

In Confidence

Office of the Minister for Climate Change

Chair, Cabinet Environment, Energy and Climate Committee

New Zealand Emissions Trading Scheme tranche two: supporting a fit-for-purpose auctioning system

Proposal

1. This paper seeks decisions to amend the Climate Change Response Act 2002 (CCRA). It is part of tranche two of a package of amendments designed to improve the New Zealand Emissions Trading Scheme (NZ ETS).
2. In December 2018, Cabinet agreed to introduce auctioning to the NZ ETS as part of setting an overall cap, in order to align the NZ ETS with our emissions reduction targets. The CCRA already includes legislative provisions that enable the Minister for Climate Change (the Minister) to sell New Zealand Units (NZUs) by auction after setting regulations.
3. In this paper, I seek operational decisions to amend the CCRA to enable a robust auctioning system to be developed. Specifically, I propose to:
 - 3.1. enable an 'auction monitor' to be established to mitigate auction integrity risks and provide independent oversight of auctions; and
 - 3.2. amend the CCRA to provide further clarity on the types of decisions Cabinet should take when creating regulations for auctioning.

Executive summary

4. The Government is reforming the NZ ETS to ensure it effectively helps New Zealand meet emissions reduction targets, and to support the transition to a low-emission, climate resilient New Zealand. This requires amending the CCRA to provide:
 - 4.1. certainty to the market of the long-term credibility and effectiveness of the NZ ETS by signalling the trajectory of our transition to a low-emissions economy
 - 4.2. flexibility for the Government to manage the NZ ETS in changing circumstances.
5. I am seeking decisions in two tranches, which will form a single bill to amend the CCRA, to be introduced to the House in mid-2019 and enter into force in 2020.
6. Cabinet has agreed to introduce auctioning of New Zealand Units (NZUs) to the NZ ETS so that unit supply can be aligned with New Zealand's emissions reduction targets, including targets under the Paris Agreement and the proposed new climate change legislation.
7. It is important that the CCRA provides for an effective, efficient and robust auctioning system. This paper seeks agreement on two proposals to amend the

CCRA so that it enables the development of a fit-for-purpose auctioning system. I consider the proposals in this paper to be largely operational in nature and future-focused as they are about enabling decisions for the design of the auction system and do not include detail regarding auction volumes.

8. In this paper, I propose to:
 - 8.1. amend the CCRA to enable an independent auction monitor to be appointed via regulations, and for its specific functions to be set out in regulations. The purpose of an auction monitor is to mitigate auction integrity risks and provide independent oversight of the auctions; and
 - 8.2. amend the enabling provisions in the CCRA to provide clarity on the types of decisions Cabinet must or may take when creating regulations for auctioning.
9. I expect to return to Cabinet in mid-2019 seeking agreement to consult on both detail of the auctioning regulations and on volumes that could be auctioned (as part of the making coordinated decision-making unit supply regulations).

Background

Reform of the NZ ETS is underway

10. As part of the Government's programme of action on climate change, the NZ ETS is being reformed through amending the CCRA. The reforms will provide us with an effective tool to assist New Zealand in meeting emissions reduction targets, increasing removals, and transitioning to a low-emission future.
11. Decisions about the design and operation of the NZ ETS should be considered in light of their impact on New Zealand's ability to access international units with environmental integrity in the future. This is because Cabinet has agreed to retain the option to use international carbon markets after 2020 [CAB-18-MIN-0248 refers].
12. Proposals to amend the CCRA are being progressed in two tranches, which will form a single amendment bill, to be introduced to the House in mid-2019 and to enter into force in 2020:
 - 12.1. Tranche one was agreed by Cabinet in December 2018 [CAB-18-MIN-0606.01 refers] and the Parliamentary Counsel Office has commenced drafting.
 - 12.2. I am currently seeking tranche two decisions through a series of papers I am bringing to Cabinet from March to April 2019 (forestry papers are being co-ordinated with Hon Shane Jones, Minister of Forestry).

Enabling a robust auctioning system is important for the integrity of the NZ ETS

13. In December 2018, Cabinet agreed to a package of NZ ETS unit supply changes, including establishing a coordinated decision-making framework for unit supply. This framework will require the Government to make annual regulatory updates to set the supply of units on a five-year rolling basis. It sets an overall limit (a cap) on units supplied into the NZ ETS (excluding units from removal activities, like forestry).

