**Consultation document** 

Annual updates to New Zealand Emissions Trading Scheme limits and price control settings for units 2025

Ngā whakahou ā-tau ki ngā tepe me ngā tautuhinga whakatau utu mō ngā wae mō te Kaupapa Hokohoko Tukunga o Aotearoa 2025







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# **Executive summary**

Every year the Government is required to review settings for the New Zealand Emissions Trading Scheme (NZ ETS) auctions for the next five years. It must decide on the appropriate **supply of New Zealand Units** (NZUs or units) and **price control settings** that align with:

- emissions budgets
- the 2050 target
- Nationally Determined Contributions under the Paris Agreement.

These are collectively referred to here as 'emissions reduction targets'.

As part of this annual process, the Government must consider the advice and recommendations of the Climate Change Commission (the Commission).

The Commission's advice is that the Government could auction a total of 30.5 million NZUs across the settings period 2026–30, while remaining aligned with emissions reduction targets.

This volume of units for auction would represent an increase of 13.6 million units compared with the projection in 2024 NZ ETS settings. The increase is driven by three factors:

- significant changes in the methodology
- a smaller surplus estimate (using the updated methodology) than previously anticipated, in part because fewer units were sold at auction than previously forecast
- industrial allocation forecasts being revised downwards.

### The Government is keen to hear your feedback on both the option and the methodological changes that the Commission proposes.

Alongside the Commission's option, we are consulting on an alternative option. This would maintain status quo unit settings, extended to 2030.

There are three main reasons why we're consulting on this option:

- 1. Uncertainty about methodological changes. Even proportionally small refinements to some of the Commission's changes this year could have a material impact on the number of units that are assessed as aligning with emissions reduction targets.
- 2. Delivering emissions reduction targets. Tighter unit settings would strengthen the likelihood of achieving emissions reduction targets. This is especially relevant for achieving the challenging third emissions budget, for 2031–35.
- 3. Recent market dynamics. Recent market pricing and the partial clearance of auctions in 2024 suggest that additional auction volumes may not be needed.

#### We welcome your feedback on this alternative option.

The Commission has recommended that there be no changes to price control settings. It advises that the current settings are consistent with the range of emissions prices we will likely need to meet our emissions reduction targets. **We agree with this recommendation, and we now seek your feedback.** 

# **About this consultation**

This consultation seeks your views on options for annual updates to New Zealand Emissions Trading Scheme **unit limits** and **price control settings** (NZ ETS settings) for 2026–30.

The NZ ETS is the key tool to help Aotearoa New Zealand meet its emissions budgets, Nationally Determined Contributions (NDCs) under the Paris Agreement and the 2050 target. Updating NZ ETS settings every year helps New Zealand stay on track to meet those emissions reduction targets.

This is the fifth year that these settings will be updated since 2020. NZ ETS settings must be updated by the end of September each year, after consultation.

The Climate Change Response Act 2002 (CCRA) establishes the process for updating NZ ETS settings. It requires that they accord with New Zealand's emissions budgets, NDCs and the 2050 target. If settings do not strictly accord with the emissions budgets or NDCs, any departure must be justified with reference to the considerations listed in the CCRA (see Objectives – accordance test). Collectively, these are the 'accordance test'.

The options presented here have been assessed against the accordance test, based on currently available evidence and information (see Accordance with emissions budgets).

The Ministry for the Environment is seeking your feedback on these options. We are also asking if you have other options, with supporting evidence, that meet the accordance test.

### Scope

This consultation focuses on options for NZ ETS unit limit and price control settings for 2026–30.

We also seek input on a provisional NZ ETS cap for the third emissions budget.

The consultation does not:

- reassess New Zealand's level of, or commitment to, our international obligations, emissions budgets, NDCs or 2050 target (which the proposed settings are intended to support)
- include any changes to the framework or purpose of the NZ ETS, as provided for in the CCRA
- include options for reforming the CCRA.

The options presented here are based on the information and decisions that are available at the time of writing, including the second emissions reduction plan (ERP2) and the 2024 greenhouse gas inventory.

### Structure

In this consultation document, we have elevated the major, overarching question on the appropriate auction unit limits and price controls. Below this, we highlight a number of important additional questions on methodology that will help inform this and future NZ ETS settings. The appendices support all these questions and decisions. They give more detail on how we reached decisions, as well as providing information that can support your feedback.

### How to have your say

The Government welcomes your comments on this consultation document. The questions throughout the document are a guide only and all comments are welcome. See the Consultation questions section for the full list of questions. You do not have to answer them all, and all comments are welcome. To ensure others clearly understand your point of view, you should explain the reasons for your views and give supporting evidence if needed.

### **Closing date for submissions**

Send in your submission by 11:59pm, 29 June 2025. For details on how to make your submission, see How to have your say.

The consultation documents, and further details on how to make a submission, are available at https://consult.environment.govt.nz/climate/nz-ets-unit-settings-and-regulatory-updates-2025. If you have questions or want more information about the policy proposals or the submission process, please email etsconsultation@mfe.govt.nz.

### What happens next?

Once we have considered submissions, the Minister of Climate Change and Cabinet will make decisions. Any new regulations or amendments to existing regulations will then be published in the *New Zealand Gazette* by 30 September 2025 and will come into force from 1 January 2026.

### **Other consultations**

The Ministry for the Environment is also seeking feedback on proposed changes to the New Zealand Emissions Trading Scheme regulations 2025. See the related consultation document for further information.

# Background

### The role of the NZ ETS

The New Zealand Emissions Trading Scheme (NZ ETS) is the Government's key tool to help Aotearoa New Zealand meet its:

- international obligations under the United Nations Framework Convention on Climate Change and its Paris Agreement, including Nationally Determined Contributions
- 2050 target: net zero greenhouse gas emissions (except biogenic methane) and a 24 to 47 per cent reduction in biogenic methane
- emissions budgets: a set of interim targets towards the 2050 emissions reduction target.

The NZ ETS supports net emissions reductions by:

- requiring businesses to measure and report on their greenhouse gas emissions
- pricing emissions and removals
- requiring businesses to surrender one 'emissions unit' a New Zealand Unit (NZU or unit)
   to the Government for each tonne of emissions they are responsible for under the NZ ETS
- limiting the number of units supplied into the NZ ETS through auctioning and industrial allocation.

Participants can access units from several sources:

- government auctions of units
- government allocation of units to agreed carbon-intensive and trade-exposed firms (industrial allocation)
- removal activities that generate units (mainly forestry)
- the stockpile of units banked units that originated from the above sources and that can now be traded and ultimately surrendered by emitters. This includes 'surplus' units, which are not held for future surrender or other purposes, and thus may be sold freely into the market.

The Government sets the number of units supplied into the NZ ETS over time, through auctions and industrial allocation, and reduces the number over time. This limits the total volume of net emissions for participants in the NZ ETS, in line with New Zealand's emissions reduction targets.

Participants can buy and sell units among themselves. The unit price reflects supply and demand in the NZ ETS. This price signal allows businesses to make economically efficient choices about how and when to reduce emissions and increase removals.

# Annual process for unit limits and price control settings

Under the Climate Change Response Act 2002 (CCRA), NZ ETS unit limits and price control settings for the next five years are made through an annual update process to the Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020.

At present, the settings are informed by previous tests of accordance with emission targets, and are prescribed for only the next four years. The Government needs to decide on settings for the full five-year period by re-evaluating accordance against emissions reduction targets, and considering new information.

The unit settings must accord with New Zealand's emissions budgets, Nationally Determined Contributions and the 2050 target.<sup>1</sup>

Unit limits include:

- a limit on the units available by auction
- a limit on approved overseas units currently zero
- an overall limit on units which consists of units available by auction and industrial allocation, and approved overseas units.

The price control settings for units are the:

- auction price floor the price below which the Government will not sell units at auction (the lower price floor)
- cost containment reserve (CCR) trigger prices the prices at which additional units will be released if an auction's interim clearing price reaches or exceeds this level (the upper price floor)
- CCR volumes the number of units that will be released if the CCR trigger price is reached.

Unit limits help constrain the supply of units into the NZ ETS over time. This limits the quantity of net emissions that can occur, in line with New Zealand's emissions reduction targets.

Price controls set a minimum price and a maximum price for auctions for the next five years, providing a forward-looking 'price corridor'.

This five-year look-ahead period (as illustrated in Figure 1) provides regulatory certainty to NZ ETS participants. To increase certainty, these updates are generally intended to exclude changes to unit settings for the first two years (ie, 2026 and 2027, from this year). Changes can only be made in specified circumstances for these first two years – for example, if a change significantly affects one of the matters the Minister of Climate Change (the Minister) must consider when recommending changes to settings.<sup>2</sup>

<sup>&</sup>lt;sup>1</sup> The Government is currently considering advice on 2050 emissions reduction targets. NZ ETS settings must accord with targets currently set in legislation, and have been evaluated accordingly here.

<sup>&</sup>lt;sup>2</sup> See section 30GB(5) of the CCRA, which includes "(b) the Minister is satisfied that the amendment is justified by ... (i) a change that has significantly affected any matter that the Minister was required to consider under section 30GC when recommending the limits and price control settings that are to be amended."





### The Climate Change Commission has advised on NZ ETS unit settings

The Climate Change Commission (the Commission) is required to give annual advice on NZ ETS unit settings. The Minister must consider the Commission's advice when recommending updates to settings. If there are any differences between the recommendations of the Commission and those made by the Minister, the Minister must table a report in Parliament to explain the reasons for those differences.

The Commission's advice on settings was published in April 2025.<sup>3</sup> Its major recommendations this year are:

- 13.6 million more units could be auctioned across 2026–30 than the current settings allow
- to make no changes to the unit limits for 2026–27, with higher auction volumes distributed flatly across 2028–30
- keep the auction price floor and CCR settings at current levels, adjusted only for inflation.

We are seeking feedback on options for NZ ETS settings. These options include the Commission's recommended approach.

 <sup>&</sup>lt;sup>3</sup> He Pou a Rangi | Climate Change Commission. NZ ETS unit limits and price control settings for 2026–2030. Retrieved 23 April 2025.

## How we assessed the options

### **Objectives – accordance test**

The Climate Change Response Act 2002 (CCRA) requires that New Zealand Emissions Trading Scheme (NZ ETS) settings must accord with Aotearoa New Zealand's:

- 2050 target, which is:
  - net zero emissions of all greenhouse gas emissions other than biogenic methane by 2050
  - a 24 to 47 per cent reduction below 2017 biogenic methane emissions by 2050, including a 10 per cent reduction below 2017 biogenic methane emissions by 2030
- emissions budgets, which are stepping stones along the path to the 2050 target
- Nationally Determined Contributions (NDCs) under the Paris Agreement, which sets targets of a 50 per cent reduction of net emissions below the gross 2005 level by 2030 (NDC1), and a 51–55 per cent reduction by 2035 (NDC2).

We propose to align the NZ ETS cap for 2026–30 with the projected emissions from NZ ETS sectors under the second emissions reduction plan, reflecting both the second emissions budget and the domestic contribution to NDC1. NDC1 was set with the intention that it would be met, in part, by using offshore mitigation. This aligns with the approach followed in previous settings decisions and recommended by the Climate Change Commission.

NZ ETS settings must strictly accord with New Zealand's 2050 target, meaning there is a **very high** probability that settings constrain emissions to levels necessary to meet the target.<sup>4</sup>

For emissions budgets and NDCs, the settings do not have to strictly accord<sup>5</sup> if the discrepancy is justified after considering matters prescribed in the CCRA.<sup>6</sup> Even if deviating from strict accordance, the settings must still accord, meaning there is a **good** probability that settings constrain emissions to the levels necessary to meet the targets.

