

2023 Report on reasons for differences between prescribed NZ ETS limits and price control settings for units and the Climate Change Commission's advice on these settings

25 September 2023

Presented to the House of Representatives pursuant to section 30GC(7) of the Climate Change Response Act 2002.

Introduction

1. This report sets out the reasons for differences between the Climate Change Commission's (the Commission's) advice on limits and price control settings for units in the New Zealand Emissions Trading Scheme (NZ ETS unit settings) and the settings that have been prescribed in the *Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020*¹ (the regulations).
2. A report explaining the differences is required under section 30GC(7) of the Climate Change Response Act 2002 (the Act).
3. The prescribed unit limits for 2023 to 2028 are intended to be consistent with the recommendations made by the Commission. However, there are some differences which are explained in full below.

Context

4. Unit limits cap the supply of emissions units into the NZ ETS, other than New Zealand Units (NZUs) transferred for removal activities (e.g., for carbon sequestration by forests).
5. NZ ETS price controls settings help manage unacceptably low or high prices in the NZ ETS, setting an upper and lower bound for prices within which the market can discover prices for the target level of emissions reductions.
6. Regulations prescribing NZ ETS unit settings need to be updated each year. This is to meet the requirement that, at all times, settings are in place for each of the following five calendar years. Settings for earlier years can be updated in certain circumstances defined in the Act.
7. The Commission provides annual advice with its recommendations on NZ ETS unit settings for the upcoming five years under section 5ZOA of the Act. The Commission provided its advice on unit settings for 2024-2028 in March 2023.² The Commission did not find grounds to change settings for 2024-2025.
8. The Minister was directed by the High Court in a judgment issued 13 July 2023³ to reconsider the unit settings decided in 2022 for the years 2023 to 2027, following legal action. The Government was able to amend those years due to the outcome of the litigation. The Commission was unable to consider the High Court decision as it was issued after the Commission had already provided its 2023 advice.
9. The intent of the unit settings decisions was to agree with the recommendations of the Commission because the Minister considered the recommended settings either: to be in accordance with emissions budgets, New Zealand's nationally determined contribution under the Paris Agreement, and the 2050 target; or for any discrepancy to be justified under the Act. However, there are some differences; primarily because the Commission was unable to contemplate the judgment of the High Court in developing its advice.

Differences in unit limits

10. Calculations for unit limits are based on a series of steps, used by both the Commission and the Government. A difference in any of the steps between the Commission's approach and the Government's will result in different unit limits.

¹ [Climate Change \(Auctions, Limits, and Price Controls for Units\) Regulations 2020 \(LI 2020/264\) \(as at 01 January 2023\) Contents – New Zealand Legislation](#)

² [2023-advice-on-NZ-ETS-unit-limit-and-price-control-settings.pdf \(climatecommission.govt.nz\)](#)

³ [Lawyers for Climate Action NZ Incorporated v Minister of Climate Change \[2023\] NZHC 1835](#)

Differences in unit limits for 2023

11. The Commission's 2022⁴ and 2023 advice was considered to calculate the unit limits for 2023, although only the Commission's 2022 advice provided a recommendation for 2023.
12. The Commission's 2022 advice differs from the prescribed unit settings because of more recent data that applies to 2023. The two factors underlying the updates are:
 - a. a change in forest land estimated to be registered in the scheme
 - b. more recent industrial allocation projections
13. The total difference is a 1.3 million reduction in the prescribed auction limit and overall limit compared with the Commission's 2022 recommendations (see Table 1 below). The difference are due to:
 - a. updated data regarding new forestry registrations, which impacts how emissions budgets are allocated between NZ ETS and non-NZ ETS sectors (reducing auction volume by 1.5 million units)
 - b. updated forecasts of industrial free allocation (increasing auction volume by 0.2 million units)

Table 1: unit limit difference for 2023 between the Commission's 2022 advice and those prescribed in regulations

Million units	2023
Prescribed NZUs available by auction	23.0
2022 Commission advice	24.3 ⁵
Difference	-1.3

