



Advice on Approval to Consult: NZ ETS Annual Regulatory Updates & Settings 2024

Date submitted: 21/02/2024

Tracking number: BRF-4190

Security level: **CLASSIFICATION**

MfE priority: Urgent

Actions sought from Ministers		
Name and position	Action sought	Response by
To Hon Simon Watts Minister of Climate Change	Provide feedback on draft consultation material for NZ ETS Annual Regulatory Updates. Note next advice on NZ ETS Settings.	27/02/2024

Actions for Minister's office staff
Return the signed briefing to the Ministry for the Environment (ministerials@mfe.govt.nz).

Appendices and attachments
1. Proposed Timeframes for NZ ETS Annual Regulatory Updates and Settings 2024
2. Draft Consultation Document Content for NZ ETS Annual Regulatory Updates 2024

Appendix 2
refused
under
section 18(d)

Key contacts at Ministry for the Environment			
Position	Name	Cell phone	First contact
Principal Author	Jay Forlong		
Responsible Manager	Kate Whitwell	022 137 5939	✓
General Manager (Acting)	Susan Baas		

Minister's comments

Advice on Approval to Consult: NZ ETS Annual Regulatory Updates & Settings 2024

Purpose

1. Officials are seeking your feedback on the scope of content and consultation material for Annual Regulatory Updates to the New Zealand Emissions Trading Scheme (NZ ETS). A draft consultation document is attached for you to review (see *Appendix 2*).
2. This briefing also provides an update on the legislated process to annually review Unit Limits and Price Control Settings (NZ ETS Settings), on which you will receive recommendations from the Climate Change Commission (the Commission) and advice from us over the coming weeks.

NZ ETS Annual Regulatory Updates

3. The NZ ETS requires regular updates to ensure that the scheme is accurate, efficient, and up to date with the latest available evidence and data.
4. Each year, officials assess where changes are needed. Many updates are routine and have historically occurred on an annual basis, while others are one-off clarifications or corrections to specific issues that have been identified.
5. Sectors covered by the NZ ETS generally expect these updates to be regular, as they reduce inaccuracies and compliance burden. Participants benefit from the government routinely updating values, standards, and formulae used in emissions reporting, to align with the latest industry data and international science.
6. Last year, only updates mandated in legislation occurred (i.e. NZ ETS settings). Other important updates were identified but deferred. Officials strongly recommend that such additional updates are progressed this year to preserve the integrity of the scheme.
7. A major part of these routine updates are new emissions factors, which are used to calculate a participants' emissions based on production or activity data. It is important that any default emissions factors (DEFs) and unique emissions factors (UEFs) used by participants to report emissions are current, as these determine whether the emissions costs faced by participants actually match their emissions. Some participants also rely on factors reported by other entities in the supply chain to report their emissions.
8. Several items proposed below are considered purely technical and have no or minor impacts ('impacts' here include both costs and benefits). Technical items generally only involve a numerical calculation (i.e. require no policy decision), or can be clarifications to the text of regulations that do not have economic impacts or change policy intention.
9. Officials recommend that the items considered purely technical should be delegated by Cabinet to yourself for decisions following consultation. This will allow you to direct drafting of the regulations for these items, while ensuring that Cabinet can focus on the more substantive updates as well as NZ ETS settings decisions.
10. All items will still return to Cabinet for final approval of the amended regulations once drafting is complete, ahead of the 30 September 2024 deadline for gazettal.

11. Officials request your feedback on the following:

- The scope of specific items that we consider require updating, summarised in the table below;
- The option to recommend that Cabinet delegates technical items to you;
- The structure and content of the draft consultation document (see *Appendix 2*).

