



Cabinet Economic Development Committee

Minute of Decision

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New Zealand Emissions Trading Scheme: Regulatory Decisions on the Rules for Auctioning

Portfolio **Climate Change**

On 18 March 2020, the Cabinet Economic Development Committee:

- 1 **noted** that the paper under DEV-20-SUB-0047 seeks decisions on setting regulations under the Climate Change Response Act 2002 as amended by the Climate Change Response (Emissions Trading Reform) Amendment Bill (the Bill) to provide rules for auctioning within the New Zealand Emissions Trading Scheme (NZ ETS);
- 2 **noted** that the NZ ETS is the government's key policy tool for reducing greenhouse gas emissions, meeting New Zealand's climate change targets, and transitioning to a low emissions economy;
- 3 **noted** that a key purpose of the Bill is to improve the NZ ETS by putting a cap on the supply of units and the ability for the government to auction New Zealand Units (NZUs) is a crucial component of setting the cap;
- 4 **noted** that to meet the start dates for auctioning and start the transition to a low emissions economy, regulations for auctioning rules must be in place by the end of 2020;

Enacting Cabinet decisions on auction format and frequency

- 5 **noted** that Cabinet has previously agreed that an auction platform should be developed with a sealed-bid, single-round, uniform pricing format and with flexibility for monthly or quarterly auctions [CAB-18-MIN-0606.01, ENV-19-MIN-0018];
- 6 **agreed** to the drafting of regulations for auctions to be run following the sealed-bid, single-round uniform pricing format and to be held either monthly or quarterly;
- 7 **noted** that setting the flexibility for auctions to be held either monthly or quarterly enables the auctioning system to adapt to changing circumstances as it develops;
- 8 **noted** that to support market certainty, a schedule of auction dates and the volumes available for the year will be published well ahead of time, and that the government has recently consulted on proposals to set auction volumes as part of the NZ ETS proposed settings consultation that concluded on 28 February 2020;
- 9 **agreed in principle**, subject to final decisions on NZ ETS proposed settings, to initially schedule auctions to be held quarterly in the NZ ETS;

Overall rules for scheduling auctions and managing volume across auctions

- 10 **noted** that to support market certainty and regulatory predictability, it is important to set rules about the scheduling of auctions in the NZ ETS and how auction volumes available each year will be managed;
- 11 **agreed** to publish an auction calendar annually, including expected auction volumes, no later than the end of September;
- 12 **agreed** to make an exception to the requirement to publish the calendar no later than the end of September for the first year of auctioning to allow time for regulations to be enacted;
- 13 **agreed** that auctions must be held on weekdays that are not New Zealand public holidays, regional anniversary holidays and do not fall between Christmas Eve and the day after New Year's Day (inclusive);
- 14 **agreed** that auctions should, where practicable, not be held on any known dates of major announcements that have a substantial impact on the NZ ETS market, for example Budget Day, the day the NZ ETS auction calendar is announced for the following year, or dates when major announcements are expected from the Climate Change Commission;
- 15 **agreed** that auctions should be scheduled no closer than 20 calendar days before the compliance deadline on 31 May;
- 16 **agreed** that:
- 16.1 once scheduled, auctions should not be cancelled;
 - 16.2 auctions may be postponed in the following exceptional circumstances:
 - 16.2.1 a force majeure event prevents the auction operator from running the auction;
 - 16.2.2 the auction platform is unavailable to all bidders during the bidding window, for example, if a major IT failure affects the auction operator;
- 17 **agreed** that if an auction is postponed then it must be rescheduled as soon as reasonably practicable, and the new auction date must be published on the auction operator's website and communicated to registered bidders as soon as possible;
- 18 **agreed** that if an auction is postponed once the bidding window has opened, then only bidders already qualified to bid in the postponed auction prior to the postponement may participate;
- 19 **agreed** that on the day an auction is scheduled, the auction bidding window will be open for three hours from 9am to 12 noon, and that bids received after the bidding window has closed will not be accepted;
- 20 **noted** that under the Bill's provisions to establish a five-year rolling decision-making process for announcing unit supply volumes, the first two years of auction volumes following the current year are fixed and unlikely to change;
- 21 **agreed** that within any one calendar year, the total volume of NZUs available for sale by auction should be evenly distributed across all scheduled auctions;

