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# Sign Of Things To Come? Northeast States Hold First $CO_2$ Auction Under New Climate Change Program

On September 25, 2008, the multistate Regional Greenhouse Gas Initiative (RGGI) held the first auction in the United States for legal rights to emit carbon dioxide ($CO_2$). The clearing price was $3.07, well above the reserve price of $1.86, and all 12.5 million allowances offered were sold. With other states now developing climate change programs similar in part to RGGI, this first auction may provide signals of what lies ahead for carbon regulation and management.

**Auction Results**

Six states – Connecticut, Maine, Maryland, Massachusetts, Rhode Island, and Vermont – participated in the September 25 auction by offering allowances for sale. Each of these states had previously adopted a set of detailed implementing regulations based on a RGGI model rule. Under these regulations, bidding was open essentially to any party who could post financial security, but no party could purchase more than 25 percent of the allowances available. Some 59 parties from the energy, financial and environmental sectors submitted bids. Most but not all bidders were sources subject to RGGI limits. Bids were sealed and confidential, submitted via an on-line system over a three-hour period.

The pricing format was "first rejected bid," subject to a reserve price (set for this auction at $1.86). In practice, the format works like this: at the end of the bidding, the bids are ordered from highest to lowest. Starting with the highest bid, the allowances are allocated to the bidders until all the allowances are depleted or the reserve price is reached, whichever comes first. For the September auction, $3.07 was the first bid for which allowances were no longer available, so this became the clearing price for the winning bidders.

Bids were received for about four times the 12.5 million allowances offered for sale. In other words, about three-quarters of the bids received were at or below $3.07 per allowance.

Only limited further information about the September auction is available at present. While each winning bidder has now received its allowances, the RGGI states have indicated that at least initially, they do not intend to release the names of the winning bidders or information on individual bids. The states apparently are concerned that this information could promote speculative bidding and make it more difficult for the RGGI market to establish itself.

The next auction is scheduled for December 17, 2008. All ten RGGI states will be participating, offering a total of approximately 31.5 million allowances for sale. The reserve price will remain at $1.86. Parties wishing to bid must submit a Qualification Application and Intent to Bid to RGGI, Inc., the RGGI implementing body, no later than 5:00 PM EST on Thursday, October 30, 2008.

Concurrent with the official RGGI auction process, non-RGGI secondary markets for allowances are expected to develop.

**RGGI Basics**

RGGI, which takes effect January 1, 2009, is a multistate "cap-and-trade" system developed by ten Northeastern states (from Maryland up through Maine, except Pennsylvania) to limit emissions of $CO_2$ from fossil-fueled electricity generating facilities with a nameplate capacity of 25 megawatts or more. The goal is to stabilize regional $CO_2$ emissions at current levels by 2014, and then cut emissions by 10 percent from current levels by 2019.

RGGI's "cap and trade" system limits allowable $CO_2$ emissions from all affected $CO_2$ sources in each participating state. Each source must acquire sufficient "allowances" for its emissions, with one allowance corresponding to one ton of $CO_2$ emissions in a given year. In all RGGI states that have adopted implementing regulations to date, auctions will be the primary means of acquiring allowances.

Every three years, a RGGI source must demonstrate that it holds allowances sufficient to cover its $CO_2$ emissions during the prior three years. A source facing an allowance shortfall must reduce its $CO_2$ emissions, buy allowances from another party, or face enforcement action by the state implementing agency. To a very limited degree, a source also can also seek to create or purchase emissions "offsets" (confirmed emission reductions or sequestration of $CO_2$ or other permissible greenhouse gases from certain qualifying operations not subject to RGGI). The allowance auction and secondary markets are intended to promote cost-efficient emission reductions.

**Auction Proceeds**

By RGGI state statutes, most of the $38.5 million proceeds from the September auction are slated to go to consumer-side energy efficiency programs, as well as other carbon reduction or elimination programs. Another slice of the funds is designated for the various state agencies to fund administration of the RGGI program.

**What's Ahead for RGGI**

The first three-year compliance period for RGGI-regulated sources begins January 1, 2009. Throughout 2009 and thereafter, allowance auctions are expected to be held quarterly.

As of January 1, all RGGI sources must have sophisticated $CO_2$ monitoring equipment and systems in place to confirm and ultimately report their emissions. According to RGGI states, many but not all RGGI sources already operate such systems as a result of the federal Clean Air Act's acid rain program.

Also expected in the near future is guidance from the RGGI states regarding offsets (quantification, verification, transfer, etc.). The RGGI model rules allow use of offsets from only specific types of operations, including certain end-user energy efficiency, "carbon sequestration" through afforestation, agricultural waste operations, and landfill gas. The expected guidance will likely be reviewed closely by potential offset generators looking for new revenue streams.

**Beyond RGGI**

The pace of development in climate change programs continues to accelerate. Although federal legislation stalled this past year, vigorous renewed efforts are all but certain next year, regardless of the November election results, as indicated by the Boucher/Dingell discussion draft bill released October 7, 2008 in the House of Representatives. Meanwhile, other states and regions – particularly California, the Western Climate Initiative, and the Midwest Greenhouse Gas Reduction Accord – continue to push forward with multi-sector programs aimed more broadly than RGGI's focus on large electricity generators and $CO_2$. Integrating RGGI into these federal and state/regional programs will likely be a key challenge in the years ahead.

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Robinson & Cole is currently advising a number of clients regarding emerging climate change programs at national, regional, state and local levels. We stand ready to apply our experience and insights to your operations and strategic planning. If you would like to discuss how these issues may impact your business, please contact any of these attorneys in our Sustainability and Climate Change practice group:


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