Update Item	Delegation proposed?	Summary	Document chapter
Updating DEFs & UEF methodologies for geothermal activities	No <i>Policy decision</i> <i>Non-minor impact</i>	Both the DEFs and the UEF methodologies for geothermal activities are out of date. At minimum, these need to be updated; however, we also propose that the entire reporting process can be streamlined, improving emissions reporting accuracy and better recognising mitigations implemented by participants. Currently, geothermal participants refer to DEFs listed in regulations to report their estimated emissions. If they do not consider these accurate, they can provide additional data and apply for a UEF.	<i>Section A</i> Proposed Update 1
Updating DEFs for natural gas activities	Yes <i>Technical</i> <i>Minor impact</i>	Participants who opt into the NZ ETS for the natural gas that they purchase use DEFs listed in regulations to report their estimated emissions, based on where the natural gas was mined. Significant compliance cost to these participants can be avoided by keeping these DEFs regularly updated.	<i>Section A</i> Proposed Update 2
Updating DEFs for liquid fossil fuel activities	No <i>Technical</i> <i>Non-minor impact</i>	Liquid fossil fuel participants use DEFs listed in regulation based on the type of fuels consumed in New Zealand. The closure of Refining NZ's Marsden Point Oil Refinery means that 100% of liquid fossil fuel consumed in New Zealand is now imported. Updating liquid fossil fuel DEFs ensures that participants are accurately reporting their emissions.	<i>Section A</i> Proposed Update 3
Aligning waste values in DEF & UEF regulations	Yes <i>Technical</i> <i>Minor impact</i>	Waste participants are able to apply for a site specific UEF that is up to 90% of the DEF, which can better reflect their actual emissions. Updating the UEF regulations for waste corrects a problematic misalignment introduced in 2022.	<i>Section A</i> Proposed Update 4
Clarifying data used to calculate UEFs for waste participants	Yes <i>Technical</i> <i>Minor impact</i>	Waste participants apply for a UEF for collection and destruction of landfill gas use national waste composition data if they do not have historic composition data available, and they use this to model the efficiency of the landfill gas capture system. This proposal would require UEF applicants to use historical national waste composition datapoints to improve the accuracy of the model.	<i>Section A</i> Proposed Update 5
Offsite destruction of landfill gas	Yes <i>Technical</i> <i>Minor impact</i>	Currently, UEF applicants for collection and destruction of landfill gas are required to destroy the gas onsite. This proposal would allow landfill gas to be destroyed offsite and still be eligible for a UEF, giving participants more flexibility.	
Clarifying how the destruction of synthetic greenhouse gases is recognised	Yes <i>Technical</i> <i>Minor impact</i>	Onshore destruction of synthetic greenhouse gases is provided for in regulations, but this is currently un-utilised. If this changes in the near future, ambiguous wording creates a risk that NZUs are not awarded for destroying gases that should be eligible. This proposal would provide certainty to participants that destruction of synthetic greenhouse gases will be recognised, and may incentive future investment in synthetic greenhouse gas destruction infrastructure.	
Definition of qualified person	Yes <i>Technical</i> <i>No impact</i>	Ambiguity in the wording of regulations creates risk for unsuitable individuals to manage holding accounts for NZUs. However, individuals that would otherwise be unsuitable but are mandatory participants need to manage holding accounts for NZUs. Clarifying the wording would mitigate risk to the integrity of the scheme.	<i>Section B</i> Proposed Update 6

Update Item	Delegation proposed?	Summary	Document chapter
Unsold auction volumes	No <i>Policy decision</i> <i>Non-minor impact</i>	The current roll-over provisions may have an unintended consequence of preventing participants from purchasing units through auctions due to the increasingly large number of unsold units rolled over from previous auctions over the course of a year. This proposal would better support participants to engage in auctions and receive the units required to meet their emissions obligations. This item builds on the advice that you requested last year after all auctions in 2023 did not clear (<i>BRF-4017 refers</i>). There are 6 options described in the consultation document, along with the analysis for each.	Section B Proposed Update 7
Auctioning collateral methodology	Yes <i>Technical</i> <i>Minor impact</i>	The current method for calculating auctioning collateral can result in participants being required to pay for more collateral than necessary. Clarifying the formula used would reduce the upfront cost to participants to engage in auctions.	

NZ ETS Unit Limits and Price Control Settings

12. The Commission is expected to provide you with advice on NZ ETS settings on 29 February 2024.
13. Officials will also provide you with our initial advice on the Commission's recommendations, next steps, and communications materials (i.e. a press release, suggested talking points, and Q&As) when the report is delivered.
14. We will then return to you with a separate consultation document that outlines proposals for NZ ETS settings, which will be released in parallel to the annual regulatory updates consultation document that is the primary focus of this briefing.

