

# Impact Summary: Providing Clarity for Auctions in the NZ ETS

## Section 1: General information

### Purpose

In December 2018, Cabinet agreed to develop a platform for auctioning New Zealand Units (NZUs) in the New Zealand Emissions Trading Scheme (NZ ETS), together with regulations to implement the auctions.

This Impact Summary (RIS) recommends amending the Climate Change Response Act 2002 (CCRA) to provide clarity on the types of matters for which the Minister may or must recommend auction-related regulations. This RIS does not cover the content of the regulations themselves – these will be considered in separate regulatory impact assessments.

This RIS proposes that legislative amendments be made to prescribe the following matters for which the Minister must or may recommend regulations (these regulations are highlighted in yellow in Appendix one):

- i. Auction high-level design, including format, frequency and eligibility to participate; and
- ii. Auction operation (e.g. determining auction processes). This will also include setting out in the regulations how auctions are run and out penalties for breaching regulations.

This RIS does not include details about the volumes of units to be auctioned. It is expected a decision will be sought from Cabinet on this issue separately as part of the new NZ ETS coordinated decision-making process for unit supply (see the previous RIS: *Improving the NZ ETS Framework for Unit Supply*).

A proposal for consultation on both the details of the auctioning regulations and on volumes that could be auctioned (as part of the coordinated decision making process for unit supply regulations) is expected to be taken to Cabinet in mid-2019. This decision will include accompanying regulatory impact analysis.

The Ministry for the Environment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement. This analysis and advice has been produced for the purpose of informing policy decisions on recommendations to enable auctions in the NZ ETS, expected to be made by June 2019.

### Key Limitations or Constraints on Analysis

There are no key limitations or constraints on this analysis.

Public consultation on the introduction of auctioning was undertaken during the 2015/2016 review of the NZ ETS. Further feedback was sought from stakeholders on the high-level design decisions for auctioning during the 2018 consultation on Improvements to the NZ ETS; including questions on auction format, frequency, and participation.

Consultation has not been conducted on the regulations guiding the implementation of

auctioning, the subject of this RIA. Stakeholders will have an opportunity to express their views on this through the Select Committee process for the proposed CCRA amendment bill. However, this proposal is not expected to generate a lot of feedback as it reflects a typical auction process and will provide participants with added certainty about future regulations.

**Responsible Manager (signature and date):**

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## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

- Describe the current situation and how it is expected to develop if no action is taken, over and above what is already intended. This is the “counterfactual” against which other options should be assessed, and your preferred option described, in section 4.
- Why does the current situation constitute “a problem”, or why is it expected to do so if it continues?
- What is the underlying cause of the problem? Why does government need to act – why can’t individuals or firms be expected to sort it out themselves, under existing arrangements?
- Why does it need to be addressed now?
- How much confidence is there in the evidence and assumptions for the problem definition?

#### *Auctioning of NZUs has been agreed by Cabinet*

In December 2018, Cabinet agreed to a first tranche of amendments to the legislation establishing the NZ ETS, the CCRA. As part of these amendments, Cabinet agreed to auction NZUs using a single round, sealed bid, uniform price auction format [CAB-18-MIN-0606.01]. The auctions will be open to all New Zealand Emission Unit Registry account holders who meet predetermined criteria.

This decision means that units from emissions budgets that are not otherwise freely allocated to NZ ETS participants<sup>1</sup> will be auctioned through a primary market, and the profits returned to the Crown. Decisions on the volume of units available for auctions will be determined through a coordinated decision-making process on unit supply, also agreed by Cabinet in tranche one.

Now that a decision has been taken to introduce auctioning of NZUs, and the preferred options for auction format and participation have been agreed, it is necessary to seek decisions as to how best to implement auctioning. Some of the decisions will require changes to the CCRA legislation, and others will require adoption through regulations.

#### *Problem with the current CCRA provisions*

The Climate Change Response Act 2002 (CCRA) currently enables the Minister for Climate Change to sell NZUs by auction, after developing regulations. To date the auction provisions have not been used.

Although the current provisions are sufficient to enable the development of auction regulations, they lack the clarity desirable to give certainty to the NZ ETS market regarding the regulations that will govern auctions and how they will operate. They do not provide sufficient detail of the types of matters that the Minister *must* include in these regulations, and the matters the Minister *may* include, if deemed appropriate.