Differences in unit limits for 2024 and 2025

14. In its 2023 advice the Commission considered that the settings for 2024 and 2025 could not be changed because it considered that mandatory criteria under the Act were not met. The Commission did provide an example of possible settings if the Minister disagreed and determined the 2024 and 2025 settings could be changed. However, these examples assumed the cost containment reserve would have been triggered and released in full, which has not occurred yet in 2023.
15. In the end, the High Court directed the NZ ETS unit settings for 2024 and 2025 to be reconsidered regardless, which the Minister did, ultimately adopting different settings to those suggested by the Commission in its 'example' settings. The total difference is a decrease in auction volume of 2.9 million in 2024 and 2.7 million in 2025 compared with the Commission's 2022 recommendations (see Table 3 below). The differences are due to⁶:

⁴ NZ ETS settings for 2023-2027 (climatecommission.govt.nz)

⁵ This is calculated using the Commission's 2022 workbook [Technical-annex-1-Unit-limit-settings-workbook.xlsx](#) (live.com)

⁶ The figures used in paragraph 15 have been rounded to one decimal place. When calculating the unit limits, unrounded figures are used until the final calculation step. This means if paragraphs 15a-15c are added together, there is a 0.1 difference shown in Table 2.

- a. updated data regarding new forestry registrations, which impacts how emissions budgets are allocated between NZ ETS and non-NZ ETS sectors (reducing auction volume by 1.7 million in 2024 and 1.6 million in 2025)
- b. technical adjustments due to differences between New Zealand’s Greenhouse Gas Inventory and emissions reported in the NZ ETS. These relate to likely over-reporting of emissions in the Inventory, which mean that emissions budgets were likely set higher than they would have been if the Inventory had been adjusted earlier (reducing auction volume by 1.4 million in 2024 and 1.3 million in 2025)
- c. updated forecasts of industrial free allocation (increasing auction volume by 0.2 million in 2024 and 2025)

Table 2: unit limit differences for 2024-2025 between the Commission’s 2023 advice and those prescribed in regulations

Million units	2024	2025
Prescribed NZUs available by auction	21.8	19.7
2023 Commission advice	24.8	22.5
Difference	-3.0	-3.0

Differences in unit limits for 2026-2028

- 16. The difference between the Commission’s recommendations for 2026-2028 and those prescribed in regulations is due to the need to reconsider the settings for 2023-2025 as directed by the High Court. It means that there is no longer a need to make a discrepancy adjustment to adjust for the updated free allocation projections, the allocation of the of emissions budgets between ETS and non-ETS sectors, as all these adjustments recommended by the Commission have been made.
- 17. The Commission recommended a discrepancy adjustment that would have reduced the number of NZUs auctioned by 2.2 million in 2026, 2.0 million in 2027 and 1.7 million in 2028.

Table 3: Differences in unit limits for 2026-2028 between the Commission’s 2023 advice and those prescribed in regulations

Million units	2026	2027	2028
Prescribed NZUs available by auction	17.2	15.0	12.3
2023 Commission advice	15.0	13.0	10.6
Difference	2.2	2	1.7

Differences in price control settings

- 18. The NZ ETS price controls settings, like the unit limits, have been compared to the Commission’s 2022 and 2023 advice.
- 19. The difference between price control settings recommended by the Commission and those prescribed in regulations are due to using the most recent inflation rates from Budget Economic

and Fiscal Update 2023.⁷ The Commission recognised that updated inflation rates would be released after it had provided advice and recommended that the price control settings were recalculated with updated inflation rates.

20. This means the prescribed price control settings for some years vary by \$1 to \$2 from those in the Commission’s 2022 and 2023 advice (highlighted in table 4 below).

Table 4: Differences in price control settings between the Commission’s advice and those prescribed in regulations

		2023	2024	2025	2026	2027	2028
Cost containment reserve trigger price	Tier 1	\$173	\$184	\$194	\$205	\$215	\$226
	Tier 2	\$216	\$230	\$243	\$256	\$269	\$283
Auction reserve price		\$60	\$64	\$68	\$72	\$75	\$79

⁷ <https://www.treasury.govt.nz/publications/efu/budget-economic-and-fiscal-update-2023>