

In Confidence,

Office of the Minister for Climate Change

Chair, Cabinet Economic Development Committee

Regulatory decisions on the rules for auctioning in the New Zealand Emissions Trading Scheme.

Proposal

1. This paper seeks your agreement to set regulations under the Climate Change Response Act 2002 as amended by the Climate Change Response (Emissions Trading Reform) Amendment Bill (currently before the House), that will provide the rules for auctioning within the New Zealand Emissions Trading Scheme (NZ ETS) and seeks your approval for issuing drafting instructions to the Parliamentary Counsel Office.

Executive summary

2. The NZ ETS is the Government's key policy tool for reducing greenhouse gas emissions, meeting our climate change targets and transitioning to a low emissions economy. The Government needs to manage the number of units supplied into the NZ ETS so it is in line with our emissions budgets and climate change targets.
3. Historically, the NZ ETS has not had a cap on the number of units available within the scheme. This Cabinet agreed to amend the Climate Change Response Act 2002 (CCRA) [CAB-17-MIN-0547.01 refers], which will enable a cap in the NZ ETS. The Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill) was introduced to the House on 24 October 2019.
4. The Bill includes general clauses providing an overall framework for key aspects of the NZ ETS, including auctioning and setting a cap. Regulations will provide the specific details to give effect to the framework.
5. There are three critical sets of regulations needed to take effect alongside the passing of the Bill:
 - NZ ETS settings (i.e. the cap)
 - auctioning rules
 - forestry accounting.

The regulatory proposals for NZ ETS settings and auctioning rules are interdependent and should be considered a package.

6. The proposals in this paper are intended to set regulations to define the rules for auctioning in the NZ ETS. This paper seeks your agreement to instruct the Parliamentary Counsel Office to draft new regulations for:

- 6.1. defining auction format and frequency
- 6.2. scheduling auctions and managing auction volumes within a year
- 6.3. operationalising price controls within auctioning
- 6.4. preparing for auctions, publishing auction notices, registering bidders and processing collateral
- 6.5. setting bidding rules for auctions
- 6.6. defining the approach to settle successful bids and report on auction results.
7. Regulations for the NZ ETS proposed settings and auctioning rules must be in place by the end of 2020 to ensure that the NZ ETS is able to help New Zealand meet its post-2020 climate change targets.
8. Early decisions are needed on the auctioning rules to proceed with development of the auction platform and, given the complexity of the regulations, to ensure the regulations are drafted and ready before the end of 2020. Final drafted regulations are expected to be brought back to the Cabinet Legislation Committee for approval later in 2020, subject to enactment of the Bill.
9. The Bill also provides for regulations to be made to appoint an auction monitor to provide independent oversight of auctions. Proposals for regulations relating to the auction monitor will be brought to Cabinet separately later in 2020.
10. The number of units being allocated for auctioning and the level of price controls that will operate through auctioning do not form part of these proposals because they are part of the NZ ETS proposed settings regulations. I expect to bring a further paper to Cabinet in May that includes proposals to set:
 - 10.1. overall NZU limits and price control settings in the NZ ETS
 - 10.2. an indicative schedule for auctioning
 - 10.3. a start date for auctioning.

Background

11. The Climate Change Response Act (CCRA) already provides for the Minister for Climate Change to sell NZUs by auction within a prescribed overall limit, following the development of regulations. To date, the auctioning provisions in the Act have not been utilised.
12. The Climate Change Response (Emissions Trading Reform) Amendment Bill was introduced by the Government to reform the NZ ETS. The Bill ensures the Government has the tools to manage the supply of units into the market, by setting clear caps on emissions in line with our climate change targets.
13. Cabinet agreed to public consultation on proposals to reform the NZ ETS in late 2018 [CAB-18-MIN-0374 refers]. Following consultation, Cabinet agreed a series of decisions that resulted in the introduction of the Bill to the House in October 2019. The Bill includes further provisions to enable a robust auctioning system to be developed.

14. As part of its December 2018 decisions, Cabinet agreed that the following aspects of auction design should be reflected in regulations [CAB-18-MIN-0606.01 refers]. Auctions will:
- 14.1. be held using a sealed-bid, single-round, uniform pricing format;
 - 14.2. take place monthly or quarterly; and
 - 14.3. be open for participation to all New Zealand Emissions Trading Register (the Register) account holders, subject to further qualifications provided in regulations.
15. Before auctions can commence, the rules that govern auctioning need to be set in regulations. The regulations will provide certainty for the ETS market, auction participants, and the auction operator¹ as to how auctions will be run.
16. The Bill requires the Minister for Climate Change to recommend that regulations are made to prescribe matters relating to his power to sell NZUs by auction and sets out the regulations that ‘must’ or ‘may’ be made.
17. Prior to setting these regulations, further consultation on the proposed rules for auctioning in the NZ ETS was conducted in November and December 2019 following Cabinet agreement [CAB-19-MIN-0580 refers].
18. Submitters generally expressed support for the approach the Government is taking to develop the auctioning regulations. Some recommended that the proposed rules for auctioning should be considered alongside the results of consultation on NZ ETS proposed settings, which closed on 28 February 2020².

Proposals contained in this paper (Regulations for auctioning)

19. The specific proposals in this paper are described below. Submitter views on these proposals may be found in Appendix 1.

Section 1: Enacting Cabinet decisions on auction format and frequency

20. I propose to set regulations to enact Cabinet’s decision [CAB-18-MIN-0606.01 refers] to develop an auctioning platform with a sealed bid, single-round, uniformly priced format, and with flexibility for monthly or quarterly auctions.

Format

21. The single-round, sealed bid, uniformly priced auction format is simple, has low risk of collusion, and is the format used in all overseas emissions trading schemes that include auctioning.

Frequency

22. Setting regulations to enable the flexibility for auctions to be held either monthly or quarterly enables the auctioning system to adapt to changing circumstances as it develops. A schedule of auction dates and the volumes available for the year will

¹ For the purposes of this paper the term “auction operator” is used to refer to the agent to be appointed by the Minister on behalf of the Crown under section 6A of the Act to conduct the sale of NZUs.

² The consultation on settings provided information on the proposed settings for the cap, including the number of NZUs that would be available for auctioning, and the levels of price controls that would operate through auctions.

be published on the Ministry for the Environment website well ahead of time, to support certainty for the market.

23. Decisions on frequency are largely influenced by the volumes of units that will be available for auctioning. The Government consulted on volumes as part of the NZ ETS proposed settings consultation, which concluded on 28 February 2020. [refer Reforming the New Zealand Emissions Trading Scheme: Proposed settings discussion document].
24. The Government proposes an overall auction volume over the provisional emissions budget period of 2021-2025 of 80 million NZUs. For the first two years of this budget period (2021 and 2022) this equates to approximately 18 million NZUs per annum available for auctioning. Final decisions have not been taken on the provisional emissions budget, however the proposed volumes do give an indication of the likely scale of auctioning during the first two years.
25. Taking into account the above auction volumes I propose initially to schedule auctions to be held quarterly in the NZ ETS. Making this decision now allows for related rules to be set in this paper based on a quarterly schedule, for example, lead times for auction notices and rules for treatment of unsold units. However this proposed auction schedule can only be confirmed after final decisions on the NZ ETS proposed settings are taken, so I ask for an in-principle decision from Cabinet at this time.
26. Sufficient volume needs to be available at each auction to attract interest from bidders. Holding auctions quarterly provides for greater volumes per auction than monthly auctions. Less frequent auctions also reduces transaction costs for both the Government and bidders as there are fewer auctions to run or participate in. Impacts on the secondary market can more accurately be assessed after auctioning has been introduced and empirical evidence becomes available.