- 22 **agreed** that if some or all NZUs remain unsold after an auction, then all unsold units should be added to the volume for sale at the next scheduled auction without limit, if the next auction is scheduled to occur within the same calendar year;
- 23 **noted** that if unsold volume remains from the last auction of the calendar year then it cannot be rolled over into the next year or the year after as volumes for those years are already fixed, and the unsold volume will need to be taken into account by the government when proposing auction volumes within New Zealand's budgets for future years past the next two years;

Operation of price controls within auctions

- 24 **noted** that price controls allow the government to manage unacceptably high or low prices in the NZ ETS and the Bill includes provisions to enable price controls through the auctioning system, including:
- 24.1 a cost containment reserve (to replace the existing fixed price option) that is designed to release additional NZUs for sale at auction if the auction clearing price reaches a specified price trigger(s), thereby putting downward pressure on prices;
- 24.2 a price floor that sets a minimum price at which units may be sold at auction;
- 25 **noted** that proposals to set the level of price controls in the NZ ETS will be brought to Cabinet following public consultation on NZ ETS proposed settings and are not included in the paper under DEV-20-SUB-0047;
- 26 **noted** that no further regulations are required to make the price floor operational once the value of the price floor has been set, as provisions in the Bill specify that the value of the price floor is the minimum price at which units may be sold at auction, noting that this value is able to be set to zero;
- 27 **agreed** that if the auction clearing price is at or above a price trigger set for the cost containment reserve, the relevant reserve volume will be immediately released to the market during that same auction by adding it to the original auction volume;
- 28 **agreed** that if only a single cost containment reserve price trigger is set, then relevant reserve volume will be added to the original auction volume and the resulting volume will be assigned to bids (ranked in order from highest to lowest bid price) until either:
- 28.1 all bids priced at or above the price trigger are satisfied, leaving some unsold volume in the cost containment reserve; or
- 28.2 the reserve volume is exhausted;
- 29 **agreed** that if more than one cost containment reserve price trigger is set, then the process to assign volume and determine a final auction clearing price may need to run multiple times as follows:
- 29.1 if the original auction clearing price is at or above the lowest price trigger, the auction process is run with the corresponding reserve volume added to the original auction volume, and this new auction volume will be assigned to bids until either all bids priced at or above the lowest price trigger are satisfied, or all volume is sold;

- 29.2 by definition, the clearing price of the auction in the step above is at or above the lowest price trigger level, and if this clearing price is also at or above the next highest price trigger, then the auction process is run again with the corresponding volume for the next highest price trigger also added;
- 29.3 this process continues for all price triggers until either the clearing price is less than the next remaining price trigger (if there is one) or the full reserve volume is sold;

Preparing for auctions, auction notices, registration process and provision of collateral

- 30 **noted** that the auction operator needs to publish an auction notice to confirm details of an upcoming auction to ensure that potential bidders have the information they require to prepare and for auctions to run efficiently;
- 31 **agreed** that the auction operator must publish an auction notice at least 30 calendar days prior to a scheduled auction date (for quarterly auctions) including at least the following information:
- 31.1 date and time of the auction;
 - 31.2 number of NZUs for sale at the auction, specifying the number of NZUs within this total that are carried over as unsold units from previous auctions (if any);
 - 31.3 any price controls that apply to the auction and their value (i.e. current value of the price floor, if enabled, current cost containment reserve price trigger(s) and the reserve volume(s) available);
 - 31.4 any applicable due dates for forms, if required prior to the auction, e.g. for provision of collateral;
 - 31.5 whether a technical reserve price applies to this auction;
 - 31.6 give notice of whether the goods are being sold by the vendor as a supplier and state that vendor bids are not permitted;
- 32 **agreed** that the auction operator must provide, on their website, the auction terms and conditions, any forms required for registration processes, and guidance on how the auction works;
- 33 **noted** that before participating in auctions, bidders are required to register their details and meet registration criteria, and that registration is a one-time process that, once complete, will allow bidders to participate in all subsequent auctions provided they agree to the terms and conditions;
- 34 **noted** that once registered, bidders need to meet the requirements set out in regulations, for example requirements to provide collateral, and the terms and conditions of the auction before submitting a bid at the auction;
- 35 **noted** that the government has already decided that auctions will be open for participation to all New Zealand Emissions Trading Register (the Registry) account holders, subject to further qualifications provided in regulations;