A lack of clarity is particularly problematic for NZ ETS design settings, as regulatory predictability has been an ongoing issue for NZ ETS participants. During the NZ ETS 2015/2016 review and further consultation on NZ ETS improvements in 2018, stakeholders

<sup>1</sup> For example, through industrial allocation.

consistently noted that greater regulatory predictability was required to underpin confidence in the NZ ETS. Stakeholders also provided feedback that past uncertainty, and a resulting lack of confidence in the carbon price signal, had undermined the scheme's effectiveness as a climate change policy tool by reducing its ability to encourage long-term investment in low emissions technology and afforestation.

## 2.2 Who is affected and how?

NZ ETS market participants who intend to participate in auctions (i.e. any person with an account in the New Zealand Emissions Trading Register, including NZ ETS participants).

Clarifying the current, broadly phrased, auction-related decisions that the Minister may prescribe through regulations will provide greater transparency and certainty as to the framework in which auctions will be conducted. This will benefit market participants who intend to buy NZUs through the auctions.

Note, who is affected by the introduction of auctioning more generally is not in scope of this RIS. The decision to introduce auctioning of NZUs has already been taken and its impacts were fully considered in a previous RIS (see Improving the NZ ETS Framework for Unit Supply). Cabinet has also agreed the high-level design for auctioning, and a full Impact Statement was provided for this (see High-level Design of an Auction System for the NZ ETS).

### 2.3 Are there any constraints on the scope for decision making?

The amendments proposed through this RIS are linked to other inter-dependent work that is being undertaken in parallel to establish NZ ETS auctions. The decisions that comprise this work will require amendments to the CCRA.

A package of proposals to amend the CCRA to improve the NZ ETS is being progressed in two tranches, the results of which will form a single bill, to be introduced to the House in mid-2019. No further legislative changes are expected after this bill, before the first auction which is aimed to be held by end of 2020.

Appendix one illustrates how the decisions being sought through tranches one and two (a-f listed below) of proposed amendments to the CCRA fit together. The amendments covered by this RIS are highlighted in green.

#### *Proposed legislative amendments to form a single bill*

The objectives of the legislative amendments that are being sought in tranches one and two for auctioning include:

- (a) Enabling the high-level decision to make unit supply decisions as part of a rolling five-year coordinated decision-making process;
- (b) Enabling the high-level decision to introduce a price floor and a cost containment reserve;
- (c) Specifying that the Minister may recommend regulations for the purpose of prescribing matters relating to overall limits and price controls (i.e. a cost containment) for units;<sup>2</sup>
- (d) Enabling the decision to introduce an auction monitor;
- (e) Specifying that auctions will be conducted via a single-round, sealed-bid format with uniform pricing, with auctions to be held monthly or quarterly, with NZETR account holders being eligible to participate; and
- (f) Specifying that the Minister may recommend regulations for the purpose of prescribing matters relating to auction operation and oversight.

#### *Impact assessments for the proposed legislative amendments*

For points (a)-(d) above, separate regulatory impact assessments have been, or will be provided.

This RIS covers point (f) and partially covers point (e). For point (e), a separate RIS has already been undertaken to inform the preferred options for auction format and participation eligibility. Cabinet agreed these preferred options in December 2018, as part of tranche one decisions to amend the CCRA. The auction format and eligibility rules will be prescribed through regulations. This RIS proposes legislative amendments that will specify that the Minister *may* recommend regulations prescribing the preferred auction format and eligibility

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<sup>2</sup> Annual updates to the regulations will be made thereafter to update the unit volumes and price control settings as part of the five-year coordinated decision making process.

rules.

Note that for point (f), separate regulatory impact assessments will need to be undertaken of options relating to auction operation and oversight. However, these assessments will not require legislative amendments to the CCRA.

The other main constraint relates to the timing of proposed amendments. In light of the objective to implement NZ ETS auctions by 2020, these amendments are recommended to be made as part of the upcoming package containing the other legislative amendments to the CCRA.