Section 2: Overall rules for scheduling auctions and managing volume across auctions

27. The Government will decide on and announce unit supply and auction volumes for each year annually, five-years in advance on a rolling basis. Decisions on volumes will be taken to align with emissions budgets. Therefore market participants with compliance obligations will know the total annual supply five years in advance, and can plan to meet their obligations through either abatement or the purchase of NZUs.
28. To support market transparency and regulatory predictability it is important that scheduling of auctions be subject to regulation. This will ensure NZ ETS market participants have equal access to knowledge about auction frequency and how auction volumes available for each year will be managed.

Scheduling auctions

29. I propose to set the following rules for scheduling auctions:

- 29.1. An auction calendar will be published annually on the Ministry for the Environment's website, including expected auction volumes, no later than the end of September for the following calendar year.

- 29.2. An exception will exist for the first year of auctioning, as the regulations may not be enacted in time to allow for a September publication date.
- 29.3. Auctions must be held on weekdays that are not public holidays, regional anniversary holidays and do not fall between Christmas Eve and the day after New Year's Day (inclusive).
- 29.4. Auctions should, where practicable, not be held on any known dates of major announcements that have a substantial impact on the NZ ETS market, for example Budget Day, the day the following year's auction calendar is notified or dates when major announcements are expected from the Climate Change Commission.
- 29.5. No auction may be scheduled on a date less than 20 calendar days before the annual compliance deadline of 31 May.
- 29.6. Once scheduled, auctions will not be cancelled. They may be postponed in the following exceptional circumstances:
 - 29.6.1. force majeure event prevents the auction operator from running the auction
 - 29.6.2. the auction platform is unavailable to all bidders during the bidding window, for example, if a major IT failure affects the auction operator.
- 29.7. If an auction is postponed then it must be rescheduled as soon as reasonably practicable. The rescheduled auction date must be published as soon as possible on the auction operator's website and communicated to registered bidders.
- 29.8. If an auction is postponed once the bidding window has opened then only bidders already qualified to bid in the postponed auction will be eligible to participate in the rescheduled auction.
- 29.9. On the day an auction is scheduled, the auction bidding window will be open for three hours from 9am to 12noon. Bids received after the bidding window has closed will not be accepted.

Scheduling auctions – analysis

- 30. Each auction involves administrative costs and requires preparation by both bidders and the auction operator. To maximise predictability and allow sufficient time for people to plan their bidding strategies, it is vital to set the auction schedule as far in advance as possible.
- 31. Holiday periods should be avoided to encourage maximum bidder participation. Scheduling should also seek to minimise disruption to the secondary market, for example by avoiding running auctions immediately prior to the 31 May surrender date.

Managing volume across auctions

- 32. Under the five-year rolling decision making process for announcing unit supply volumes, the first two years of auction volumes following the current year are fixed and only able to be changed under special circumstances (including the release of

reserve units or sale of units at the minimum price). This has implications for how any unsold units are managed between calendar years because it means that unsold units cannot be rolled over from one year to the next.

33. I therefore propose to set the following rules for managing volumes across auctions:
- 33.1. Within any single calendar year, the total volume of NZUs available for sale by auction should be evenly distributed across the year's scheduled auctions.
 - 33.2. If some or all NZUs are unsold in an auction then the unsold units will be added to the volume for sale at the next scheduled auction without limit, provided that the next auction is scheduled within the same calendar year.
34. If unsold volume remains from the last auction of the calendar year it cannot be rolled over into the following year as volumes for that year are already fixed. Therefore, any unsold volume at the end of the year will need to be taken into account by the Government when proposing auction volumes within New Zealand's budgets for future years past the next two.

Managing volume – analysis

35. Distributing volume evenly across years is a simple approach to create certainty and avoid disrupting the secondary market. It allows people to plan their bidding strategies well in advance and does not require taking a decision on how to weight volume across a calendar year that I do not consider necessary at this time.
36. Adding all unsold volume to the next auction in a calendar year is also a simple approach that reduces complexity for the market and the auction operator. As I am proposing to hold auctions quarterly this is a practical approach to take when volumes cannot be rolled over to the next year.
37. During consultation the Government's preferred option was to set a limit on the number of unsold units that can be carried over to the next auction. However for the reasons stated in the above paragraph I do not propose setting such a limit at this time.

Section 3: Operation of price controls within auctions

38. Price controls allow the Government to manage unacceptably low or high prices in the NZ ETS. The Bill includes provisions to set regulations to enable price controls through the auctioning system.
39. The two price controls enabled by the Bill are:³
- 39.1. a cost containment reserve (to replace the existing fixed price option) that is designed to release additional NZUs for sale at auction if the auction clearing price reaches a specified price trigger, thereby putting downward pressure on unit prices in the market.

³ Climate Change Response (Emissions Trading Reform) Amendment Bill, section 30GB (2) (d) and (e)

- 39.2. a price floor that sets a minimum price at which units may be sold at auction, ensuring that the Government does not sell units at a price that it considers to be unacceptably low.
40. I am not proposing to set the level of these price controls in this paper. Proposals for regulations to set the level of price controls will be brought to Cabinet in a separate paper following public consultation on the NZ ETS proposed settings.
41. Public consultation on NZ ETS proposed settings consultation proposed setting one price trigger for the cost containment reserve. The design of the auction platform regulations, however should set rules that enable the cost containment reserve to operate if multiple price triggers are set. This is prudent because the auction platform should be configured to work with all possible future regulatory settings and the proposal to set a single price trigger is still under consideration. Each price trigger would be associated with a specified reserve volume.
42. Officials have advised that no further regulations are required to make a price floor operational once the value of the price floor has been set. Provisions in the Bill⁴ specify that the price floor is the minimum price at which units may be sold at auction, noting that this value is able to be set to zero.
43. I therefore propose setting regulations to define how the cost containment reserve will work within the auctioning system as follows:
- 43.1. If the auction clearing price is at or above a price trigger set for the cost containment reserve, the relevant reserve volume will be immediately released to the market during that same auction by adding it to the original auction volume.
- 43.2. If only a single price trigger is set, then the new auction volume will be assigned to bids (ranked in order from highest to lowest bid price) until either:
- 43.2.1. all bids priced at or above the price trigger are satisfied⁵, leaving some unsold volume in the cost containment reserve, or
- 43.2.2. the reserve volume is exhausted.
- 43.3. If more than one price trigger is set then the process to assign volume and determine a final auction clearing price may need to run multiple times as follows:
- 43.3.1. If the original auction clearing price is at or above the lowest price trigger, the auction process is run with the corresponding reserve volume added to the original auction volume. This new auction volume will be assigned to bids until either all bids priced at or above the lowest price trigger are satisfied, or all volume is sold.
- 43.3.2. By definition, the clearing price of the auction in the step above is at or above the lowest price trigger level. If this clearing price is *also* at or above the *next highest* price trigger, then the auction process is run again with the corresponding volume for the next highest price trigger also added.

⁴ Climate Change Response (Emissions Trading Reform) Amendment Bill, section 30GB (2) (e) (iii)

⁵ The effect of this regulation is to set the clearing price to be the lowest successful bid price at or above the price trigger for any auction that triggers the cost containment reserve.

- 43.3.3. This process continues for all price triggers until either the clearing price is less than the next remaining price trigger (if there is one) or the full reserve volume is sold.

