



Climate Change Commission Advice on NZ ETS Limit and Price Control Settings for Units

Date Submitted:	15 July 2022	Tracking #: BRF-1853	
Security Level	Policy and Privacy In-Confidence- Commercial	MfE Priority:	Urgent

	Action sought:	Response by:
Hon James SHAW, Minister of Climate Change	Review the Commissions advice on NZ ETS limit and price control settings for units. Meet with officials to discuss the Commission's advice on Monday Agree to release the Commission's advice as soon as possible	18 July 2022

Actions for Minister's Office Staff	Provide a copy of the Commission's report to Hemi Smiler, Director Return the signed briefing to MfE
Number of appendices and attachments: 2	1. Questions and answers to support release of Commission's report 2. Transition policies and programmes

Key contacts

Position	Name	Cell phone	1st contact
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Climate Change Commission Advice on NZ ETS Limit and Price Control Settings for Units

Key Messages



1. The Climate Change Commission (the Commission) has provided you with recommendations on updates to NZ ETS limit and price control settings for units (unit settings). The Commission's recommended settings differ very significantly from current settings and include much higher and wider auction price control settings for units
2. The advice is market sensitive. You are required to present a copy of the Commission's report to the House of Representatives, and we recommend this is done as early as possible and outside market hours. We prefer you communicate this tabling alongside decisions on industrial allocation policy and NZ ETS regulation updates on Thursday 21 July. The Commission must make the document publicly available as soon as practicable after it is tabled.
3. You are required to make recommendations on updates to NZ ETS unit settings, and for regulations to be updated in time to be in force by 1 January 2023. There is a requirement to consult on these updates, and that the Commission's advice is considered when making recommendations on updates. If you make recommendations about prescribing unit settings that differ from those from the Commission, you must prepare a report of the reasons for the differences and present this to the House.
4. There are significant timing pressures in delivering these updates in 2022. We are currently drafting a consultation document and Cabinet paper, due to you by 26 July.
5. To support you in the public release of the Commission's advice, Appendix one is back-pocket questions and answers, and Appendix two is a list of policies and measures helping reduce impacts of higher emission costs. Key points to be communicated include:
 - a. updates to unit settings are required to be made this year, as the regulations are required to be extended to include 2027.
 - b. updates to settings for the immediately following two years (2023 and 2024 in this case) can only occur in certain circumstances, such as setting emissions budgets and sale of the cost containment reserve. These circumstances are met this year.
 - c. consultation on updates to unit settings, including recommendations from the Commission is intended to occur during September.
 - d. the Commission is not a decision-making body, decisions on updates will be made by government.
 - e. updates to the cost containment reserve trigger price and auction reserve price may influence, but do not directly determine, auction clearing prices or market prices.

Recommendations

We recommend that you:

- a. **Note** the Climate Change Commission's advice on NZ ETS limit and price control settings for units is market sensitive
- b. **Agree** to meet with officials to discuss the Commission's advice and process for its release Yes / No ☒ Yes
- c. **Agree** to present the Commission's report to the House of Representatives outside market hours on 21 July Yes / No ☒ Yes
- d. **Note** the Commission will publish its report once you have presented it to the House
- e. **Note** stakeholder questions relating to the Commission's recommendations and analysis should be directed to the Commission for answer.

Signature

Hemi Smiler Director Climate Change Directorate	
Hon James SHAW, Minister of Climate Change	
[Date field]	17/7/22

Purpose

6. This briefing introduces advice from the Climate Change Commission (the Commission) on New Zealand Emissions Trading Scheme (NZ ETS) limit and price control settings for units (unit settings) for 2023 to 2027.
7. Our recommended next steps are also provided. We note the market sensitivity of this advice and recommend it should be made publicly available as soon as possible. Initial communication materials are provided in the two appendices.
8. The information in this briefing is based on the limited information we received in an advance copy of the executive summary only. We have now received the report, and will continue to work through the implications.

