



New Zealand Emissions Trading Scheme Auction Monitor role update

Date Submitted:	23 April 2020	Tracking #: 2020-B-06614	
Security Level	IN CONFIDENCE	MfE Priority:	Non-Urgent

	Action sought: Agree to defer regulatory process Agree to progress appointment of interim auction monitor	Response by:
To Hon James Shaw, Minister for Climate Change		4 May 2020

Actions for Minister's Office Staff	Return the signed report to MfE.
Number of appendices and attachments #	Titles of appendices and attachments (ie separate attached documents): Nil

Ministry for the Environment contacts

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New Zealand Emissions Trading Scheme Auction Monitor role update

Key Messages

1. This briefing responds to your request on deferring the policy process to appoint an auction monitor to 2021 while the Government focuses on the short and medium term response to the Covid-19 pandemic.
2. Deferring the regulatory process to start in 2021 is likely to mean that final appointment of an auction monitor will not occur until the start of 2022. This is because consultation needs to occur before developing the regulations. Regulations then specify the process to appoint the auction monitor, and then the appointment must follow that process.
3. A deferral means that the first year of auctioning would occur without oversight by an auction monitor unless an alternative interim solution was in place. While the legislation does not require an auction monitor to begin auctioning it was clearly intended. It will help to promote the integrity and instil confidence in the new auctioning service and so is highly desirable.
4. Due to the importance of providing oversight for auctions and the risk to the integrity of the NZ ETS, we therefore recommend that you consider appointing an interim auction monitor from within Government to perform a limited auction monitoring role until the auction monitor policy process is complete. We will provide you with further advice on the details of this approach within the next month.
5. We note that related policy processes to set regulations to define the rules for auctioning and the NZ ETS settings required for auctioning are continuing. Both sets of regulations will be in place before the planned auction start date. This advice regarding deferral relates only to regulations to appoint the auction monitor.

Background

6. It is important that the reforms to the NZ ETS as specified in the Climate Change Response (Emissions Trading Reform) Bill (the Bill), provide for an effective, efficient and robust auctioning system to enable auctioning of units to meet New Zealand's international and domestic climate change targets.
7. Cabinet decided in May 2018 to enable an independent 'auction monitor' to be appointed via regulations as part of the reforms of the NZ ETS to support a fit-for-purpose auctioning system [ENV-19-MIN-0018 refers].
8. The Bill specifies that regulations are required to define the process to appoint an auction monitor and to describe the functions of the role.

Role of the auction monitor is to provide independent oversight of auctions

9. The role of the auction monitor is to mitigate auction integrity risks by providing independent oversight of auctions. If appointed, the Bill specifies that the functions of the auction monitor must include at least the validation of auction results and publishing a report on auction outcomes.
10. Cabinet has already recently decided to set auctioning regulations [DEV-20-MIN-0047, confirmed by CAB-20-MIN-0120 refers] that require the auction monitor, when appointed, to
 - publish a report on the outcome of each auction, before the next auction occurs and

- provide a review of the auctioning system after the first year of operation and then once every two years.
11. The intention in the longer term is to reassess the role of the auction monitor with a view to potentially expanding their functions, as part of the broader NZ ETS market governance work programme.

Analysis and Advice

Setting regulations to appoint an auction monitor will take time

12. Setting regulations under the Climate Change Response Act 2002 (the Act) as amended by the Bill to appoint an auction monitor (new section 30GD) requires a full regulatory policy process, including consultation with persons likely to be affected by these regulations.
13. Based on experience setting annual regulations for the NZ ETS, this full regulatory process, including the standard six week timeframe for consultation with affected parties, is estimated to take approximately seven or eight months from development of proposals to regulations being notified in the Gazette. Under the Bill, these regulations then come into force three months after their date of notification.
14. Regulations, once set, specify a process to appoint and outline the role of the auction monitor. It may then take a period of time to confirm any appointment made under those regulations, perhaps a few months.
15. Therefore deferral to 2021 is likely to lead to final appointment of the auction monitor in early 2022. If the policy process begins at the end of 2020, it may be possible to make the appointment in late 2021 prior to the final auction of that year.
16. Therefore we estimate that the elapsed time from the beginning of this policy process to final appointment could range from approximately ten months to one year.
17. Proposals to set these regulations are still under development and no date had been set for consultation prior to the start of New Zealand's response to the COVID-19 pandemic.

Impact of COVID-19 pandemic on the process

18. Under normal circumstances, the regulatory policy process to enable the Government to appoint an auction monitor was expected to be underway now to ensure the appointment could take effect prior to the start of auctioning in early 2021.
19. However, the COVID-19 pandemic has had an impact on this work. In the current COVID-19 response environment all non-essential consultation has been postponed and Cabinet's availability to consider regulatory policy proposals over the new few months is uncertain, meaning it is virtually impossible to meet the original timetable.
20. Given the importance of ensuring that decision-making for this regulatory process is robust and the need to meet statutory consultation requirements, we recommend deferring the setting of regulations to appoint an auction monitor to begin in late 2020 or early 2021. The deferral is to ensure the process can be given the appropriate focus.