Operation of price controls within auctions – analysis

44. During consultation, the Government preferred option was to hold a separate reserve auction soon after the auction at which the price trigger is hit.
45. Releasing the reserve volume immediately is a simpler approach overall that enables the market to build in clear price expectations based on auction frequency (now proposed to be quarterly, with no extra reserve auctions) and the value of the price trigger (or triggers). For this reason, and to reduce transaction costs for all parties, I propose to sell reserve volume through the same auction that hits the cost containment reserve price trigger.

Section 4: Preparing for auctions; auction notices, registration process and provision of collateral

46. Before an auction starts, the auction operator needs to provide confirmation to the market of the details of the upcoming auction via an auction notice. Eligible bidders need to register and then provide information to the auction operator to enable the auction to run efficiently.

Auction operator to publish auction notices and guidance for bidders

47. To ensure that auctions run efficiently and that potential bidders have the information they require to prepare for an auction, the auction operator should publish an auction notice a minimum of 30 calendar days prior to the auction date (for quarterly auctions).
48. The auction notice must contain at least the following information:
 - 48.1. date and time of the auction
 - 48.2. total number of NZUs for sale at the auction, specifying the number of NZUs within this total that are carried over as unsold units from previous auctions (if any)
 - 48.3. any price controls and their value (i.e. current value of the price floor, if enabled, current value of the cost containment reserve trigger price(s) and reserve volume(s) available)
 - 48.4. whether there is a technical reserve price
 - 48.5. any applicable due dates for pre-auction forms, if required, e.g. relating to provision of collateral.
 - 48.6. give notice of whether the goods are being sold by the vendor as a supplier and state that vendor bids are not permitted, as per the requirements of the Fair Trading Act 1986.
49. In addition to publishing an auction notice, the auction operator must provide, on their website, the auction terms and conditions, forms required for registration processes and guidance on how the auction works.

Auction operator to publish auction notices and guidance for bidders – analysis

50. The auction notice formally advises the market of the upcoming auction details (note that the auction date would have already been advised through the published auction schedule from the previous year) and to give potential bidders time to prepare.
51. The lead time for the auction notice should be sufficient to allow bidders to prepare their bids and complete any pre-auction processes, for example submitting collateral.
52. Given that I propose quarterly auctions, I also propose regulations set a minimum lead time of 30 calendar days for the publication of the auction notice. This does not preclude the auction operator from publishing earlier.

Registration process needed for bidders

53. Before being eligible to bid in an auction, bidders need to register their details and meet defined registration criteria. The auction operator will need time to verify bidder registrations before allowing them to participate in auctions. Registration is a one-time process that, once complete, will allow bidders to participate in all subsequent auctions provided they agree to the terms and conditions and periodically confirm that their registration details remain accurate.
54. Once registered, bidders also need to meet the requirements set out in regulations and the terms and conditions of the auction, for example, any requirements to provide collateral, before submitting a bid at the auction.
55. The Government has already decided that auctions will be open for participation to all New Zealand Emissions Trading Register (the Register) account holders, subject to further qualifications provided in regulations [CAB-18-MIN-0606.01 refers].
56. It is important that the auction operator be required to establish bidder identities and validate their authority to act on behalf of the relevant Registry account. It is also vital for the integrity of the NZ ETS that registration processes are seen to be robust.
57. Therefore I propose that:
 - 57.1. the auction operator be authorised and required to collect the following information from prospective bidders in NZ ETS auctions:
 - 57.1.1. name of registered account holder⁶
 - 57.1.2. registry account number to which the account holder wishes the units to be transferred
 - 57.1.3. for companies; full legal name, trading name (if different), company identifier or registration number
 - 57.1.4. principal business address or registered office address
 - 57.1.5. names, contact details and relationship to the account holder for any authorised representatives of the registered account holder

⁶ Registry account holders may be natural persons, companies, trust or incorporated societies

- 57.1.6. names and contact details of each person authorised to bid in an NZ ETS auction on behalf of the registered account holder
- 57.2. the auction operator must verify that the Registry account number provided is a valid New Zealand Emissions Trading Register account and the prospective bidder is the registered account holder.
- 58. The auction operator is required to verify that registration information is true and correct. Therefore I propose that alongside the information listed above, the prospective bidder be required to provide a statutory declaration.
- 59. While registration is a one-off process, the registered bidder must inform the auction operator if any of the above information changes. Any amendments must also be provided with a statutory declaration that the amended information is true and correct and the bidder must confirm that their registration details are accurate before bids will be accepted by the auction operator. Therefore I propose that bidders are required to confirm that their registration details are accurate before a bid can be submitted.

Provisions for collateral

- 60. The Government needs to manage the risk of a winning bidder defaulting on payment to ensure the credibility of the financial management system for NZ ETS auctions and preserve market integrity.
- 61. I therefore propose to require bidders in NZ ETS auctions to provide collateral for their bids using the following rules:
 - 61.1. Collateral must be provided for auctions at a rate of 25 per cent of a bid's maximum bid value, where maximum bid value equals the maximum price a bidder is willing to pay times the expected bid volume.
 - 61.2. Bids submitted by individual bidders will only be accepted by the auction operator if collateral requirements are met.
 - 61.3. If bidders amend their bid(s) during the bidding window, all amendments must stay within the limits set by the collateral provided. For example, if a bidder has provided more collateral than required for their initial bid(s) then they may amend their bid or bids upwards until 25 per cent of the new total maximum bid matches the collateral held by the auction operator, but no further.
 - 61.4. Collateral must be received by the auction operator five working days prior to the auction date.
 - 61.5. The following forms of collateral will be accepted:
 - 61.5.1. cash
 - 61.5.2. bank guarantee
 - 61.5.3. irrevocable letter of credit.
 - 61.6. Collateral may be used as partial payment for successful bids if requested by the bidder and the form of collateral provided allows for this.
 - 61.7. Bidders may request that their collateral be automatically returned after an auction or released only when requested.

- 61.8. Non-cash forms of collateral may be retained for future auctions if requested by the bidder.
- 61.9. Any remaining cash collateral will be returned after each auction.
- 61.10. If successful bids are not settled by the settlement date then collateral provided for that bid will be forfeit to the Crown.

Provisions for collateral – analysis

- 62. Requiring collateral to be provided can mitigate the risk of settlement default, ensure a level of commitment from bidders to deter frivolous bidding and increase public confidence in the integrity of auctions. It may also help to deter strategic behaviour which could occur if a winning bidder refuses to pay, for example if the auction clearing price exceeds the secondary market spot price.
- 63. On balance I consider that the need to maintain the integrity of auctions outweighs the transaction costs and potential opportunity costs for bidders that arise from collateral requirements for the auction operator as they will be required to collect, hold, release and report on collateral.

Section 5: Bidding rules during an auction

- 64. Rules are required to specify what types of bids can be accepted during an auction and how these bids should be treated in certain circumstances, for instance in case bids are tied at the clearing price.
- 65. The following proposals are designed to give bidders certainty over how to bid at auction and how their bids will be treated. The auction clearing price rules proposed here are required to enact the single-round, sealed bid, uniform price auction format.
- 66. I propose that the following bidding rules should apply to NZ ETS auctions:
 - 66.1. The minimum acceptable bid size is 500 NZUs.
 - 66.2. Bids must be made using a lot size of 100 NZUs.
 - 66.3. Bids must be made with a minimum price increment of \$0.05.
 - 66.4. Bidders may amend or withdraw their bids at any time up to the close of the bidding window.
 - 66.5. The clearing price of the auction is the lowest successful bid price when all bids are ranked in order from highest to lowest price.
 - 66.6. All bidders pay the clearing price for their bids once it has been determined.
 - 66.7. A technical reserve price must be set for each auction relative to the secondary market price of NZUs, using a prescribed methodology that is kept confidential.
 - 66.8. If the clearing price of the auction does not reach the technical reserve price then no units will be sold.

