Ministry for the Environment
Manatū Mō Te Taiao

PROACTIVE RELEASE COVERSHEET: NZ ETS settings LEG paper and accordance assessment

Minister	Hon Simon Watts	**Portfolio**	Climate Change
Name of package	NZ ETS settings LEG and accordance assessment	**Date to be published**	Once approved by the Minister

List of documents that have been proactively released		
Date	***Title***	***Author***
On approval by Minister	1. Cabinet paper*: Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations*	Office of the Minister of Climate Change
	2. Cabinet minute: LEG-24-MIN-0190 *Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations*	Cabinet Office
	3. Appendix One: 2025-2029 unit limits and price control settings accordance assessment	Office of the Minister of Climate Change

Information redacted **YES / ~~NO~~**

Any information redacted is in accordance with the Ministry for the Environment's policy on proactive release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Summary of reasons for redaction

Some information has been withheld for the reasons of maintaining legal professional privilege and the confidentiality of advice tendered by officials.

Title	***Redactions***
Cabinet paper*: Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations*	N/A
Cabinet minute: LEG-24-MIN-0190 *Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations*	N/A
Cabinet paper*: New Zealand Emissions Trading Scheme unit limits and price control settings for 2025-2029*	Section 9(2)(h) to maintain legal professional privilege Section 9(2)(f)(iv) to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials

Office of the Minister of Climate Change

LEG – Cabinet Legislation Committee

Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations

Proposal

1 I propose that the Cabinet Legislation Committee authorises the submission to the Executive Council of the following amendment regulations:

1.1 Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024;

1.2 Climate Change (Liquid Fossil Fuels) Amendment Regulations 2024;

1.3 Climate Change (Other Removal Activities) Amendment Regulations 2024;

1.4 Climate Change (Stationary Energy and Industrial Processes) Amendment Regulations 2024;

1.5 Climate Change (Unique Emissions Factors) Amendment Regulations 2024;

1.6 Climate Change (Unit Register) Amendment Regulations 2024; and

1.7 Climate Change (Synthetic Greenhouse Gas Levies) Amendment Regulations 2024.

2 These regulations are included as an attachment to this paper.

Executive summary

3 This paper seeks Cabinet approval to amend regulations that set New Zealand Emissions Trading Scheme (NZ ETS) unit limits and price controls.

4 It also seeks Cabinet agreement to technical amendments to multiple sets of NZ ETS regulations, including annual amendments that set the price of carbon and associated levy rates for the synthetic greenhouse gas levy (‘SGG levy’).

Policy

5 This paper seeks Cabinet approval to amend regulations supporting the operation of the NZ ETS and the SGG levy. These regulations are made under the Climate Change Response Act 2002 (‘the Act’).

6 I propose to:

6.1 update the Climate Change (Auctions, Limits, and Price Controls for Units) Regulations 2020 (‘Unit Settings Regulations’) to prescribe unit limits and price control settings for the NZ ETS;

6.2 make technical updates to multiple sets of NZ ETS regulations, including:

6.2.1 additional technical amendments to the Unit Settings Regulations;

6.2.2 the Climate Change (Liquid Fossil Fuels) Regulations 2008 ('LFF Regulations');

6.2.3 the Climate Change (Other Removal Activities) Regulations 2009 ('ORA Regulations');

6.2.4 the Climate Change (Stationary Energy and Industrial Processes) Regulations 2009 ('SEIP Regulations');

6.2.5 the Climate Change (Unique Emissions Factors) Regulations 2009 ('UEF Regulations'); and

6.2.6 the Climate Change (Unit Register) Regulations 2008 ('Unit Register Regulations').

6.3 update the price of carbon and the levy rates for imported goods and motor vehicles in the Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 ('SGGL Regulations').

Updating the Unit Settings Regulations

7 The Unit Settings Regulations will prescribe unit settings for NZ ETS auctions from 2025 to 2029. New unit settings for 2029 are mandatory under the Act.

8 The unit settings will determine, for each of those years, the number of New Zealand Units (units) that will be available to be sold at auction, a minimum price below which units cannot be sold, a reserve volume of units that will be released in the event prices at auction hit a prescribed trigger price (or prices), and what that trigger price (or prices) will be.