Context

Updates to unit settings are required annually

9. The first regulations for NZ ETS unit settings entered into force in January 2021, in time for the introduction of NZ ETS auctions.
10. Updates to unit setting regulations are required annually to ensure that, at all times, they cover each of the next five calendar years.
11. Now that the first emissions budgets are set, the Commission is required to provide recommendations on these settings annually. These recommendations are significantly different from the advice provided by the Commission on these settings only a year ago.

Settings for all years can be updated this year

12. The settings for the immediately upcoming years can only be updated in specific circumstances. These circumstances include sale of volume from the CCR and the first setting of emissions budgets. These objective criteria are met for the 2022 updates.

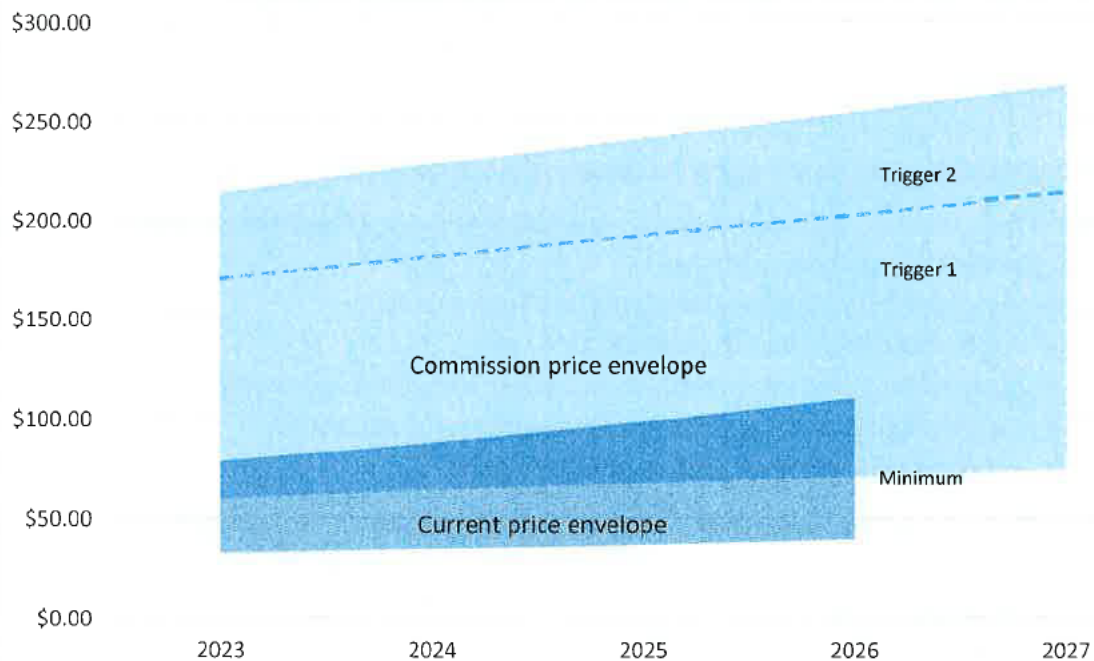
Analysis and advice

There are two types of NZ ETS unit settings

13. NZ ETS unit settings are broken into two categories:
 - a. price control settings for units, which are the price and volume settings for a cost containment reserve volume and auction reserve price floor
 - b. limit settings for units, which are limits on unit supply volumes

Price control settings for units

14. The Commission has recommended much higher and wider auction price control settings for units, as shown in figure 1. Notably, it has recommended a two-tier cost containment reserve volume.