### Criteria

To assess the options, we used a set of criteria (table 1). These criteria align with the mandatory considerations for updating New Zealand Unit (NZU or unit) settings, as prescribed in the CCRA (see appendix 2 for how they align). They are identical to the criteria used last year.

The first two criteria apply to both unit limit and price control settings. The third and fourth criteria apply to price control settings only.

We have put more weighting on the criterion 'likelihood of incentivising (net) emissions reductions'. This is because this criterion relates the most closely to the overarching objective.

<sup>&</sup>lt;sup>4</sup> Section 30GC(2)(b) of the CCRA.

<sup>&</sup>lt;sup>5</sup> Section 30GC(3) of the CCRA.

<sup>&</sup>lt;sup>6</sup> Sections 30GC(5) and 30GC(6) of the CCRA outline the criteria.

#### Table 1: Criteria for assessing options for NZ ETS settings

Criterion	Description
Likelihood of incentivising (net) emissions reductions	The NZ ETS must accord with New Zealand's emissions budgets, NDCs and the 2050 target, which all require a mix of gross emissions reductions and removals. Settings should provide a price signal to incentivise emissions reductions and removals.
	Because the stockpile could impede the achievement of emissions reductions and increase the risk of not meeting budgets, options that risk continuing the stockpile beyond the intended drawdown date will rate negatively for this criterion.
Support for proper functioning of the NZ ETS	The NZ ETS should operate in a transparent and durable manner, so that participants can form expectations about supply and demand, to support investment in reducing emissions.
	The restrictions on how settings are updated allow for changes in response to new information, while maintaining regulatory predictability. Options that undermine this standard approach will rate negatively for this criterion.
	This criterion also includes NZ ETS participants being able to attain and surrender NZUs to meet NZ ETS obligations.
	The NZ ETS must function properly, to effectively play its role in meeting emissions reduction targets.
Support for NZU prices consistent with the level and	There are two reasons for considering the level and trajectory of international emissions prices.
trajectory of international emissions prices	<ul> <li>International emissions prices provide a way of comparing New Zealand's contribution with that of other countries in the global effort towards addressing climate change, notwithstanding fundamental differences between individual emissions pricing schemes.</li> </ul>
	<ul> <li>Offshore mitigation could be needed to meet emissions reduction targets in addition to reducing emissions domestically.</li> </ul>
Management of overall costs to the economy and households	Settings influence, and can help manage, the costs of the NZ ETS on the economy, households, sectors and regions.

# How we developed the options

We used two major approaches together to determine options for unit settings that would meet the accordance tests and goals of the New Zealand Emissions Trading Scheme (NZ ETS):

- seven steps methodology
- NZ ETS market model.

### Seven steps methodology

Developed in 2020, the seven steps methodology is an approach for calculating maximum annual auction volumes. The Government and the Climate Change Commission have used it every year since then.

The appropriate auction volumes are determined using seven calculations.

- 1. Align with emissions reduction targets.
- 2. Allocate the emissions budgets to NZ ETS and non-NZ ETS sectors.
- 3. Make technical adjustments.
- 4. Account for industrial allocation volumes.
- 5. Set the reduction volume to address the New Zealand Unit (NZU or unit) surplus.
- 6. Set the approved overseas unit limit.
- 7. Calculate the base auction volumes.

Working through these seven steps provides an estimate of the maximum number of units that could be auctioned while meeting our emissions reduction targets, given current circumstances and our best assumptions for other sources of units.

Steps 1 and 2 combined provide us with the 'NZ ETS cap'. This is the total level of net emissions allowed under the NZ ETS for the settings period. Caps can also be determined for emissions budget periods – for example, the EB2 NZ ETS cap sets the total level of net emissions allowed under the NZ ETS for the EB2 period.

Appendix 1 shows the seven steps, and the underpinning methodology and assumptions.

### Addressing the unit surplus stockpile

A large quantity of units is banked in private accounts. These provide liquidity to the market and help to reduce price volatility. However, the current number of banked units presents a risk to achieving emissions budgets.

Some of the banked NZUs are held to meet future surrender liabilities, or for other reasons. Others are estimated to be held for investment purposes and can be more readily sold when market price expectations change – these are considered 'surplus'. Emitters' use of these surplus units to meet increased NZ ETS obligations could cause challenges in meeting emissions budgets. To reduce this risk, we need to manage the surplus. Last year, the Government agreed to set unit limits with the aim of reducing the surplus to zero by 2030. This is reflected in step 5a of the seven steps methodology.

However, there is inherent uncertainty about the size of the surplus, as it is not a fixed number. Estimating the size of the surplus also requires making assumptions about how participants respond to changing market dynamics. In particular, the seven steps methodology assumes that the permanent (ie, non-surplus) stockpile is illiquid and will not become available in response to price changes.

### NZ ETS market model

The NZ ETS market model estimates supply and demand for NZUs under different conditions, and can generate price projections based on supply and demand.<sup>7,8</sup>

The model estimates emissions reductions and removals, and the flow of units in and out of the stockpile, internally (endogenously) in the model using equations that relate these changes to different prices. It sets an objective for the market (minimising the stockpile by 2050 while meeting demand every year) and uses price to optimise supply and demand relative to that objective.

2024 was the first year in which we have used this model to support decisions about settings. We are continuing to refine and improve the model, and how we use it to support analysis of the NZ ETS. For more detail and recent updates, see the technical annex.

The annex also includes further sensitivity analysis to supplement the modelling insights in this consultation document.

We appreciate the feedback on the model received to date and welcome any further input from participants.

### How we use both models together

The market model and seven steps are fundamentally different models, though with considerable overlap. Both provide insights into the NZ ETS.

The seven steps methodology is one approach for identifying the maximum volume of unit settings that satisfy the accordance tests. The Government may also explore settings that are tighter or looser than this estimated maximum.

The market model explores potential implications of different unit and price control settings, and informs impact analysis.

Using both models together can help overcome the shortcomings of each approach. It also provides a more robust overall assessment of the merits and trade-offs of each option considered here. As with all models that attempt to simplify complex real-world interactions, there is a high degree of uncertainty. The sensitivity analysis touches on some of this – see the technical annex.

<sup>&</sup>lt;sup>7</sup> Ministry for the Environment. 2023. *Review of the New Zealand Emissions Trading Scheme: Summary of modelling*. Wellington: Ministry for the Environment.

<sup>&</sup>lt;sup>8</sup> Ministry for the Environment. 2025. *Updates to the New Zealand Emissions Trading Scheme market model*. Wellington: Ministry for the Environment.

# **Recent secondary market price dynamics**

Following a period of stability after the 2024 settings decisions were announced, secondary market spot prices have declined from around \$65 in January 2025 to around \$50 at the time of writing. This is more than 25 per cent below the 2025 auction reserve price of \$68 (figure 2).

Forward and futures price curves are sitting below future auction price floor levels, although these instruments are not traded in large volumes. These prices are significantly below the expected price path generated from the modelling to develop the second emissions reduction plan and the 2024 New Zealand Emissions Trading Scheme settings.



Figure 2: New Zealand Unit secondary market spot price and auction price floors, January 2022–April 2025

Source: NZU secondary market spot prices from Jarden commtrade

Market commentary has been mixed on the possible cause of the decline in prices. Some has focused on short-term factors that could reverse. Initially much of the focus was on the financial pressures on small-scale foresters, some of whom were thought to be selling New Zealand Units (NZUs or units) to meet cashflow needs. Larger compliance buyers are generally well supplied and have been able to buy opportunistically when certain price triggers are met.

More recently, global sentiment has deteriorated significantly, which is weighing on markets in general. This appears to be spilling over into carbon markets, most notably the Californian scheme, but also the European and Australian schemes. There is also some domestic policy uncertainty as the details on policies such as the proposed limits on whole-farm conversions of high-quality productive land to exotic forestry registering in the NZ ETS and afforestation on Crown-owned land are being confirmed.

Other commentators have noted that current price dynamics could represent a more fundamental re-pricing of the cost of reducing net emissions. This means that emissions budgets could be achievable at a lower market price than previously anticipated.

Afforestation has been considerably higher over the past few years than was anticipated when auctions were introduced. In addition, a growing share of forestry has switched into the permanent forest category, which frees up NZUs previously held against future harvest liabilities.

To the extent a repricing is taking place, current price levels would indicate that the market has enough supply that additional units from auction are not needed.

### We are keen to hear your views on the possible causes and implications of current market pricing.

We also gratefully acknowledge those who responded to the recent survey of NZU holders. The results are still being analysed, but we expect to be able to draw on insights when making final policy decisions. This includes the extent to which the insights shed light on recent market dynamics.

Quest	tions
1	What do you think are the key drivers behind recent market price dynamics?
2	How do you think recent price developments should factor into the Government's thinking about unit settings and price controls?

# Key options for 2025 settings

# The Climate Change Commission's recommended unit limits

Analysis by the Climate Change Commission (the Commission), using the seven steps methodology, suggests that the Government could auction a total of 30.5 million New Zealand Units (NZUs or units) across 2026–30 and still align with the New Zealand Emissions Trading Scheme (NZ ETS) cap outlined in the second emissions reduction scheme (ERP2), and achieving Aotearoa New Zealand's emissions reduction targets. The Commission's approach also aligns with the objective of the 2024 NZ ETS settings decision to draw down the surplus stockpile to zero by 2030. The total auction volume of 30.5 million units is an increase of 13.6 million units compared with the projection in 2024 NZ ETS settings. This change was driven by the following developments.

#### Drivers decreasing unit limits

- 6.7 million fewer units from changes to the NZ ETS cap. This mainly stems from ERP2 clarifying expected emissions across ETS and non-ETS covered sectors between 2026 and 2030. ERP2 proposed an EB2 NZ ETS cap of 91 Mt CO<sub>2</sub>e. The changes to the NZ ETS cap also reflect methodological changes to New Zealand's 2024 greenhouse gas inventory.
- Approximately 5 million fewer units (± 1 million) drawn down from the stockpile than projected (excluding impacts of methodological changes and unsold units from 2024 auctions).

#### Drivers increasing unit limits

- 7.1 million more units as a result of the 2024 NZ ETS auctions not fully clearing.
- Approximately 7 million more units (± 1 million) due to methodological changes decreasing the surplus stockpile. This is the net impact of much larger underlying changes that offset each other. Changes that decrease the size of the surplus equate to about 36 million units, while changes that increase the estimate total about 28 million units.
- 4.4 million more units as a result of updated information and forecasts for industrial allocation levels, which mean we expect to allocate fewer units to industrial allocation over the settings period.
- 3.4 million more units because a technical adjustment is no longer required.
- 3.1 million more units due to changes in 2025 forecasts. Because 2025 auction volumes are fixed, these 3.1 million units instead increase unit limits for the 2026-30 period.<sup>9</sup>

Figure 3 illustrates our analysis of how these changes together increase the maximum possible auction volumes over the settings period. To quantify the impact of methodological changes, we compared estimates of the surplus stockpile using the Commission's 2024 and 2025 methodologies.

<sup>&</sup>lt;sup>9</sup> This is referred to as the 'discrepancy adjustment' within the seven-step methodology. It covers adjustments to things like updated forecasts of 2025 industrial allocation volumes and changes to the NZ ETS cap affecting 2025.

<sup>18</sup> Annual updates to NZ ETS limits and price control settings for units 2025: Consultation document

Our approach differs from the Commission's approach to describing these impacts. The Commission subtracts the unsold 2025 auction volume (7.1 million units) and the projected surplus reduction in 2024 (7.7 million units) from the estimate of the surplus made in 2024. It then attributes the remaining 2.9 million reduction to methodological and data changes.

Our analysis indicates that the surplus has reduced by less than expected after accounting for the unsold auction volume.<sup>10</sup> This is shown in figure 3 as 'projected 2024 surplus reduction which did not occur'.

