



Approach to consulting on NZ ETS unit limits and price control settings for 2022-2026

Date Submitted:	18 February 2021	Tracking #: 2021-B-07564	
Security Level	In Confidence	MfE Priority:	Non-Urgent

	Action sought:	Response by:
To Hon James Shaw, Minister of Climate Change	<p>Agree that consultation on updates to unit limits and price control settings should propose the adoption of the Climate Change Commission's draft advice on the budgets and NZ ETS price controls.</p> <p>Meet with officials to discuss timing implications for emissions budgets and NZ ETS policy decisions</p>	22 February

Actions for Minister's Office Staff	Return the signed report to MfE.
Number of appendices and attachments 2	<p>Appendix 1: Indicative timeline for emissions budgets and NZ ETS regulations</p> <p>Appendix 2: Summary of NZ ETS regulation updates</p>

Ministry for the Environment contacts

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Approach to consulting on NZ ETS unit limits and price control settings for 2022-2026

1. This briefing seeks your agreement to include the Climate Change Commission's draft advice on emissions budgets and price control settings in the upcoming consultation on NZ ETS unit limit and price control regulations (the regulations) for 2022-2026.
2. This briefing also seeks your feedback on our recommendation to align Government decisions on emissions budgets with decisions on the regulations. An indicative timeline is set out in Appendix 1.

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

- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]

5. We also intend to consult on the regulations as a package with wider planned technical NZ ETS changes, due to the number of issues being considered, and because stakeholders are likely to be impacted by multiple issues. The full list of topics is set out in Appendix 2.
6. You are also receiving a briefing on the delivery of the emissions reduction plan [2021-B-07569 refers]. Appendix A of that briefing includes the timeline recommended here for Government decisions on emissions budgets and the NZ ETS regulations.

The unit limit and price control regulations need to be updated every year

7. The NZ ETS unit limit and price control settings are prescribed in the regulations. The regulations specify:
 - a. the overall limits on New Zealand emission units (NZUs), annual auction volumes and international units supplied into the NZ ETS market
 - b. the price controls for NZUs sold at auction (the lower price control is currently \$20, while the upper price control is \$50)
 - c. several auctioning operational matters such as the indicative schedule.
8. The Climate Change Response Act 2002 (the Act) requires that the regulations be updated annually so that they always provide a five-year look ahead period (known as the rolling five-year cap). The Act also requires that the regulations be set with regard to emissions budgets (or a provisional emissions budget until the official budgets are set) the 2050 target, and our Nationally Determined Contribution under the Paris Agreement.

The Commission's draft advice recommends increasing price control settings in the next annual update, which poses timing challenges

9. The Commission's draft advice contains recommendations for the first three emissions budgets and policy direction for the emissions reduction plan. As part of this advice, the

Commission also provided a specific recommendation to increase the price control settings in the NZ ETS and the rate of increase in the next annual update.¹

10. The Commission made this set of recommendations so the NZ ETS will be able to support New Zealand to meet emissions budgets, to reduce the risk of triggering the cost containment reserve (and resulting increase in the New Zealand emissions unit stockpile) and to incentivise abatement investment and behaviours they determined as available now.
11. Actioning the Commission's recommendation on price control settings raises timing challenges, and would require consulting on its draft advice (rather than its final advice).

We recommend consulting on the Commission's draft recommendation to enable their advice to be reflected in NZ ETS settings from 1 January 2022

12. The Commission is required to provide detailed advice on NZ ETS unit limits and price control settings from 2022 (once Government has set emissions budgets). We consider the draft recommendations to be relevant and likely indicative of their future detailed advice.
13. To enable the Commission's recommendations to be implemented in the NZ ETS from 1 January 2022, consultation needs to start as soon as possible. This is to allow for sufficient legislative drafting time and the mandatory three month stand down in the Act. This means consultation will need to commence prior to the Commission providing its final advice on 31 May 2021.
14. We are drafting a consultation document that reviews the current unit limits and price control settings and extends these to 2026. We recommend the consultation document includes two options:
 - a. A proposal to adopt the Commission's draft recommendations on the basis that these are likely representative of the Commission's final advice
 - b. The status quo as an alternative option. This option would involve extending the current provisional emissions budget and price control settings out to 2026.
15. Our proposed approach should allow for some changes between the options consulted on and final regulation decisions, while still enabling effective and genuine consultation.