14. As part of these decisions, Cabinet agreed to introduce auctioning of New Zealand Units (NZUs) into that decision-making process. Auctioning will allow units supplied into the NZ ETS to be aligned with New Zealand's emissions reduction targets, including targets under the Paris Agreement and the proposed new climate change legislation.
15. Cabinet also agreed to aspects of high-level auction design [CAB-18-MIN-0606.01 refers] to inform officials' ongoing work. These decisions were that auctions will:
 - 15.1. be held using a sealed-bid, single-round, uniform pricing format;
 - 15.2. take place monthly or quarterly; and
 - 15.3. be open for participation to all New Zealand Emissions Trading Register (the Register) account holders, subject to further qualifications provided in regulations.
16. Detail of the high-level auctioning design, alongside further operational details, will eventually be reflected in regulations. The CCRA already provides for the Minister for Climate Change to sell NZUs by auction, and appoint agent(s) to carry out the sale of units by auction, following the development of such regulations (although these provisions have not yet been used).
17. I anticipate returning to Cabinet in mid-2019 for approval to consult on auctioning regulations, which will set out detailed rules and processes for the auction. These regulation decisions could impact how businesses choose to participate in NZ ETS auctions. It will therefore be important to understand stakeholder views on the operational rules and processes for auctions and the impact these decisions could have for different types of market players, including small NZ ETS participants and iwi/Māori.

Analysis section

18. The proposals in this paper put in place enabling mechanisms to enhance the integrity of the NZ ETS auctioning system, and increase clarity about the types of matters that must or may be included in auctioning regulations.

Proposal 1: enabling the future establishment of an 'auction monitor'

19. I propose to amend the CCRA to enable an independent 'auction monitor' to be appointed via regulations, and for its specific functions to be set out in regulations. The purpose of the auction monitor would be to mitigate auction integrity risks by providing independent oversight of the auctions.
20. Oversight of the NZ ETS auction system will be important for open and fair access to auctions, increasing information transparency, and promoting competitive and fair price formation in the auction. Oversight settings also play a key role in mitigating integrity risks, such as anti-competitive behaviour.
21. I propose that if auctioning regulations are made, regulations can also be made appointing an auction monitor. These regulations would also describe its functions in accordance with the below requirements.
22. The auction monitor's functions must include:
 - 22.1. validating auction results and calculating additional specified metrics; and
 - 22.2. publishing a report on auction outcomes

23. The auction monitor's functions may also include:
- 23.1. monitoring the conduct of auction participants and any agent appointed to sell NZUs by auction under section 6A
 - 23.2. providing periodic assessments of the auction system and making recommendations for improvements
 - 23.3. any other functions that the Minister considers relevant to the effective conduct of the auction monitor
24. I recommend that regulations enable the appointment of an independent entity to act as the auction monitor, and not preclude private entities from fulfilling this function. This will provide flexibility to appoint the most appropriate entity. For example, officials' initial analysis indicates that appointing a private entity through a public tender process might be the least administratively costly approach.
25. In order for the auction monitor to successfully carry out its functions, data sharing provisions should be included in the CCRA. These should include the ability for the auction monitor to access information, including disaggregated information, from the EPA, the Registrar and the Minister or agent(s) appointed to carry out the sale of NZUs by auction for the purposes of it carrying out its functions. The auction monitor would then be required to maintain the confidentiality of that information, like all other CCRA actors.
26. I consider it important to enable the establishment of an auction monitor now so that policy work for the regulations governing its function can be developed alongside the auctioning regulations. This will allow for an auction monitor to be implemented alongside the first auction.
27. In addition, I expect that over the longer term the functions of an auction monitor will be reassessed, and potentially expanded, as part of the broader NZ ETS market governance work programme that will assess oversight for the market as a whole - both primary (i.e. auction) and secondary markets.

Proposal 2: amending the CCRA to provide further clarity about auctioning regulations

28. The CCRA already provides for the Minister for Climate Change to sell NZUs by auction after developing regulations. It does not, however, provide a great deal of detail about the types of matters that may be included in these regulations.
29. Although the current provisions are sufficient to enable the development of auctioning regulations, they do not provide market participants with sufficient clarity or confidence about how auctioning will operate.
30. Providing additional detail in the legislation will support regulatory predictability in the NZ ETS. It will give potential auction participants increased certainty and support the overall integrity of the auction system.
31. I propose that the CCRA be amended so the enabling provisions for auctioning regulations adequately reflect a typical auction process, and include detail about matters that must be included in auctioning regulations as well as other matters that may be desired if appropriate.¹

