# Update on NZ ETS reform

19th  June 2020

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

# Context

- The NZ ETS has been going through significant reform. The Climate Change Response (ETS Reform) Amendment Bill provides the overall framework for key aspects of the NZ ETS, whereas detailed settings are implemented through ETS Regulations.

- The ETS Reform Bill passed through the Parliament on 16 June 2020. Three Cabinet Papers from June include the detailed settings that will be included in Regulations. These Regulations are expected to be in place before end of 2020.

- BusinessNZ previously made three submissions on ETS reform:
  - A submission in December 2019 focused on technical details of ETS auctions
  - A submission in January 2020 focused on high-level changes in the Bill
  - A submission in February 2020 focused on a suite of ETS changes, including price control mechanisms and phase-out of industrial allocations.

- These slides compare the changes in the Bill (as at June 3 on legislation.govt.nz) and the related Cabinet Papers with the BusinessNZ position on key issues as reflected in the three submissions above.

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

# Summary of key changes

**ETS volumes**

- The Bill introduces an overall cap for the NZ ETS. The ETS cap for 2021-2025 is proposed to be 159.5 million NZUs. The provisional emissions budget for 2021-25 is 354 Mt CO2.
- Out of the cap, 43 million NZUs will be allocated for free (industrial allocation), and 27 million NZUs will be withheld from auctions to address the stockpile issues. This results in a total auction volume of 89.6 million NZUs over the 2021-25 period.

**Price controls**

- The Bill introduces price controls through minimum auction prices and a cost containment reserve (CCR). It is proposed that the minimum price is set at $20 for 2021, increasing to $21.65 in 2025.
- A single price trigger is proposed to release CCR volumes. This will start at $50 in 2021, increasing annually by 2% to $54.12 in 2025. The price trigger may be increased in the future at the recommendation of CCC. CCC may also recommend multiple triggers if necessary.
- The Bill extends the FPO, and increases it from $25 currently to $35 until the first auction.

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

# Summary of key changes

**CCR volumes**

- The Government originally proposed that CCR volumes are set at 90% the difference between forecast net emissions and proposed unit supply. A new methodology is now being proposed, such that the CCR volume is equal to the total nr of units withheld from auction to deal with the stockpile (5.4m annually), plus 5% of the NZ ETS cap. This means the CCR volumes to be released if the trigger is reached is 7m NZUs annually over 2021-2024, and 6.9m NZUs in 2025.

**Auctions**

- Auctions are recommended to be held quarterly, with the following schedule for 2021: 17 March 2021, 23 June 2021, 1 September 2021, 1 December 2021.
- Most of the technical details for how auctions will be run align with BusinessNZ position.

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Summary of key changes

**Industrial allocations**

- A default industrial allocation phase-out rate of 1% is set to 2030. After that, higher default rates are set, unless CCC recommends different rates.

**International units**

- There will be a limit set on international limits. The limit for 2021-2025 is recommended at zero (due to no decision yet made on accessing carbon markets), and after that it will be revised annually as part of the five-year rolling cap.

**Other**

- The EPA will start publishing participant and activity-level emissions data.
- The penalties for failure to surrender or repay units will be set at three times the carbon price.

# Taxonomy

The following slides use the taxonomy below to summarise how changes in the Bill or those proposed through Regulations compare to BusinessNZ position:

✓ – the changes align with our stated position

~ – the changes align with our stated position only partially

X – the changes do not align with our stated position

TBD – the changes in the Bill are high-level (so it is not yet possible to make a determination), or do not address the specific issue

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

# Provisional emissions budget and ETS volumes

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| Net emissions for 2021 and 2020 should be set at levels held at 2020. A straight-line approach towards the 2050 target should be used over the short-term | The budget proposed for 2021 to 2022 is 71.8 $MtCO2$. A straight-line approach is proposed through to 2025. | ✓ |
| Withholding 54 million NZUs from 2021-2030 auctions is not an adequate approach to address the issue of stockpiled NZUs | June Cabinet Paper on ETS regulations proposes withholding 27 million NZUs from 2021-2025 auctions. | X |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# ETS auctions

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| Auctions must have clear rules and timetables | Regulations will prescribe an indicative auction schedule and specify bidding rules. An auction notice will be published 30 days in advance | ✓ |
| Auction outcomes must be transparent | Auction results with be made publicly available | ✓ |
| The bidding process must be competitive | It is proposed that the auctions follow a uniform-pricing sealed-bid process | ✓ |
| Auction volumes should be evenly distributed across the year | An even distribution of auction volumes is proposed. | ✓ |

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

# ETS auctions

| Business NZ position | Changes approved in the Bill or proposed through Regulations |
| --- | --- |
| Unsold unit should be added to next auction | It is proposed that unsold units will be added to the next auction without a limit ✓ |
| Minimum number of units to be sold at auctions should be 500 NZUs. | It is proposed that the minimum acceptable bid size is 500 NZUs. Bids must be made using a lot size of 100 NZUs. Price increments will be of $0.05. ✓ |
| Tied bids should be resolved through random assignment by lot | Tied bid will be resolved using a pro-rata approach rounded to the minimum lot size, i.e. for each tied bid, the auction operator will calculate the amount of NZUs that represents a proportionate share of all remaining auction volume ✓ |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# ETS auctions