Next steps

15. Officials will incorporate your feedback into the annual regulatory updates consultation document, and progress it through the publication process (formatting, editing, etc.).
16. Following the advice on NZ ETS settings signalled above, officials will support you with Cabinet material to seek approval to consult jointly on the annual regulatory updates and settings. This will include a joint Cabinet paper and relevant required appendices.
17. Our advice is that consultation should begin on 8 April 2024, following Cabinet approval in late March – lodgement to Cabinet is proposed for 21 March 2024.
18. This will be followed by two more stages of Cabinet decision making:
 - Cabinet needs to make 'Policy decisions' by early July, instructing the parliamentary counsel office to draft regulations;
 - Cabinet needs to make 'LEG decisions' in September, approving the drafted regulations for gazettal by 30 September.
19. Officials will continue to engage with relevant sectors and NZ ETS participants as part of public consultation, building on our existing conversations. Sectors with whom we have been speaking are generally aware that these updates are in the pipeline, and some have expressed particular enthusiasm for specific updates to be progressed, especially where they were deferred in previous rounds.
20. *Appendix 1* provides a proposed timeline of these and other key dates.

Recommendations

We recommend that you:

- a. **Agree** to provide feedback to officials on the scope of content and consultation material for annual regulatory updates to the NZ ETS, including items proposed for Cabinet to delegate to you.
- b. **Note** the timeframes advised by officials in order to meet the legislated deadline of 30 September 2024 for gazettal of any new regulations for the NZ ETS.
- c. **Note** that you will receive and must consider recommendations from the Commission on NZ ETS Settings on 29 February 2024, and that officials will provide you with advice to support this.

Yes | No

Signatures



Susan Baas

General Manager (Acting)

Markets Unit, Climate Change Mitigation & Resource Efficiency

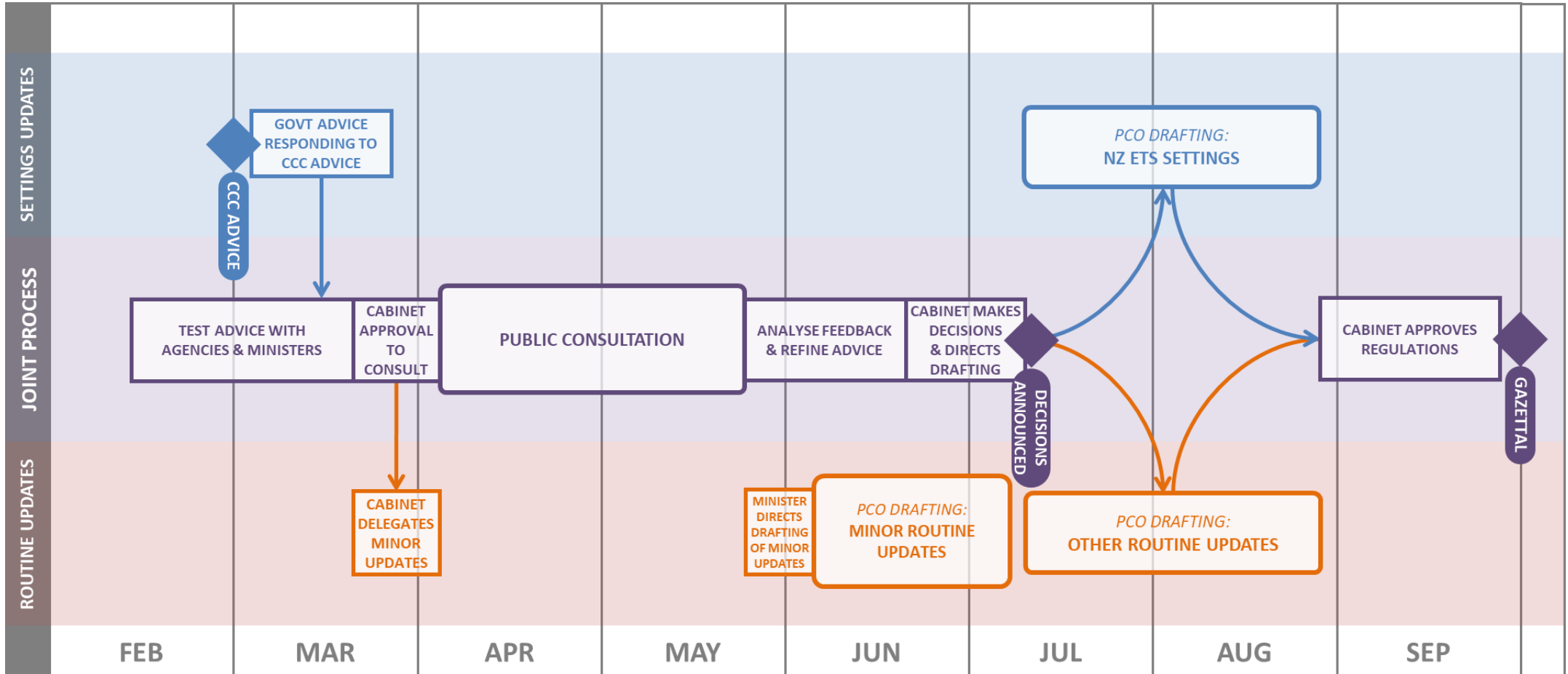
Date: 20 February 2024

Hon. Simon Watts

Minister of Climate Change

Date:

Appendix 1 – Proposed Timeframes for NZ ETS Annual Regulatory Updates and Settings 2024





Briefing: Approval to consult on proposed annual updates to NZ ETS settings

Date submitted: 15 March 2024

Tracking number: BRF-4379

Security level: CLASSIFICATION

MfE priority: Urgent

Actions sought from Ministers		
Name and position	Action sought	Response by
To Hon Simon WATTS Minister of Climate Change	Provide feedback to the draft Cabinet paper and draft consultation document on proposed annual updates to NZ ETS settings.	As soon as practicable by 19 March 2024

Actions for Minister's office staff
<ul style="list-style-type: none"> • Forward this briefing to the office of the Minister of Finance. • Return the signed briefing to the Ministry for the Environment (ministerials@mfe.govt.nz).

Appendices and attachments
<ol style="list-style-type: none"> 1. Draft Cabinet paper: <i>Approval to consult: NZ ETS settings and Annual Regulatory Updates 2024</i> 2. Draft consultation document: <i>Proposed annual updates to New Zealand Emissions Trading Scheme unit limit and price control settings 2024</i> 3. Draft consultation document: <i>Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2024</i>

Appendices
refused
under
section 18(d)

Key contacts at Ministry for the Environment			
Position	Name	Cell phone	First contact
Principal Author	Arwen Norrish		
Responsible Manager	Kate Whitwell	0221375939	✓
General Manager	Mark Vink		

Minister's comments

Approval to consult on proposed annual updates to NZ ETS settings

Purpose

1. This briefing seeks your feedback on the attached:
 - Draft Cabinet paper that covers proposal to consult on NZ ETS settings as well as annual NZ ETS regulatory updates.
 - Draft consultation document for NZ ETS settings.
 - Updated draft consultation document for NZ regs update for further feedback.

Key messages

2. We have previously provided a summary of the Climate Change Commission's (the Commission) advice on NZ ETS Settings [BRF-4335 refers]. We have now reviewed the Commission's recommendations.
3. The consultation document seeks feedback on the Commission's recommendations. This includes adjusting the auction volumes for the next two years (2025 and 2026) to address the significant increase in surplus estimates.
4. While the first two years of settings can only be amended in specific circumstances, we consider the requirements have been met. This is because the substantial increase in the surplus estimates increases the risk of not meeting emissions budgets and targets.
5. The Commission has advised that the Government could consider further adjustment to unit limits to account for emission reductions that were not expected when emission budgets were set, such as the emission reductions from the NZ Steel investment.
6. We recommend including this option as your preferred option at consultation, as this would better accord with emissions budgets and targets, and further reduce the gap in meeting the nationally determined contributions under the Paris Agreement (the NDC). It is also consistent with your direction in the draft Cabinet paper *Delivering New Zealand's Climate Commitments*.

Recommendations

We recommend that you:

- a. **note** the Climate Change Commission has put forward two options for unit limits:
 1. Option 1: align unit limits with emissions budgets and account for methodological changes made in the latest New Zealand's Greenhouse Gas Inventory (GHG Inventory).

2. Option 2: in addition to option 1, also adjust for unexpected emission reductions.
- b. **note** the Climate Change Commission did not recommend option 2 because the Government is yet to announce its policy direction on the role of the NZ ETS in meeting the NDC.
- c. **agree** to consult option 2 as the preferred option in the consultation document, as it is better aligned with meeting NDC than option 1 and is consistent with direction in the draft Cabinet paper *Delivering New Zealand's Climate Commitments*.
- Yes | No
- d. **note** that following consultation, if you make recommendations that are different to the Climate Change Commission's recommendations, you must prepare a report of the reasons for the difference as soon as is reasonably practicable and make the report publicly available.
- e. **discuss** this briefing with officials at the officials' meeting.
- Yes | No
- f. **Provide feedback** on the attached consultation documents and draft Cabinet paper.