Figure 1: Price control settings for units – Commission and current recommendations¹

15. Based on the limited information in the executive summary and technical discussions with Commission staff, we understand that these recommendations are consistent with those in *Ināia tonu nei: a low emissions future for Aotearoa*, including those relating to the role and quantity of exotic forestry in the NZ ETS.
16. We note that while supply and demand in the secondary market are the primary drivers of NZU prices, those prices have been closely aligned with the price controls in place².
17. Section 30GC Act requires the Commission to consider several matters when recommending price control settings. These include the impact of emissions prices on households and the economy. We understand the report contains a comprehensive impacts chapter, including by income groups. These impacts are mentioned in passing in the executive summary with a note that the NZ ETS price control settings are not an appropriate tool for addressing these concerns. Appendix two of this briefing provides a list of existing Government policies and measures designed to support households and firms to manage higher emissions costs.
18. The Commission recommends a two-tier cost containment reserve³. The executive summary does not explain why, though we expect it includes reduced risk of releasing the full reserve volume, including that additional to the emission budget. We note the

¹ The Commission has recommended fixed value increase in price settings, rather than the current annual percentage increase.

² The fixed price option at \$25, then \$35, and then the CCR trigger price of \$50 in 2021 and \$70 in 2022.

³ The second trigger price is recommended to be consistently 25% higher than the first and contain two thirds of the reserve volume.

Government originally decided on a single tier because it is easy to understand and minimises risk of market manipulation via auction bidding strategies.

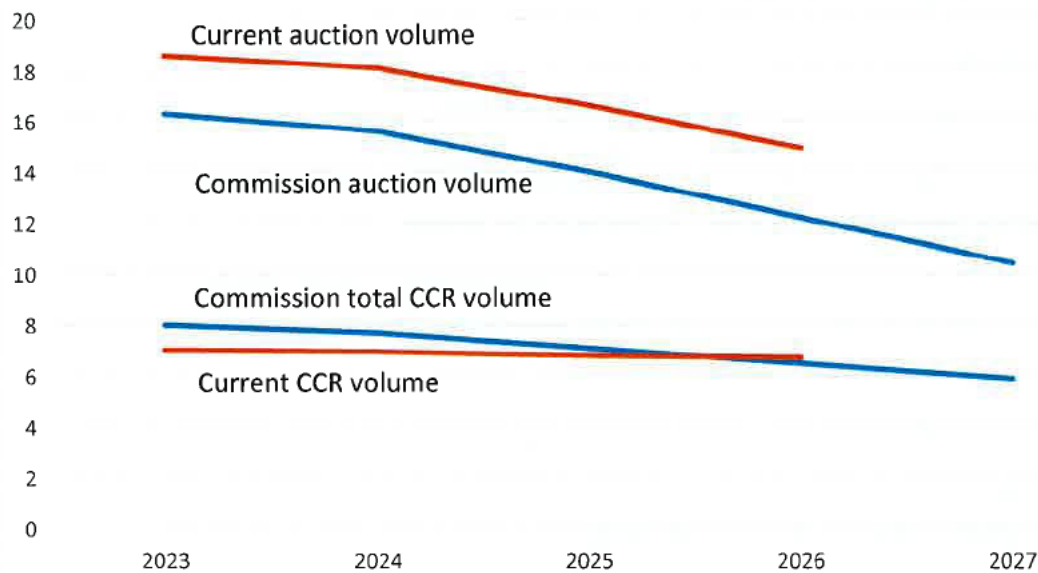
19. More analysis on the impacts of the recommended settings will be provided in the draft consultation paper and cover brief which we intend to provide on 26 July.

The recommended price settings will impact other climate policy work

20. There are several work programmes underway that will be directly affected by these recommendations. These include:
 - pricing of agricultural emissions/He Waka Eke Noa
 - permanent forestry in the NZ ETS
 - the balancing of gross and net emissions reductions in the NZ ETS
 - implementation of industrial allocation reform decisions
 - implementation and funding of ERP actions.
21. We ask you to agree to sending a copy of the Commission's report to Ministry officials as soon as possible. This will assist us in developing communications materials for its release and in our policy analysis and writing of the NZ ETS review Cabinet paper and the 2022 NZ ETS settings consultation document and Cabinet paper.