66.9. Tied bids⁷ will be resolved using a pro-rata approach rounded to the minimum lot size as follows:

66.9.1. Calculate for each tied bid the amount of NZUs that represents a proportionate share of all remaining auction volume.

66.9.2. Round the volumes calculated above to the nearest minimum lot size, noting that this may result in zero NZUs being assigned if the proportionate share is less than half of the minimum lot size.

Setting minimum bids, lot sizes and price increments

67. Setting the minimum bid size at 500 NZUs and the minimum lot size at 100 NZUs is intended to make auctions more accessible to smaller participants as secondary market minimum bid sizes are larger.

68. I recommend setting a smaller lot size as it does not preclude larger bids while allowing for a wide range of bid sizes to support accessibility.

69. The bid increment is the minimum price difference per NZU in which bids can be increased. I propose a bid increment of five cents (\$0.05) for NZ ETS auctions both because this is common practice in the secondary market and it is small enough to keep the likelihood of tied bids to an acceptable level.

A technical reserve price should be set

70. A technical reserve price is the lowest price that the Government would be willing to accept for NZUs during any one particular auction and is calculated relative to the secondary market price.

71. The technical reserve price is different from an auction price floor. The latter is a price control set in regulations, defined as the minimum price at which units may be sold at auction. The price floor is set at a fixed and publicly known value that does not change for every auction but remains in place until new regulations are made.

72. Setting a technical reserve price protects against the risk of NZUs being sold at a price significantly below the prevailing secondary market price. If that was to occur it could represent a windfall for auction participants at the expense of Government revenue and potentially disrupt the secondary market.

73. Setting the technical reserve price requires a methodology, however keeping this methodology confidential is recommended to prevent it becoming an undesirable focus for bidding strategies and discourage attempts to manipulate the auction clearing price. This is also the approach taken in some ETS schemes in other jurisdictions.

74. I therefore propose to set a technical reserve price relative to the secondary market price of NZUs before each auction using a prescribed methodology that is kept confidential.

⁷ Tied bids occur when more than one bid is received that matches the clearing price of the auction

75. If the clearing price of any particular auction does not reach the technical reserve price for that auction then no units will be sold.

Resolving tied bids in single-round, sealed bid, uniformly priced auctions

76. In a single-round, sealed bid, uniformly priced auction, the auction clearing price is determined by ranking all bids received in descending order of price until the total bid volume (demand) is equal to (or greater than) the volume of units for sale (supply). The clearing price is set at the price of the lowest priced bid for the final amount of volume.

77. Tied bids occur when more than one bid is received that matches the clearing price of the auction and the total demand exceeds total supply.

78. Three proposals were consulted on to resolve tied bids. Two of these proposals involved randomly assigning volume to either entire bids, or to lots within bids until all volume is assigned. The third was to rescale bids downward in proportion to the amount of volume remaining.

79. Both approaches that use random assignment reduce the risk of collusion because bidders trying to coordinate their bids will not be certain that they will receive the volume they have bid for. However it also means that some market participants bidding at the clearing price may not receive any units. Officials advise that the risk of collusion in this particular circumstance is low.

80. Pro-rata rescaling of bids would reduce all tied bids proportionately so that total demand equals total supply. This approach is more likely to ensure that all bidders bidding at the clearing price will receive at least some units and also that the number of units received are in proportion to the size of their original bid. This approach requires rounding rules to be in place to ensure that minimum lot sizes are retained, so it is possible that bids for very small volumes may be rounded down to zero.

81. For equity reasons I propose that tied bids be resolved using pro-rata rescaling with rounding rules in place to ensure minimum lot sizes are retained.

Amending and withdrawing bids

82. Auctions governed by the Fair Trading Act 1986 must allow bids to be withdrawn up until the close of an auction. This is also common practice for emissions trading schemes in other jurisdictions.

83. Allowing bidders to amend or withdraw their bids until the bidding window closes will allow bidders to fix errors or change their minds about proceeding with a bid. No other participant is affected by amendments to bids in a sealed-bid format auction and it does not affect auction integrity.

Considering a maximum bid limit

84. Consultation on rules for auctioning asked whether regulations should set a limit on the maximum volume of units that could be bid for by any one bidder or by bidders that may be related through a group of companies. This is referred to as a maximum bid limit. There was some support from submitters to set a limit. The main rationale was that this would reduce the risk that participants facing

surrender obligations are unfairly disadvantaged by someone bidding for a large portion of the available supply. At present, officials see this as a low risk given the level of supply to the market.

85. To reduce administration and ensure simplicity for bidders and the auction operator, I recommend not setting a limit at this time. Instead I recommend that Government monitor market behaviour and make a decision to set such a limit in the future, should it prove necessary.

Section 6: Settlement approach and reporting auction results

Auction settlement approach

86. Settlement refers to the process whereby successful bidders pay for the bids they have won and then the corresponding number of NZUs are transferred to the bidder's Registry account.
87. Officials have advised that full settlement and delivery usually takes two days and may take up to four days. This is because banks making payment on instructions of bidders have their own procedures to work through. Similarly the Registrar needs to transfer NZUs from the Crown account to that of the successful bidder.
88. I propose that a payment before delivery approach be used for auctions in the NZ ETS and that the maximum settlement time should be four working days. Under this approach payment by the successful bidder must be made and cleared before NZUs won in the auction are transferred to the bidder's account.
89. If a bid does not settle within four working days then I propose that the bid volume be treated as unsold units and the collateral provided for that bid be forfeit to the Crown.
90. Payment before delivery is a relatively simple approach that protects against defaults because transfers of NZUs are only initiated once payment has been received.
91. An alternative 'delivery-versus-payment' approach was considered, but this would require both the bidder and the auction operator to be members of, or use the services of, a central counter-party or clearing house to concurrently exchange payments from successful bidders with units from the auction operator, via the counter-party/clearing house. As the provider of these services would charge a fee, this would result in would have higher transaction costs than the payment before delivery approach.

Reporting auction results

92. Once the auction has completed, the auction results must be communicated to the successful bidders and the wider market. Some results can be released shortly after the auction while others can only be released to the market later following further analysis.
93. The wider market has an interest in the auction results and any delay between the end of an auction and disclosure of results should be minimal, so the results can be reflected in trades on the secondary market. It is also important to ensure that

the entire market has access to the information at the same time to prevent knowledge asymmetry.

94. I propose that the following information be published as soon as practicable after the end of each auction by the auction operator, at a minimum within the same business day:

- 94.1. auction clearing price
- 94.2. total volume of units auctioned
- 94.3. total volume of bids
- 94.4. average bid size
- 94.5. number of bids
- 94.6. cover ratio (total volumes bid divided by total volumes for sale)
- 94.7. total number of bidders and the number of successful bidders
- 94.8. the number of unsold units, if any.

Reporting auction results via the auction monitor

95. Monitoring and reporting on auction results will increase transparency in the market and ensure all participants are informed appropriately about the results of each auction.

96. I propose that after each auction and prior to the next, the auction monitor when appointed, publishes a report on the outcome of the auction that contains at least the following information:

- 96.1. detailed volume statistics, e.g. average volume per bidder⁸, average volume won per bidder
- 96.2. detailed statistics on the number of bids, e.g. average number of bids per bidder, number of bids submitted, number of successful bids
- 96.3. relevant aggregate information, e.g. largest bids as a percentage of total volumes sold
- 96.4. relevant distributional information, e.g. number of units awarded to which winner, with bidder names withheld
- 96.5. distribution of successful bids among market participants with and without mandatory compliance obligations
- 96.6. relevant information on resolved tied bids.