We would like to hear your views on possible reasons for this lower-than-forecast surplus reduction.



Figure 3: Drivers of changes in estimated auction volumes across 2026–30

Source: Ministry for the Environment analysis

### **Option for tighter unit limits**

Alongside the Commission's option, we are consulting on an alternative option: to maintain the status quo unit settings, extended to 2030. The following are the three main reasons why we are consulting on this option.

### 1. Methodological change

A significant portion of possible additional units stems from methodological changes that, on net, have reduced the Commission's estimate of the surplus stockpile. This includes a new 'holding volume' category of non-surplus units, which reduces the Commission's estimate by 34 million units. However, other methodological changes largely offset this impact.

<sup>&</sup>lt;sup>10</sup> This excludes the unanticipated reduction due to some auctions not clearing in 2024. When these are factored in, the surplus has reduced faster than expected.

Based on our preliminary assessment, these methodological changes are conceptually valid and likely to improve the accuracy of the surplus estimate. However, substantial uncertainty remains about the true size of the surplus stockpile. This is the first year of testing these methodological changes and there may be refinements to them in future years. Even proportionally small refinements to some of these changes could have a material impact on the number of units that are assessed to align with emissions reduction targets.

### 2. Delivering emissions budgets

Compared with the Commission's recommendation, maintaining status quo volumes would strengthen the country's position for achieving its domestic emissions budgets and international emissions targets, by allowing less supply into the market. This is likely to put greater upwards pressure on the secondary market price, and further incentivise gross emissions reductions and afforestation. It would also support a faster drawdown of the surplus stockpile, and reduce the risk posed by the stockpile to achieving both EB2 and the third emissions budget (EB3). We know that meeting EB3 is likely to be challenging, and there is a case for tighter settings in the short term in order to give us more options in the future.

### 3. Market dynamics

Recent market pricing and the partial clearance of 2024 auctions suggest that additional auction volumes may not be needed. Increasing volumes compared with the status quo appears to run counter to this market signal.

### NZ ETS settings options

### **Unit limit options**

We have presented two options: status quo settings (keeping existing unit settings and expanding to 2030 based on projections) and the Commission's recommended settings. These options are not exhaustive and there are other packages that could be feasible for meeting accordance requirements. We invite your feedback on the options presented and other options you think are worth consideration.

### **Option 1: Status quo auction volumes**

In option 1, **auction volumes are unchanged** from 2024 settings, which apply to 2025-29, and would be extended to 2030. 2030 auction volume is based on the same information used to determine 2024 settings, including industrial allocation forecasts and surplus drawdown volumes as estimated at the time, making it internally consistent with the settings currently in regulation.

#### **Option 2: Commission-recommended auction volumes**

In option 2, all changes to unit volumes would be reflected in auction volumes, resulting in an **increase of 13.6 million units to be auctioned over 2028-30**.

The Government has the choice, in certain circumstances, to change auction volumes for the first two years of settings (eg, 2026 and 2027). The Commission recommended not adjusting settings for the first two years, to maintain stability for participants.

The current market price suggests there is limited risk of undersupply in the near future. This again supports not changing the volumes in 2026 and 2027.

Currently auction volumes are distributed so they decline in line with the NZ ETS cap. The Commission recommended taking a different approach to the distribution of volume changes across years 2028–30. It recommended distributing volumes evenly across this period. This would mean relatively lower auction volumes in 2028 and higher auction volumes in 2029 and 2030, compared with the default approach. This would preserve more volume in later years that could be more easily changed in future.

Question		
3	What is your preferred approach for distributing auction volumes for option 2?	

### **Price controls**

It is important that recommendations on auction volumes and price controls are considered together as a package of recommendations. Our proposed options on unit limits discussed in the previous section do not include changes to price control settings, beyond adjustment for inflation.

### The role of price controls

Auction price controls provide the Government with additional tools to manage the supply of units. The settings do not set the NZU price, but can influence that price by withholding units from, or adding units to, the market.

Price controls act as a safety valve to prevent the auction price from going too low (which could lower the secondary market NZU price below what is needed for meeting emissions reduction targets) or too high (unnecessarily impacting on the cost of living and the economy). They also signal the price pathway likely to be needed to meet future emissions reduction targets. Price controls apply only to government auctions, and not the secondary market.

Auction price controls include the:

- auction price floor the Government will not sell units at auction below this price (the lower price floor) and the confidential reserve price
- cost containment reserve (CCR) trigger prices additional NZUs will be released if an auction's interim clearing price reaches or exceeds one or both of these prices (the upper price floor)
- CCR volumes the number of NZUs that will be released if the trigger price is reached.

The auction price floor<sup>11</sup> (lower price floor) stays at a prescribed value for each auction within the year. It prevents additional units from being sold if the market is so well supplied that businesses are not willing to pay a price aligned with emissions reduction targets.

The confidential reserve price functions to prevent the sale of units at a price below prevailing secondary market prices. It can be different at each auction and is not revealed to the public. This price is not set alongside other NZ ETS settings and is not being consulted on.

<sup>&</sup>lt;sup>11</sup> In its advice, the Commission refers to the auction price floor as the auction reserve price.

The CCR exists to manage the risk from shocks and unforeseen events that may result in extremely high prices in the NZ ETS. It functions by releasing more NZUs into an auction where prescribed prices have been met. In 2023, the government adopted the Commission's recommended two-tier design for the CCR. This means there are two trigger prices – each with its own CCR.

Our auction price floor and CCR trigger prices should together set out a price corridor that allows units to enter the market at prices that accord with our emissions reduction targets.

#### Auction price floor and CCR trigger prices

The Commission has concluded that the auction price floor and CCR trigger prices remain fit for purpose. It recommended that they remain unchanged (apart from routine inflation adjustments to figures from 2028 onwards).

On the auction price floor, the Commission highlighted evidence suggesting that prices around or above the current auction price floor are needed to support emissions reductions necessary for meeting EB2 and EB3. Additionally, the Commission highlighted the risk of selling NZUs at prices below the cost of offshore mitigation.

We agree with the Commission's assessment that the current price floor remains fit for purpose. Although current secondary market prices are below the current auction price floor, this could be a signal that the market is currently oversupplied. The auction price floor helps limit supply until the oversupply is addressed. Internal modelling suggests that pricing is likely to return to above the auction floor price for both options. Maintaining the auction price floor will also support the Government's key objectives of supporting confidence in the NZ ETS and encouraging investment in decarbonisation activities.

For the CCR trigger prices, the Commission highlighted a risk that trigger prices may be too low to allow the high NZU prices needed to meet EB3 through additional gross emissions (if afforestation follows the trajectory projected in ERP2). However, additional afforestation in the next few years could help meet EB3 at a relatively lower price. It advised maintaining current CCR trigger prices (adjusted for inflation) until it is clearer whether current trigger prices are too low to allow the NZU prices needed to meet EB3. We agree with the Commission's findings.

We present below potential adjustments to the auction price floor and CCR trigger price levels for inflation and extended to 2030. We consider that the rationale for maintaining current price controls holds for both the Commission-recommended option and the status quo unit volume option.

#### We seek your feedback on this approach.

#### **Cost containment volumes**

The CCR volumes need to be large enough for the CCR to perform its function of bringing down the auction price when it gets too high. Where prices are high, there is a risk that the cost will be passed on to consumers, potentially resulting in pressure on household budgets.

In its 2025 advice, the Commission recommended maintaining CCR volumes for 2026–29, plus an extension to 2030. It has recommended that changes to the surplus stockpile estimate do not justify a change to CCR volumes.

As with last year, there is no indication that changes to CCR volumes are necessary. We consider the current volumes to be sufficient for the CCR to perform its role without risking accordance with emissions budgets if the CCR is triggered. This applies for both the Commission-recommended option and the status quo unit volume option.

Questions		
4	Do you have any feedback on the proposed auction price floor?	
5	Do you have any feedback on the proposed cost containment reserve prices or volumes?	

### Summary of unit limits and price control settings

Tables 2 and 3 show the auction volumes and proposed price control settings for each option.

Table 2: Options for auction volumes, 2026–30

	Year (million NZUs)					
	2026	2027	2028	2029	2030	2026–30
Option 1: Status quo	5.2	4.3	3.3	2.4	1.7	16.9
Option 2: Commission-recommended volumes (flat distribution)	5.2	4.3	7.0	7.0	7.0	30.5

Table 3: Proposed price control settings for the next five years, 2026–30

	2026	2027	2028	2029	2030 (new)
Auction price floor	\$71	\$75	\$78	\$82	\$86
Cost containment reserve (CCR) tier 1	\$203	\$213	\$223	\$235	\$246
CCR tier 2	\$254	\$267	\$279	\$293	\$308
Tier 1 volume (million NZUs)	2.3	2.1	1.9	1.7	1.4
Tier 2 volume (million NZUs)	4.2	3.8	3.4	3.0	2.5
Total CCR volume (million NZUs)	6.5	5.9	5.3	4.7	3.9

Note: These figures assume that changes will only be made to 2028–30 in line with the NZ ETS cap. They are also based on the assumption that recommended changes to the surplus stockpile estimate are followed.

# Implications of the options for market dynamics and emissions budgets

We have modelled a range of scenarios in the NZ ETS market model, based on the different options outlined above, and accounting for different starting points in 2025. This section presents some of the key insights from that modelling.

All models are subject to high levels of uncertainty, which typically increases the further out in time they attempt to model. They also rely on a range of model-specific and other assumptions. The results are not predictions – their purpose is to help explore the implications and trade-offs between the different options.

The market model has been aligned with ERP2 projections where relevant and with industrial allocation forecasts and surplus stockpile estimates as set out in this consultation document. For more detail on modelling assumptions and sensitivity analysis, see the technical annex.

### Projected sources of NZU supply

Figure 4 shows the projected sources of NZU supply to meet compliance demand under option 1.

The broad outlook for supply is similar for both option 1 and option 2. Government supply, from industrial allocation and auctions, is projected to be a material but declining share of supply in the 2020s. The projections shown assume that all auctions clear and use the updated estimate of the surplus stockpile (50.2 million NZUs).

Forestry supply from 'low-risk' (or unencumbered) NZUs is projected to steadily increase over time.<sup>12, 13</sup> However, forestry makes up a smaller share of supply in the near term, requiring the stockpile to be drawn down further in the interim. The 'other stockpile' (non-surplus stockpile) use reflects some additional stockpiled units coming to the market based on future price expectations. Notwithstanding this additional stockpile use, the total stockpile of units is projected to remain between 60 million and 90 million NZUs (more than double annual compliance demand) across the modelled period.

The surplus is drawn down faster under option 1 than under option 2. Therefore, faster reductions in emissions (reduced compliance demand) and some additional stockpile drawdown are needed, both of which require higher prices to incentivise.

Under option 2, higher auction volumes in 2028–30 mostly offset the need for additional stockpile drawdown in EB2, reducing the upwards pressure on prices.

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<sup>&</sup>lt;sup>12</sup> Low-risk units are from permanent or average accounting forests that do not have a surrender liability. For modelling, these are assumed to become available to the market as they are earned.

<sup>&</sup>lt;sup>13</sup> Forestry supply in figure 4 is based on ERP2 projections. It is consistent with the Government policy to restrict conversion of farmland to exotic forestry. If forestry is more responsive to price, additional low-risk supply is projected to displace most of this ongoing other stockpile drawdown post-2030. The technical annex has more detail.



Figure 4: Projected sources of New Zealand Unit supply dynamics under option 1 (status quo) unit and price control settings, 2024–50

Source: Ministry for the Environment modelling

#### Implications for projected prices

Figures 5 and 6 show a range of carbon price pathways based on different scenarios for options 1 and 2. The drivers of the ranges relate to assumptions about the starting point (the price in 2025 and whether auctions clear or not), and stockpile liquidity.

