



## NZ ETS auctions – notes on the Cost Containment Reserve

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	<b>Action sought:</b>
To Hon James SHAW, Minister of Climate Change	For noting only

<b>Actions for Minister's Office Staff</b>	No action required.
Number of appendices and attachments Nil.	N/A

### Ministry for the Environment contacts

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# NZ ETS auctions: notes on the Cost Containment Reserve

## Purpose

1. This aide memoire answers some commonly-asked questions on the cost containment reserve (CCR), including your question on whether the CCR trigger price could be changed for auctions this year.

## Background and content

### *Definitions*

2. The CCR is a reserve volume of units available to be released to the market if the CCR trigger price is hit at auction. The CCR trigger price is the auction clearing price at which units are released from the CCR.

### *Context – why are we providing this now?*

3. The CCR has been the focus of several conversations with you and your office recently, in preparation for decisions on updating the settings for the auction price floor and CCR trigger price.
4. You asked for more detail on whether the CCR trigger price could be changed for auctions this year. The Q and As below answer this and other questions on the CCR more generally.

## Questions and answers on the cost containment reserve

5. Can the CCR trigger price be updated before the September auction, or anytime in 2021?
  - a. No, the Climate Change Response Act 2002 (the Act) does not allow for the CCR trigger price settings in regulations for the current year to be updated in the same year.
  - b. To do so would require amendment to the Act.
6. Can the CCR trigger price be updated for 2022 auctions?
  - a. Yes, but only if justified by specified special circumstances. This is described in detail in BRF-115.
  - b. We consider that such special circumstances apply.
  - c. 2022 values can be updated, any updates must be gazetted by end September 2021.
  - d. Officials recommend increasing the CCR trigger price for 2022.

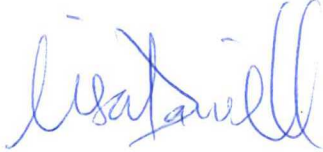
7. Is the CCR likely to be released in auctions during 2021?
  - a. Market commentators have expressed varying views on this.
  - b. Participants will have a greater degree of confidence in gaining auction unit supply by bidding at or above \$50 a unit, which is likely to appeal to at least some ETS auction participants.
  - c. The CCR volume is only released if the number of bids at or above the trigger price exceeds the initial auction volume (4.75 million units for each auction in 2021). Whether there will be 4.75 million units bid at over \$50 is dependent on bidding behaviour by auction participants.
  - d. Factors that may contribute to more NZ ETS participants seeking to secure unit supply during 2021, and being prepared to bid over \$50 to do so, are:
    - i. prevailing market prices (\$48 on 21 July 2021) and trajectory
    - ii. the number of bidders who bid unsuccessfully (21 of 37) at the last auction, and
    - iii. the increasing awareness of the magnitude of penalties faced (approximately \$120/unit) for any failure to surrender units before the ETS deadline.
8. How many units can be sold from the CCR during 2021 and at what prices?
  - a. If the CCR trigger price is hit, only bids above it (\$50) are allocated units from the CCR.
  - b. This results in a minimum clearing price of the CCR trigger price in situations where reserve units are released.
  - c. Only bids at or above \$50 can receive units from the CCR volume in 2021.
  - d. 7 million units is the maximum number of reserve units that can be sold out of the 2021 CCR volume during 2021.
  - e. None of the CCR volume has been released during the first two ETS auctions. This volume could be released into either (or both) of the remaining two auctions in 2021.
  - f. The CCR being released to auctions in 2021 does not necessarily mean that the whole reserve volume is sold in 2021.
9. Will units sold from the CCR during 2021 need to be backed?
  - a. Short answer: No.
  - b. Section 30IA of the Act details situations where units sold from the CCR would need to be “backed”.
  - c. What being “backed” means is that you must ensure, or enter into agreements that require, that the emission of greenhouse gases is reduced, or the removal of greenhouse gases from the atmosphere is increased, by 1 tonne of carbon dioxide equivalent for each of the units, whether by domestic means or offshore mitigation.
  - d. Work is underway on identifying sources of mitigation for backing units, including purchase of units from international markets.

- e. A key point is that this section only applies to the extent that the sale of units from the CCR has caused the emissions budget for an emissions budget period to be exceeded.
  - f. The mechanism for assessing emissions against emissions budgets is not finalised. We anticipate that units sold from the CCR during 2021 will not need to be backed as 2021 is outside of the first emissions budget period of 2022-2025.
10. Will units sold from the CCR during 2022 need to be backed?
- a. Short answer: Possibly some of them.
  - b. Same points apply as above; however, the first emissions budget period will encompass 2022, so the release of reserve volume during 2022 could cause the emissions budget to be exceeded in this period.
11. What are other implications for releasing the CCR?
- a. Any release of reserve volume in 2021 adds to the unit stockpile, and thus reduces the scarcity of units that drives emissions reductions.
12. How does the CCR trigger price interact with market price in 2021 and 2022? What about an announcement to increase the CCR trigger price in 2022?
- a. We cannot predict how the market will respond to any announced future change to the CCR trigger price.
  - b. The fixed price option (at both \$25 and \$35) appeared to act as a proxy ceiling on the price paid for units in the secondary market.
  - c. Since access to the \$35 fixed price option ended, the price paid for units in the secondary market has increased to approach, but not exceed, \$50.
  - d. Whether buyers in the secondary market are prepared to pay above \$50 a unit during 2021, while the CCR trigger price remains at \$50, remains to be seen, noting that an additional seven million units of supply are available at auction prices at or above \$50.

## Next steps

13. We can discuss this at the weekly meeting with you on 26 July 2021 if this is something that you wish to include on the agenda.

## Signature

Lisa Daniell Director - Climate Mitigation	
Date:	22 July 2021