97. I also propose that the auction monitor periodically assess the auctioning system in order to recommend improvements. It is important to have an early review soon after establishment of the auctioning platform, with regular reviews afterwards. Therefore I propose that the auction monitor review the auctioning system initially after the first year of operation and then once every two years.

⁸ This is different from average bid size as one bidder can place multiple bids.

Consultation (with other agencies, departments, interest groups etc)

Public Consultation

98. Section 30GH of the Act, as amended by the Bill, requires me to consult with persons that are likely to be substantially affected by making these regulations specifying the rules for the auctioning.
99. The Ministry for the Environment has run two separate public consultations relating to these proposals.
100. Consultation on the high-level design options for auctions was undertaken as part of the consultation on Improvements to the NZ ETS held in August and September 2018.
101. Stakeholder feedback was sought on auction format, frequency and participation. Submissions were received from 253 submitters from a range of sectors. There was clear, though not majority, support for the preferred auction format (45 per cent supported the preferred auction format, while 35 per cent supported the introduction of auctioning but preferred a different auction format).
102. Public consultation on the proposed rules for auctioning in the NZ ETS was then conducted in November and December 2019. This consultation received 47 submissions from a wide range of stakeholders, the majority of whom were either ETS participants or actively involved in the ETS market. One submission was received from a submitter who identified as iwi/Māori.
103. Stakeholders in general expressed support for the approach the Government is taking to develop regulations for auctioning. There was majority support for a significant number of the Government's preferred proposals, with a range of views expressed on some of the more technical proposals.
104. I am satisfied that the requirements of section 30GH has been met.

Agency consultation

105. This paper was prepared by the Ministry for the Environment. The Treasury, the Environmental Protection Authority, Ministry of Business, Innovation and Employment, Ministry for Primary Industries, Ministry of Foreign Affairs and Trade, Ministry of Justice, Ministry of Transport and the Department of Conservation were consulted in preparation of the paper and all comments are reflected in the paper. The Department of Prime Minister and Cabinet and Te Puni Kōkiri were informed.

Financial implications

106. I am not seeking any further funding at this stage. The proposals in this Cabinet paper are required to implement previous Cabinet decisions, consequently funding for the Ministry for the Environment project to develop the auctioning platform is already in place.
107. Implementing the proposals in this paper will have costs for the EPA. The magnitude of these costs will depend on further decisions to be made about how the auction platform will operate, and any linking required to the New Zealand Emissions Trading Register (the Register).

108. The EPA considers that without funding, changes to the Register and the required operational support cannot be operationalised.

Legislative implications

109. Implementation of these proposals will require regulations under sections 30GA and 30GD of the Bill. With Cabinet's approval, I will issue instructions to the Parliamentary Counsel Office to draft Orders in Council for consideration by the Cabinet Legislation Committee. The Orders in Council will be presented to the Cabinet Legislation Committee after enactment of the Bill and will create new regulations under the amended Act. The proposals do not require further amendment of the Act.

110. Pending enactment, the Act as amended by the Bill allows new and amended regulations made under section 30GA and 30GD to come into force not less than three months after the date of their notification in the New Zealand Gazette.

Regulatory impact analysis

Quality assurance Assessment:

111. The quality assurance panel has reviewed the Regulatory Impact Assessment (RIA) and considers it meets the Quality Assurance criteria.

Reviewer comments and recommendations:

112. The Panel considers the RIA provides an adequate description of the proposed changes being considered within the context of wider changes to the Emissions Trading Scheme (ETS) and provides a clear summary of the potential scale of these changes by quantifying the volume and value of ETS auctioning. We are satisfied that sufficient consultation has taken place around the options, and, where appropriate the public's concerns have been addressed

113. Given the relatively narrow scope of the regulations and that an auctioning system is new to the New Zealand ETS, and only used in a small number of other jurisdictions, quantified information on the costs and benefits of the proposals is relatively limited. However, the panel is satisfied that the assessment includes the available information.

Climate implications of policy assessment

114. The Ministry for the Environment's CIPA team has reviewed this Cabinet paper and confirms that the CIPA requirements do not apply to this proposal as the impacts are indirect. However the Ministry notes that this proposal is part of the package of NZ ETS proposals and is necessary to achieve emissions reductions.

Te Tiriti o Waitangi

115. I acknowledge the significant interest iwi/Māori, including Māori entities, have in the NZ ETS, particularly as much of the Māori economy is involved in natural resource management, including forestry.

116. Iwi/Māori were invited to participate in consultation on these proposals alongside other stakeholders and notice of the consultation was included in a regular Ministry iwi newsletter during December 2019.

Human rights

117. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Gender implications

118. There are no immediate gender implications arising from this paper.

Disability perspective

119. There are no immediate disability implications of the proposals in this paper.

Publicity

120. Announcements about the NZ ETS need to be managed carefully to avoid any inconsistencies and market risks, including sudden rises of NZU prices in the NZ ETS. In addition, information should not be disseminated in a way that advantages some market participants over others and compromises NZ ETS investments.

121. I recommend that announcement of these decisions be coordinated with the announcement of decisions arising from the subsequent Cabinet paper proposing decisions for NZ ETS settings. Together, these Cabinet papers form a package that set the regulatory framework for enabling auctioning within the NZ ETS.

Proactive Release

122. I intend to proactively release this paper on the Ministry for the Environment's website subject to redactions as appropriate equivalent to those under the Official Information Act 1982 once all final relevant policy decisions have been announced.

Recommendations

1. The Minister for Climate Change recommends that the Committee:
2. **note** that this paper provides proposals to set regulations under the Climate Change Response Act 2002 as amended by the Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill) to provide rules for auctioning within the New Zealand Emissions Trading Scheme (NZ ETS).
3. **note** that the NZ ETS is the Government's key policy tool for reducing greenhouse gas emissions, meeting our climate change targets and transitioning to a low emissions economy.
4. **note** that a key purpose of the Bill is to improve the NZ ETS by putting a cap on the supply of units and the ability for the Government to auction NZUs is a crucial component of setting the cap.
5. **note** that to meet the start dates for auctioning and start the transition to a low emissions economy, regulations for auctioning rules must be in place by the end of 2020.

Enacting Cabinet decisions on auction format and frequency

6. **note** that Cabinet has previously agreed that an auction platform should be developed with a sealed-bid, single-round, uniform pricing format and with flexibility for monthly or quarterly auctions.
7. **agree** to draft regulations for auctions to be run following the sealed-bid, single-round uniform pricing format and to be held either monthly or quarterly.
8. **note** that setting the flexibility for auctions to be held either monthly or quarterly enables the auctioning system to adapt to changing circumstances as it develops.
9. **note** that to support market certainty a schedule of auction dates and the volumes available for the year will be published well ahead of time and the Government has recently consulted on proposals to set auction volumes as part of the NZ ETS proposed settings consultation that concluded on 28 February 2020.
10. **agree in principle**, subject to final decisions on NZ ETS proposed settings, to initially schedule auctions to be held quarterly in the NZ ETS.

