



Further considerations for setting the confidential reserve price methodology

Date Submitted:	4 March 2021	Tracking #: 2021-B-07694	
Security Level	Confidential	MfE Priority:	Urgent

	Action sought:	Response by:
To Hon James Shaw, Minister of Climate Change	Agree, sign and return. Forward to Minister of Finance.	8 March

Actions for Minister's Office Staff	Forward this report to the Minister of Finance Return the signed report to MfE.
Number of appendices and attachments 2	Titles of appendices and attachments (ie separate attached documents): 1. Appendix 1 - 2021-B-07514 Setting a methodology for the NZ Emissions Trading Scheme auction confidential reserve price 2. Appendix 2 – Relevant Clauses of amended Climate Change Response (Auction Price) Amendment Bill
Note any feedback on the quality of the report	

Ministry for the Environment contacts

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Principal Analyst	Matthew Cowie		

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Further considerations for setting the confidential reserve price methodology

1. The purpose of this briefing is to advise you what is required to set the confidential reserve price methodology following several small amendments to the Climate Change Response (Auction Price) Amendment Bill (the Bill) when it was before Select Committee.
2. This briefing, after considering these amendments, recommends setting the methodology as previously outlined and advises what steps are required to ensure that the methodology is in place for the first auction on 17 March 2021. A copy of the previous methodology briefing [2021-B-07514, dated 16 February 2021] is attached as Appendix 1.

Reconsideration of criteria is needed after changes to the Bill

3. In the previous methodology briefing we noted our advice was provided based on the Bill as introduced rather than the Act for timing reasons, and that the Bill includes transitional provisions to allow an early decision on the methodology to be treated as if it were made after enactment.
4. Making an early decision introduced a risk that the criteria we included for your consideration could be changed by Select Committee meaning that you may then need to repeat your consideration. This has now occurred. One amended and one new criteria need to be included for your further consideration when setting the methodology.

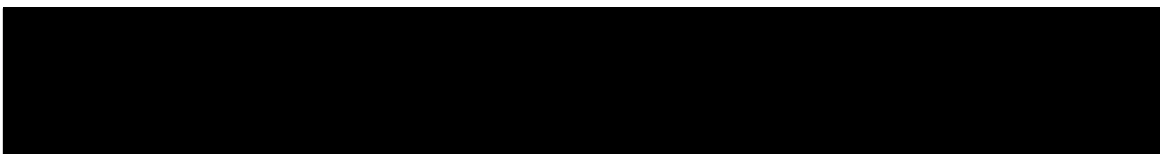
Proposed changes to the Bill

5. Select Committee has recently agreed to make several minor changes to the Bill after considering public submissions, a recommendation from the Regulations Review Committee and the MfE Departmental Report. Three of these changes affect what must be considered when you are setting the methodology in accordance with the Regulations.
6. The amended Bill now requires you, when setting the methodology for confidential reserve prices, to:
 - 6.1. “ensure that the methodology promotes the purpose of confidential reserve prices” rather than simply “consider the purpose of confidential reserve prices” (Appendix 2, Bill clause 4, new section 2A(b)(i) and Bill clause 9, new regulation 15A(2)(b) and (c))
 - 6.2. “ensure that the methodology includes” ways to determine a representative price for units and a price below the representative price that will achieve the purpose of confidential reserve prices (Appendix 2, Bill clause 9, new Regulation 15A (2)(c))
 - 6.3. consult with any auction monitor appointed, as well as with the Minister of Finance. (Appendix 2, Bill clause 9, new Regulation 15A (3)(b)).

Ensure that the methodology promotes the purpose

7. The Bill has strengthened the consideration of the purpose of confidential reserve prices when making regulations for the confidential reserve price. It now requires the regulations to “ensure that the methodology promotes the purpose of confidential reserve prices” to increase accountability. The Bill also updates the amendments to the regulations in accordance with this requirement.