9 The settings in the Unit Settings Regulations implement the policy decisions made by Cabinet on 19 August 2024 [CAB-24-MIN-0303, CBC-24-MIN-0083 refer].

10 As there are differences between the Climate Change Commission's (the Commission) recommendations and what Cabinet agreed to [CAB-24-MIN-0303 refer], a report outlining the reasons for difference is required to be presented to the House and made publicly available under 30GC(7) of the Act.

Technical updates to NZ ETS regulations

11 Multiple sets of regulations under the Act support and govern the NZ ETS. It is important to regularly review and update these regulations to maintain the efficiency and accuracy of the NZ ETS.

12 The amendments to these regulations implement the policy decisions made by Cabinet on 19 August 2024 [CAB-24-MIN-0303, CBC-24-MIN-0084 refer], as well as the decisions made by the Minister of Climate Change under the delegation provided by Cabinet on 13 May 2024 [CAB-24-MIN-0156, ECO-24-MIN-0075 refer].

13 The draft regulations for Cabinet's approval include the following amendments:

13.1 The Unit Settings Regulations are amended to include an improved formula for calculating the collateral that auction participants must submit, better aligning

the amount submitted with the amount paid if successful, potentially reducing upfront costs to participants;

13.2 The LFF Regulations are amended with new default emissions factors (DEFs), reflecting the chemical composition of fuels consumed in New Zealand, in particular after the closure of Refining NZ's Marsden Point Oil Refinery. In addition, references in these regulations to the tariff and excise duties tables (managed by NZ Customs) are corrected;

13.3 The ORA Regulations are amended to clarify that SGGs destroyed domestically can be recognised and awarded with units;

13.4 The SEIP Regulations are amended with new DEFs for both the geothermal and natural gas sectors, based on recent data from those sectors;

13.5 The UEF Regulations are amended with new methodologies for recognising the reinjection of "non-condensable gases" back into the geothermal reservoirs, avoiding the emission of these gases to the atmosphere.

13.6 In addition, three error corrections/clarifications are made relating to the waste sector in the UEF Regulations, including to:

13.6.1 the reference to the waste DEF in the Climate Change (Waste) Regulations 2010;

13.6.2 the historical waste composition values for reporting emissions from waste over time; and

13.6.3 the ability for offsite destruction of landfill gases to be recognised.

13.7 The Unit Register Regulations are amended with clarifications to the definition of a qualified person, and how this definition is used in subsequent clauses, to mitigate the risk of unsuitable individuals being allowed to manage holding accounts in the New Zealand Emissions Trading Register (the Unit Register).

Updating the SGGL Regulations

14 The carbon price and levy rates prescribed in the SGGL Regulations are updated each year using the methodology specified in regulations. As these amendments are routine and formulaic they do not require Cabinet policy approvals [paragraph 7.95(d) of the Cabinet Manual refers].

15 Synthetic greenhouse gases (SGGs) are contained in goods including air-conditioning units, refrigerators and motor vehicle air conditioning units. These gases have high global warming potentials (GWP), which are released into the atmosphere as the product is used, serviced and disposed of. Importers of bulk SGGs and domestic manufacturers of SGGs are mandatory participants in the NZ ETS.

16 Importers of goods containing SGGs, and those who first register motor vehicles containing SGGs, are not mandatory participants in the NZ ETS. Instead, they pay a levy linked to the amount and type of SGG in the item, and the price of carbon.

17 The price of carbon is set using a mandatory formula set out in the SGGL Regulations, based on a weekly average of NZU values form the previous 12 months. The price in

2025 will decrease to $62.32 per tonne of carbon dioxide equivalent. This is a change of approximately 13 per cent from the 2024 price of carbon ($71.97).

18 The price of carbon is then used to calculate the SGGL rates for each regulated good or motor vehicle containing SGGs according to a formula set out in the Act. Some penalties under the Act also refer to the price of carbon.

Timing and 28-day rule

19 Section 30H(3) of the Act provides that the Unit Settings Regulations must come into force 3 months after their publication under the Legislation Act 2019, or on any later date specified in the regulations.