- 36 **agreed** that to register prospective bidders, the auction operator collects the following information:
- 36.1 name of the registered account holder;
 - 36.2 registry account number to which the account holder wishes the units to be transferred;
 - 36.3 for companies: full legal name, trading name (if different), company identifier or registration number;
 - 36.4 principal business address or registered office address;
 - 36.5 names, contact details and relationship to the account holder for any authorised representatives of the registered account holder;
 - 36.6 names and contact details of each person registered to bid in an NZ ETS auction on behalf of the registered account holder;
- 37 **agreed** that the auction operator must verify that the Registry account number provided is a valid New Zealand Emissions Trading Register account and the prospective bidder is the registered account holder;
- 38 **agreed** that prospective bidders be required to provide a statutory declaration that all registration information provided is true and correct;
- 39 **agreed** that bidders are required to confirm that their registration details are accurate before a bid can be submitted to the auction operator;
- 40 **noted** that the government needs to manage the risk of a winning bidder defaulting on payment to ensure the credibility of the financial management system for NZ ETS auctions and preserve market integrity;
- 41 **agreed** that collateral must be provided for bidders to participate in NZ ETS auctions and the following rules apply:
- 41.1 collateral must be provided for auctions at a rate of 25 percent of each bid's maximum bid value, where maximum bid value equals the maximum price a bidder is willing to pay times the expected bid volume;
 - 41.2 bids will only be accepted by the auction operator if collateral requirements are met;
 - 41.3 if bidders amend their bid(s) during the bidding window, all amendments must stay within the limits set by the collateral provided, for example, if a bidder has provided more collateral than required for their initial bid(s) then they may amend their bid or bids upwards until 25 percent of the new total maximum bid matches the collateral held by the auction operator, but no further;
 - 41.4 collateral must be received by the auction operator 5 working days prior to the auction date;
 - 41.5 the following forms of collateral will be accepted:
 - 41.5.1 cash;
 - 41.5.2 bank guarantee;

- 41.5.3 irrevocable letter of credit;
 - 41.6 collateral may be used as partial payment for successful bids if requested by the bidder and the collateral is in an appropriate form;
 - 41.7 bidders may request that their collateral be automatically returned after an auction or that it is released only when requested;
 - 41.8 non-cash forms of collateral may be retained for future auctions if requested by the bidder;
 - 41.9 any remaining cash collateral will be returned after each auction;
 - 41.10 if successful bids are not settled by the settlement date then collateral provided for that bid will be forfeit to the Crown;
- 42 **noted** that the government needs to manage the risk of a winning bidder defaulting on payment to ensure the credibility of the financial management system for New Zealand;

Bidding rules during an auction

- 43 **noted** that rules are required to specify what types of bids can be accepted during an auction and how these bids should be treated in certain circumstances, for instance in case bids are tied at the clearing price to give bidders certainty over how to bid at auction;
- 44 **agreed** that the following bidding rules should apply to NZ ETS auctions:
- 44.1 the minimum acceptable bid size is 500 NZUs;
 - 44.2 bids must be made using a lot size of 100 NZUs;
 - 44.3 bids must be made with a minimum price increment of \$0.05;
 - 44.4 bidders may amend or withdraw their bids at any time up to the close of the bidding window;
 - 44.5 the clearing price of the auction is the lowest successful bid price when all bids are ranked in order from highest to lowest price;
 - 44.6 all bidders pay the clearing price for their bids once it has been determined;
 - 44.7 a technical reserve price must be set for each auction relative to the market price of NZUs, using a prescribed methodology that is kept confidential;
 - 44.8 if the clearing price of the auction does not reach the technical reserve price then no units will be sold;
 - 44.9 tied bids will be resolved using a pro-rata approach rounded to minimum lot size as follows:
 - 44.9.1 calculate for each tied bid the amount of NZUs that represents a proportionate share of all remaining auction volume;
 - 44.9.2 round the volumes calculated in paragraph 44.9.1 above to the nearest minimum lot size, noting that this may result in zero NZUs being assigned if the proportionate share is less than half of the minimum lot size;