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9. The recommended methodology also needs to set the confidential reserve price at a level that balances the risk that auctions clear 'significantly below' the secondary market price against the risk that the confidential reserve price acts as designed and prevents units being sold at that auction but rather rolled forward to be added to the next auction.¹
10. In our view, the methodology outlined in the briefing attached as Appendix 1 does ensure the purpose of the confidential reserve prices is promoted as it will prevent the sale of NZUs significantly below the secondary market price.

Ensure that the methodology includes ways to determine relevant prices

11. Previously you were required to consider ways to determine relevant prices, but the Bill now requires you, in line with the strengthened consideration of purpose, to "ensure that the methodology includes" a way to determine:
 - 11.1. a representative price for NZUs sold on secondary markets before the auction, taking into account any volatility in prices,
 - 11.2. a price below the representative price that will achieve the purpose of confidential reserve prices.
12. The recommended methodology includes ways to determine both of these prices.

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Requirement to consult with the Minister of Finance now includes auction monitor

13. The Bill now requires you to consult not only with the Minister of Finance but also with any auction monitor when setting the methodology.
14. In the future, it will be a requirement to consult with the auction monitor(s) when setting the methodology, however it is not required now because there are no auction monitors appointed yet under the Climate Change Response Act 2002.
15. It is still a requirement to consult with the Minister of Finance, and therefore we recommend that you forward this advice to his office and request his response.
16. In the previous briefing we had advised that you request a response from him by 5 March 2021, although we understand that your office has already been notified that he agrees to the methodology as recommended. Noting that we do not advise changing the methodology and given the short notice, we recommend asking his office to respond to this briefing by Friday 12 March at the latest. This will enable us to finally confirm the methodology with the auction operator.

¹ Provided that the next auction is scheduled for the same calendar year. Units cannot be rolled forward into the next calendar year because each year's auction volumes are fixed in regulations for the current and next year.

Risks

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Next Steps

18. We recommend that you forward this briefing to the Minister of Finance for consultation
19. We recommend you agree to set the methodology, as previously outlined (in briefing 2021-B-07514, dated 17 February 2021 attached as Appendix 1) in line with these amended criteria.

Recommendations

We recommend that you:

- a. **Note** that, Select Committee has recently agreed to make three minor changes to the Climate Change Response (Auction Price) Amendment Bill (the Bill) that change what must be considered when you are making the regulations and setting the methodology used to calculate confidential reserve prices;
- b. **Note** that the amended Bill now requires you to, "ensure that the methodology promotes the purpose of confidential reserve prices" rather than simply, "consider the purpose of confidential reserve prices" when setting the methodology;
- c. **Note** that the amended Bill now requires you to, "ensure the methodology includes" a way to determine a representative price for NZUs sold on secondary markets and a way to determine a price below the representative price that achieves the purpose, rather than simply "consider the need for the methodology to include" these prices;
- d. **Note** our advice is that the methodology outlined in the attached briefing (Appendix 1) does ensure that the methodology promotes the purpose of confidential reserve prices and ensures the methodology includes ways to determine the relevant prices;
- e. **Note** that the amended Bill now requires you to consult not only with the Minister of Finance but also with any auction monitor when setting the methodology;
- f. **Note** that no auction monitor has been appointed under the Act and therefore this consultation requirement will only be relevant when setting methodologies in the future;
- g. **Agree** that after considering the matters outlined above and the matters outlined in the attached briefing (Appendix 1) that confidential reserve prices should be set

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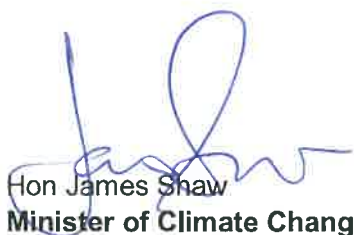
- h. **Agree** to forward this briefing to the Minister of Finance and consider any feedback he provides before making your decision.

 Yes/No

Signature



Matthew Cowie
Principal Analyst
Climate Change



Hon James Shaw
Minister of Climate Change

6/3/21

Date