Signatures



Mark Vink

General Manager

**Markets, Climate Change Mitigation and
Resource Efficiency**

15 March 2024

Hon Simon WATTS

Minister of Climate Change

Date

Background

7. As the Minister of Climate Change, you are required under the Climate Change Response Act 2002 (the Act) to update the NZ ETS settings every year, as informed by the recommendations of the Commission. The Act also requires you to consult before making any recommended changes to settings to Cabinet. Updates to NZ ETS settings must be set by 30 September every year, with the new settings come into force on 1 January the next year.
8. To meet the deadline for updating NZ ETS settings this year, we have prepared a draft consultation document and a draft Cabinet paper attached to this briefing for your feedback. Once approved, a final Cabinet paper will be provided to you for your Cabinet committee meeting on 10 April, the same day as the discussion on your Cabinet paper *Delivering New Zealand's Climate Commitments*.
9. As provided in BRF-4335, the Commission's key recommendations are:
 - Significantly reducing (by half) the auction volumes for 2025 to 2029 from the volumes that are currently in regulations.
 - Adjusting the first two years of NZ ETS settings, which can only be adjusted in specific circumstances.
 - Retaining the existing amount of New Zealand Units (NZUs) in the cost containment reserve (CCR).

Preferences in the consultation document

10. We have reviewed the Climate Change Commission's (the Commission) recommendations on auction unit volumes for 2025-2029. The consultation document indicates your preference for those recommendations.
11. The consultation document also indicates your preference for the Commission's recommendations on changes to auction price control settings. We agree with the Commission that the current settings remain fit for purpose, and only minor adjustments to 2027 and 2028 values for inflation updates are needed.
12. A full analysis of accordance with statutory tests is required to support final policy decisions. We will provide further advice on this following consultation to inform your and Cabinet's final decision-making.
13. There are other work programmes that may affect the setting of unit limits in future. For example, the current policy work on land use classification system would have an impact on future unit supply. However, these policies have yet to be implemented, therefore they will not affect this year's NZ ETS settings.
14. There are two issues in the consultation document that might generate stakeholder interest. The first is whether to improve alignment with the Nationally Determined Contribution by accounting for emissions reductions that are additional to those expected

when the emission budgets were set. The second is whether tests are met to allow the updating of unit limits for 2025 and 2026.

We recommend you consult on an option that will improve alignment with the NDC

15. The Commission recommended adjusting the unit limits to account for greenhouse gas methodological changes made last year (the Commission labelled this as 'option 1'). We consider this to be the minimum option, because if those adjustments were not made, the gap between the emission budgets and the NDC would be larger. 9(2)(h)
16. The Commission advised that the Government could consider further adjustment to unit limits to account for unanticipated emission reductions. The Commission labelled this as 'option 2' and did not recommend it because it considered the Government had not made clear decisions on the role of the NZ ETS in meeting the NDC.
17. 9(2)(g)(i)
18. Consulting on option 2 means a deviation from the Commission's recommendations. An explanation for this would need to be tabled in the House of Representatives following policy decisions. We will provide you with a draft explanation for your approval for tabling.

We recommend a preference for updating unit limits for 2025 and 2026 for the purposes of consultation

19. As noted in BRF-4335, the Commission has estimated that there are approximately 68 million units in the surplus stockpile, within a range of 51-85 million units. This is an increase of 19 million units from its previous central estimate in 2022. The Commission has described the following reasons for this increase:
- An increase from pre-1990 forest allocation units being on-sold by their original recipients at a faster rate than previously estimated (approximately 7 million additional surplus units).
 - An increase of approximately 11 million surplus units in post-1989 forests than estimated in 2022.
20. The consultation document seeks feedback on the Commission's methodology and estimates.

21. 9(2)(f)(iv) [Redacted]

22. Therefore, the draft consultation document has included updating unit limits for 2025 and 2026 as a preferred option. Settings for the first two years (2025 and 2026 in this case) can only be adjusted in specific circumstances. 9(2)(h) [Redacted]

Impact on liquidity

23. The proposals, if agreed to by Cabinet in final policy decisions, will mean the unit limits and auction supply is reduced. This could impact market liquidity. The uncertainty in surplus estimate means there is a risk that the surplus stockpile could be used prior to 2030.

24. We think this risk can be managed through monitoring and adjustment as part of the annual NZ ETS settings process. If the surplus reductions are set too high, we will have the opportunity to correct it through this annual process.