Overall rules for scheduling auctions and managing volume across auctions

11. **note** that to support market certainty and regulatory predictability it is important to set rules about the scheduling of auctions in the NZ ETS and how auction volumes available each year will be managed.
12. **agree** to publish an auction calendar annually, including expected auction volumes, no later than the end of September.
13. **agree** to make an exception to the requirement to publish the calendar no later than the end of September (rec 12) for the first year of auctioning to allow time for regulations to be enacted.
14. **agree** that auctions must be held on weekdays that are not New Zealand public holidays, regional anniversary holidays and do not fall between Christmas Eve and the day after New Year's Day (inclusive).
15. **agree** that auctions should, where practicable, not be held on any known dates of major announcements that have a substantial impact on the NZ ETS market, for example Budget Day, the day the NZ ETS auction calendar is announced for the following year, dates when major announcements are expected from the Climate Change Commission.
16. **agree** that auctions should be scheduled no closer than 20 calendar days before the compliance deadline on 31 May.
17. **agree** that, once scheduled, auctions should not be cancelled. Auctions may be postponed in the following exceptional circumstances:
 - 17.1. a force majeure event prevents the auction operator from running the auction
 - 17.2. the auction platform is unavailable to all bidders during the bidding window, for example, if a major IT failure affects the auction operator.
18. **agree** that if an auction is postponed (rec 17) then it must be rescheduled as soon as reasonably practicable. The new auction date must be published on the auction operator's website and communicated to registered bidders as soon as possible.

19. **agree** that if an auction is postponed once the bidding window has opened (rec 17) then only bidders already qualified to bid in the postponed auction prior to the postponement may participate.
20. **agree** that on the day an auction is scheduled, the auction bidding window will be open for three hours from 9am to 12 noon. Bids received after the bidding window has closed will not be accepted.
21. **note** that under the Bill's provisions to establish a five-year rolling decision making process for announcing unit supply volumes, the first two years of auction volumes following the current year are fixed and unlikely to change.
22. **agree** that within any one calendar year, the total volume of NZUs available for sale by auction should be evenly distributed across all scheduled auctions.
23. **agree** that if some or all NZUs remain unsold after an auction then all unsold units should be added to the volume for sale at the next scheduled auction without limit, if the next auction is scheduled to occur within the same calendar year.
24. **note** that if unsold volume remains from the last auction of the calendar year then it cannot be rolled over into the next year or the year after as volumes for those years are already fixed. This unsold volume will need to be taken into account by the Government when proposing auction volumes within New Zealand's budgets for future years past the next two years.

Operation of price controls within auctions

25. **note** that price controls allow the Government to manage unacceptably high or low prices in the NZ ETS and the Bill includes provisions to enable price controls through the auctioning system, including:
 - 25.1. a cost containment reserve (to replace the existing fixed price option) that is designed to release additional NZUs for sale at auction if the auction clearing price reaches a specified price trigger(s), thereby putting downward pressure on prices
 - 25.2. a price floor that sets a minimum price at which units may be sold at auction.
26. **note** that proposals to set the level of price controls in the NZ ETS will be brought to Cabinet following public consultation on NZ ETS proposed settings and are not included in this paper.
27. **note** that no further regulations are required to make the price floor operational once the value of the price floor has been set, as provisions in the Bill specify that the value of the price floor is the minimum price at which units may be sold at auction, noting that this value is able to be set to zero.
28. **agree** that if the auction clearing price is at or above a price trigger set for the cost containment reserve, the relevant reserve volume will be immediately released to the market during that same auction by adding it to the original auction volume.
29. **agree** that if only a single cost containment reserve price trigger is set, then relevant reserve volume will be added to the original auction volume and the resulting volume will be assigned to bids (ranked in order from highest to lowest bid price) until either:
 - 29.1. all bids priced at or above the price trigger are satisfied, leaving some unsold volume in the cost containment reserve, or

29.2. the reserve volume is exhausted.

30. **agree** that if more than one cost containment reserve price trigger is set, then the process to assign volume and determine a final auction clearing price may need to run multiple times as follows:

30.1. If the original auction clearing price is at or above the lowest price trigger, the auction process is run with the corresponding reserve volume added to the original auction volume. This new auction volume will be assigned to bids until either all bids priced at or above the lowest price trigger are satisfied, or all volume is sold.

30.2. By definition, the clearing price of the auction in the step above [rec 30.1] is at or above the lowest price trigger level. If this clearing price is *also* at or above the *next highest* price trigger, then the auction process is run again with the corresponding volume for the next highest price trigger also added.

30.3. This process continues for all price triggers until either the clearing price is less than the next remaining price trigger (if there is one) or the full reserve volume is sold.

Preparing for auctions, auction notices, registration process and provision of collateral

31. **note** that the auction operator needs to publish an auction notice to confirm details of an upcoming auction for auctions to ensure potential bidders have the information they require to prepare and for auctions to run efficiently.

32. **agree** that the auction operator must publish an auction notice at least 30 calendar days prior to a scheduled auction date (for quarterly auctions) including at least the following information:

32.1. date and time of the auction

32.2. number of NZUs for sale at the auction, specifying the number of NZUs within this total that are carried over as unsold units from previous auctions (if any)

32.3. any price controls that apply to the auction and their value (i.e. current value of the price floor, if enabled, current cost containment reserve price trigger(s) and the reserve volume(s) available)

32.4. any applicable due dates for forms, if required prior to the auction, e.g. for provision of collateral

32.5. whether a technical reserve price applies to this auction

32.6. give notice of whether the goods are being sold by the vendor as a supplier and state that vendor bids are not permitted⁹.

33. **agree** that the auction operator must provide, on their website, the auction terms and conditions, any forms required for registration processes and guidance on how the auction works.

34. **note** that before participating in auctions, bidders are required to register their details and meet registration criteria. Registration is a one-time process that, once

⁹ Requirements under the Fair Trading Act 1986

complete, will allow bidders to participate in all subsequent auctions provided they agree to the terms and conditions.

35. **note** that once registered, bidders need to meet the requirements set out in regulations, for example requirements to provide collateral, and the terms and conditions of the auction before submitting a bid at the auction.
36. **note** that the Government has already decided that auctions will be open for participation to all New Zealand Emissions Trading Register (the Registry) account holders, subject to further qualifications provided in regulations.
37. **agree** that to register prospective bidders, the auction operator collects the following information:
 - 37.1. name of the registered account holder
 - 37.2. registry account number to which the account holder wishes the units to be transferred
 - 37.3. for companies: full legal name, trading name (if different), company identifier or registration number
 - 37.4. principal business address or registered office address
 - 37.5. names, contact details and relationship to the account holder for any authorised representatives of the registered account holder
 - 37.6. names and contact details of each person registered to bid in an NZ ETS auction on behalf of the registered account holder
38. **agree** that the auction operator must verify that the Registry account number provided is a valid New Zealand Emissions Trading Register account and the prospective bidder is the registered account holder.
39. **agree** that prospective bidders be required to provide a statutory declaration that all registration information provided is true and correct.
40. **agree** that bidders are required to confirm that their registration details are accurate before a bid can be submitted to the auction operator.
41. **note** that the Government needs to manage the risk of a winning bidder defaulting on payment to ensure the credibility of the financial management system for NZ ETS auctions and preserve market integrity.
42. **agree** that collateral must be provided for bidders to participate in NZ ETS auctions and the following rules apply:
 - 42.1. Collateral must be provided for auctions at a rate of 25 per cent of each bid's maximum bid value, where maximum bid value equals the maximum price a bidder is willing to pay times the expected bid volume.
 - 42.2. Bids will only be accepted by the auction operator if collateral requirements are met.
 - 42.3. If bidders amend their bid(s) during the bidding window, all amendments must stay within the limits set by the collateral provided. For example, if a bidder has provided more collateral than required for their initial bid(s) then they may amend their bid or bids upwards until 25 per cent of the new total maximum bid matches the collateral held by the auction operator, but no further.