Limit settings for units

22. The Commission has recommended lower annual auction volumes, mainly due to a reduced overall limit on units (also known as the cap). The recommended volumes include consideration of an updated review of unit stockpile liquidity, and a technical adjustment to account for variation between reported emissions in the inventory and the NZ ETS.
23. We expect the report contains a far more detailed description of the differences than we have been able to determine from our limited discussion to date. The Commission has introduced a new step to the methodology to calculate these settings. Our understanding is that although this introduces an additional step, it does not change the outcomes from what would be arrived at using the original methodology. Figure 2 illustrates the recommended auction volumes against the present.

Figure 2: Commission and current auction and cost containment reserve volumes

24. Lower volumes of units available at auction increases the dependency on access to stockpiled units to meet surrender obligations unless reductions in gross emissions are made over time.
25. As far as we can tell, the proposed volumes are not adjusted to withdraw the already released cost containment reserve volume from the market⁴. Also, it appears that a proportion of the Commission's recommended cost containment reserve volume is outside the emissions budget, similar to current settings.

Next steps

Timing of release

26. As indicated above, this advice is market sensitive and we recommend it should be made public as soon as possible to minimise risks of information leakage.
27. Our preference is to release the report by presenting it to the House of Representatives on 21 July outside market hours. You could release a press release at the same time, which could also cover the release of decisions on NZ ETS and SGG Levy technical amendments and policy decisions resulting from the industrial allocation review. The report will be made available on the Commission's website as soon as it is presented.
28. Initial back-pocket questions and answers, as well as a list of policies supporting an equitable transition, are provided in the appendices. We welcome your feedback on these materials and your requests for further supporting information.
29. We recommend all queries relating to the Commission's recommendations, including the methodologies and potential impacts on emissions and costs, are directed to the Commission for response. It could be reinforced that those recommendations are not

⁴ 14 million NZUs, of which 1.6 million are additional to the first emissions budget.

government policy, however they will be part of public consultation on possible updates to the settings later this year.

Regulation updates

30. The timelines for making the required updates this year remain very difficult. Mitigations underway include working proactively as far as possible to ensure the work remains on track. It is likely that reduced duration of ministerial consultation will be needed at the LEG stage, and maybe at other Cabinet decision points.
31. Indicative timelines are provided in the table below. These will be fluid through this process. Decisions will need to be made quickly to enable the legislative deadline to be met.

Table 1: Indicative timelines for this work

A draft Cabinet paper seeking approval to consult and draft consultation document for these updates sent for review	28 July (tbc)
Ministerial consultation	3-16 August
Paper considered at DEV	24 August
Public consultation	20 August-27 September
Draft policy decisions Cabinet paper to Minister	13 October
Ministerial consultation	17-26 October
Policy decisions considered at ENV	10 November
PCO drafting, draft LEG paper to Minister	17 November
Ministerial consultation (5 days)	22-29 November
Paper considered at LEG	8 December

Appendix 1: Back-pocket questions and answers

Why are these changes being proposed?

Updates to unit settings are required to be made this year, as settings need to be set in regulations for at least the next five years. Updates to settings for 2023 and 2024 can only occur in certain circumstances. These circumstances are met this year

The Climate Change Commission is required to provide advice every year to the Minister of Climate Change on NZ ETS settings for the subsequent five-year period.

What is next?

Subject to Cabinet approval, the Minister, through the Ministry for the Environment, will publicly consult on updates to unit settings. The options will include the recommendations from the Commission. Consultation is intended to occur during September.

Does the Government have to take the Commission's recommendations?

No. The Commission is not a decision-making body, decisions on updates will be made by government. However, if the Minister recommends settings that are different from the Commission's, the Minister must table a report on Parliament explaining why.

What will emissions prices be next year?