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| Decisions on a maximum bid limit should not be made outside a broader review of ETS governance, so as to clearly understand potential market abuse risks | It is proposed that a limit should not be introduced for the time being, and that the Government should monitor market behaviour to decide on a limit when necessary | ✓ |
| An auction monitor should be introduced to oversee the auction process and validate the auction results | An auction monitor will be introduced through regulations. After each auction, the monitor will publish an auction report providing different statistics on bids (e.g. nr of bids submitted, average volume per bidder etc.). It will also provide distributional information, e.g. nr of unit awarded to each winner, with bidder names withheld | ✓ |

GROWING PROSPERITY AND POTENTIAL

# ETS auctions

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| The cost of participating in auctions must not be onerous. Collateral should be between 10%-25% of maximum bid value. | Prospective bidders will need to pre-register for auctions, providing company details and a statutory declaration. Auction registration will be a one-time process.<br>They will also need to provide collateral at a rate of 25% of maximum bid value. Accepted collateral is cash, bank guarantee, irrevocable letter of credit. Collateral can be used against payment of successful bids. Cash collateral will be returned after auction.<br>The payment will be made before NZU delivery, with a maximum settlement of 4 days. | ✓ |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Reserve price and FPO

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| A technical reserve price (indexing minimum auction price to secondary market price) should be introduced alongside an in-principle auction reserve price | It is proposed that regulations introduce a technical reserve price, with the prescribed methodology being kept confidential | ✓ |
| The FPO should be increased gradually from $25 to $30 for 2020 and $35 for 2021 | An FPO of $35 will be in place up until the first ETS auction | x |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Cost Containment Reserve

| Business NZ position | Changes approved in the Bill or proposed through Regulations |
|---|---|
| Settings for determining the CCR price triggers should be made more transparent, as it has not been clear why giving discretion to the decision-maker to determine price controls is preferred over having a mandated formula | The CCR price trigger will start at $50 in 2021, increasing 2% annually. The levels may change in the future at the recommendation of CCC, which is yet to clarify the process for reviewing and amending the triggers ~ |
| More clarity is required on how the market is expected to meet the 10% of "potential additional demand" that will not be included in CCR volumes | A new methodology is proposed for determining CCR volumes, i.e. the sum of units withheld from auction to deal with the stockpile, plus 5% of the NZ ETS cap. This means an annual CCR volume of ~7m NZUs over 2021-2025 |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Phase-out rates

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| The allocation formula is impacted by a number of separate reforms, i.e. level of assistance, allocative baseline, electricity allocation factor. Given the uncertainty of impacts from changes to allocation settings, the proposed 0.01 default phase-out rate should be set until 2030, but changes beyond 2030 should follow review and recommendations by the Climate Change Commission. | The default phase-out rate to 2030 is set at 0.01 | ✓ |
| | Post 2030, default rates are set as follows:<br>• 0.02 for 2031-2040<br>• 0.03 for after 2040 | ~ |
| | These rates can be superseded by regulations that can set different rates at the recommendation of CCC. However, these rates cannot be less than:<br>• 0.01 for 2031-2040<br>• 0.02 for 2041-2050 | ✓ |

# Phase-out rates

| Business NZ position | Changes approved in the Bill or proposed through Regulations |
|---|---|
| An increase in the phase-out rate should be communicated with an adequate notice period – commencing the second budget period after a change is made (i.e. minimum of 5 years) | Regulations made in respect of an emissions budget period must include a statement of what phase-out rate the Minister intends to set in respect of the subsequent emissions budget period (section 84B(2) of the Bill) ✓ |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Information transparency

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| BusinessNZ is not convinced that, in proposing that EPA annually publishes entity-level net emissions or removals broken down by activity (as applicable), sufficient analysis has been done of the potential risks that such annual publication might give insights into commercially sensitive information.<br>BusinessNZ would support a smaller step up the regulatory pyramid via strengthening recommendation 4.3 of the NZX Corporate Governance Code | The EPA will publish at least annually, for each participant or consolidated group, emissions broken down by participant and activity (except forestry, which must be combined for all forestry activities).<br><br>An exclusion applies to post-1989 forest land during a mandatory emissions returns period commencing before 1 January 2023 (Part 2, section 10(3)(b) of the Bill). | X |

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

# Penalties

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| The penalty for failure to surrender or repay units by due date should be set at $30/NZU or carbon price at the time of the original infringement, whichever is the higher. A multiple of 3 times the carbon price is excessive | The penalty will be calculated as follows:<br>3 x Carbon price at due date x Nr of units not surrendered/repaid | X |
| Force Majeure provisions should be introduced to protect firms from penalties when the ability to surrender or repay units is outside their control | The Bill does not seem to provide such exceptions | X |

# International units

| Business NZ position | Changes approved in the Bill or proposed through Regulations | |
|---|---|---|
| Dispelling the uncertainty around the quality of international units is the more pressing issue. While the quality risk exists, a limit on international units may be justified. However, over the long term, a limit is not necessary as it will result in costlier mitigation than necessary | There will be a limit imposed on approved overseas units | X |

BusinessNZ

GROWING PROSPERITY AND POTENTIAL