

FIRST RGGI CARBON ALLOWANCE AUCTION HITS A HOME RUN

By **Kimberly E. Diamond**

On September 25, 2008, the Regional Greenhouse Gas Initiative (RGGI, pronounced “Reggie”) made history by holding its first auction of 12.5 million tradable carbon dioxide (CO₂) emissions allowances that raised \$38.5 million to be spent on renewable and energy-efficient technologies. This was the first carbon allowance auction held in the United States and was the first in a series of quarterly RGGI auctions. The auction lasted only three hours, followed an Internet-based platform, and used a sealed-bid format in a single round. Emissions allowances were sold in blocks of 1,000. The rationale for having such an auction was for RGGI member states to cap-and-trade emissions allowances to diminish CO₂ emissions from electric power plants to help reduce global warming. The RGGI auction format is currently being viewed as a model for the Western Climate Initiative (WCI), composed of Arizona, California, Montana, New Mexico, Oregon, Utah, Washington, and certain Canadian provinces, and as a possible model to prompt a national cap-and-trade program to reduce CO₂ emissions.

Of the ten RGGI member states, only six—Connecticut, Maine, Maryland, Massachusetts, Rhode Island, and Vermont—participated in this historic event. As a precondition to participation, each state needed to: (1) create an account in the RGGI allowance tracking system; (2) complete an auction qualification ap-

plication; (3) complete an “intent to bid” form; and (4) provide a submission of financial security. The other four RGGI states, Delaware, New Hampshire, New Jersey, and New York, did not participate.

Six greenhouse gases (GHGs) are generally included in carbon markets: CO₂, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, and perfluorocarbons. GHGs are traded in carbon credits, which represent the reduction of GHGs equal to one metric ton of CO₂. Carbon dioxide is the most common GHG. The U.S. Environmental Protection Agency has estimated that the production of electricity causes approximately 39 percent of CO₂ emissions domestically and that the reduction of CO₂ emissions from the electricity sector is necessary if CO₂ emissions reductions are to occur. Through the auction, RGGI assisted domestic trading in the carbon markets by facilitating the buying and selling of emissions permits generated through a GHG emissions reduction project.

Under a cap-and-trade initiative, the regulatory authority caps the quantity of pollution units its members are permitted to emit and effectively converts these pollution units into property by issuing pollution permits, called “allowances” or “allowance units,” which are tradable and collectively equal to the cap. RGGI, a cap-and-trade initiative, requires all fossil-fuel-burning power plants that generate 25 megawatts of power or more and that are located within a RGGI member state to purchase credits to cover their respective annual carbon emissions in compliance with RGGI’s CO₂ Budget Trading Program.

An individual state’s Budget

Trading Program establishes that state’s share of the aggregate regional cap. Regulated power plants may use CO₂ allowances issued by any RGGI state to comply with their own state’s emissions program governing their particular facility.

With respect to the RGGI cap structure, each RGGI state has committed to setting its own limits in proportion to its share of the aggregate regional cap and to issuing allowances in a number equivalent to its portion of such cap. Also, each RGGI state has implemented its own regulations based on RGGI’s Model Rule and has put in place certain controls over the number of allowances issued to ensure that the aggregate RGGI emissions cap is not exceeded.

The shrinking initial cap of 188 million tons annually across all ten RGGI states will likely cause the allowance price to increase, giving power plants incentive to reduce their emissions and invest in clean-energy-producing technology. Regulated power plants must possess sufficient allowances by March 1, 2012, to match their CO₂ emissions for the first cap compliance period. To meet the cap, power plants can cut their emissions by employing improved technologies, use measures such as investments in solar and wind power to generate additional allowances, or, if they cannot cut their emissions, purchase additional allowances to cover their emissions. Currently, RGGI power plants that reduce their emissions beyond required levels can sell unused allowances to other RGGI participants at market price.

RGGI bidders’ high demand for allowances helped determine the allowances’ market price. According to Potomac Economics, the in-

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dependent market monitor for the RGGI allowance market, there was no material evidence of collusion or manipulation of the bid price by bidders, and the auction results were consistent with market rules and the bids received. Of the 59 bidders, approximately 80 percent were power-generation companies and their affiliates. Bidders included emitters who believe they will exceed their permitted emissions level, financial companies, environmental groups interested in retiring emissions allowances to lower overall emissions levels below the regulated target level, and others who posted collateral to participate in the auction.

The money raised in the RGGI auction will be distributed to the six participating states, based on the number of allowances each state contributed to the auction. These states have indicated their intent to invest these monies in alternative energies and energy-efficient technologies, programs on energy conservation, and programs that benefit utility rate payers. Some states have indicated that they will use auction proceeds for programs to help their states adapt to the effects of climate change, as well as for consumer rebates.

RGGI auction proponents argue that auction proceeds used to fund conservation programs will enable consumers to become less dependent on fossil fuels, lower their greenhouse gas emissions, and lower their energy bills overall by much more than the increase in their utility bills. Another positive aspect of RGGI auctions is that they provide a unique and beneficial public relations opportunity for companies. Companies that purchase and retire RGGI allowances may enhance their "green" image, thereby increasing their environmentally

conscious profiles. People who have clients that may be interested in this type of image enhancement should consider alerting their clients to the potential benefits of participating in RGGI auctions.

Despite concerns such as potential rate hikes to consumers' electric bills that the initial RGGI auction raised, the long-term benefits of this auction outweigh its downsides. This auction legitimized a cap-and-trade format, setting a positive example for the country on a national level, as well as for WCI and other regional initiatives considering the adoption of similar cap-and-trade regimes. Federal lawmakers should consider this auction's success when contemplating the adoption of a cap-and-trade program in the future. Also, the RGGI auction format was positive from an economic perspective. Because there was over four times as much demand as there was supply for emissions allowances in this auction, there was robust, competitive bidding among regulated and nonregulated entities. This scenario was welcome because it reflected the elevated confidence level participants had in this auction and established market credibility for the allowance price reached—one free from an artificial floor or ceiling price. Moreover, and perhaps most importantly, this auction was encouraging insofar as it was the first of many small steps that will be taken as part of a forward-looking, long-term plan to reduce CO₂ emissions under RGGI. Focusing on the positive aspects of this first step should give us hope and confidence that such a beneficial goal can be reached. **GPSOLO**

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- **This article** is an abridged and edited version of one that originally appeared on page 52 of *Natural Resources & Environment*, Spring 2009 (23:4).

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