All else being equal, the option 1 settings are projected to lead to higher prices than option 2. Overall, the different options result in a similar price projection profile – rising in the near term to induce enough supply from auctions and the stockpile to meet compliance demand, while in the medium to long term forestry supply exerts downward pressure on prices. Option 1 prices typically peak at about \$5 to \$25 (in 2023 dollar terms) higher than option 2, although there is considerable uncertainty around the projected price pathways. The timing of the peak in prices has been imposed in this modelling, but there is a high degree of uncertainty over when and if prices might peak. An alternative, continuously rising price profile is explored in the technical annex.

The wider range of prices shown for option 1 also illustrates the risk of higher price volatility under this option. Given option 1 involves fewer auctioned units than under option 2, prices may become more sensitive to the liquidity of the stockpile.



Source: Ministry for the Environment modelling. Highest and lowest prices are derived from the scenario modelling. Ranges have been smoothed to simplify presentation.

Option 2 — ERP2 — Auction floor price

2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035

spot price

#### Implications for total net emissions projections

The market model was not designed to estimate total net emissions; its focus is on net emissions covered by the NZ ETS. However, we can combine the model outputs with other information to make high-level projections of total net emissions. These estimates are subject to high uncertainty. They are communicated within ranges constructed from sensitivity analysis based on the price responsiveness ranges.

Projected price paths under option 1, 2021–35

Figure 5:

40

20

Within these limitations, there is a very high probability that under both options, total net emissions will be within EB2 (figure 7). There is a risk to New Zealand meeting EB3 due to the ongoing potential for stockpiled units to become available to the market. A key factor that will influence EB3 net emissions will be how afforestation rates respond to price movements in the next few years and in particular the extent to which the Government's policy to restrict farm conversions constrains aggregate exotic planting registered in the NZ ETS. Reflecting this uncertainty, the figure shows two alternative scenarios for the price-responsiveness of afforestation.

Figure 7 shows midpoint estimates for all options sitting above EB3. This is similar to modelling for ERP2, which included a comparable gap (about 9 Mt CO<sub>2</sub>e) between projected emissions and EB3. Decisions on 2025 NZ ETS settings do not cover the EB3 period but do need to enable future NZ ETS settings decisions, as well as the third emissions reduction plan (ERP3), to further reduce emissions, consistent with achieving EB3. This is primarily achieved through aiming to eliminate the surplus stockpile before EB3.





Source: Ministry for the Environment modelling

Note: Horizontal lines represent the indicative central estimate, and vertical lines the high and low estimates.

Question	
6	Do you think the stockpile will pose a risk to achieving the third emissions budget in the way described here?

### Impacts on the economy and households

The NZ ETS works by placing a cost on emissions for businesses that have obligations under the NZ ETS. It incentivises greater reduction of gross emissions as businesses consider low-emissions alternatives that avoid that cost. The NZ ETS impacts on various sectors of the New Zealand

economy differently. It adds higher costs to activities that are more emissions intensive, and provides an additional revenue stream for foresters who can earn NZUs.

Businesses may choose to offset this cost where they can, by investing in lower-emissions technologies or processes, by increasing their prices to consumers or by reducing their costs. Reducing their costs could include reducing their number of employees. Higher prices passed on to consumers contribute to inflation, and increase the cost of household essentials such as fuel, electricity and food. Households can look to substitute towards lower-emissions alternatives to offset some of these costs.

The Ministry for the Environment estimates that a \$10 increase in the NZ ETS price adds about \$90 per year to the average household's expenditure, mostly through its impacts on fuel and electricity prices. For lowest-income households, a \$10 increase amounts to an increase in expenditure of about \$50–60 per year, while it represents an increase of \$130–160 per year for highest-income households.

Changes in NZ ETS prices make modest contributions to consumer inflation. A \$10 increase in the NZ ETS price is estimated to increase annual consumer price inflation by 0.12 percentage points, assuming businesses pass on the costs in full and swiftly to consumers.

The price of NZUs is projected to increase over time across both options presented here (figures 5 and 6). Option 1 is expected to have larger price increases than option 2 and correspondingly larger impacts on businesses and households. Similarly, option 1 is expected to increase returns to foresters from sequestering carbon by more than option 2. The impacts on consumer inflation are expected to be modest under both unit volume options, adding about 0.1 per cent per year to inflation.

Māori are affected by the NZ ETS in various ways. The following Māori interests are likely to be affected by NZU price and unit settings:

- income through plantation forestry on Māori land included in the NZ ETS
- costs related to obligations under the NZ ETS when considering land-use change
- business profits and jobs that rely on earnings from NZUs
- higher living costs that affect Māori households and whānau particularly those who are disproportionately represented in lower-income groups.

For more detail on expected impacts on different groups, see appendix 3.

We acknowledge the possibility of gaps in our analysis, including on impacts specific to Māori.

### As part of this consultation, we are interested in your views on our impact assessment, including views from different Māori groups.

Quest	ions
7	Do you agree with our impact analysis? Are there any further impacts to consider that we have not captured in our analysis?
8	What are your key concerns about the potential impacts of each option on Māori communities?

### Assessing the options

### Accordance with emissions reduction targets

A full accordance assessment will be made based on the Government's final NZ ETS settings decisions later this year. However, our preliminary current assessment and modelling suggest that both options included for consultation will meet the accordance requirements under the Climate Change Response Act 2002 (CCRA) when assessed.

### Accordance with EB2

Ministry for the Environment modelling (see Implications for total net emissions projections) shows both options have a very high probability of achieving EB2 across the scenarios tested. Therefore they are likely to meet the requirements set out in the CCRA.<sup>14</sup>

#### Accordance with EB3

Current modelling shows that both options will exceed EB3. For that reason, our current assessment is that both options are likely to accord, but not strictly accord, when formally assessed.

If an option accords, but does not strictly accord, the Minister of Climate Change must be confident that this deviation is justified after considering matters prescribed in the CCRA. We identify two major reasons justifying deviation.

- A plan to fully meet EB3 is not yet required. ERP3 will set out the Government's full approach for meeting EB3, including any complementary policies that can further support accordance.
- Adopting 2025 NZ ETS settings that strictly accord with EB3 could run counter to the proper functioning of the NZ ETS, requiring significant reductions in unit volumes between 2026 to 2030 that could impede participants' ability to obtain units to meet their compliance obligations, and is likely to lead to highly volatile prices.

Both options set unit limits to reduce the estimated surplus stockpile to zero before the start of the EB3 period (2031) and by keeping price controls high to ensure volumes do not enter the market at a price below what is needed to achieve EB3. This means that both options enable flexibility to meet EB3 through future changes to settings during the EB2 period.

Option 1 provides the strongest probability of meeting the requirements – it results in the greatest reduction in the risk the stockpile poses to achieving emissions budgets.<sup>15</sup> Option 1 is also likely to lead to higher prices relative to option 2 (all else being equal), and therefore would provide greater incentives for emissions reductions and removals.

<sup>&</sup>lt;sup>14</sup> Emissions budgets set the total quantity of net emissions allowed to be released during an emissions budget period. Emissions budgets will act as stepping stones to the 2050 emissions reductions targets. For more information, see: Ministry for the Environment. *Emissions budgets and the emissions reduction plan*. Retrieved 16 May 2025.

<sup>&</sup>lt;sup>15</sup> The surplus of NZUs poses a risk to the achievement of emissions budgets because emitters could choose to use these units to meet surrender obligations, rather than reduce emissions at source. This is a risk to the time-bound budgets.

### Accordance with Nationally Determined Contributions

The first Nationally Determined Contribution (NDC1) was set with the intention that it would be met, in part, by using offshore mitigation. Both options have a very high probability of meeting the expected domestic contribution to NDC1, but New Zealand will require offshore mitigation to meet NDC1. As a result, both options are likely to accord, but not strictly accord, with NDC1. Deviation from strict accordance would be justified (in part) by the proper functioning of the NZ ETS and impacts on households and the economy.

NDC2 is set at approximately the same level as EB3. Therefore the accordance of options will match the accordance with EB3.

#### Accordance with 2050 target

Both options for unit limits and price control settings are in line with what is needed to meet EB1 and EB2, and position us well to meet EB3. These emissions budgets act as interim targets towards the 2050 target. Additionally, both options are aligned with the NZ ETS cap set out through ERP2, which meets the 2050 target.

For these reasons, both options are likely to strictly accord with the 2050 target.

### Assessing the options

Table 4 compares the two options against the assessment criteria. This is a preliminary assessment. The relative ranking of options relies heavily on the accuracy of methodological changes. Further analysis and consultation feedback on the changes will enable a more accurate assessment at the time of final settings decisions.

Criterion	Option 1: Status quo auction volumes	Option 2: Commission-recommended auction volumes
Likelihood of incentivising emissions reductions	<b>0</b> Compared with option 2, option 1 is expected to incentivise greater levels of emissions reductions and removals and reduce the stockpile faster. It is more likely to align with emissions reduction targets, including the challenging EB3.	- Option 2 is expected to incentivise lower emissions reductions and removals than option 1, but still enough to achieve EB2. Given the uncertainty in the estimated surplus, this option also comes with higher risk that the surplus will persist into the EB3 period. The price floor mitigates this risk somewhat. It only allows supply to enter at a price expected to incentivise decarbonisation. Flat distribution of volumes and keeping 2026–27 volumes unchanged further mitigate the surplus risk.
Support the proper functioning of the NZ ETS	<b>0</b> Option 1 has a higher risk than option 2 of constraining unit supply such that the draw down in the stockpile exceeds the estimated surplus. This may impede the ability of participants to efficiently manage their current and future surrender obligations and generate greater price volatility, with negative flow-on impacts on emissions reduction investments.	+ Less risk of overly constraining unit supply compared with option 1, with correspondingly lower risk of excessive price volatility. See comment below on predictability and certainty.

#### Table 4: Assessment of options

Criterion	Option 1: Status quo auction volumes	Option 2: Commission-recommended auction volumes
	See comment below on predictability and certainty.	
Support for consistency of NZU prices with the level and trajectory of international emissions prices*	0	0
Management of overall costs to the economy and households*	0	0
Overall assessment	0	0

\* These assessment criteria only apply to price controls. Because price controls are identical for both options, both are evaluated as the same.

*Comment on predictability and certainty:* The purpose of this criterion is (in part) to allow 'participants to form expectations about supply and demand' to inform future investment decisions. Doing so requires predictable expectations about future auction volumes while recognising that expectations should change over time in light of new information. In this context, new information could include improvements in methodological approach.

Option 2 incorporates significant changes in methodology that may not have been expected by market participants. This consultation supports regulatory predictability by seeking feedback on these changes and the other relevant factors so that this can be incorporated into the Government's final assessment of decisions

#### Key for assessing options against the status quo

- ++ much better than the status quo
- + better than the status quo
- **0** about the same as the status quo
- worse than the status quo
- -- much worse than the status quo

Quest	Questions			
9	Which is your preferred option?			
10	What benefits or improvements could result from each option?			
11	What are the challenges or risks of these options?			
12	Do you prefer another option not outlined here? Please describe what it would involve.			