## Section 3: Options identification

### 3.1 What options have been considered?

Two options have been considered:

Option 1 is to develop auction regulations using the current provisions in the CCRA. This would mean that the framework for auction high-level design, auction operation and oversight will remain broadly phrased and unclear in the CCRA.

The current guidance for auctioning regulations, includes that the Minister *may* make regulations prescribing matters related to:

- i. prescribing the date on which the sale of New Zealand units by auction commences:
- ii. providing for a pilot auction to be conducted in advance of the date from which sale by auction is to commence:
- iii. prescribing the persons or classes of persons eligible to participate in an auction of New Zealand units:
- iv. prescribing penalties for breaches of regulations made under this paragraph:
- v. providing for any other matters for the conduct of an auction that the Minister considers relevant to the effective conduct of the auction:

Option 2 is to amend the CCRA to provide additional detail and specify the matters for which the Minister *may* or *must* recommend auction-related regulations.

This option amends the CCRA so that regulations for auctioning must include matters relating to the rules and settings underpinning a typical auction process. There are generally three stages in an auction, each consisting of different processes as follows:

- The pre-bidding stage includes auction notification and pre-registration. Pre-registration involves submission of an application to participate in auctions (with relevant disclosures), and provision of financial assurances.
- The bidding stage includes various rules governing the actual bidding. These rules refer to lot sizes, price increments, and rules to deal with tied bids. The rules can also include limits on the maximum volumes that an entity can acquire in any single auction.<sup>3</sup>
- The post-bidding stage includes the release of auction results, and the financial and physical settlement of successful bids.

Matters would also need to be prescribed with regards to general settings governing the operation of auctions, such as an indicative schedule of auctions for upcoming year(s), and situations when the auction could be cancelled.

Matters relating to auction processes would potentially also include prescribing penalties for breaches of regulations governing the sale of units through auction. There are however, already appropriate provisions in the CCRA to address this. There is also a current offence in the CCRA, with a penalty not exceeding \$5,000, for knowingly signing a false declaration (refer section 30J). This would apply to declarations required under the auctioning regulations. These provisions should be sufficient to ensure that anyone providing false or

<sup>3</sup> The objective of such limits would be to prevent auction acquisitions being dominated by larger participants. Whether or not such limits are warranted in the NZ ETS is a decision that is being considered separately.

misleading information to the entities operating or monitoring auctions can be sanctioned for this conduct under the CCRA.

Therefore, this option prescribes some matters to always be included in regulations, including those that relate to the auction format, eligibility and operation. These matters are required for the effective operation of auctioning and have been chosen as they reflect the typical auction process.

The “must” matters relating to the auction operation specifically include:

- the date for auctioning to commence;<sup>\*4</sup>
- an indicative auction schedule for when auctions are planned to be held;
- details of auction registration requirements or criteria a person must met to participate in the auction;
- the auction format, including rules for bidding;
- financial processes that a person must follow when participating in an auction, including financial assurance and payment and delivery requirements;
- publication of auction results after each auction, for example auction clearing price and the volumes sold at auction; and
- situations where the auction would not proceed.

Additionally, there are some matters that should be provided for in regulations, if appropriate. These are:

- providing for a pilot before auctioning commences\*
- penalties for breaching auction regulations; and
- providing for any other matters for the conduct of an auction that the Minister considers relevant to the effective conduct of the auction.\*

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<sup>4</sup> The matters with an asterisk (\*) are already included in the CCRA

### 3.2 Which of these options is the proposed approach?

The proposed approach is Option 2, which is administratively simple to implement through amendments to the CCRA.

This RIS recommends amending the CCRA to provide further clarity on the types of decisions that must or may be included in auctioning regulations. Specifying this detail in the legislation will provide greater regulatory predictability with regards to the operation of auctions and the oversight matters that can be prescribed through regulations. It will give auction participants increased certainty and support the overall integrity of auctioning. If these purposes are not specified in the CCRA legislation, there will not be sufficient regulatory predictability with respect to the nature of auction-related decisions that must or may be made through regulations.

Providing clarity through legislation about the types of regulations the Minister must or may recommend is important for enhancing the integrity of the NZ ETS auction system. Market participants have consistently called for improvements to the regulatory predictability of the scheme, and for transparency in its operation. Clear signalling of the operation of the auctioning system will assist in providing an effective, efficient and robust environment for the auction of NZUs.

