

In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Business Committee

Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020

Proposal

- 1 I propose the Cabinet Business Committee authorises the submission of the Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020 to the Executive Council.

Executive Summary

- 2 This paper seeks Cabinet Business Committee approval to make regulations setting the rules for auctioning within the New Zealand Emissions Trading Scheme (NZ ETS). These regulations are made under sections 30GA and 30GB of the Climate Change Response Act 2002 (the Act).
- 3 These regulations are required to operationalise auctioning in the NZ ETS under the Climate Change Response (Emissions Trading Reform) Amendment Act 2020 (ETR Act). The overall design of NZ ETS auctions, including the auction format, timing and frequency has been developed in consultation with market participants, and with input from external experts over the course of several years.
- 4 In March 2020, Cabinet agreed the specific technical rules for auctioning within the NZ ETS and approved issuing associated drafting instructions to the Parliamentary Counsel Office [DEV-20-MIN-0047 refers].
- 5 These regulations need to be made now to allow the first auction to take place on 17 March 2021. The Act requires three months' notice before the regulations come into force. This notice period, combined with the change to the 2020 General Election date, means that these regulations need to be agreed now to meet the auction dates that have already been communicated to the market.
- 6 The auction regulations will provide the auction operator and participants with rules for the auctioning process.
- 7 Work is progressing to define the regulations for the auction monitor and these regulations include a requirement to provide a public report on the first year of operation of NZ ETS auctions.
- 8 Officials have also advised that they intend to provide me with advice on the functioning of the auctioning system after the first year of operation.

Policy

- 9 On 18 March 2020 Cabinet agreed to policy decisions to set the rules for auctioning within the NZ ETS [DEV-20-MIN-0047 refers]. Further policy decisions for some of the rules relating to the auction schedule were made by Cabinet on 14 May 2020 alongside decisions on overall unit limits and auction price controls for the NZ ETS [ENV-20-MIN-016 refers].
- 10 The new Climate Change (Auctions, Limits and Price Controls for Units) Regulations 2020 will replace the existing Climate Change Response (Limits and Price Control Settings for Units) Regulations 2020. These earlier regulations, made in August 2020, set the overall unit limits, auction volumes and price control values for the NZ ETS for the 2021–2025 period. The intent is to put all regulations relating to NZ ETS unit supply and auctions in the one set of regulations for ease of use.
- 11 The ability of the Government to sell NZUs by auction is a key component of the NZ ETS that will enable New Zealand to meet its climate change targets.
- 12 These regulations ensure that the auctions take place with clear rules, enabling NZ ETS scheme participants, the auction operator and other stakeholders to understand how and when auctions will take place and what is expected of them.
- 13 The following sections summarise the particular auction rules by their purpose under the Act.

Auction commencement date, schedule and restrictions

- 14 Under subsections 30GA(2)(a), (b) and (c) of the Act, regulations must be set to specify the date that auctions commence, prescribe an indicative schedule and specify circumstances when auctions will not be held.
- 15 The proposed regulations under ***When auctions are held***, specify that auctions will commence on 17 March 2021 and will be scheduled quarterly. An annual auction calendar must be made publicly available each year before the end of September.
- 16 The proposed regulations specify that auctions will not be held on weekends, public holidays or between 26 December and 2 January. Auctions must not be held within 20 calendar days of the annual surrender date for the NZ ETS.
- 17 Auctions may be postponed only in exceptional circumstances and must be rescheduled as soon as is reasonably practicable.

Determining auction results

- 18 Section 30GA(2)(d) of the Act requires regulations for auctions to sell NZUs to be set which specify the format of an auction (for example, a single-round, sealed bid, uniformly priced format).
- 19 The proposed regulations, under ***How auction results are determined***, state how the clearing price for the auction is determined, namely by ranking the bids in order from highest to lowest bid and then allocating cumulative volume to bids. Auctions are referred to as uniformly-priced because the clearing price for NZ ETS auctions will be set by the lowest successful bid price and will be paid by all bidders.

- 20 The auction operator must not make the details of any bid publicly available or to any other person, except if necessary to assist with the operation of the auction. This ensures the auction is a 'sealed-bid' auction.
- 21 In the case where auction prices are high and the interim clearing price is greater or equal to the reserve trigger price for the cost containment reserve (acting as a price ceiling), then setting the final clearing price can only be done once extra units are released for sale from the cost containment reserve.

