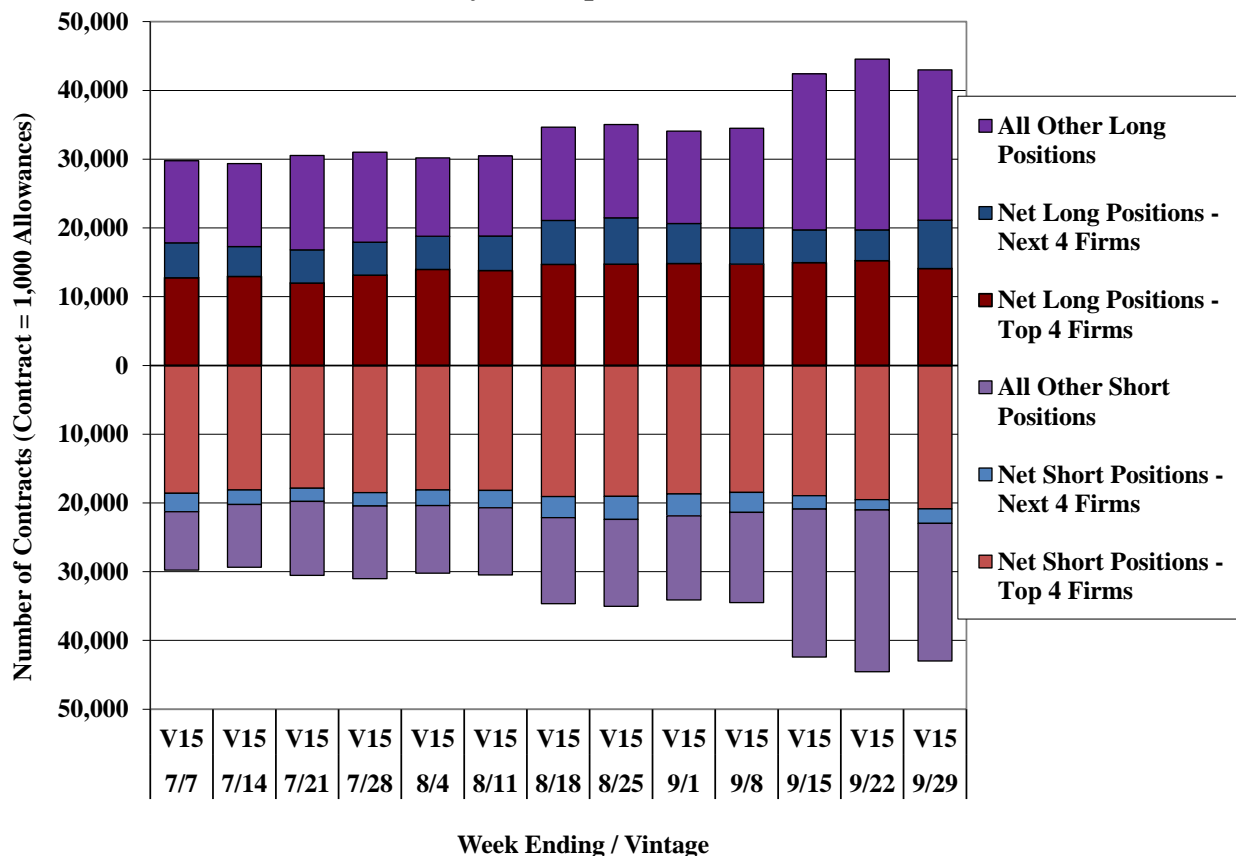
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<sup>11</sup> Each day, firms with an open interest of 25 contracts or more are required to report their positions to the CFTC. The CFTC categorizes each firm as Commercial if it engages in trading primarily to supply its own need for allowances or Non-Commercial if it trades for another purpose. Hence, compliance entities are generally designated as Commercial and other entities are frequently designated as Non-Commercial. Each Tuesday, the CFTC issues the COT report, which is a summary of the long and short positions of participants in the market.

<sup>12</sup> The CFTC does not publish information from the COT reports for weeks when fewer than 20 firms have reportable positions in a given product, which is why no information is shown for any vintage contract other than 2014 (each vintage is reported separately).



Figure 5: Concentration of Open Interest in CCFE Futures and Options<sup>13</sup>  
July 1 to September 30, 2015



Observations regarding the concentration of open interest:

- Many firms have open interest in RGGI CO<sub>2</sub> allowance futures and options, although a small number of firms account for large shares of the net long and short positions in 2015 vintage contracts.
  - ✓ The “Top Four” Firms accounted for an average of 40 percent of the total net long positions for the weeks shown during the quarter, while 56 percent of the total net long positions were held by eight firms.
  - ✓ The “Top Four” Firms accounted for an average of 55 percent of the total net short positions for the weeks shown during the quarter, while 62 percent of the total net short positions were held by eight firms.

<sup>13</sup> Source: The CFTC’s Commitment of Traders reports which are available at [www.cftc.gov/MarketReports/CommitmentsofTraders/HistoricalCompressed/index.htm](http://www.cftc.gov/MarketReports/CommitmentsofTraders/HistoricalCompressed/index.htm).

- ✓ These results suggest that many firms have significant spreading positions (i.e., combinations of long and short positions of equal magnitude with different expiration dates).
- The CFTC does not publish firm-level information on open interest, although the information they publish provides an indication of the upper limits of the net long and net short positions of individual firms. Combined with firm-specific information about CO<sub>2</sub> allowance holdings from COATS, the information on open interest that is published by the CFTC is useful for evaluating the potential for a firm to hoard RGGI CO<sub>2</sub> allowances, which is discussed further in Section E.

## E. DISCUSSION OF MARKET MONITORING

As the RGGI Market Monitor, we monitor trading in the secondary CO<sub>2</sub> allowance market in order to identify anticompetitive conduct. Additionally, the Commodity Futures Trading Commission (“CFTC”) evaluates trading in the secondary CO<sub>2</sub> allowance market consistent with its role as the regulator of derivative markets in the U.S. This section discusses two types of anti-competitive conduct for which we monitor. As in previous reports on the secondary market, we find no evidence of anti-competitive conduct.

In any commodity market, one potential concern is that a firm could hoard a substantial share of the supply of a commodity to influence prices or to prevent a competitor from obtaining CO<sub>2</sub> allowances. Hence, we screen information on the holdings of CO<sub>2</sub> allowances and allowance-derivatives and the demand for allowances to identify firms that might acquire a position that raises competitive concerns. The ability of an individual firm to hoard is limited by the substantial private bank of CO<sub>2</sub> allowances that has been accumulated and also by the market rules, particularly the auction rules that limit the amount of allowances that can be purchased by a single party or group of affiliated parties in a single offering to 25 percent.

Another potential concern is that a firm expecting to purchase CO<sub>2</sub> allowances in the auction might sell a large number of futures contracts in an effort to push the price of the contracts below the competitive level. Such a firm might profit from buying a large number of CO<sub>2</sub> allowances in the auction at a discount if the bidding in the auction were influenced by the depressed futures price. For this to be a profitable strategy, the firm would need to be able to substantially depress the futures price with a relatively small amount of sales—an amount smaller than the amount of CO<sub>2</sub> allowances it planned to buy in the auction. The best protection against this strategy is a market where other firms respond by making additional purchases. Firms that are looking for an opportunity to reduce their short positions or to purchase CO<sub>2</sub> allowances for their future compliance needs help limit the effectiveness of a strategy to depress prices below the competitive level. Nevertheless, the CFTC has access to confidential transaction data, which allows it to monitor for evidence of manipulative conduct.