¹ Note the matters with an asterisk (*) are already included in the CCRA

32. I propose that, should the Minister choose to make auctioning regulations, the Minister would be required to make regulations about the following matters:
- 32.1. the date for auctioning to commence*
 - 32.2. an indicative auction schedule for when auctions are planned to be held
 - 32.3. details of auction registration requirements or criteria a person must meet to participate in the auction
 - 32.4. the auction format, including rules for bidding
 - 32.5. financial processes that a person must follow when participating in an auction, including financial assurance, payment and delivery requirements
 - 32.6. publication of auction results after each auction, for example auction clearing price and the volumes sold at auction
 - 32.7. situations where the auction would not proceed
33. The Minister may also make auctioning regulations about the following matters:
- 33.1. providing for a pilot before auctioning commences*
 - 33.2. penalties for breaching auction regulations*
 - 33.3. providing for any other matters for the conduct of an auction that the Minister considers relevant to the effective conduct of the auction*
34. Together, I consider that this updated set of enabling provisions adequately reflects a typical auction process, and will provide sufficient clarity about what might be included in auctioning regulations.
35. For consistency, I also propose that the current CCRA offence regarding false declarations should continue to apply to any declarations required under the auctioning regulations. I also propose that the current CCRA consultation provisions for certain regulations should continue to apply for any auctioning and auctioning monitor regulations.

Consultation

Public consultation

36. Public consultation on the introduction of auctioning was undertaken during the 2015/2016 review of the NZ ETS. Stakeholders at that time expressed their support and Cabinet subsequently took the decision to introduce auctioning.
37. Further 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.
38. Stakeholder feedback was sought on auction format, frequency, participation, and the use of auction proceeds. Submissions were received from 253 submitters from a range of sectors. There was clear, though not majority, support for the preferred auction format. There was widespread support for the introduction of auctioning, however there was some disagreement amongst stakeholders as to the preferred format (45 per cent supported the preferred auction format, while 35 per cent supported the introduction of auctioning but preferred a different auction format).

39. Consultation was not specifically held on clarifying the matters relating to auctioning that the Minister may prescribe under regulations, nor on the introduction of an auction monitor. Further public consultation on auction regulations is planned for later this year. A separate consultation document will be prepared at that time. This consultation is expected to take place alongside Select Committee consultation on proposed NZ ETS changes as part of a bill to amend the CCRA.

Agency Consultation

40. This paper was prepared by the Ministry for the Environment. The Treasury, the Environmental Protection Authority, the Ministry of Foreign Affairs and Trade, the Ministry for Primary Industries, Te Puni Kōkiri, the Department of Conservation, the Ministry of Business, Innovation and Employment, the Ministry of Transport and the Ministry of Justice were consulted in the preparation of this paper. Where feedback was received it is reflected in this paper. The Department of Prime Minister and Cabinet was informed.

Financial implications

41. I am not seeking any additional funding in this paper. s9(2)(f)(iv)

42. s9(2)(f)(iv)

Legislative implications

43. The policy decisions from this paper will require legislative amendments to the CCRA. The amendments were given a category 2 priority on the 2019 Legislation Programme (meaning the bill must be passed by the end of 2019). The Parliamentary Counsel Office has already commenced drafting tranche one amendments.

Regulatory impact analysis

44. A Quality Assurance Panel with representatives from the Ministry for the Environment and the Treasury Regulatory Quality Team has reviewed the 'auction monitor' and 'clarity for auctions' Regulatory Impact Assessments (RIA) produced by the Ministry for the Environment and dated April 2019.

45. The Panel considers that both RIA meet the Quality Assurance criteria.

46. The only matter the Panel highlights is that, while the problems were consulted on, the proposals were not. The proposals appear to be low cost and low risk.

The proposals will also be subject to further analysis and consultation as detail is considered when regulations are made. It will nevertheless be important to explore the proposals with submitters at Select Committee.

Human rights

47. The proposal in this paper is consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Crown-Māori Partnership

48. Māori have a significant stake in climate change action, and a significant interest in the NZ ETS. Māori have a large economy and asset base sitting largely in the primary industries, as well as Treaty-based rights and interests in natural resource use and management. It will be critical when implementing the proposals to maintain Treaty of Waitangi principles as provided by section 3A of the CCRA.
49. A Māori Leaders' Forum was held in Wellington on 17 September 2018 as part of consultation on improvements to the NZ ETS. The Ministry for the Environment plans to further engage with iwi/Māori on a range of environmental issues through a series of hui in May. This will include discussions on the NZ ETS and seek views on how we can best support iwi/Māori ahead of consultation on regulations anticipated for the second half of this year.

International obligations

50. The proposed amendments are consistent with New Zealand's obligations under the Paris Agreement and other international commitments.

Gender implications

51. There are no gender implications arising from this paper.

Disability perspective

52. There are no disability implications arising from this paper.

Publicity

53. Announcements about the NZ ETS need to be managed carefully to avoid any inconsistencies and market risks, including sudden NZU price rises. In addition, information should not be disseminated in a way that advantages some market participants over others and compromises NZ ETS investments.
54. I intend to make public announcements on the proposed amendments to the CCRA and the amendment bill as part of a wider climate change communications plan, in consultation with other Ministers.