- 45 **noted** that no limit will be set on the maximum volume of units that can be bid for by any one bidder, or by bidders that may be related through a group of companies, at this time, and the government intends to monitor market behaviour and may recommend that such a limit be set in the future, if it becomes necessary;

Settlement approach and reporting auction results

- 46 **noted** that settlement refers to the process whereby successful bidders pay for the bids they have won and then the correct amount of NZUs are transferred to the bidder's Registry account, and an approach is needed that protects against default;
- 47 **agreed** that auctions should be settled using a payment before delivery approach where payment by the successful bidder must be made and cleared before NZUs won in the auction are transferred to the bidder's Registry account;
- 48 **agreed** that the maximum time allowed for settlement is four working days;
- 49 **agreed** that if bids fail to settle then the bid volume is treated as unsold units;

Settlement approach and reporting auction results

- 50 **noted** that once an auction has taken place, results must be notified to the wider market and to successful bidders, and that any delay between the end of an auction and disclosure of results should be minimal so the results can be reflected in trades on the secondary market;
- 51 **agreed** that the auction operator should publish the following information as soon as practicable after the auction has closed, at a minimum within the same business day:
- 51.1 auction clearing price;
 - 51.2 total volume of units auctioned;
 - 51.3 total volume of bids;
 - 51.4 average bid size;
 - 51.5 number of bids;
 - 51.6 cover ratio (total volumes bid divided by total volumes for sale);
 - 51.7 total number of bidders and the number of successful bidders;
 - 51.8 the number of unsold units, if any;
- 52 **agreed** that the auction monitor (when appointed) publishes a report on the outcome of each auction before the next auction occurs that contains at least the following information:
- 52.1 detailed volume statistics, e.g. average volume per bidder, average volume won per bidder;
 - 52.2 detailed statistics on the number of bids, e.g. average number of bids per bidder, number of bids submitted, number of successful bids;
 - 52.3 relevant aggregate information (e.g. largest bids as a percentage of total volumes sold);

- 52.4 relevant distributional information (e.g. number of units awarded to which winner, with bidder names withheld);
- 52.5 distribution of successful bids among market participants with and without mandatory compliance obligations;
- 52.6 relevant information on resolved tied bids;
- 53 **agreed** that the auction monitor provides a review of the auctioning system after the first year of operation and then once every two years;

Next steps

- 54 **invited** the Minister for Climate Change to issue drafting instructions for new regulations to the Parliamentary Counsel Office based on the agreed and “in principle” decisions presented in the paper under DEV-20-SUB-0047;
- 55 **noted** that the Minister for Climate Change intends to bring the next set of proposals for regulations for NZ ETS proposed settings under the Act as amended by the Bill in May 2020;
- 56 **noted** that subject to the enactment of the Bill and following drafting by the Parliamentary Counsel Office, both sets of regulations will be presented to the Cabinet Legislation Committee for approval later in 2020.

Vivien Meek
Committee Secretary

Present:

Rt Hon Winston Peters
Hon Grant Robertson (Chair)
Hon Phil Twyford
Hon Dr Megan Woods
Hon David Parker
Hon Nanaia Mahuta (via phone)
Hon Stuart Nash
Hon Iain Lees-Galloway
Hon Jenny Salesa
Hon Damien O'Connor
Hon Shane Jones
Hon James Shaw
Hon Eugenie Sage

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Minister for Climate Change

Officials present from:

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