Rules for the auction format

- 22 Under section 30GA(2)(e) of the Act regulations must be set which specify rules for the format of the auction (for example, rules on how bids are made and how tied bids are resolved). There are a range of regulations required to set these rules to a level that ensure auction participants, the auction operator and the public understand clearly how auctions will function.
- 23 In particular, further regulations are set in the section titled **How auction results are determined** to specify how to resolve tied bids. Tied bids occur when there are multiple bids for units at the clearing price that cannot all be satisfied with the remaining number of units. Tied bids will be resolved by assigning remaining units to the tied bids proportionally to their original bid volume, then rounding to the nearest minimum lot size of 100 units.
- 24 To clarify the rounding rules, any remainder will be rounded down to avoid over-allocation. If rounding rules result in unassigned lots at the end of the tied bids process then individual lots will be randomly assigned to tied bids until all the auction volume is assigned.
- 25 Regulations relating to **Auction notices and information**, state that the auction operator must publish auction notices 30 calendar days before each auction. The notice must include specific information including the auction date and time, information on the number of units for sale, any price controls and the latest date for provision of collateral.
- 26 The auction operator must publish general information about the auctions, including terms and conditions for auctions, any applicable forms and guidance material for potential bidders.
- 27 The proposed regulations, under **How auction results are run**, specify how long the bidding window must be open, that the auction lot size is 100 units, the minimum acceptable bid size is 500 units and bids must be entered using price increments of \$0.05.
- 28 The auction operator is required to enable any submitted bids to be amended or withdrawn on request while the bidding window is open.
- 29 The existing Cabinet decision specifies that the bidding window will be open for three hours between 9:00 am and 12:00 pm. However, an auction can be postponed if the platform is unavailable to the bidders. To minimise the risk of postponing an auction when short outages occur, regulations allow for small outages by specifying the maximum outages that could occur before postponement is required. Short outages are defined as being no more than 5

minutes at any one time, must be no more than 15 minutes overall and cannot occur during the last half hour of the auction.

Technical reserve price

- 30 [Redacted under 9(2)h]
Due to an issue in the development of the Act, we are unable to progress with a technical reserve price at this time
- 31 Cabinet decided in March 2020 to set a technical reserve price to prevent NZUs being sold at a price significantly below the prevailing secondary market price [DEV-20-MIN-0047 refers]. This would help ensure the primary auction does not significantly influence prices in the secondary market. It protects against the risk of a windfall for participants (if auction prices are substantially below the secondary market price), which comes at the expense of auction proceeds to the Crown.
- 32 The technical reserve price would be set for each individual auction, using a confidential methodology to avoid affecting bidding behaviour. Note, the technical reserve price is distinct from the minimum price set in regulations, which is intended to set a clear expectation in the market that the government will not accept bids below that price level.
- 33 However, [Redacted under 9(2)h]
I recommend the proposed regulations be set without providing for a technical reserve price at this time.
- 34 There is a risk that without a technical reserve price the clearing price for an auction may be significantly lower than the prevailing secondary market price. Officials advise me this risk is low, and that auctions are likely to still clear in line with recent secondary market prices. To put in place the technical reserve price in future will require an amendment to the Act.
- 35 Officials will be monitoring the first auctions in 2021 in order to develop advice for how to fix the technical reserve price in the next amendment bill to the Act.

Requirements for registration of bidders

- 36 Section 30GA(2)(f) of the Act requires regulations to be set which specify criteria and requirements for registration that a person must satisfy to participate in an auction.
- 37 The proposed regulations under **Registration of bidders** require auction participants to register before they can bid at auction, and rules are set in these regulations to specify who can bid if an auction is postponed.
- 38 The auction operator must verify the details on the registration application, make a decision on registration applications, and maintain a detailed register of bidders.
- 39 To verify the details on the registration application, the auction operator is required to collect identifying information from the bidder that is held in the

Registry, including the unique id that is assigned to person submitting the application.

Financial auction processes – provision of collateral and settlement

- 40 Section 30GA(2)(g) of the Act requires regulations to be set to specify financial processes that a person must follow. This includes regulations relating to the provision of collateral and settlement of bids.
- 41 Provision of collateral rules are set under **How auctions are run**. Bidders are required to provide collateral before bids are accepted and rules specify how collateral will be treated, options that bidders have regarding how their collateral may be used, and how the auction operator is required to treat collateral payments.
- 42 The proposed regulations under **Settlement of auction sales** specify that successful bidders must pay for all units within 4 working days of the auction. The auction operator must then arrange to have these units transferred to their Registry account.
- 43 If the bidder fails to pay within the set timeframe, the units will be treated as unsold and the collateral provided for that successful bid will be forfeit to the Crown.
- 44 To ensure the collateral amount to be forfeit is clearly specified for both auction participants and the auction operator, the proposed regulations provide the collateral for that bid is calculated as follows: Collateral forfeit on failure to settle = successful bid volume (number of NZUs won in the auction) x auction clearing price x 0.25.
- 45 Any excess collateral held over and above the amount forfeited will be returned to the auction participant.

