



NZ ETS Auctioning Regulations update

Date Submitted:	5 February 2020	Tracking #: 2019-B-06374	
Security Level	IN CONFIDENCE	MfE Priority:	Non-Urgent

	Action sought:	Response by:
To Hon James Shaw, Minister for Climate Change	Note this Briefing	10 Feb 2020

Actions for Minister's Office Staff	Return the signed report to MfE.
Number of appendices and attachments #2	Titles of appendices: 1: NZ ETS Auctioning Regulations Timeline 2: High level summary of submissions "Reforming the New Zealand Emissions Trading Scheme: Rules for Auctioning"

Ministry for the Environment contacts

Position	Name	Cell phone	1 st contact
Principal Author	Kate Whitwell		
Responsible Manager	Fraser Wyeth		✓
Director	Roger Lincoln		

NZ ETS Auctioning Regulations update

1. This briefing provides options for the timing of final decisions on the regulations that need to be enacted to enable the Government to auction NZUs. This briefing also provides a brief summary of the submissions received during the recent consultation on rules for auctioning (refer Appendix 2).
2. Officials seek your direction over which of the following options is preferred for making decisions on the regulations for auctioning in the New Zealand Emissions Trading Scheme (NZ ETS):
 - Option 1 - Auctioning Regulations decided and drafted before the election
 - Option 2 - Auctioning Regulations policy decisions pre-election, drafting to continue through the election period.
3. Cabinet needs to make decisions and release regulations on the detailed rules for auctioning before the start of auctioning, currently scheduled for early 2021. This timeframe could be met under either option 1 or 2, but there are different risks and trade-offs to be considered with each.
4. A high level summary of submissions is included with this briefing (refer Appendix 2).

Background

5. Holding regular scheduled auctions of NZUs is a critical component of the reformed NZ ETS and is a key part of the framework for the NZ ETS that will allow New Zealand to reach its climate change targets.
6. The Government has previously announced an intention to set initial regulations that will allow auctioning to begin under a reformed NZ ETS in late 2020 or early 2021 (refer Reforming the New Zealand Emissions Trading Scheme: Proposed Settings, public consultation document).
7. There are dependencies between some of the decisions required to set the technical rules for auctioning and proposals currently being consulted on as part of the 'Reforming the New Zealand Emissions Trading Scheme: Proposed Settings' consultation that closes on 28 February 2020.
8. The election date has now been set for September 2020, and there is traditionally a caretaker convention in place for a few months post-election during which time decisions may be less likely to progress through Cabinet. Similarly, during the immediate pre-election period decisions can often progress less quickly through Cabinet.
9. The work required to draft a new set of regulations of this scope and complexity is likely to require a minimum of three to four months. Even that timeframe risks impacting the quality of the resulting regulations. It would be preferable to allow at least six months for drafting these regulations. That is likely to result in much higher quality work for a complex area of new policy that is critical to the integrity of the NZ ETS.
10. The Ministry is currently evaluating responses to a Request for Proposal (RFP) to appoint a Managed Auction Service provider to run auctions of NZUs on behalf of the Government. A decision on the preferred tenderer is likely at the end of the first quarter of 2020. The successful tenderer will be working to implement the auctioning platform at the same time as final regulatory decisions are progressing and drafting is underway under both options. We consider the slight delay in Cabinet decisions proposed under option 2 as a low risk to the progress of this project.

Options to progress regulatory decisions on the technical rules for auctioning in the NZ ETS

11. The following two options consider the implications of implementing regulations for auctioning either before or after the election in 2020.
12. Note that under either option Cabinet will be considering regulatory policy decisions for auctioning before the enabling legislation (the Emissions Trading Reform Bill) has been enacted (the Bill is expected to be passed in early May).¹

Option 1. Auctioning Regulations decided and drafted before the election

13. Under this option, a set of early policy decisions could be taken to DEV on 18 March 2020 and then Cabinet on 23 March 2020. PCO would have three months to draft the resulting regulations if final regulations are taken to LEG at the end of June 2020 before the House rises (refer Appendix 1, option 1).
14. The main risk with this option is that three months may not be enough time to complete drafting of these regulations, or that this timeframe could have an impact on the quality of resulting regulations. If drafting work is not complete then final regulations may be delayed until after the election. Any risk to the quality of drafting must be considered as a risk to the integrity of the auctioning system and new unit supply process.
15. Drafting time could be extended under this option by taking regulations to LEG closer to the election than June. However, this would only extend the drafting time by a small amount and the risk could be greater that Cabinet may choose not to consider decisions of this nature that close to the election.
16. Under this option we recommend reducing Ministerial consultation timeframes from the recommended 10 days to 5 days as per the timeline in Appendix one. This is to ensure there is time to consider the results of the ETS settings consultation.
17. Taking final policy decisions in March is likely to be too early to consider the results of consultation on ETS settings that include proposals for auction volumes and price controls in the NZ ETS. Some of these proposals may have a significant impact on some of the detailed proposals for auction rules, especially any that are related to how often, and when, auctions should be scheduled. There are only a few weeks between the date this consultation closes and the proposed lodgement date for a March Cabinet meeting. We recommend under this option including some of the schedule related decisions that are highly dependent on proposed auction volumes in a later Cabinet paper that will also address ETS settings.