# **Questions on detailed methodology**

### NZ ETS cap for EB2

In the second emissions reduction plan (ERP2), the Government proposed to align the New Zealand Emissions Trading Scheme (NZ ETS) cap with the projected emissions from NZ ETS sectors under ERP2. Choosing NZ ETS settings aligned with ERP2 supports market confidence in the NZ ETS. It specifically proposed to allocate 91 Mt CO<sub>2</sub>e of the second emissions budget (EB2) to NZ ETS sectors, and committed to consulting on this allocation as part of the 2025 NZ ETS settings process.<sup>16</sup>

The Climate Change Commission (the Commission) has refined this proposed figure slightly, as it uses a more granular breakdown of emissions than that used to develop the cap proposed through ERP2. The Commission's more detailed methodology applied to the cap proposed through ERP2 results in an EB2 cap of 89.4 Mt  $CO_2e$ .<sup>17</sup>

This cap could be adjusted in the future to incorporate methodological or technical changes. These changes would not change the level of ambition. We do not propose to adjust the cap if projections change in the future.

We would like to hear your views on using ERP2 projections to determine the NZ ETS cap for EB2.

Quest	Question			
13	Do you have any feedback on the proposal to align the NZ ETS cap for EB2 with ERP2 projections? Do you have any suggestions for a more appropriate method for determining the NZ ETS cap for EB2?			

### **Provisional NZ ETS cap for EB3**

ERP2's 'new measures projections' estimate net emissions of 249.2 Mt  $CO_2e$  in the third emissions budget (EB3). The EB3 limit is 240 Mt  $CO_2e$ . This means additional abatement of 9.2 Mt  $CO_2e$  is required across 2031–35 to meet EB3.<sup>18</sup>

Unit limit decisions from 2026 onwards will start to include the EB3 period, and so we will need to make an assumption on how to allocate this additional abatement. However, it will also be relevant to current decisions, as it impacts on hedging volumes in the surplus estimate. (For more detail, see Changes to surplus methodology.)

<sup>&</sup>lt;sup>16</sup> Ministry for the Environment. 2024. Our journey towards net zero: New Zealand's second emissions reduction plan 2026–30. Wellington: Ministry for the Environment, p25.

<sup>&</sup>lt;sup>17</sup> For more detail on the Commission's methodology see: Climate Change Commission. 2025. Advice on NZ ETS Unit Limits and Price Control Settings for 2026–2030. Technical annex 1: Unit limit settings. Wellington: Climate Change Commission, p 5.

<sup>&</sup>lt;sup>18</sup> We expect additional reduction initiatives to be developed for ERP3 to make up this gap.

<sup>32</sup> Annual updates to NZ ETS limits and price control settings for units 2025: Consultation document

We propose that ETS-covered sectors account for all the increased reductions necessary to accord with EB3. This would result in a provisional NZ ETS cap for EB3 of 41 Mt  $CO_2e$ . This figure is similar to the 38 Mt  $CO_2e$  EB3 NZ ETS cap that was provided by the Commission's demonstration pathway.

This approach reflects the Government's direction that the NZ ETS is the main tool to reduce net emissions and will also support market confidence in the NZ ETS. It also aligns with the Commission's approach to calculating hedging volumes related to EB3, as part of estimating the surplus in its NZ ETS settings advice this year.

Table 5 shows the proposed provisional NZ ETS cap for EB3 across 2031–35.

### Table 5: Proposed provisional allocation of EB3 volume across ETS and non-ETS covered sectors, 2031–35

	Year (million NZUs) Total					
	2031	2032	2033	2034	2035	2031–35
NZ ETS-covered sectors	9.8	9.1	8.3	7.2	6.3	40.7
Non-NZ ETS covered sectors	41.8	41.0	39.9	38.9	37.8	199.3

#### Question

14 Do you have any feedback on the proposed provisional allocation of EB3 volume between ETS and non-ETS covered sectors?

### **Changes to surplus methodology**

To set appropriate unit limits, we need to estimate how many of the units currently in the NZ ETS market are 'surplus', and how to address them over time. Surplus units are units in private accounts that are not held for future surrender or other compliance purposes, and therefore may be sold freely into the market. Determining how many units are surplus is important as, by enabling additional emissions, surplus units create the risk that emissions budgets will not be met.

However, the size of the surplus stockpile is inherently uncertain. Estimating the surplus requires making assumptions about future behaviour of market participants such as unit holders, emitters and foresters. This uncertainty can be partially managed by the adaptive management approach the Government takes to setting unit limits.

This year, as well as including the latest data, the Commission has made substantial changes to its surplus estimate methodology. Some changes came from its consideration of a 2024 Ernst & Young (EY) report (commissioned by the Ministry for the Environment – see step 5a of the seven steps methodology), which reviewed the methodology.<sup>19</sup> Other changes resulted from the Commission's own analysis.

<sup>&</sup>lt;sup>19</sup> Ernst & Young. 2024. New Zealand's Emissions Trading Scheme (ETS) NZU Surplus Advice: Final report. Prepared for the Ministry for the Environment by EY.

The Commission's changes this year include incorporating two additional categories of units into its estimate of the surplus:

- units held by emitters for emissions that have already occurred (holding volumes)
- post-1989 forestry units relating to the fourth mandatory emissions return period (MERP4, 2023–25)<sup>20</sup> that may be carried over into EB2 and contribute to the surplus.

Other material changes include:

- adjusting the base year of estimates of units held for hedging to use the volume forecast for 2030, instead of the most recent calendar year
- reducing the estimate of hedging by the liquid fossil fuels sector
- adjusting assumptions about the age at which post-1989 forests are harvested, and the proportion of potential maximum 'low-risk carbon' foresters can achieve in managing their forest areas.

Based on our preliminary assessment, we consider these methodological changes are conceptually valid and likely to improve the accuracy of the surplus estimate. They have been developed using quantitative evidence (where available) and refined through industry engagement conducted by the Commission and EY.

However, the changes have large impacts on the surplus estimate. Even relatively small refinements to some of them could have a material impact on the number of units that are assessed to align with emissions reduction targets.

The inclusion of holding volumes alone reduces the estimated surplus by 34 million units. The Commission has recommended that we consult on this change in particular, and whether holding volume may partially overlap with units held for hedging.

Table 6 sets out the impact on the surplus estimate of each individual methodological change. We would like to hear further feedback to ensure the assumptions are accurate, and based on the best information available to us.

Category	Approximate impact on surplus (millions)		
Inclusion of non-surplus holding volumes	-34 m		
Units estimated to become surplus from MERP4	+10 m		
Adjusting the base year of the price hedge to 2030	+8 m		
Updated assumptions about harvest ages of post-1989 forestry	+7 m		
Updated assumption about liquid fossil fuel hedging	+4 m		
Updated assumption of pre-1990 transfer rate	-2 m		
Approximate overall impact	<b>-7 m</b> (±1 m)		

Table 6:	Approximate impact of methodological changes on the size of the surplus stockpile

<sup>&</sup>lt;sup>20</sup> Mandatory emissions return periods (MERPs) form the framework for submitting regular reporting about the carbon in post-1989 forest land. Owners of post-1989 forest land must submit a return after the end of each MERP, but may also submit provisional returns within MERPs. This means that many allocations relating to post-1989 forestry only occur after the end of each MERP, even though the removals occurred in an earlier period.

<sup>34</sup> Annual updates to NZ ETS limits and price control settings for units 2025: Consultation document

# Key aspects of the surplus estimation methodology for feedback

We detail these changes at step 5a of the seven steps methodology in appendix 1.

#### We would like your feedback on the following areas.

#### Units held for surrender for past emissions (holding volume)

This year, the Commission has incorporated a new category of non-surplus units, referred to as 'holding volume'. The report distinguishes between units held for future emissions (hedging volume) and units held for surrender for emissions that have already occurred (holding volume).

Emitters will accumulate units over the year for emissions that have occurred, increasing to a peak in May when units are due to be surrendered. Following the surrender period in May, the holding volume falls to a minimum, before growing again.

Including this new non-surplus category has the effect of reducing the central surplus estimate by about 34 million units.

#### Assumption that holding and hedging volumes are separate

The EY report recommended accounting for the holding volume separately from the hedging volume when estimating the unit surplus. This is the approach the Commission has taken.

However, it may be that some emitters use this holding volume as a partial hedge for future price risk. If this behaviour was prevalent, it could mean we are double-counting the number of units held by firms to manage future obligations. This would result in an underestimate of the surplus size.

#### We would like to hear from you on:

- whether this assumption reflects participant behaviour
- whether the estimated total scale is appropriate.

If your response is no to either or both points above, what adjustments to the approach may be needed?

#### Units held for hedging by emitters

It is common for NZ ETS participants to hold NZUs to cover a proportion of their emissions compliance obligations over a certain period in advance (hedging). Hedging involves emitters pre-purchasing NZUs when they fix prices with customers or suppliers, to manage their exposure to NZU forward price risk.

The estimate of units held in this way has reduced from 28.3 million to 17.4 million units. This is mainly due to two adjustments to the methodology:

- an adjusted base year of the estimate of units held for hedging using the volume forecast for 2030, instead of the volume from the most recently completed calendar year (2024)
- a reduced estimate of hedging by the liquid fossil fuels sector, as EY recommend in its report.

#### Estimating hedging requirements for 2030, rather than the current year

The Commission has changed the base year for its hedging estimate. This is to account for the fact that, as emissions reduce, the required units for hedging will also reduce. It means that some of the units currently held for hedging will become surplus by 2030, unless we factor in future changes to hedging volumes now. Factoring in those changes aligns with the Government's target of reducing the surplus to zero by 2030.

Taking the hedging estimate at 2030, rather than the most recent year (ie, 2024), has the effect of increasing the surplus estimate by about 8 million units. This reflects the additional units that may become surplus over this period, as hedging requirements decrease.

- To estimate the 2030 forward hedging volumes, an assumption has to be made about the NZ ETS emissions cap over EB3.
  - We discuss this issue and seek your views on this under Provisional NZ ETS cap for EB3.
- We would like to hear from you about the proposal to take the hedging estimate at 2030, rather than the current calendar year.

#### Reduction in assumptions about liquid fossil fuel hedging requirements

The EY report advised on lower hedging volumes for the liquid fossil fuel sector. The Commission tested this information through its targeted engagement with participants, and has revised its assumption about liquid fossil fuel accordingly. Other hedging assumptions are unchanged.

This assumption has the effect of increasing the surplus estimate by about 4 million units. This reflects that liquid fossil fuel participants are holding fewer units for hedging than previously assumed.

#### **Surplus units from MERP4**

This year the Commission identified a need to anticipate the impact of forestry units expected to be allocated after MERP4 ends. This will help avoid an unexpected surplus increase in 2027 after final unit allocations are completed for MERP4 (2023–25).

A proportion of the post-1989 forestry units earned over MERP4 will only be allocated into the market after participants submit their end-of-MERP final returns in June 2026. This means that the removals will have occurred during the EB1 period, but the NZUs issued for them could allow emissions during the EB2 period.

The Commission has estimated that, of the forecast post-1989 forestry units still to be issued up to the end of MERP4, 10 million are likely to add to the surplus. This has been estimated by considering the modelled low-risk carbon units still to be allocated, and comparing this volume with the projected demand in the NZ ETS, above the net emissions cap over 2023–25 (MERP4).

We would like to hear your views on including these new surplus units, and the approach to estimating them.

# Updated assumptions about units held for post-1989 harvest obligations

Owners of forests planted after 1989 receive NZUs for the carbon stored in their forests. However, if the forest is harvested and not replanted, they must surrender a large proportion of these units back to the Government. This means that forestry participants need to hold many units in advance of harvesting their forests. Estimates of the number of units held for future liabilities are based on a model of forestry allocations and surrenders developed by the Commission.<sup>21</sup> This model is underpinned by several inputs and assumptions, such as the rate of sequestration and the proportion of permanent forests that are harvested annually.

This year, the Commission has updated two sets of assumptions, relating to:

- the distribution of ages at which post-1989 forests are harvested
- the low-risk carbon level.<sup>22</sup>

Together, these updated assumptions have the effect of increasing the surplus estimate by about 7 million units.