Compliance

20 All proposed amendments described in this paper are consistent with:

20.1 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;

20.2 the principles of the Treaty of Waitangi. In developing the NZ ETS unit settings proposed in this paper, the interests, and impacts of the proposals on Māori were considered throughout analysis. During public consultation, the Ministry asked if there were any negative impacts on Māori missed through analysis, and invitations to the public webinars were sent to iwi/Māori NZ ETS stakeholders for input;

20.3 the principles and guidelines set out in the Privacy Act 2020;

20.4 relevant international standards and obligations;

20.5 the Legislation Guidelines (2021 edition), which are maintained by the Legislation Design and Advisory Committee.

21 The annual updating of the Unit Settings Regulations is a statutory requirement under section 30GB(3)(b) of the Act.

22 Before recommending the making of the Unit Settings Regulations I must first consider the matters set out in section 30GC(5) and (6) of the Act (‘the statutory matters’) and then be satisfied that the settings are either: in accordance with emissions budgets, New Zealand’s Nationally Determined Contribution under the Paris Agreement (‘NDC’), and the 2050 target under the Act; or, if not strictly in accordance with an emissions budget or the NDC, that the discrepancy is justified (with reference to the statutory matters).

23 I have complied with these requirements. See Appendix 1 – Assessment of Accordance 2024 for further details.

24 The annual updating of the SGGL Regulations by calculating levy rates for leviable goods or motor vehicles is a statutory requirement under section 233(1) of the Act.

25 Before recommending the making of the SGGL Regulations I must take into account matters set out in section 30W(2) of the Act:

25.1 The price of units used to calculate revenue from the NZ ETS in the Crown annual financial statements in the preceding 12 months;

25.2 The price of units sold by auction in the preceding 12 months;

25.3 Any changes to the operation of the NZ ETS that have affected the price of the units surrendered, or may do so before the end of the next levy year.

26 I have been advised on these three matters and have complied with this requirement.

27 Before recommending the Unit Settings Regulations and other regulations that govern the NZ ETS, under sections 3A(b) and 3B of the Act I must also consult, or be satisfied that the Chief Executive of the Ministry for the Environment has consulted any persons or their representatives that appear likely to be substantially affected by the regulations, and also the representatives of iwi and Māori that appear likely to have an interest in the regulations. I have complied with these requirements by consulting with the public from 15 May to 14 June 2024 on two consultation documents, Annual updates to New Zealand Emissions Trading Scheme limits and price control settings for units 2024 and Proposed changes to New Zealand Emissions Trading Scheme regulations 2024.

Regulations Review Committee

28 I do not consider that there are grounds for the Regulations Review Committee to draw these regulations to the attention of the House of Representatives under Standing Order 327.

Certification by Parliamentary Counsel

29 The draft regulations have been certified by the Parliamentary Counsel Office (PCO) as being in order for submission to Cabinet.

Impact analysis

30 A Regulatory Impact Statement (RIS) was prepared to inform Cabinet's policy decisions on the NZ ETS unit settings [CAB-24-MIN-0303 refers].

31 The technical regulatory updates, along with the price of carbon and SGG levy rates, are not subject to the RIS requirements. This is under the authority of clause 7.95(d) of the Cabinet Manual, on the basis that these changes are a routine update to secondary legislation that does not require new policy decisions.

Publicity

32 The Ministry for the Environment and the Environmental Protection Authority will collaborate to initiate follow-up communications to NZ ETS participants and agencies affected by the regulations.

33 The Ministry for the Environment will also work with New Zealand Customs and the New Zealand Transport Agency to ensure the levy rate changes and other changes to the levy schedules are understood by persons subject to the SGG levy.

Proactive release

34 I intend to proactively release this paper on the Ministry for the Environment's (the Ministry) website subject to any redactions as appropriate under the Official Information Act 1982.

Consultation

35 The Ministry published a discussion document for public consultation on the updates to the NZ ETS settings. Public webinars occurred as part of this consultation process.

36 This paper was circulated with agencies for feedback on 23 August. The agencies consulted included Ministry of Primary Industries, Ministry of Transport, Ministry of Foreign Affairs and Trade, Ministry of Business Innovation and Employment, Department of the Prime Minister and Cabinet, Treasury, Environmental Protection Authority, New Zealand Transport Agency, Te Puni Kōkiri, Te Arawhiti and Customs New Zealand.