- 42.4. Collateral must be received by the auction operator 5 working days prior to the auction date.
 - 42.5. The following forms of collateral will be accepted:
 - 42.5.1. cash
 - 42.5.2. bank guarantee
 - 42.5.3. irrevocable letter of credit.
 - 42.6. Collateral may be used as partial payment for successful bids if requested by the bidder and the collateral is in an appropriate form.
 - 42.7. Bidders may request that their collateral be automatically returned after an auction or that it is released only when requested.
 - 42.8. Non-cash forms of collateral may be retained for future auctions if requested by the bidder.
 - 42.9. Any remaining cash collateral will be returned after each auction.
 - 42.10. If successful bids are not settled by the settlement date then collateral provided for that bid will be forfeit to the Crown.
43. **note** that the Government needs to manage the risk of a winning bidder defaulting on payment to ensure the credibility of the financial management system for NZ

Bidding rules during an auction

44. **note** that rules are required to specify what types of bids can be accepted during an auction and how these bids should be treated in certain circumstances, for instance in case bids are tied at the clearing price to give bidders certainty over how to bid at auction.
45. **agree** that the following bidding rules should apply to NZ ETS auctions:
- 45.1. The minimum acceptable bid size is 500 NZUs
 - 45.2. Bids must be made using a lot size of 100 NZUs
 - 45.3. Bids must be made with a minimum price increment of \$0.05.
 - 45.4. Bidders may amend or withdraw their bids at any time up to the close of the bidding window.
 - 45.5. The clearing price of the auction is the lowest successful bid price when all bids are ranked in order from highest to lowest price.
 - 45.6. All bidders pay the clearing price for their bids once it has been determined.
 - 45.7. A technical reserve price must be set for each auction relative to the market price of NZUs, using a prescribed methodology that is kept confidential.
 - 45.8. If the clearing price of the auction does not reach the technical reserve price then no units will be sold.
 - 45.9. Tied bids¹⁰ will be resolved using a pro-rata approach rounded to minimum lot size as follows:

¹⁰ Tied bids occur when more than one bid is received that matches the clearing price of the auction

45.9.1. Calculate for each tied bid the amount of NZUs that represents a proportionate share of all remaining auction volume.

45.9.2. Round the volumes calculated above (rec 44.9.1) to the nearest minimum lot size, noting that this may result in zero NZUs being assigned if the proportionate share is less than half of the minimum lot size.

46. **note** that no limit will be set on the maximum volume of units that can be bid for by any one bidder, or by bidders that may be related through a group of companies, at this time. The Government intends to monitor market behaviour and may recommend that such a limit be set in the future, if it becomes necessary.

Settlement approach and reporting auction results

47. **note** that settlement refers to the process whereby successful bidders pay for the bids they have won and then the correct amount of NZUs are transferred to the bidder's Registry account. An approach is needed that protects against default.

48. **agree** that auctions should be settled using a payment before delivery approach where payment by the successful bidder must be made and cleared before NZUs won in the auction are transferred to the bidder's Registry account.

49. **agree** that the maximum time allowed for settlement is four working days.

50. **agree** that if bids fail to settle then the bid volume is treated as unsold units.

Settlement approach and reporting auction results

51. **note** that once an auction has taken place, results must be notified to the wider market and to successful bidders. Any delay between the end of an auction and disclosure of results should be minimal so the results can be reflected in trades on the secondary market.

52. **agree** that the auction operator should publish the following information as soon as practicable after the auction has closed, at a minimum within the same business day:

52.1. auction clearing price

52.2. total volume of units auctioned

52.3. total volume of bids

52.4. average bid size

52.5. number of bids

52.6. cover ratio (total volumes bid divided by total volumes for sale)

52.7. total number of bidders and the number of successful bidders

52.8. the number of unsold units, if any.

53. **agree** that the auction monitor when appointed, publishes a report on the outcome of each auction, before the next auction occurs that contains at least the following information

- 53.1. detailed volume statistics, e.g average volume per bidder¹¹, average volume won per bidder
 - 53.2. detailed statistics on the number of bids, e.g. average number of bids per bidder, number of bids submitted, number of successful bids
 - 53.3. relevant aggregate information (eg, largest bids as a percentage of total volumes sold)
 - 53.4. relevant distributional information (eg, number of units awarded to which winner, with bidder names withheld)
 - 53.5. distribution of successful bids among market participants with and without mandatory compliance obligations
 - 53.6. relevant information on resolved tied bids.
54. **agree** that the auction monitor when appointed, provides a review of the auctioning system after the first year of operation and then once every two years.

Next steps

55. **invite** the Minister for Climate Change to issue drafting instructions for new regulations to the Parliamentary Counsel Office based on the agreed and “in principle” decisions presented in this paper.
56. **note** that the Minister for Climate Change intends to bring the next set of proposals for regulations for NZ ETS proposed settings under the Act as amended by the Bill in May 2020.
57. **note** that subject to the enactment of the Bill and following drafting by the Parliamentary Counsel Office, both sets of regulations will be presented to the Cabinet Legislation Committee for approval later in 2020.
58. **agree** that the Minister for Climate Change will proactively release this paper on the Ministry for the Environment’s website, subject to redactions equivalent to withholdings under the Official Information Act 1982 once all final relevant policy decisions have been announced.

Authorised for lodgement.

Hon James Shaw
Minister for Climate Change

¹¹ This is different from average bid size as one bidder can place multiple bids.

Appendix 1- Submitter Views on Auctioning Proposals

Section	Summary of Proposals	Submitter Views
2. Overall rules for scheduling auctions and managing volume across auctions	Auctions should be scheduled to avoid key dates and not too close to the compliance deadline.	<p>Submitters provided a range of suggestions regarding how and when to schedule auctions. They generally agreed that auctions should be scheduled during the week, avoid major holidays and key announcement dates. Some suggested specific day ranges, for example suggesting holding auctions at the end of the month or during the first five days of the month to align with business practices or mid-week to avoid public holidays.</p> <p>Submitter views were mixed on how close to the compliance deadline an auction should be scheduled. Several suggested that ten working days should be sufficient while others said a gap of at least a month was needed, even if auctions were to be held monthly.</p>
2. Overall rules for scheduling auctions and managing volume across auctions	Bidding window will be open for three hours from 9am to 12noon.	Most submitters agreed that a three-hour bidding window in the morning was appropriate. Of the six who did not agree there was a preference to have a later start time to allow international bidders more time.
2. Overall rules for scheduling auctions and managing volume across auctions	Within any single calendar year, the total volume of NZUs available for sale by auction should be evenly distributed across the year's scheduled auctions.	Most submitters supported the even distribution of volume for reasons of simplicity and predictability. The submitters that disagreed generally had surrender obligations and preferred an approach that increased volumes for sale between January and April each year prior to the surrender date in May.
2. Overall rules for scheduling auctions and	If some or all NZUs are unsold in an auction then the unsold units will be	Submitters had differing views on how to treat unsold units. Those supporting a limit on the number of unsold units that could be added to subsequent auctions felt this would be more effective in avoiding