Publishing auction results

- 46 Section 30GA(2)(h) of the Act requires regulations to be set for the results of each auction to be made publicly available.
- 47 The proposed regulations under **Publication of auction results** auction operator must publish auction results as soon as practicable on the same day of the auction on their website.

Limits and price control settings

- 48 Section 30GB(2) of the Act requires regulations to prescribe limits on units and price control settings, if auctioning regulations are made. The Climate Change Response (Limits and Price Control Settings for Units) Regulations were made on 3 August 2020. These regulations are now being superseded by the new auction regulations.
- 49 In the process of combining the regulations, officials and the Parliamentary Counsel Office identified two errors in the way the limits were calculated.

50 Section 30GB of the Act requires the reserve volume be included as part of the auction limit. In the previous regulations the reserve volume was only listed separately and not also included in the auction limit. To address this issue the auction limit and overall limit are being revised to include the reserve volume.

51 Subsection 30GB(2)(a)(iii) of the Act requires the regulations prescribe an 'overall limit', which is the sum of the units available at auction, the units issued for free for industrial allocation and through negotiated greenhouse gas agreements, and any approved overseas units. The 'overall limit' incorrectly included an additional adjustment in relation to the existing stockpile of units in the NZ ETS, making the overall limit for each year too large.

52 Revising these limits will have no practical impact, as there is no change to the amount of units that will be available for auction. The regulations stipulate the reserve volume cannot be sold at auction unless the cost containment reserve trigger price is reached. The limits are consistent with the information that has already been publicly communicated.

53 The correct values are provided in the following table:

Year	2021	2022	2023	2024	2025
Units to be auctioned (<i>amended</i>)	26.0	26.3	25.6	24.2	22.4
Overall limit (<i>amended</i>)	34.4	34.5	34.5	32.9	31.1

Even distribution of volume and rounding

54 The number of units available for sale by auction annually are evenly split across all auctions during that year. There is also a rule stating that auctions sell units in minimum lot sizes of 100 NZUs. Therefore, there is a risk that annual auction volumes may not divide evenly into amounts that round to the minimum lot size.

55 To clarify what should happen in this situation, regulations state that the number of units for sale at each auction should be rounded to the nearest 100 units.

56 Rounding rules always have remainders left to manage. Therefore, to ensure that all units made available for sale in one year can be sold at auction, any remainder left after rounding should be added or subtracted as appropriate to the final auction of the year. In other words, the number of units for sale at the final auction of the year then becomes the annual auction amount less the subtotal of all other auction amounts for the year calculated so far.

Timeline

57 Section 30H of the Act specifies regulations made under section 30GA (auctions to sell New Zealand units) and section 30GB (limits and price controls for units) come into force 3 months after the date of their notification in the *Gazette*, or on any later date specified in the regulations.

Consultation

58 The Ministry of Justice, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Ministry for Primary Industries, the Ministry of Business, Innovation and Employment, Te Arawhiti, Department of Conservation, the Treasury and the Environmental Protection Authority were consulted on this paper. Where feedback was provided, it has been reflected in this paper. Te Puni Kōkiri and the Department of the Prime Minister and Cabinet were informed.

Compliance

59 The proposed amendments described in this paper are consistent with:

59.1 the principles of the Treaty of Waitangi;

59.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;

59.3 the principles and guidelines set out in the Privacy Act 1993;

59.4 relevant international standards and obligations; and

59.5 the Legislation Design and Advisory Committee, Guidelines on the Process and Content of Legislation.

60 The requirements that I must comply with when making regulations about limits and price control settings are set out in Section 30GA, 30GB and 30H of the Act.

61 Section 30GC sets out requirements for regulations under section 30GB. These requirements have been met by the earlier Climate Change Response (Limits and Price Control Settings for Units) Regulations made in August 2020.

62 Section 30H requires me to meet the consultation requirements set out in sections 3A and 3B when making regulations under sections 30GA (auctions to sell New Zealand units) and 30GB (limits and price controls for units). Those requirements are that:

62.1 The Minister must consult, or be satisfied that the chief executive has consulted, representatives of iwi and Māori that appear to the Minister or chief executive likely to have an interest in the regulations.

62.2 The Minister must be satisfied that persons (or representatives of those persons) that are likely to be substantially affected by any regulations made in accordance with the recommendation.

63 The Ministry for the Environment has run two separate public consultations relating to these proposals:

63.1 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. Stakeholder feedback was sought on auction format, frequency and participation. There was clear, though not majority, support for the Government's preferred auction format.

63.2 Public consultation on the proposed rules for auctioning in the NZ ETS was conducted in November and December 2019. 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.

64 If regulations are made under section 30GA, the Minister must recommend the making of regulations under section 30GB. These regulations were made as the Climate Change (Limits and Price Control Settings for Units) Regulations 2020. These regulations are to be revoked and replaced with the proposed regulations so that all of the regulations relating to auctioning are located together. No change is being made to the content of the limits and price control settings.