The Government does not make predictions on market prices. These recommended settings are guardrails for prices during the quarterly emission unit auctions. Updates to these auction price controls, called the cost containment reserve trigger price and auction reserve price, may influence, but do not directly determine, auction clearing prices or market prices.

The purpose of the price corridor is to provide visibility over a potential price path, while still allowing for prices to fluctuate within the market and drive the most efficient forms of emissions reductions.

Why the big change?

Detail behind the recommendations is not available from the Executive Summary provided to the Ministry for early review. Our understanding is that the changes are to respond to recent changes in secondary market prices, auction results, and sector-level targets in the ERP.

How do these settings compare with other ETS's?

All ETS have price control mechanisms, however they function differently which makes direct comparison difficult. The Commission's report considers the level and trajectory of international emissions prices for these recommendations.

What emission reductions will occur with these prices

These are detailed in the Commission's report

How does this advice mesh with agricultural emissions pricing?

The Commission prepared this advice in parallel with its advice on agricultural emissions pricing. Questions on the interplay between these two sets of advice should be referred to the Commission.

Will the costs of living go up if these recommendations are adopted?

The Commission's report contains an extensive impacts analysis.

What government support is there for people and businesses wanting to avoid emissions?

See appendix 2

Appendix 2: Policies and measures supporting the transition to higher emissions costs

A balanced mix of emissions pricing, well-targeted regulations, tailored sectoral policies, direct investment (public and private), innovation and mechanisms are needed to meet our climate targets and support an equitable transition to a low-emissions economy.

New Zealand's first emissions reduction plan (ERP) sets out these policies, actions, and strategies as a coherent, strategic package to meet the first emissions budget and set the path for much deeper reductions out to 2030 and beyond. Many of the complementary measures and actions in the ERP are designed to support firms, households, workers and communities to meet the challenges and seize the opportunities that the transition brings. Examples include:

- Expanding the Government Investment in Decarbonising Industry Fund. This fund will support businesses' energy efficiency and enable fuel switching toward low-carbon alternatives.
- The development of sector decarbonisation plans to support smaller businesses in emissions-intensive sectors to reduce emissions
- provision of the Climate Action Toolbox, which helps businesses to understand their emissions profile and complete actions to reduce emissions.
- Establishing a platform for a Māori climate action to strengthen Māori-Crown relationship, support Māori-led strategy and alignment, and resource community-based kaupapa Māori and tāngata Māori solutions.
- An equitable transition strategy to help us proactively identify and develop initiatives that are tailored to make the most of the opportunities the transition brings and address the challenges that different groups may face
- Increasing access to low- and zero-emissions vehicles for low-income households by supporting social leasing schemes and piloting an equity-oriented vehicle scrap and replace scheme that supports lower-income households to replace their family vehicle with a lower-emissions alternative.
- Work with local government to deliver public transport, walking and cycling improvements and to make public transport more affordable, particularly for low-income users
- The Warmer Kiwi Homes programme to fund heating and insulation upgrades that help households reduce their energy bills and keep their homes healthy, warm and dry
- Supporting waste minimisation initiatives, including waste avoidance programmes for urban and rural households
- Initiatives to support regions, communities and industries to plan for – and successfully manage – the transition including Industry Transformation Plans, the Regional Strategic Partnership Fund and the Just Transition Partnership programme.

These actions sit alongside broader measures to support workers and households to manage the impacts and seize the opportunities of Aotearoa New Zealand's transition to a low emissions economy. This includes:

- Providing an education and training system that equips all learners to seize the opportunities of the transition, responds flexibly to the skills and needs of a low-emissions economy and enables access to lifelong learning.
- Strengthened employment support services that enable New Zealanders to prepare for, find and retain suitable employment.
- A welfare system that ensures people have an adequate income and standard of living, are treated – and can live – with dignity and are able to participate meaningfully in their communities.

New Zealand has the mitigation options, technology and ability to reduce emissions.