## Section 4: Impact Analysis (Proposed approach)

### 4.1 Summary table of costs and benefits

Affected parties (identify)	Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	Impact <i>\$m present value, for monetised impacts; high, medium or low for non-monetised impacts</i>
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#### Additional costs of proposed approach, compared to taking no action

Regulated parties	N/A	
Regulators	N/A	
Wider government	N/A	
Other parties	N/A	
<b>Total Monetised Cost</b>	N/A	
<b>Non-monetised costs</b>	N/A	<i>(High, medium or low)</i>

#### Expected benefits of proposed approach, compared to taking no action

Regulated parties	Greater predictability of regulatory decisions that the Government intends to make with regards to NZ ETS auctions	High
Regulators	N/A	
Wider government	N/A	
Other parties	N/A	
<b>Total Monetised Benefit</b>	N/A	
<b>Non-monetised benefits</b>	As per "Regulated parties"	<i>High</i>

#### 4.2 What other impacts is this approach likely to have?

- *Other likely impacts which cannot be included in the table above, eg because they cannot readily be assigned to a specific stakeholder group, or they cannot clearly be described as costs or benefits, eg equity impacts*
- *Potential risks and uncertainties*

N/A

## Section 5: Stakeholder views

### 5.1 What do stakeholders think about the problem and the proposed solution?

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.

To implement Cabinet's decision, further consultation on the high-level design options for auctions was undertaken in 2018. This formed part of the consultation on *Improvements to the NZ ETS* undertaken between 13 August and 21 September 2018. Stakeholder feedback was sought on auction format, frequency, participation, and use of auction proceeds. Submissions were received from 253 submitters, including forestry and non-forestry participants, iwi and Māori representatives, industry, city councils and non-governmental organisations.

Consultation has not specifically been conducted on clarifying the matters the Minister may prescribe under regulations.

Further consultation on auctioning is planned for July 2019, to seek feedback on proposals for the regulations. This will take place alongside select committee consultation on the Climate Change Response Amendment Bill. A separate consultation document will be provided at that time for auctioning operational design matters. It will enable stakeholders to provide their views on the different decisions that the Government must make with regards to the operation of an NZ ETS auctioning system.

The details of these matters will be subject to a consultation process planned for mid-2019. The consultation process will include public consultation on regulations being developed to implement CCRA amendments, alongside the Select Committee process for the proposed CCRA amendment bill. It is expected the regulations will come into effect in 2020 at the same time as the amendment bill.

## Section 6: Implementation and operation

### 6.1 How will the new arrangements be given effect?

The high-level proposals in this RIS that require legislative amendments are to be included in the Climate Change Response Act Bill, expected to be introduced to the House in mid-2019. The actual decisions on NZ ETS auction implementation rules that will be given effect through regulations will be sought as part of a regulatory process expected to be undertaken in July 2019.

The proposed amendments will distinguish between matters that “must” and those that “may be” prescribed by the Minister through regulations as described in the options identification section.

## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

This RIS only provides recommendations on how the list of *purposes* of regulations can be expanded to provide more clarity about the auction-related decisions that can be made through regulations. It does not make any recommendation on the detailed content of those regulations.

The immediate impact will be to provide market participants with more clarity with regards to the regulatory settings governing NZ ETS auction operation. Detailed decisions on the auction implementation rules will require consultation and further analysis.

### 7.2 When and how will the new arrangements be reviewed?

This RIS only provides recommendations on how the list of purposes of regulations can be expanded. It does not make any recommendation on the detailed content of those regulations. Therefore there is no clear need for the arrangement to be reviewed.

However, it should be noted that feedback from stakeholders will be sought through consultation for the regulations that are developed. In addition, the arrangements could be reviewed when a general review of the NZ ETS is initiated at the discretion of Minister, which is provided for in section 160 of the CCRA.

A separate RIS on *Options for an NZ ETS Auction Monitoring* has been undertaken. It proposes that one of the roles of the auction monitor would be to provide recommendations for auction design improvements. This could include recommendations on the purposes of regulations.

# Appendix 1

s9(2)(f)(iv)