9(2)(h) [Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

9(2)(h)

We have updated the annual NZ ETS regulatory updates consultation document

30. Following your consideration and direction of our previous *briefing Advice on Approval to Consult: NZ ETS Annual Regulatory Updates and Settings 2024* [BRF-4190 refers], in addition to making minor and editorial updates to the consultation document, we have updated the options put forward to manage unsold auction volumes.
31. We have included the option to cancel previous unsold auction units. We have removed an option previously included for consultation, which is to 'add unsold auction units into the cost containment reserve (CCR)'. This is because cost containment reserve volumes are determined as part of the annual NZ ETS settings process. This option would potentially change the volume of the CCR, overriding previous Government decisions on CCR (as determined through the settings process). The preferred option for this proposal remains the same.

Next steps

32. Once we have received your decision on this briefing and feedback on the draft Cabinet paper and consultation document, we will provide you with an updated draft Cabinet paper and consultation document to begin Ministerial consultation.
33. Timeframes for next steps are outline below:

Milestone	Timeframe
Ministerial consultation	21 March – 2 April
Your final approval of Cabinet paper	2 April – 3 April
Lodging Cabinet paper	4 April
Cabinet Economic Policy Committee consideration	10 April
Cabinet decision	15 April
Consultation	17 April – 24 May

9(2)(h)



Cover note – Ministerial consultation process for NZ ETS Annual Regulatory Updates and Settings 2024

Date submitted: 21 March 2024

Tracking number: BRF-4475

Security level: Policy and Privacy

MfE priority: Urgent

Actions sought from Ministers		
Name and position	Action sought	Response by
To Hon Simon WATTS Minister of Climate Change	Provide feedback on attached Cabinet paper and consultation documents and send for Ministerial consultation	22/03/24

Actions for Minister's office staff
Return the signed briefing to the Ministry for the Environment (ministerials@mfe.govt.nz).

Appendices and attachments
1. Draft Cabinet paper: <i>Approval to consult: NZ ETS settings and Annual Regulatory Updates 2024</i>
2. Draft consultation document: <i>Annual updates to New Zealand Emissions Trading Scheme unit limit and price control settings 2024</i>
3. Draft consultation document: <i>Proposed changes to regulations for the New Zealand Emissions Trading Scheme 2024</i>

Appendices
refused
under
section 18(d)

Key contacts at Ministry for the Environment			
Position	Name	Cell phone	First contact
Principal Author	Charlotte Berg		
Responsible Manager	Kate Whitwell	0221375939	<input type="checkbox"/>
General Manager	Mark Vink		

Minister's comments

Cover note – Ministerial consultation process for NZ ETS Annual Regulatory Updates and Settings 2024

1. This briefing seeks your feedback on the attached documents and agreement to circulate the attached Cabinet paper and consultation documents relating to NZ ETS settings and NZ ETS regulatory updates for Ministerial consultation.

Updates to consultation documents

1. We have updated the NZ ETS settings consultation document, so it provides options for consultation without indicating any Government or Minister proposal or preference, in line with your feedback. Where issues relate to mechanically updating numbers to ensure accuracy in calculation, only one option was included.
2. The consultation document for the other regulatory updates (not NZ ETS settings) continues to signal preferred options as further analysis has already been completed on these options, and many of them only include options to make the update or not. This does not prevent changes being made to the updates following consultation. This consultation document is unlikely to be controversial.
3. We are interested in any feedback you may have on the Cabinet paper section titled 'Relation to government priorities'. This content will be repeated in future NZ ETS settings Cabinet papers.
4. You can use the NZ ETS settings consultation document to signal the Government's direction on its plan to deliver the NDC, 9(2)(f)(iv)

Ministerial consultation process and next steps

5. If you have further feedback on these papers we will prioritise updating them to enable commencement of Ministerial consultation on Friday 22 March.
6. We will continue with improvements to the papers during the Ministerial consultation period, including editing and formatting of the consultation documents. The modelling of impacts will also be reviewed and updated if necessary.
7. We will circulate the Cabinet paper and updated NZ ETS settings consultation document for agency review at the same time as Ministerial consultation. Any feedback from agencies or from your colleagues will be addressed ahead of lodgement and summarised in the next briefing.
8. We will provide you with updated versions with a briefing that requests your approval to lodge ahead of lodgement on 4 April 2024. Any significant changes to the documents will be highlighted and summarised in the briefing.
9. Timeframes for next steps are outline below:

Milestone	Timeframe
Ministerial consultation	22 March – 2 April
Your final approval of Cabinet paper	2 April – 3 April

Lodging Cabinet paper	4 April
Cabinet Economic Policy Committee consideration	10 April
Cabinet decision	15 April
Consultation	17 April – 24 May (TBC)

Recommendations

We recommend that you:

- a. **Note** your approval to commence Ministerial consultation is required now to ensure this work can be delivered on time.
- b. **Note** that the NZ ETS settings consultation document has been updated so it provides options instead of preferred Government or Minister positions.
- c. 9(2)(f)(iv)
- d. **Note** that the NZ ETS regulatory updates consultation document continues to include preferred positions.
- e. **Agree** to circulate the draft Cabinet paper and associated draft consultation documents for Ministerial consultation once any further feedback received from you has been addressed.