Deferring the regulatory policy process will mean the auction monitor will not be appointed until late 2021 at the earliest

21. The Government is committed to begin auctioning of NZUs within the NZ ETS on schedule in early 2021, and work is continuing on these auctioning regulations. It would be highly desirable to have an auction monitor appointed before auctions begin, however it is not required by the Bill.

22. Final decisions on an indicative auction schedule for 2021 and 2022 have not yet been made, however Cabinet has made an in-principle decision to initially schedule auctions to be held quarterly [DEV-20-MIN-0047 refers] and we are proposing to hold the first auction in mid-March 2021 [briefing 2020-C-06573 NZ ETS settings regulations [shortened]. refers].
23. If the policy process to appoint an auction monitor begins in late 2020 or early 2021, then the auction monitor is unlikely to be appointed until late 2021 or early 2022.

Impact of deferring the process to appoint an auction monitor

24. Simply deferring the process and taking no further action would result in the first few auctions (possibly the first year of auctioning) taking place with no oversight by an independent auction monitor.
25. Given that the role of the auction monitor is to mitigate auction integrity risks then this approach means that such risks to the market could not be monitored in the short term.
26. We have very little evidence of poor market behaviour in the existing ETS market and therefore the risks to market integrity in the short term are perceived to be low. Also the contractual relationship between MfE and the auction operator will provide some understanding of how auctions are operating in the short term. However if no monitoring occurs then it may be difficult to gain an independent overview of the auctioning system and review it for any improvements.
27. Furthermore, even if instances of poor market behaviour are low, there is a risk that the integrity of the auctions may be questioned if no monitoring is in place. Therefore we do not recommend leaving auctions completely unmonitored.
28. The Bill, as introduced, does allow regulations to appoint an auction monitor to be set more rapidly by the Minister under certain limited circumstances. For example, if the Minister considered it to be in the national interest then regulations could be set without requiring consultation. However, we do not consider that the 'national interest' test is met in this instance and do not recommend taking this path. Also it is not clear that this option could allow an appointment to be made prior to the beginning of auctioning in the current environment.

Officials recommend further work to define how to appoint an interim auction monitor

29. Officials recommend appointing an interim auction monitor from within Government to perform a limited role to monitor auctions until the full policy process is complete. Further work is required to define how the appointment could operate in practice and to specify their limited role.
30. We expect this interim role to fulfil only a limited set of functions in the short term. Primarily to collect information and provide a report after each auction on auction outcomes, and to assist the formally appointed auction monitor to provide the first annual review of the auction system.

Information sharing requirements may need further consideration

31. The Bill provisions, once enacted, provide for information to be shared with the auction monitor from the EPA, the Registrar and others to enable them to perform their functions (section 30GE). The Bill also specifies that any information provided to the monitor is subject to confidentiality requirements (section 30GF) with certain exceptions (for example if the information is already in the public domain, or is required to be disclosed by the Act).
32. If an interim auction monitoring role is established, then the person(s) performing this role will require access to information from auctions in order to perform their functions.
33. It is expected that the interim auction monitor will be able to access some information from the auction operator as this will be covered under the terms of the contract between the

auction operator and MfE. However their access to certain information (for example if information is required from the EPA) may be limited as the provisions of the Bill that support information sharing with the auction monitor do not apply.

34. Further consideration will also be needed to clearly specify any confidentiality requirements that must be met by the interim auction monitor.

Next Steps

35. Officials will continue work to clarify the process required to appoint an interim auction monitor and will provide further advice including timeframes and further consideration of confidentiality requirements, if required.

Recommendations

36. We recommend that you:

- a. **Note** that setting regulations and then appointing an auction monitor under normal circumstances is likely to take between ten months and approximately a year, including time to consult with affected parties.
- b. **Note** that due to the impact of the COVID-19 pandemic on this process and the deferral of all non-essential consultation it is now virtually impossible to ensure that an auction monitor can be appointed before the start of auctioning in early 2021.
- c. **Note** that it is important to ensure that decision-making for this regulatory process is robust and meets statutory consultation requirements.
- d. **Note** that deferral to 2021 is likely to lead to final appointment of the auction monitor in early 2022. If the regulatory policy process begins at the end of 2020, it may be possible to make the appointment in late 2021 prior to the final auction of that year.
- e. **Agree** to defer the regulatory policy process to appoint the auction monitor to begin in:
- Late 2020 Yes / No
 - Early 2021 Yes / No
- f. **Agree** to progress the appointment of an interim auction monitor until the regulatory policy process is complete and a final appointment can be made: Yes / No
- g. **Direct** officials to provide further advice to specify details of this interim appointment Yes / No
- h. **Agree** that this briefing and appendices will be released proactively on the Ministry for the Environment's website within the next eight weeks. Yes/No

Signature

This briefing has been approved electronically by

Roger Lincoln
Director, Climate Change

Hon James Shaw
Minister for Climate Change

Date