Option 2. Auctioning Regulations policy decisions only pre-election, drafting to continue through the election period

18. Under this option, policy decisions could be taken slightly later by Cabinet in April, allowing more time to include policy decisions that are dependent on the results of consultation on ETS proposed settings. Drafting the regulations could then continue through the election period and final regulations could be taken to LEG at the end of 2020 following the election (refer Appendix 1, option 2).
19. Taking advantage of the election period to complete the drafting of these regulations would allow more time to ensure that these regulations are drafted to a high standard.

¹ The regulations making process in the Bill enables work done on regulations prior to commencement to satisfy regulation making requirements as long as it would have done so after commencement – refer schedule 1AA.

20. The key risk of this option is that Government timeframes for making decisions through Cabinet post-election are not known. It is possible that regulatory decisions such as this may be able to be taken within a few months of the election and before the end of the year. If that were the case and decisions were taken by any new Government in November then the regulations could be in place by February/March 2021. However if decisions are re-prioritised by the incoming Government then the start date for auctioning in the NZ ETS may be delayed to later in 2021.
21. Any delays to the start date for auctioning will have an impact on market certainty for the NZ ETS and could affect unit supply decisions. The scale of the impact would depend on how long the start date for auctioning was delayed for and whether or not the delay had an impact on the total volume of NZUs to be auctioned during 2021.
22. The most recent NZ ETS settings proposal was to maintain the fixed price option for emissions created in 2020, but at the increased price of \$35 (from the current \$25). This recommendation was made to ensure participants a degree of certainty over the value of the emissions they were creating throughout 2020.
23. If regulations are delayed and auctioning is postponed further into 2021, this could have the same negative impact of participants not having visibility over the value of the emissions they are creating at the time because they would not be able to purchase units to account for their emissions until further into the year. Having confidence over the cost of their emissions would be particularly challenging as the auctioning system will be new, and there will be a high level of uncertainty over how it will impact the NZU price.

Next Steps

24. We would like to discuss these options and agree a preferred approach with you at the officials meeting on 10 February 2020.

Recommendations

25. We recommend that you:

- a. **Note** that drafting new regulations for a complex policy area such as auctioning takes a significant amount of time and timeframes are impacted during an election year.

Yes/No

- b. **Meet** with officials on 10 February to discuss the options and agree a preferred approach to setting the regulations for auctioning in the NZ ETS.

Yes/No

- c. **Agree** to pursue either:

Option 1. Auctioning Regulations decided and drafted before the election

or

Option 2. Auctioning Regulations policy decisions only pre-election, drafting to continue through the election period.

- d. **Agree** that this briefing and appendices be released proactively on the Ministry for the Environment website following final decisions on all relevant regulatory policy.

Yes/No

Signature

Roger Lincoln
Director, Climate Change

Date

Hon James Shaw
Minister for Climate Change

Date

Appendix One – NZ ETS Auctioning Regulations Timeline Options

Option 1 – Auctioning Regulations decided before the election

	Due Date	Notes
First draft of Cabinet paper to Minister for comment and to agencies for review	Wed 27 Feb	
Draft Cabinet paper to Minister for Ministerial consultation (5 days)	Wed 4 Mar	
Cabinet paper lodged	Thu 11 Mar	
DEV considers ETS Auctioning Regs decisions	Weds 18 Mar	
Cabinet considers ETS Auctioning decisions	Mon 23 Mar	
PCO Drafting begins	Tues 24 Mar	
Auctioning Summary of Submissions published	Late March/early April	to be confirmed
PCO Drafting ends (3 months)	Thu 18 Jun	to be confirmed
LEG Cabinet paper lodged	Thu 18 Jun	to be confirmed
LEG Consider Cabinet paper	Tue 23 Jun	to be confirmed
Cabinet considers approval of LEG paper	Mon 29 Jun	to be confirmed
House rises	Thu 6 Aug	
In force - 3 months from Gazette notice	Anytime from 30 Sep onwards	