#### Updated distribution of harvest age for post-1989 forests

A key assumption affecting the estimated volume of units held for future harvest liability is the rotation age of post-1989 forests (ie, the age at which forests are harvested). This year, the Commission has used a weighted average of harvest age by area in its modelling of units held for harvest. This better reflects the spread of harvest age.

This change shifts the distribution of harvest age lower than previously assumed. It has the effect of lowering the estimate of units held for future harvest liabilities, and increasing the size of the surplus. This is because, all else equal, a younger harvest age will require fewer units to be held, as fewer NZUs have been allocated for the forest.

#### Updated assumptions about low-risk carbon units

The carbon stock of forests does not return to zero immediately on harvest, due to residual carbon stored in roots underground. Some units earned by production forests on their first rotation can be considered low risk as they will never have to be surrendered if the forest is replanted. Additional units may also be considered low risk if a forester can manage liabilities across a portfolio of forests of different ages (effectively smoothing their harvest liabilities).

This year, the Commission has made a minor reduction in its assumptions about the proportion of low-risk units that foresters can achieve. This has the effect of increasing the number of units foresters need to hold for future liabilities and reducing the size of the surplus.

To support these updated assumptions, the Commission analysed the range of possible levels of low-risk units available to owners of post-1989 forestry, identifying the minimum and theoretical maximum low-risk units that could be achieved.

It then compared these against a breakdown of NZ ETS forestry by forest estate size, to derive the final assumptions. This is because foresters' ability to obtain low-risk units depends on the size of their forestry portfolio. For example, large forest estates are more likely to be made up of diverse portfolios of multiple age classes, allowing increased low-risk units.

<sup>&</sup>lt;sup>21</sup> For a copy of the Commission's 2024 forestry model, go to its website: ETS Forestry Model version 2.0.

<sup>&</sup>lt;sup>22</sup> Low-risk carbon (or 'safe' carbon) refers to units earned by a forest that are considered low risk to sell, as they will likely never have to be surrendered if the forest is replanted due to carbon stored in roots that remain post-harvest.

Ques	tions
15	Do you agree with the changes to the way the surplus stockpile is estimated? Do you have any feedback on the new and updated assumptions underlying the estimate (eg, the proposal to take the hedge estimate at 2030)?
16	Do you consider the updated assumptions about hedging and holding volumes reflect participant behaviour? Do you think the estimated total scale is appropriate? If not, what adjustments to the approach may be needed?
17	Do you consider the updated assumptions about post-1989 harvest liabilities and units liable to become surplus from MERP4 are based on the best available data and evidence? Is there additional information that could improve our confidence in these estimates?

### **Unsold auction volumes**

When setting unit limits, all upcoming auctions are assumed to clear. When auctions do not fully clear in a calendar year, this means less supply has entered the market than expected, which reduces future estimates of the size of the surplus. A smaller estimated surplus means more units can be made available for future auctions while remaining aligned with the NZ ETS cap.

This year the Commission has indicated that its recommended unit limits are 7.1 million units higher because 7.1 million fewer units were sold through auctions in 2024 than forecast.

Units not selling at auction provides a signal that the market may be adequately supplied without the unsold units. This raises a question about how this information should be incorporated into the assessment of the appropriate unit limits for the future regulatory period. We are interested in your views on how the auction non-clearance should be factored into the NZ ETS settings decisions.

Question		
18	How should unsold auction units be considered as part of the Government's NZ ETS settings decisions?	

# Further feedback on methodology for calculating unit limits

We have focused our discussion of the seven steps methodology on the overall question on appropriate unit settings. We also addressed specific major decisions around surplus methodology and unsold auction volumes.

#### However, we also invite any other feedback on the approach taken for any of the seven steps.

To enable this, we have provided further detail on each of the seven steps the Commission took to arrive at its recommended unit settings as shown in appendix 1.

Questions			
19	Do you have any additional feedback on the calculations made for any of the steps in the seven steps methodology?		
20	Do you have any evidence or information to support a different approach?		

# **Consultation questions**

The questions below are also included under the relevant sections throughout the document.

Ques	tions
1	What do you think are the key drivers behind recent market price dynamics?
2	How do you think recent price developments should factor into the Government's thinking about unit settings and price controls?
3	What is your preferred approach for distributing auction volumes for option 2?
4	Do you have any feedback on the proposed auction price floor?
5	Do you have any feedback on the proposed cost containment reserve prices or volumes?
6	Do you think the stockpile will pose a risk to achieving the third emissions budget in the way described here?
7	Do you agree with our impact analysis? Are there any further impacts to consider that we have not captured in our analysis?
8	What are your key concerns about the potential impacts of each option on Māori communities?
9	Which is your preferred option?
10	What benefits or improvements could result from each option?
11	What are the challenges or risks of these options?
12	Do you prefer another option not outlined here? Please describe what it would involve.
13	Do you have any feedback on the proposal to align the NZ ETS cap for EB2 with ERP2 projections? Do you have any suggestions for a more appropriate method for determining the NZ ETS cap for EB2?
14	Do you have any feedback on the proposed provisional allocation of EB3 volume between ETS and non-ETS covered sectors?
15	Do you agree with the changes to the way the surplus stockpile is estimated? Do you have any feedback on the new and updated assumptions underlying the estimate (eg, the proposal to take the hedge estimate at 2030)?
16	Do you consider the updated assumptions about hedging and holding volumes reflect participant behaviour? Do you think the estimated total scale is appropriate? If not, what adjustments to the approach may be needed?
17	Do you consider the updated assumptions about post-1989 harvest liabilities and units liable to become surplus from MERP4 are based on the best available data and evidence? Is there additional information that could improve our confidence in these estimates?
18	How should unsold auction units be considered as part of the Government's NZ ETS settings decisions?
19	Do you have any additional feedback on the calculations made for any of the steps in the seven steps methodology?
20	Do you have any evidence or information to support a different approach?

## How to have your say

The Government welcomes your feedback on the issues described in this consultation document. The questions throughout the document are summarised in the Consultation question section.

They are a guide only and all comments are welcome. You do not have to answer all the questions.

To ensure your point of view is clearly understood, you should explain your rationale and provide supporting evidence where appropriate.

### Timeframes

This consultation opens on 28 May 2025 and closes at 11.59 pm on 29 June 2025.

When the consultation period has ended, we will develop recommendations on changes to the Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020.

### How to provide feedback

There are two ways you can send your feedback:

- via Citizen Space, our consultation hub, available at https://consult.environment.govt.nz/climate/nz-ets-unit-settings-and-regulatory-updates-2025
- by writing your own submission.

If you want to send your own written submission, you can include this as an uploaded file in Citizen Space.

We request that you do not email or post submissions as this makes analysis more difficult. However, if you need to post a written submission, please send it to: NZ ETS settings consultation, Ministry for the Environment, PO Box 10362, Wellington 6143 and include:

- the title of the consultation
- your name or organisation
- your postal address
- your telephone number
- your email address.

If you are emailing your submission, send it to etsconsultation@mfe.govt.nz as a:

- PDF
- Microsoft Word document (2003 or later version).

### For more information

Please send any queries to:

Email: etsconsultation@mfe.govt.nz

Postal: NZ ETS annual settings updates, Ministry for the Environment, PO Box 10362, Wellington 6143

### **Publishing and releasing submissions**

All or part of any written comments (including names of submitters) may be published on the Ministry for the Environment's website, environment.govt.nz. Unless you clearly specify otherwise in your submission, the Ministry will consider that you have consented to website posting of both your submission and your name.

Contents of submissions may be released to the public under the Official Information Act 1982 following requests to the Ministry for the Environment (including via email). Please advise if you have any objection to the release of any information contained in a submission and, in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. We will take into account all such objections when responding to requests for copies of, and information on, submissions to this document under the Official Information Act.

The Privacy Act 2020 applies certain principles about the collection, use and disclosure of information about individuals by various agencies, including the Ministry for the Environment. It governs access by individuals to information about themselves held by agencies. Any personal information you supply to the Ministry in the course of making a submission will be used by the Ministry only in relation to the matters covered by this document. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry may publish.

# Appendix 1: Seven steps methodology

The seven steps methodology calculates theoretical maximum auction volumes within the New Zealand Emissions Trading Scheme (NZ ETS) that accord with emissions reduction targets. This yields the auction volumes in option 2.

The Climate Change Commission (the Commission) has published detailed technical materials about the methodology to support this year's settings decisions (see the Commission's website<sup>23</sup>). Its reports are as follows.

- Advice on NZ ETS unit limits and price control settings for 2026–2030: Part 3: Te herenga utu – Unit limits. This is a detailed discussion of the Commission's analysis using the seven steps, and its implications for this year's advice on unit limits.
- **Technical annex 1: Unit limit settings:** This gives further information on the data, methodology and assumptions the Commission used to reach its final recommendations for unit limit settings. The same analysis underpins this consultation document.
- Supporting spreadsheet: 2025 NZ ETS settings advice: This presents the data, analysis and calculations that informed the Commission's advice on unit limits.

This appendix does not attempt to duplicate this technical material. Instead, it gives a summary of the analysis and options relevant to policy decisions.

### **Step 1: Align with emissions reduction targets**

This first step sets out how units should align with Aotearoa New Zealand's emissions reduction targets (including emissions budgets, the Nationally Determined Contributions (NDCs) and the 2050 target).

Adjustments from 2024 settings are required both to account for methodological changes made in the 2024 New Zealand's Greenhouse Gas Inventory (GHG inventory), and to align with the latest emissions projections as outlined in ERP2.

Methodological changes to the GHG inventory are refinements to how emissions are calculated, to reflect better data and information. They are not actions that have reduced emissions. Aligning with these changes keeps the NZ ETS in line with our international reporting and actual emissions levels.

Additionally, last year's second emissions reduction plan (ERP2) includes new emissions projections. These incorporate ERP2 policy decisions to show expected emissions over the second emissions budget (EB2) and third emissions budget (EB3) periods. This update adjusts unit limits in line with the Government's plan for achieving EB2.

Table A1.1 shows the projected unit limits following this step.

<sup>&</sup>lt;sup>23</sup> Climate Change Commission. NZ ETS unit limits and price control settings for 2026–2030. Retrieved 18 May 2025.

#### Table A1.1: Update for step 1 in the seven steps methodology, 2026–30

	Year (million NZUs)				
	2026	2026	2028	2029	2030
Align with emissions budget	65.9	63.7	60.4	57.9	55.2

### Step 2: Allocate the budgets to NZ ETS and non-NZ ETS sectors

This step allocates emissions budgets between emissions and removals that the NZ ETS covers, and those that it does not. It recognises that non-NZ ETS emissions and removals will account for a portion of the emissions budget.

For previous settings decisions, the budgets were allocated to NZ ETS and non-NZ ETS sectors based on sector sub-targets. However, we propose to base allocations on projections in ERP2 to reflect the Government's plan for achieving EB2.

This approach means that if non-NZ ETS emissions (mainly from agriculture) are different from projections, the level of reductions required by NZ ETS sectors does not change. For example, if non-NZ ETS emissions increase compared with projections, further reductions would not be expected from NZ ETS sectors to 'make up' for that increase. Conversely, if emissions from non-NZ ETS sectors decrease, NZ ETS sectors retain the same level of effort as before. This increases predictability and certainty for NZ ETS participants, which is particularly important for making long-term investment decisions on reducing and removing emissions.