Yes | No

Signatures



Mark Vink
General Manager
Climate Change Mitigation and Resource Efficiency
21/03/2024

Hon Simon WATTS
Minister of Climate Change

Date



Cover Note – Approval to lodge Cabinet Paper: NZ ETS Settings and Annual Regulatory Updates 2024

Date submitted: 02/04/2024

Tracking number: BRF-4359

Security level: CLASSIFICATION

MfE priority: Urgent

Actions sought from ministers		
Name and position	Action sought	Response by
To Hon Simon Watts Minister of Climate Change	Approve the lodgement of the appended Cabinet paper and consultation documents	03/04/2024

Actions for Minister’s Office staff
<p>Lodge the attached Cabinet paper and associated appendices with the Cabinet office upon approval from the Minister by 10 am on 04 April 2024.</p> <p>Return the signed briefing to Ministry for the Environment (ministerials@mfe.govt.nz) — please send both hard <i>and</i> soft copies to ensure we meet our public record obligations.</p>

Appendices and attachments
<ol style="list-style-type: none"> Feedback incorporated and other recent changes CAB-386: Approval to Consult – NZ ETS Settings and Annual Regulatory Updates Consultation Document: Annual Updates to the New Zealand Emissions Trading Scheme Limits and Price Control Settings for Units 2024 Consultation Document: Proposed Changes to New Zealand Emissions Trading Scheme Regulations 2024

Appendices
refused
under
section 18(d)

Key contacts at Ministry for the Environment			
Position	Name	Cell phone	First contact
Principal Author	Jay Forlong		
Responsible Manager	Kate Whitwell	022 137 5939	✓
General Manager	Mark Vink		

Minister’s comments

Cover Note – Approval to lodge Cabinet Paper: NZ ETS Settings and Annual Regulatory Updates 2024

Purpose

1. This briefing provides you with the final versions for lodgement of the material seeking Cabinet’s approval to consult on NZ ETS Settings and Annual Regulatory Updates.

Key Messages

2. You have previously reviewed draft versions of the Cabinet paper “Approval to Consult – NZ ETS Settings and Annual Regulatory Updates 2024” and associated consultation materials [BRF-4190 and BRF-4379 refer].
3. Officials have since incorporated your feedback, as well as confirmed final minor details. No feedback was received from your Ministerial colleagues directly, though feedback from agencies has been considered and actioned where appropriate. It is possible that we may receive further feedback following close of Ministerial consultation, in which case officials will work with your office to make any final changes required, so long as time permits before the lodgement deadline.
4. Notable feedback and other changes are listed in Appendix 1.
5. The Cabinet paper (Appendix 2) recommends the public release of two consultation documents, which also serve as interim regulatory impact statements for their respective proposals:
 - *Annual Updates to the New Zealand Emissions Trading Scheme Limits and Price Control Settings for Units 2024* (Appendix 3);
 - *Proposed Changes to Regulations for the New Zealand Emissions Trading Scheme 2024* (Appendix 4).
6. Officials will provide you with suggested talking points and Q+As to support your discussions at ECO and Cabinet following the lodgement of the Cabinet paper.
7. The timeframes to begin consultation no later than 17 April 2024 are as follows:
 - Lodgement by 10:00 AM on Thursday 04 April 2024;
 - Sub-committee (ECO) consideration on Wednesday 10 April 2024;
 - Committee (CAB) consideration on Monday 15 April 2024;
 - Public announcement of consultation period on Tuesday 16 April 2024;
 - Consultation material released and submissions open on Wednesday 17 April 2024.
8. Note that officials recommend that the Cabinet paper goes to Cabinet on 15 April 2024 despite your absence, as Cabinet does not meet for the rest of the month, which would

significantly postpone consultation. We suggest that the Assoc. Minister of Climate Change present the paper.

9. These timeframes are designed to ensure that any necessary steps for updating the regulations (for example, returning to Cabinet for policy decisions, drafting amendments, etc.) can be completed by the legislated deadline of 30 September this year.