Section	Summary of Proposals	Submitter Views
managing volume across auctions	added to the volume for sale at the next scheduled auction without limit, provided that the next auction is scheduled within the same calendar year	disruption to the secondary market. Those who did not support a limit expressed a preference for certainty over the volume that would be available at each auction and across the calendar year. Several submitters thought it unlikely that any NZUs would be unsold in the current market. Some submitters also suggested that unsold units could be added to the cost containment reserve, particularly if units are left unsold at the end of a calendar year.
3. Operation of price controls within the auctioning system	Volume from the cost containment reserve will be sold to bidders immediately, during the same auction that triggers the reserve.	<p>Submitter views were evenly split over the best option for releasing the cost containment reserve to the market. Those who supported releasing the reserve volume immediately submitted that this option is simpler, cheaper and more efficient because no separate auction needs to be held. They also noted that this would better prevent bidders paying unacceptably high prices in the original auction.</p> <p>Submitters who supported the Government's original preferred option to hold a separate reserve auction without limiting participation, generally agreed with the rationale that this would support accessibility. Some noted that it would be important to keep the time between the original and reserve auctions short to minimise uncertainty and reduce the impact on the secondary market.</p> <p>Submitters who supported restricting participation in the reserve auction to entities with surrender obligations were concerned that an open auction may encourage speculation and make it difficult for those with compliance obligations to access supply.</p>
4. Preparing for auctions; auction notices, registration process and provision of collateral	The auction operator is required to publish an auction notice with sufficient lead time for the market.	The majority of submitters who commented on the lead time required for auction notices said that 30 days should be sufficient regardless of auction frequency. However some suggested this may need to be shortened for monthly auctions.

Section	Summary of Proposals	Submitter Views
4. Preparing for auctions; auction notices, registration process and provision of collateral	Prospective bidders must register with the auction operator before bidding at auctions.	<p>Submitters had a range of views on the registration process. Some larger companies felt that a rigorous vetting and due diligence process is warranted to ensure the integrity of auctions. Other submitters thought it sufficient to rely on information already held in the Registry for registration and saw no need for further checks.</p> <p>Submitters commonly expressed the view that providing an intent to bid form for each individual action should not be required. They viewed it as an administrative burden that was not a binding indication of an intention to bid and considered it unnecessary. If an intention to bid form is required then these submitters felt that only a short lead time needed, from one to five days before the auction. Therefore I propose that regulations require bidders to advise the auction operator of any changes to their registration details prior to bidding in an auction and do not require an intent to bid form be provided.</p>
4. Preparing for auctions; auction notices, registration process and provision of collateral	Collateral is required to participate at auction of 25 per cent of the bidder's maximum bid volume.	<p>A small majority of submitters supported proposals to require collateral. However there were a number of organisations who did not agree that collateral was needed. Some suggested that different types of bidders should face different collateral requirements, for example that bidders with surrender obligations should not need to provide collateral but should require collateral from those with no obligations.</p> <p>There was broad support for the Government preferred value for collateral of between 10 and 25 per cent of the maximum bid, and for the Government's preferred lead time for collateral of five working days. A minority preferred the option of 100 per cent collateral and some submitted it could then be used to immediately settle bids.</p>
4. Preparing for auctions; auction	Acceptable forms of collateral are cash, bank	Submitters generally agreed that cash, bank guarantees and irrevocable letters of credit should be acceptable forms of collateral.

Section	Summary of Proposals	Submitter Views
<p>notices, registration process and provision of collateral</p>	<p>guarantee and irrevocable letter of credit.</p>	<p>There were a few other suggestions to increase these options (either now or in future phases of development of the auctioning system). Suggestions included accepting NZUs as collateral, using credit ratings or that collateral obligations could be removed for bidders with proven payment records in prior auctions.</p>
<p>4. Preparing for auctions; auction notices, registration process and provision of collateral</p>	<p>Bidders should have flexibility to decide how their collateral is treated after an auction, if they do not default on their settlement</p>	<p>Submitters almost universally supported flexibility when asked whether bidders should be able to choose what happens to collateral after an auction closes. They largely agreed that collateral (depending on its form) should be used against payment if the bidder requests and that bidders should be able to choose to have their collateral either automatically returned after the auction, released at their request, or retained for future auctions.</p>
<p>5: Bidding rules during an auction</p>	<p>Set a minimum bid size of 500 NZUs and minimum lot size of 100 NZUs</p>	<p>There was a range of views from submitters on the preferred minimum bid size. Support was evenly split between those who supported the preferred option of 500 NZUs and those who preferred a larger minimum of either 1000 or 5000 NZUs to align with the secondary market. The few who supported a smaller bid size submitted that this would make auctions more accessible for small scale participants.</p> <p>Support was similarly split on a minimum lot size, with the majority of submitters supporting either 100 or 500 NZUs. Nine submitters supported a larger lot size of either 1000 or 5000 NZUs some of who submitted that the secondary market was available to support smaller trades.</p>
<p>5: Bidding rules during an auction</p>	<p>Set a price increment of \$0.05</p>	<p>Larger and smaller increments were considered, however most submitters who commented supported an increment of \$0.05.</p>

Section	Summary of Proposals	Submitter Views
5: Bidding rules during an auction	A technical reserve price should be set relative to the secondary market price, but the methodology should be kept confidential	<p>A majority of submitters supported the introduction of a technical reserve price. Those commenting in support agreed with the Government's rationale that this would ensure units are not sold below their market value.</p> <p>Submitters who opposed the technical reserve price noted either that it was not needed in the presence of a price floor or that if one were set then it may be hit if prices on the secondary market spiked quickly, creating the risk that units are unsold in a market where demand is actually high. However, the risk of this occurring is deemed to be low if the reserve price methodology is based on the current price in the secondary market rather than a recent average.</p> <p>Submitters were evenly split on whether the methodology for calculating the clearing price should be kept confidential. The most common rationale of those opposing confidentiality was to increase transparency. Officials have advised that while transparency is a guiding principle of the NZ ETS, in this case the need for transparency is outweighed by the risk that publication may encourage attempts at market manipulation.</p>
5: Bidding rules during an auction	Tied bids should be resolved using a pro-rata approach	<p>Submitter views were slightly in favour of the pro-rata approach, primarily for equity reasons and because it is easier for bidders to understand. Several also submitted that this matches the approach taken in some financial markets.</p> <p>Those favouring either of the random assignment approaches were more likely to do so as a way of preventing undesirable market behaviour or because the approach is simple and is used in international markets (random assignment to the entire bid). Officials advise however that the risk of collusion in this particular circumstance is low.</p>

Section	Summary of Proposals	Submitter Views
5: Bidding rules during an auction	A maximum bid limit will not be set at this time.	There was some support from submitters to set a limit. The main rationale was that this would reduce the risk that participants facing surrender obligations are unfairly disadvantaged by someone bidding for a large portion of the available supply.
6. Settlement approach and reporting auction results	A payment before delivery approach will be used for settlement of bids	Submitters overwhelmingly supported the payment before delivery approach for reasons of simplicity and minimising transaction costs, with only one submitter suggesting an alternative approach.
6. Settlement approach and reporting auction results	The auction operator should report auction results as soon as practicable after each auction.	Most submitters were supportive of the listed information being published. A few suggested that there may be limited value in publishing average bid sizes and number of bids as these will vary greatly depending on bidder strategies.
6. Settlement approach and reporting auction results	The auction monitor should also publish regular reports following each auction, and regularly review the auctioning system.	<p>Generally submitters were supportive of the listed information being published, provided care was taken to avoid identification of individual bidders inadvertently.</p> <p>Most submitters were supportive of the role of the auction monitor, and the majority agreed with the recommended frequency of reviews, i.e. after the first year of operation initially and biannually thereafter. Where submitters disagreed with the frequency of reviews they tended to prefer a more frequent review schedule, e.g. six monthly at first then annually or annually.</p>