#### The following sources of emissions and removals are currently outside the NZ ETS.<sup>24</sup>

- Agriculture. Biogenic methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O) and carbon dioxide (CO<sub>2</sub>) from fertiliser use are outside the NZ ETS.
- Waste. All waste emissions except CH<sub>4</sub> from municipal landfills are outside the NZ ETS.
- Synthetic greenhouse gases. Some sources of emissions associated with certain goods and vehicles are priced through the Synthetic Greenhouse Gas Levy, instead of facing NZ ETS unit emissions surrender obligations. Some additional, very small sources (such as medical uses) are not covered by either pricing mechanism.
- Industrial processes and product use. Several small emissions sources in the industrial processes and product use category of the GHG inventory are outside the NZ ETS, including:
  - non-energy products from fuels and solvent use
  - N<sub>2</sub>O from medical applications
  - other uses of carbonate.
- Forestry. Sources of removals outside the NZ ETS comprise the subset of post-1989 forest land that is not registered in the NZ ETS. The Commission has assumed that all currently registered forest land will remain registered, and that all eligible post-1989 forests planted

<sup>&</sup>lt;sup>24</sup> For more information, see: Climate Change Commission. 2024. Advice on NZ ETS Unit Limits and Price Control Settings for 2025–2029: Technical Annex 1: Unit limit settings. Wellington: Climate Change Commission, from step 2, p 4.

<sup>44</sup> Annual updates to NZ ETS limits and price control settings for units 2025: Consultation document

from 2019 will register or have already done so. This equates to allocating 100 per cent of post-1989 forestry (both  $CO_2$  removals from forest growth, and emissions from deforestation) to the NZ ETS sectors.

ERP2 sets out the Government's proposal to allocate the emissions budget volume between sectors in and outside the NZ ETS. The plan proposes apportioning 89.4 Mt  $CO_2e$  to the NZ ETS scheme for the EB2 period (2026–30). The Commission also recommends this approach.

Table A1.2 shows the updated allocated volume of emissions budgets to sectors in and outside the NZ ETS scheme.

	Year (million NZUs)					
	2026	2027	2028	2029	2030	Total
Share of emissions budget allocated to non-NZ ETS sectors	42.7	42.9	42.8	42.8	42.6	213.7
Share of emissions budget allocated to NZ ETS sectors	23.2	20.8	17.6	15.1	12.6	89.4

Table A1.2:	Update for step 2 in the seven steps methodology, 2026–30
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Note: Totals may not add due to rounding

### **Step 3: Make technical adjustments**

Emissions reported into the NZ ETS for the sectors it covers are intended to align with emissions reported in the GHG inventory, as New Zealand uses inventory data to report progress towards emissions reduction targets. Any accounting misalignment could mean too many, or too few, emissions units are supplied into the market, risking over- or under-achieving those targets.

The 2024 settings included a technical adjustment to account for an observed discrepancy between the GHG inventory and the NZ ETS of about 3 per cent in the total liquid fossil fuels and stationary energy emissions.

On further investigation, the Commission has determined that this discrepancy no longer exists, and it is no longer necessary to carry this adjustment through to future years. This is reflected in this year's technical adjustment. We agree with the Commission's view.

This adjustment increases the volume of units available over the NZ ETS settings period by 3.4 million.

The Commission has also identified a discrepancy between waste emissions in the GHG inventory and NZ ETS reported emissions. This issue is believed to be connected to an error in the calculation of the unique emissions factors (UEFs) used for several waste disposal facilities. We expect it to be resolved before it impacts on any of the years covered by this settings decision, so no technical adjustment is required.

Table A1.3 outlines the update for this step.<sup>25</sup>

<sup>&</sup>lt;sup>25</sup> For more information, see: Climate Change Commission. 2024. Advice on NZ ETS Unit Limits and Price Control Settings for 2025–2029: Technical Annex 1: Unit limit settings. Wellington: Climate Change Commission, from p 6.

#### Table A1.3: Update for step 3 in the seven steps methodology, 2026–30

	Year (million NZUs) 2026 2027 2028 2029 2020				
Technical adjustment	0	0	0	0	0

# **Step 4: Account for industrial allocation volumes**

The Government allocates units to businesses undertaking industrial activities that are prescribed as 'emissions-intensive' and 'trade-exposed'. To ensure alignment with emissions budgets, these allocations reduce the number of units that the Government can sell at auction.

The Commission has forecast industrial allocation volumes for the coming five years. This is based on the existing allocative baselines and production levels of businesses in eligible activities.

The Commission has forecast industrial allocation to be 23.2 million units over the period 2026–30, which is about 25 per cent of the total emissions volume allocated to NZ ETS sectors. This is 4.4 million units lower over the next five years than forecast in 2024 settings. Table A1.4 shows the change in volume by source.

	Millions of NZUs
2024 forecast of industrial allocation for 2026–30 <sup>26</sup>	27.6
Using reported data for 2023 allocations to forecast production levels	-1.60
Updated assumptions about Methanex production levels and closure	-0.82
Updated assumptions about pulp and paper mill closures	-1.47
Updated Electricity Contracts Allocation Factor (ECAF) for New Zealand Aluminium Smelter <sup>27</sup>	+0.58
Updated allocative baseline estimates	-0.19
Additional technical changes since the 2025 March Baseline Update forecast	-0.85
Updated forecast of industrial allocation for 2026–30	23.2

#### Table A1.4: Drivers of change in forecast industrial allocation volumes for 2026–30 settings period

Source: Ministry for the Environment analysis of Commission forecasts

This increases the number of units available by 4.4 million over the settings period. Table A1.5 outlines the update for this step.<sup>28</sup>

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<sup>&</sup>lt;sup>26</sup> This figure uses the 2026–29 forecasts used in the 2024 NZ ETS settings. The 2030 figure is from the Commission's 2024 'for visibility' forecasts.

<sup>&</sup>lt;sup>27</sup> As Cabinet had not yet made a decision on the ECAF, last year's NZ ETS settings assumed a midpoint between the two ECAFs being considered. The forecast of the smelter's allocation has now increased as the higher ECAF option was chosen.

<sup>&</sup>lt;sup>28</sup> For more information, see: Climate Change Commission. 2024. Advice on NZ ETS Unit Limits and Price Control Settings for 2025–2029: Technical Annex 1: Unit limit settings. Wellington: Climate Change Commission, from p 12.

#### Table A1.5: Update for step 4 in the seven steps methodology, 2026–30

	Year (million NZUs)				
	2026	2027	2028	2029	2030
Industrial allocation	-5.1	-5.1	-4.6	-4.5	-4.0

# Step 5a: Set the reduction volume to address the unit surplus

This step calculates the reduction of surplus units. A large quantity of units is banked in private accounts. These units provide liquidity to the market and help to reduce price volatility. However, the current number of banked units presents risks to achieving the budgets.

Some of these banked NZUs are held to meet future surrender liabilities or for other reasons. Others are estimated to be held for investment purposes, and will more readily be sold when market price expectations change. The latter are considered 'surplus' to the needs of emitters. Emitters' use of these surplus NZUs to meet increased NZ ETS obligations could make it more challenging to meet emissions budgets. To reduce this risk, the surplus must be managed.

Units move from the Government into participants' accounts as the units are:

- sold by auction
- transferred for industrial allocation
- transferred for removal activities such as forestry.

Units move **out of** accounts as they are surrendered to the Government by participants to meet their obligations.

Step 5a of the seven steps methodology is to enable a managed reduction of the surplus. This step involves setting an auction limit to reduce the risk of emissions being allowed to exceed emissions budgets. With this limit, participants must use some NZUs from the surplus to meet their surrender obligations.

In 2024, the Government made adjustments to the number of units available for auction, to reduce the surplus to zero by 2030. This year's settings remain in line with this goal.

# The Commission's estimate of the surplus volume has decreased

The Commission has updated its central surplus estimate to 50.2 million units, within a range of 28 to 68 million units. Last year the central estimate used to inform final decisions was 67.9 million units, within a range of 51 to 84 million units.<sup>29</sup> This equates to a 17.7 million unit reduction in the central surplus estimate.

<sup>&</sup>lt;sup>29</sup> The Ministry for the Environment updated this to 67.3 million units for the calculations used in the final policy decisions. The minor difference was due to using the total number of units held in private accounts from the December quarter rather than September quarter, and minor changes to pre-1990 forestry units held long term and the units held for hedging estimates.

The lower surplus estimate means that the surplus reduction volume factored into previous years' unit limit settings is no longer appropriate. When factored into the overall unit limit calculations, this lower surplus contributes to about 10 million additional units being available to auction over the 2026–30 period. Choices about how to manage this additional volume are discussed under Key options for 2025 settings.

#### Explaining the drivers of this surplus reduction

We explain this 17.7 million unit reduction in the surplus estimate as follows.

- Auction units went unsold in 2024, meaning fewer units than expected entered the market (-7.1 million units)
- Several changes were made to the surplus estimate methodology (-7 million units (± 1 million units)).
- Market-driven surplus reduced in 2024, due to emitters using surplus units for surrender obligations (-2.8 million units (± 1 million units)).

It is difficult to precisely quantify the impact of the methodological changes on the surplus estimate. However, we have attempted to do so to illustrate their relative impact. We did this by comparing estimates of the December 2024 surplus stockpile using the Commission's 2024 and 2025 methodologies.

Figure A1.1 illustrates the impacts of each of the key methodological changes on the change in surplus estimate. These figures are indicative only.





Source: Ministry for the Environment analysis

\*LFF = Liquid fossil fuels, p90 = pre-1990 forestry, p89 = post-1989 forestry, MERP4 = fourth mandatory emissions reporting period

Our approach differs from the Commission's approach to attributing the source of the reduction in surplus. The Commission's approach assumes the entire projected surplus reduction in 2024 occurred, and the remaining reduction is due to methodological changes.

Using the Commission's approach, market-driven reductions explain 7.7 million units of the change and 7.1 million units are due to unsold auctions. The remaining 2.9 million units are due to methodological and data changes.

### **Unsold auction volumes**

When setting unit limits, we assume all upcoming auctions will clear. This is reflected in our estimate of the surplus, which assumes the auctioned units will be available for use by NZ ETS participants to meet their NZ ETS obligations (rather than using units from the surplus).

If an auction does not clear and the units are not sold, as happened in 2024, this decreases future estimates of the size of the surplus. This is because the additional source of supply (from auction) did not occur as expected, and so participants are assumed to use some surplus units to meet their obligations.

The smaller surplus estimate means more units can be made available for future auctions, while still achieving our goal of drawing down the surplus to zero by 2030, and keeping the NZ ETS cap stable.

### Changes to estimating the surplus volume

In 2024, the Ministry for the Environment commissioned Ernst & Young (EY) to assess the surplus calculation methodology and analysis of the NZ ETS stockpile. The purpose was to support the continuous improvement of our understanding of the stockpile. EY found the surplus estimate methodology was robust and fit for purpose, but recommended some improvements for future estimates.<sup>30</sup> The changes to the methodology in this year's estimate were driven by EY's recommendations, and additional analysis by the Commission.<sup>31</sup>

We discussed the substantive changes for consultation under Changes to surplus methodology.

We highlight the following changes here.

- Account for units held by emitters for emissions that have already occurred.
- Account for post-1989 forestry units relating to the fourth mandatory emissions return period (MERP4) that may become surplus in EB2.
- Change the date when the hedge estimate is made.

#### Include units held for emissions that have already occurred

This year, the Commission has included a new category of non-surplus units, referred to as 'holding volume'. These are units that are held for surrender for emissions that have already occurred. This differs from the existing 'hedging volume', which estimates units held in anticipation of future emissions. This inclusion was recommended by EY.

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<sup>&</sup>lt;sup>30</sup> Ernst & Young. 2024. New Zealand's Emissions Trading Scheme (ETS) NZU Surplus Advice: Final report. Prepared for the Ministry for the Environment by EY.