Recommendations

We recommend that you:

- a. **approve** the lodgement of the attached Cabinet paper seeking approval from your Cabinet colleagues to begin public consultation on NZ ETS Settings and Annual Regulatory Updates proposals;

Yes | No

- b. **note** the key changes to specific sections across the Cabinet material, which are summarised in Appendix 1. No substantive changes to overall structure or messaging have been made since your last review;

- c. **note** that, if we receive any last-minute feedback from Ministerial consultation, officials will work with your office to make required changes ahead of lodgement (by 10:00 AM on 04 April 2024).

Signatures



Mark Vink

General Manager

Markets Unit

Climate Mitigation & Resource Efficiency

Date: 02/04/2024

Hon Simon Watts

Minister of Climate Change

Date:

Appendix 1: Feedback incorporated and other recent changes

1. All changes made to the Cabinet material since your last review address specific sections; there have been no changes to the overall structure or messaging of the documents. The key revisions to specific sections are detailed below.
2. Editorial changes as part of the Ministry's standard publication process are not reflected here, but likewise do not impact the structure or messaging of the documents.

Cabinet Paper (Appendix 2)

3. We have revised the analysis section on other regulatory updates to aggregate connected items and bring the content up a level (paragraphs 46–51).
4. s 9(2)(f)(iv)

NZ ETS Settings Consultation Document (Appendix 3 in the previous version)

Modelling

5. We have removed the modelling appendix from the NZ ETS Settings consultation document. This has been replaced with a summary of the modelling at the end of the unit settings section on page 25. The summary focuses on accordance with emissions budgets. We will work with your office on a time to talk you through the modelling appendix, as this is likely to be of public interest.

Step 1 – Aligning with climate change targets (NDC) (page 12)

6. The option to directly adjust NZ ETS unit limits to support meeting the NDC has been largely rewritten to provide further clarity on how it could work. The explanation of how the waterbed effect is already managed by the current policy framework has been simplified.

Step 2 – Allocating the emissions budget to NZ ETS and non-NZ ETS sectors (page 15)

7. There is an additional paragraph included in step 2 (allocating the emissions budget to NZ ETS and non-NZ ETS sectors) in response to feedback from MPI. MPI sought more information on whether NZ ETS Settings should be adjusted for updated projections of agricultural emissions in order to address risks to meeting emission budgets.
8. The existing framework separates the share of the emissions budget allocated to NZ ETS and non-NZ ETS sectors. Achievement of each share is independent to what is happening in the other. It means that the allocation of the emissions budget volume does not change in response to changing emissions projections. Therefore, if non-NZ ETS emissions (mainly from agriculture) are higher than the assumed pathway, NZ ETS sectors do not become responsible for further emissions reductions to 'make up' for that increase. Conversely, if non-NZ ETS emissions are lower than the assumed pathway then NZ ETS sectors are not enabled to emit more.
9. This approach has been used since 2022. A key benefit of the current approach is that it provides some certainty to NZ ETS sectors about their ongoing share of the emissions budget, which supports market confidence and regulatory certainty. However, this approach could pose a risk to the achievement of emissions budgets if agricultural emissions

increase (or do not decrease) in line with the assumed pathway. If this approach changed, and the NZ ETS is used to 'make up' for an increase in agricultural emissions, this could significantly reduce auction volumes.

10. This issue is presented in the consultation document. We have asked for views on how the emissions budget is allocated. Feedback could inform policy decisions by Cabinet on the level of effort required from different sectors. These decisions would need to be made looking at implications across the whole economy, rather than sector by sector. A suitable avenue for these decisions, rather than part of the NZ ETS Settings process, would be via the finalisation of the second emissions reduction plan by the end of 2024. The Commission's advice on Settings next year would then be informed by the second emissions reduction plan.

Price controls (page 26)

11. There are minor changes to the price control settings section to clarify the option to have lower trigger prices for the price corridor (e.g. for the auction price floor and the cost containment reserve). We have also included a consultation question seeking feedback on a price corridor, and views on having just the auction floor or the cost containment reserve.

NZ ETS Annual Regulatory Updates Consultation Document (Appendix 4)

12. The introductory sections have been revised to match changes to the same content in the Settings consultation document (pages 6–8).
13. Numbers updated for some geothermal default emissions factors based on the latest data from the sector (page 19).
14. Numbers added for all liquid fossil fuel default emissions factors based on the latest data from MBIE (page 25).

15. s 9(2)(f)(iv)