65 The regulations made are in accordance with the empowering legislation as follows:

65.1 section 30GA, Regulations for auctions to sell New Zealand units;

65.2 section 30GB, Regulations about limits and price control settings for units.

66 Sections 30H, 3A, and 3B set out consultation requirements. Consultation with representatives of iwi and Māori that have an interest in the regulations, and consultation with persons that are substantially affected by the regulations, was carried out in December 2019 for the auctioning rules and February 2020 for further decisions on the auction schedule and commencement date of auctioning.

67 The transitional provisions of the ETR Act enabled these consultations to be carried out prior to the passing of the ETR Act.

68 I am satisfied all statutory requirements were considered and met when the policy decisions regarding the regulations were agreed by Cabinet on 23 March and 14 May 2020.

Regulations Review Committee

69 I do not consider there are grounds for the Regulations Review Committee to draw the regulations described in this paper to the attention of the House under Standing Order 319.

Certification by Parliamentary Counsel

70 Parliamentary Counsel has certified the regulations as being in order for submission to Cabinet.

Regulatory Impact Statement

71 A Regulatory Impact Assessment was prepared in accordance with the necessary requirements, and was submitted when Cabinet approved the policy decisions relating to the regulations [DEV-20-MIN-0047 refers].

Publicity

72 The amendment regulations will be available on the New Zealand Legislation website following their notification in the New Zealand Gazette.


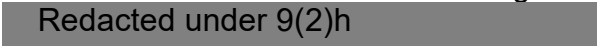
- 73 The rules implemented in the regulations were announced via press release and email updates were sent to Emissions Trading Register participants on 2 June 2020. Those decisions are currently available on the Ministry for the Environment website.

Proactive Release

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

Recommendations

I recommend that the Cabinet Business Committee:

- 1 **note** the proposed Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020 are required to operationalise the changes made by the Climate Change Response (Emissions Trading Reform) Amendment Act 2020;
- 2 **note** on 18 March 2020 Cabinet agreed to policy decisions to set the rules for auctioning within the NZ ETS [DEV-20-MIN-0047 refers]. Further policy decisions were made by Cabinet on 14 May 2020 alongside decisions on overall unit limits and auction price controls for the NZ ETS [ENV-20-MIN-016 refers];
- 3  Redacted under 9(2)h
- 4 **invite** the Minister for Climate Change to report back to Cabinet regarding  the technical reserve price before the third auction in 2021;
- 5 **note** the proposed regulations correct the limit on units sold by auction and the annual overall limit on units by including the reserve volume;
- 6 **note** that the changes to the auction limits and overall limits will have no practical impact as they do not change the amount of units that will be available for auction.;
- 7 **agree** to amend the values in the proposed regulations for:
 - 7.1 the annual limit on units sold by auction to be 26.0 million NZUs in 2021, 26.3 million NZUs in 2022, 25.6 million NZUs in 2023, 24.2 million NZUs in 2024, and 22.4 million NZUs in 2025; and
 - 7.2 the annual overall limit to be 34.4 million NZUs in 2021, 34.5 million NZUs in 2022, 34.5 million NZUs in 2023, 32.9 million NZUs in 2024, and 31.1 million NZUs in 2025;

- 8 **note** the proposed regulations clarify that when annual auction volumes are divided equally among auctions, each auction volume must be rounded to meet the minimum lot size;
- 9 **note** the proposed regulations clarify that the bidding window is considered to be open between 9:00 am and 12:00 pm if only very short outages occur during that time. Short outages are defined as being no more than 5 minutes at any one time, must be no more than 15 minutes overall and cannot occur during the last half hour of the auction;
- 10 **note** the proposed regulations clarify that to ensure that collateral amount to be forfeit is clearly specified for both auction participants and the auction operator, it is calculated as follows: Collateral forfeit on failure to settle = successful bid volume (number of NZUs won in the auction) x auction clearing price x 0.25;
- 11 **note** that to clarify the rounding rules for tied bids, any remainder units will be rounded down to avoid over-allocation and if rounding rules result in unassigned lots at the end of the tied bids process then individual lots will be randomly assigned to tied bids until all the auction volume is assigned;
- 12 **note** these regulations will come into force on the date 3 months after they are notified in the New Zealand Gazette, in accordance with the requirements of the Act and be in force when unit auctioning begins in March 2021;
- 13 **authorise** the submission to the Executive Council of the Climate Change Response (Auctions, Limits, and Price Controls for Units) Regulations;
- 14 **note** the advice of the Minister for Climate Change that the statutory prerequisites have been met.

Authorised for lodgement

Hon James Shaw

Minister for Climate Change