<sup>&</sup>lt;sup>31</sup> For a detailed discussion of these changes, see: Climate Change Commission. 2024. Advice on NZ ETS Unit Limits and Price Control Settings for 2025–2029: Technical Annex 1: Unit limit settings. Wellington: Climate Change Commission, from p 16.

We have considered EY's recommendation and the Commission's approach, and agree additional holding volume units should be excluded from the surplus.

Like the Commission's approach, our estimate assumes the holding volume will increase over the year, as emitters accumulate units for their obligations. This volume will continue to rise until the annual surrenders are due at the end of May, before falling to a minimum and then growing again.

Accounting for this 'holding volume' reduces the size of the central surplus estimate by 34.2 million units.

# Include forestry units for MERP4 (2023–25) that may become surplus in EB2

An emitter can use forestry units in a different budget period from that in which the removal those units represent took place. Such use would allow for higher net emissions in the budget period, putting meeting the budget at risk. These units can contribute to the surplus.

To quantify and manage this risk for EB2, the Commission has included an estimate of these units in this year's surplus estimate. We agree with the Commission, and have included these units when estimating the total unit surplus to be reduced by 2030.

Including these surplus post-1989 forestry units increases the size of our central surplus estimate by 10 million units.

#### Change the date when the hedge estimate is made

This year, the Commission has estimated the hedging volume for the target year of reducing the surplus (ie, 2030). This differs from previous years, when estimates were taken for the number of units held for hedging in the current year (ie, 2025). We agree with this approach.

This is based on the goal of reducing the stockpile, so that the surplus is zero in 2030. Thus, taking the hedging estimate at 2030 takes into account that, as emissions reduce, the units needed for hedging volume will also reduce.

The hedging category reflects that emitters need to hold a certain number of units to manage their obligations. However, as emitters decarbonise, some of these units will no longer be needed and will become surplus over time.

### **Step 5b: Adjust for discrepancies**

This step makes adjustments to address changes to unit limits that cannot be made in the year when the change occurs. These adjustments are needed due to limitations on changes to existing limit settings. This year, the Commission proposes applying a discrepancy adjustment to 2028–30 to account for changes across 2025–27.

This discrepancy adjustment would account for the volume changes that otherwise would have been implemented for the first two years of the settings period (ie, 2026 and 2027). This is because the Commission does not propose changing volumes for those years. The discrepancy adjustment would also account for differences between current regulations and updated estimates of unit requirements in 2025, which also cannot be changed.

The discrepancy adjustment for 2025–27 represents a 4.4 million increase in possible auction volume across the settings period. This reflects the differences in the NZ ETS emissions cap, industrial free allocation forecasts and removal of the technical adjustment. This volume would be proportionally allocated across auction volumes for 2028–30 in line with the emissions cap. Table A1.6 outlines the update for step 5b.

	Year (million NZUs)				
	2026	2027	2028	2029	2030
Discrepancy adjustment	0.3	0.3	-1.5	-1.5	-1.4

#### Table A1.6: Update for step 5b in the seven steps methodology, 2026–30

Note: Adjustments for 2026 and 2027 are already incorporated into regulations, and as such are also fixed.

### Step 6: Set the approved overseas unit limit

There are currently no overseas units approved for use in the NZ ETS. Therefore, the approved overseas unit limit is zero.

### Step 7: Calculate the base auction volumes

Table A1.7 sets out the calculation of the annual auction volumes, using the above updates and recommended option for step 5a for 2026–30. It reflects the Commission's recommendation to make no changes to settings for 2026 and 2027, and to distribute volumes evenly across 2028–30, instead of taking the default approach of declining in line with the emissions cap.

Table A1.7:	Calculation	of the base	auction volume	2026-30
	culculation			, 2020 30

		(n	Year nillion NZU	Js)	
Step	2026	2027	2028	2029	2030
Step 1: Align with emissions reduction targets	65.7	63.4	60.4	57.9	55.2
Step 2a: Allocate to non-NZ ETS sectors	42.7	42.9	42.8	42.8	42.6
Step 2b: Allocate to NZ ETS sectors	23.2	20.8	17.6	15.1	12.6
Step 3: Make technical adjustments	0.7	0.7	0.0	0.0	0.0
Step 4: Account for industrial allocation volumes	5.7	5.7	4.6	4.5	4.0
Step 5a: Set the reduction volume to address the unit surplus*	11.5	10.5	5.4	5.3	5.0
Step 5b: Adjust for discrepancies	0.3	0.3	-1.5	-1.5	-1.4
Step 6: Set the approved overseas unit limit	0	0	0	0	0
Step 7: Calculate the base auction volumes – flat distribution*	5.2	4.3	7.0	7.0	7.0

Note: \* After consultation, we will identify a preferred set of options. We will provide final numbers when seeking Cabinet approval.

Table A1.7 excludes adjustments for:

- abatement that was not expected when budgets were set (step 1)
- the possibility that the non-NZ ETS share of the budget will be exceeded.

Both adjustments would reduce auction volume.

# Appendix 2: Aligning criteria with mandatory considerations for NZ ETS settings

The Climate Change Response Act 2002 (CCRA) prescribes mandatory factors the Minister of Climate Change (the Minister) must consider when determining the New Zealand Emissions Trading Scheme (NZ ETS) settings. These factors can also justify settings that do not strictly accord with the emissions reduction targets.

The mandatory considerations are outlined in table A2.1, along with our rationale. Some have been used to derive criteria to compare proposed options with the status quo (table 1).

Relevant matter in section 30GC of the CCRA	Criteria that reflect this matter
The Minister must be satisfied that the limits and price control settings are in accordance with: (a) the emissions budget and the NDC (b) the 2050 target.	We used the criterion 'likelihood of incentivising (net) emissions reductions' (table 1) to assess whether the option increases or decreases the likelihood of meeting the budgets. This recognises a potential range of options that might align with the budgets, but with different risk levels.
Matters the Minister must consider	
Projected trends in greenhouse gas emissions, whether covered by the New Zealand Emissions Trading Scheme (NZ ETS) or not	We considered this when determining the unit limits as an input to emissions in and outside the NZ ETS (step 2).
The proper functioning of the NZ ETS	We considered this as the criterion 'Support for the proper functioning of the NZ ETS' (table 1).
International climate change obligations and contracts Aotearoa New Zealand may have for accessing offshore mitigation from other carbon markets	New Zealand has no current instruments or contracts with other jurisdictions to access emissions reductions in their carbon markets. Officials are currently focused on building capacity in the international carbon market to support options for possible international cooperation in the future.
The forecast availability and cost of ways to reduce emissions that may be needed for New Zealand to meet its targets	This is derived from the policies and measures in the second emissions reduction plan and is considered as part of steps 1 and 2 to calculate unit limits.
The recommendations by the Climate Change Commission (the Commission) under section 5ZOA of the CCRA	We included the Commission's recommendations in the options for consultation in this document.
Additional matters the Minister must consider in an	alysing price control settings
The impact of emissions prices on households and the economy	We consider this within the criterion 'Management of overall costs to the economy and households' (table 1).
The level and trajectory of international emissions prices (including price controls in linked markets)	We considered this in the criterion 'Support for consistency of NZU prices with the level and trajectory of international emissions prices' (table 1).
Inflation	All price control options have been adjusted for forecast inflation.
	Inflationary impacts of the NZU price are considered in the criterion 'Management of overall costs to the economy and households' (table 1).

#### Table A2.1: Considerations for determining unit limits and price control settings

# Appendix 3: Detailed impacts of options for New Zealand Emissions Trading Scheme (NZ ETS) settings

Table A3.1:	Estimated NZ ETS cost to households	2025 dollars and as	percentage of gross income)

			Но	usehold by in	come
Actual / projected NZU p	orice	Modelling scenario	Lowest (Decile 1/2)	Average	(Decile 9/10)
At current prices	\$50		240–280 (0.8%)	450 (0.4%)	640–780 (0.4%)
In 2030 at modelled price	\$83	Options 1 and 2 if stockpile liquidity is relatively high	340–400 (1.2%)	650 (0.5%)	920–1,120 (0.5%)
	\$90	Option 2 if 2025 auctions do not clear	370–440 (1.3%)	710 (0.6%)	1,010–1,240 (0.6%)
	\$114	Option 1 under moderate stockpile liquidity	470–550 (1.7%)	900 (0.7%)	1,270–1,560 (0.8%)
	\$124	Option 1 if 2025 auctions do not clear	500–590 (1.8%)	960 (0.8%)	1,360–1,670 (0.8%)

Source: Ministry for the Environment modelling

Note: The future estimated impacts on households have been scaled by the ratio of modelled gross NZ ETS emissions in 2030 to 2023 levels (the base year for the household impacts modelling). This is to proxy the reduction in household emissions footprints that is expected to occur over time.

#### Table A3.2: Estimated impacts of each option on different groups

This table compares the projected impacts of options 1 and 2 on the current NZU price and how they are expected to affect different NZ ETS stakeholders, households and the wider economy. Under both options, the NZU price is expected to rise compared to current prices. Option 1 is projected to result in a higher increase in price than option 2.

Affected group	Option 1: Status quo auction volumes	Option 2: Commission-recommended auction volumes
Landowners (eg, foresters and farmers), including Māori	Higher NZU prices can lead to greater returns for foresters. Higher returns on forestry land may incentivise afforestation. The long-term increase in availability of units through forestry will put downward pressure on future NZU prices. Increased cost to landowners of deforestation due to increased price.	The price increase under option 2 will still benefit foresters, but not to the same extent as option 1.
Emitting firms subject to NZ ETS obligations	<ul> <li>Higher NZU prices incentivise firms to transition to lower-emissions production and reduce gross emissions.</li> <li>Higher costs for firms to meet surrender obligations. This may be mitigated by the extent to which: <ul> <li>firms invest in transitioning to lower-emissions alternatives</li> <li>firms have hedged their forward obligations</li> <li>these additional costs can be passed on to households (see 'Households' row below).</li> </ul> </li> </ul>	A smaller price increase than under option 1 is less likely to incentivise firms to reduce gross emissions. The cost for firms to meet surrender obligations will still increase but will not be as high as under option 1. Lower additional costs to businesses mean they pass less cost on to households.
Other NZ ETS participants, including Māori businesses that rely on NZU earnings	Higher NZU prices would increase the financial value of stockpiled units, both those held for hedging, and the liquid stockpile.	A smaller price increase than under option 1 means a smaller increase in the value of stockpiled units.
Households, including Māori households and whānau (refer also to table A3.1 on previous page)	Under option 1, annual costs for lower-income households are projected to increase from today's price range of \$240–280 to \$340–590 by 2030. The variation depends on how much the stockpile decreases and whether auctions clear in 2025. Households may also be affected via the labour market. Businesses may adjust the type or number of jobs they offer in response to cost changes. Rising prices have a disproportionate impact. Low-income households, and single-adult households such as sole-parent families, bear the largest relative impacts.	Under option 2, households are expected to face similar costs and impacts as option 1, but to a lesser extent, due to the smaller increase in the price of NZUs. Under option 2, annual costs for lower-income households are projected to increase from today's range of \$240–280 to \$340–550 by 2030.

Affected group	Option 1: Status quo auction volumes	Option 2: Commission-recommended auction volumes
Wider economy	<ul> <li>Higher prices for household items cause a moderate reduction in disposable income for low-income households, which may impact on the wider economy.</li> <li>Forestry plays a large role in the wider Māori economy. The increase in value of NZUs now and in the future impacts on businesses' asset base and capacity as an employer.</li> <li>Relatively higher NZ ETS prices are likely to marginally increase inflationary pressures.</li> <li>However, we judge this highly unlikely to influence the trajectory of monetary policy.</li> </ul>	Option 2 will have similar impacts on the wider economy as option 1, but to a lesser extent, due to the smaller increase in the price of NZUs.