Basing consultation on the Commission's draft advice may allow policy decisions on the NZ ETS to be informed by the Government's final emissions budgets

16. We recommend Cabinet make decisions on emissions budgets alongside policy decisions on the NZ ETS regulations on 4 August 2021. The Commission's final advice will be available prior to policy decisions on the NZ ETS regulations so could be taken into account when Cabinet considers the regulations (see Appendix 1 Table 1 for timing).
17. The Commission's final advice on emissions budgets may change from its draft recommendations. We propose to mitigate this risk by providing a clear methodology for how the unit limits and price control settings are determined once an emissions budget has been agreed. The consultation document will also communicate clearly that the consultation proposal that is based on the draft emissions budgets is not intended to preempt the Commission's final advice or the Government's decisions on emissions budgets.
18. Presenting the status quo option will allow submitters to understand the general bounds of unit limits and price controls and provide feedback on the expected impacts of settings at these bounds.
19. If the status quo option is used, revisions to NZ ETS settings to take account of the final

¹ Chapter 6.2.6: Time-critical necessary action 7 – Driving low emissions choices through the NZ ETS

emissions budgets and the emissions reduction plan would not take effect until 2023. This means the NZ ETS settings applied in 2022 would be inconsistent with decisions on the emissions reduction plan and may increase the risk of the stockpile increasing, reducing the effectiveness of the NZ ETS.

We seek your feedback on the timing for final Government decisions on emissions budgets and the regulations

20. It would be useful for the development of the emissions reduction plan for Government decisions on emissions budgets to be made as soon as possible. We understand that this is also your preference.
21. As described above, it may be possible to align the NZ ETS settings with emissions budgets if decisions on emissions budgets are made in August 2021 alongside policy decisions on the NZ ETS regulations. An indicative timeline for this process is provided in Appendix 1.
22. The NZ ETS regulations need to be notified by 30 September 2021 to take effect by 1 January 2022. If they are to reflect final emissions budgets, the Government would need to consider the Commission's final advice and complete cross-party consultation on emissions budgets in June/July 2021. For this to be possible you are likely to need to start making a plan for cross-party consultation now. We can work with your office to develop this.
23. The timeline would also condense usual time for drafting the package of regulation updates. While the various updates are relatively straightforward there are a number of changes across several different regulations. This could create a risk of errors; however, we will work with the Parliamentary Counsel Office to streamline the process where possible.
24. The timeline is challenging and would only be possible in a best case scenario. On balance, we recommend this timeline because it will allow the NZ ETS settings to align with emissions budgets from 1 January 2022. We seek your feedback on the implications of this timeline, including the approach to Ministerial engagement and cross-party consultation.

Next steps

25. We will arrange a meeting to discuss the implications of making decisions on NZ ETS regulations alongside decisions on emissions budgets.

Recommendations

26. We recommend that you:
 - a. **Note** there are several updates to NZ ETS regulations which need to be notified by the end of September 2021 to take effect from 1 January 2022, including updating the unit limits and price control settings and extending these to 2026
 - b. **Note** that we intend to consult on the NZ ETS regulation changes as a package from 13 April to 28 May 2020, subject to Cabinet approval
 - c. **Note** that in its draft advice the Climate Change Commission recommended amending the NZ ETS emissions budgets and price control settings in the next annual update
 - d. **Note** there are risks to consulting on regulation changes based on the Commission's draft advice as the Commission's final advice could differ, but consulting on a range

of options will keep the options open for final policy decisions

- e. **Agree** to consult on the Commission's draft advice as the proposal for the unit limits and price control settings for 2022-2026, with status quo presented as an alternative option

Yes/No

- f. **Note** we recommend that policy decisions on the NZ ETS regulations are made alongside decisions on emissions budgets on or before August 4 2021

- g. **Note** if the Government is unable to make decisions on emissions budgets before 4 August 2021, the current settings of the NZ ETS would likely continue for 2026, reducing the effectiveness of the NZ ETS.

- h. **Meet** with officials to discuss the timing implications for decisions on emissions budgets and policy decisions for the NZ ETS regulations

Yes/No

- i. **Agree** that this briefing and appendices will be released proactively on the Ministry for the Environment's website only once the Government has released the consultation material for the NZ ETS regulation updates

Yes/No

Signature



Lisa Daniell
Director
Climate Change

Date: 17/02/2021

Hon James Shaw
Minister of Climate Change

Date

Appendix 1: Indicative timeline for emissions budgets and NZ ETS regulations

Event	Date
ENV seeking approval to consult on NZ ETS regulations (based on Commission's draft advice)	8 April
Consultation on NZ ETS regulations (based on Commission's draft advice)	13 April – 28 May
Commission's final advice due by	31 May
Draft Cabinet paper to you seeking policy decisions on: <ul style="list-style-type: none"> - Emissions budgets - NZ ETS regulations (informed by the emissions budgets) 	1 July
ENV seeking policy decisions on emissions budgets and NZ ETS regulations	5 August
LEG authorising NZ ETS regulations	23 September
NZ ETS regulations notified in the Gazette	28 September

Appendix 2: Summary of NZ ETS regulation updates

Proposal	
1	Update unit limits and price control settings
2	Update the electricity allocation factor used in industrial allocation
3	Regulations for an auction monitor
4	Update the emissions factors to maintain accuracy of the scheme
5	Improve the methodology that accounts for waste in the NZ ETS
6	Update the liquid fossil fuels tariff codes
7	Update the schedule of goods covered by the synthetic greenhouse gas levy

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