Proactive Release

55. I propose to proactively release this paper on the Ministry for the Environment's website in whole, subject to redactions as appropriate equivalent to those under the Official Information Act 1982, once public announcements have been made.

Recommendations

The Minister for Climate Change recommends that the Committee:

1. **note** the New Zealand Emissions Trading Scheme (NZ ETS) is the Government's key tool to assist New Zealand to meet its climate change targets, and that:
 - 1.1. the Government is reforming the NZ ETS to ensure it can support the transition to a low-emissions and climate resilient New Zealand
 - 1.2. this requires amendments to the Climate Change Response Act 2002 (CCRA)
2. **note** these amendments are being developed in tranches;
 - 2.1. in December 2018 Cabinet agreed to tranche one of amendments to the CCRA and drafting has commenced [CAB-18-MIN-0606.01]
 - 2.2. tranche two comprises of a series of papers with discrete proposals which will be considered by Cabinet over March to May 2019
 - 2.3. tranche one and two will result in a single bill amending the CCRA to be introduced to the House in mid-2019, and to enter into force in 2020
3. **note** that in December 2018 Cabinet agreed to begin developing an auction platform and regulations to implement auctioning of NZUs to align the supply of NZUs in the NZ ETS with emission reduction targets [CAB-18-MIN-0606.01]

Enabling an auction monitor

4. **agree** to amend the CCRA to enable an independent 'auction monitor' to be appointed via regulations to mitigate auction integrity risks by providing independent oversight of auctions
5. **agree** that the functions of the auction monitor would be provided for in regulations
6. **agree** that if regulations were made to appoint an auction monitor, its functions must include at least:
 - 6.1. validating auction results and calculating additional specified metrics; and
 - 6.2. publishing a report on auction outcomes
7. **agree** that if regulations were made to appoint an auction monitor, its functions could include:
 - 7.1. monitoring the conduct of auction participants and any agent appointed to sell NZUs by auction under section 6A
 - 7.2. providing periodic assessments of the auction system and making recommendations for improvements

7.3. any other functions that the Minister considers relevant to the effective conduct of the role of the auction monitor

8. **agree** that the CCRA should be amended to provide for information sharing so that the auction monitor can access information from the EPA, the Registrar and the Minister for Climate Change or agent(s) appointed to carry out the sale of NZUs by auction under section 6A of the CCRA for the purpose of the auction monitor carrying out its functions
9. **note** that the role of the auction monitor will be reassessed, and potentially expanded, as part of the broader NZ ETS market governance work programme

Providing further clarity about auctioning regulations

10. **note** that the CCRA enables the Minister for Climate Change to sell New Zealand Units (NZUs) by auction, but that to date an auctioning mechanism has not been utilised
11. **note** that the current regulation making power is sufficient to enable the development of an auctioning platform and regulations, but that it does not provide sufficient clarity for potential auctioning participants about what will be included in auctioning regulations
12. **agree** to amend the current statutory prerequisites for auctioning regulations so that, should the Minister choose to make auctioning regulations, the Minister would be required to make regulations about the following matters:
 - 12.1. the date for auctioning to commence
 - 12.2. an indicative auction schedule for when auctions are planned to be held
 - 12.3. details of auction registration requirements or criteria a person must meet to participate in the auction
 - 12.4. the auction format, such as rules for bidding
 - 12.5. financial processes that a person must follow when participating in an auction, including financial assurance and payment and delivery requirements
 - 12.6. publication of auction results after each auction
 - 12.7. situations where the auction would not proceed
13. **agree** to amend the current statutory prerequisites for auctioning regulation so that, should the Minister choose to make auctioning regulations, the Minister may make auctioning regulations about the following matters:
 - 13.1. providing for a pilot before auction commence
 - 13.2. penalties for breaching auction regulations
 - 13.3. providing for any other matters for the conduct of an auction that the Minister considers relevant to the effective conduct of the auction
14. **agree** that the current CCRA offence regarding false declarations should continue apply to any declarations required under the auctioning regulations

15. **agree** that the current CCRA consultation provisions for regulations should continue apply for any auctioning and auctioning monitor regulations
16. **authorise** the Minister for Climate Change to further clarify policy decisions relating to the amendments proposed in this paper, in a way not inconsistent with Cabinet's decisions
17. **invite** the Minister for Climate Change to issue drafting instructions to the Parliamentary Counsel Office based on the agreed decisions presented in this paper

Authorised for lodgement.

Hon James Shaw

Minister for Climate Change