Option 2 – Auctioning Regulations policy decisions only pre-election

	Due Date	Notes
First draft of Cabinet paper to Minister for comment and to agencies for review	Wed 5 Mar	
Draft Cabinet paper to Minister for Ministerial consultation (10 days)	Wed 12 Mar	
Cabinet paper lodged	Thu 26 Mar	
ENV considers ETS Auctioning Regs decisions	Thu 2 Apr	
Cabinet considers ETS Auctioning decisions	Mon 6 Apr	
Auctioning Summary of Submissions published	early April	
PCO Drafting begins	mid Apr	
House rises	Thu 6 Aug	
Election	Sat 19 Sep	
PCO Drafting ends (6 months)	Nov 2020	to be confirmed
LEG Cabinet paper lodged	Nov 2020	to be confirmed
LEG Consider Cabinet paper	*Nov 2020	to be confirmed
Cabinet considers approval of LEG paper	*Nov 2020	to be confirmed
In force - 3 months from Gazette notice	Feb 2020	to be confirmed

Appendix Two – High level summary of submissions “Reforming the New Zealand Emissions Trading Scheme: Rules for Auctioning”

26. Consultation on “Reforming the New Zealand Emissions Trading Scheme: Rules for Auctioning” ran from 12 November to 19 December 2020 and received 47 submissions from a wide range of stakeholders, the majority of whom were either ETS participants or actively involved in the ETS market.
27. Two public meetings were held, in Wellington on 6 December and Auckland on 9 December 2020. Approximately 30 stakeholders attended each meeting. A webinar was held on 10 December to enable stakeholders outside these centres the opportunity to ask questions and view the presentation. Slides from the meetings were subsequently published on the MfE website.
28. Of the 47 submitters, 24 identified as ETS participants, 10 were not and the remaining 14 did not specify.
29. When asked to identify their submitter type over half of submitters (who could choose more than one, so numbers add to more than 47) identified as business/industry (25), six as individuals and one as iwi/Māori. Sector categories chosen were: liquid fossil fuels (8), forestry (7), electricity (5), market intermediaries (5), agricultural and horticultural (5), industrial processors (4), stationary energy (3), waste (2), central/local government (3), research/tertiary (2), iwi (1).
30. There was widespread support for the approach the Government is taking to develop the auctioning regulations. Some submitters stated that the rules need to be considered alongside the results of consultation on auction volumes (part of the NZ ETS Settings consultation) to take into account concerns about ETS market operation. For example, some submitters were concerned about being able to access sufficient supply to meet compliance obligations with the removal of the fixed price option and the introduction of the cost containment reserve.
31. A small group of forestry submitters expressed concern that the introduction of auctioning will oversupply the market with units that, in their view, do not represent real emissions removals.
32. Looking at the detailed proposals for the rules, a majority of submitters expressed support for the Government’s preferred approach for proposals to:
 - spread auction volumes evenly across all auctions within a year
 - add any unsold units to the next auction, within a limit
 - accept bids during a three hour ‘bidding window’ in the morning on the day of the auction
 - set a single price trigger which, if the price is reached during an auction, will release all the units held in the cost containment reserve for sale
 - require bidders to provide collateral, of some form, prior to the auction
 - set a minimum bid size of 500 NZUs
 - set a price increment of \$0.05
 - set a technical reserve price
 - use the payment before delivery approach for settling successful bids.
33. Submitters largely did not support:

- the recommended tied bid approach, preferring the pro-rata approach to the recommended 'random assignment by lot'
- timeframes for publication of the auction notice, preferring a shorter period than recommended, depending on whether auctions are to be held monthly or quarterly
- the requirement to submit an intent to bid form, with the majority of submissions on this point saying that it seemed an unnecessary step in the process.

34. There was a range of views on:

- the type/value of collateral that should be provided
- how the cost containment reserve auction should be run
- a preferred minimum lot size
- whether the technical reserve price methodology should be confidential
- whether a maximum bid limit should be set.

35. Submitters provided further useful comments regarding how close auctions should be scheduled relative to surrender dates and on the proposed pre registration process.

36. Those who commented on reporting requirements were largely supportive of the suggested information to be reported by the auction operator and auction monitor. Some submitters reiterated the need to ensure that reporting does not release commercially sensitive information.

37. A more detailed analysis of submitter's views on each proposal will be provided alongside recommendations for regulatory decisions, and in a formal Summary of Submissions document.

38. We expect to publish the Summary of Submissions for this consultation in late March or early April 2020.