Recommendations

I recommend that the Cabinet Legislation Committee:

1 **note** that, on 19 August 2024, Cabinet agreed to unit limits and price control settings for auctions to sell New Zealand units under the New Zealand Emissions Trading Scheme for the years 2025–2029 [CAB-24-MIN-0303 refer];

2 **note** that Cabinet agreed to update limits for units and maintain the current price control settings, including the cost containment reserve volumes, with minor changes made to reflect Treasury Budget 2024 inflation forecasts, and to extend the price control settings to 2029;

3 **note** that the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 will give effect to the decisions referred to in recommendation 1;

4 **note** that before making the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 the Minister of Climate Change is required to comply with sections 3A(b), 3B, 30GC(2), 30GC(3), 30GC(4), 30GC(5), 30GC(6), and 30H(3)(b) of the Climate Change Response Act 2002;

5 **note** that the Minister of Climate Change advises that the requirements in recommendation 4 have been met;

6 **authorise** the submission to the Executive Council of the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024;

7 **note** that the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 will come into force on 1 January 2025

8 **note** that the Minister of Climate Change recommends making the following amendment regulations under the delegation provided by Cabinet on 13 May 2024 [CAB-24-MIN-0156, ECO-24-MIN-0075 refer]:

8.1 make the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 to include an improved formula for calculating the collateral that auction participants must submit;

8.2 make the Climate Change (Other Removals Activities) Amendment Regulations 2024 to clarify that SGGs destroyed domestically can be recognised and awarded with NZUs;

8.3 make the Climate Change (Stationary Energy and Industrial Processes) Amendment Regulations 2024 to prescribe new DEFs for the natural gas sector;

8.4 make the Climate Change (Unique Emissions Factors) Amendment Regulations 2024 to correct or clarify:

8.4.1 the reference to the waste DEF in the Climate Change (Waste) Regulations 2010;

8.4.2 the historical waste composition values for reporting emissions from waste over time; and

8.4.3 the recognition of offsite destruction of landfill gases;

8.5 make the Climate Change (Unit Register) Amendment Regulations 2024 to clarify the definition of a qualified person, and clarify the uses of this definition in subsequent clauses relating to managing holding accounts in the Unit Register;

9 **note** that, on 19 August 2024, Cabinet agreed to updates to regulations affecting the geothermal and liquid fossil fuel sectors [CAB-24-MIN-0303, CBC-24-MIN-0084 refer], including to:

9.1 make the Climate Change (Liquid Fossil Fuels) Amendment Regulations 2024 to prescribe new DEFs for obligation fuels, and to update cross-references to the tariff and excise duties tables;

9.2 make the Climate Change (Unique Emissions Factors) Amendment Regulations 2024 to include new methodologies for recognising the reinjection of “non-condensable gases” back into the geothermal reservoirs.

10 **note** that the Minister of Climate Change recommends making the Climate Change (Synthetic Greenhouse Gas Levies) Amendment Regulations 2024 to:

10.1 prescribe the price of carbon for the 2025 calendar year to be $62.32 per tonne of carbon dioxide equivalent; and

10.2 prescribe the levy rates for levy goods and motor vehicles using the updated price of carbon for 2025.

11 **note** that the Minister of Climate Change advises that the requirements of sections 3A, 3B, 30G, 30GA, 30H, 30W, 163, 164, 166, 168, 244, 245, and 246 of the Act have been met in relation to updating the amendment regulations listed in recommendations 8, 9 and 10;

12 **authorise** the submission to the Executive Council of the amendment regulations listed in recommendations 8, 9 and 10;

13 **note** that the amendment regulations listed in recommendations 8, 9, and 10 will come into force on 01 January 2025.

Authorised for lodgement

Hon Simon Watts

Minister of Climate Change

LEG-24-MIN-0190

Cabinet Legislation Committee

Minute of Decision

Amendments to the New Zealand Emissions Trading Scheme (NZ ETS) Regulations

Portfolio **Climate Change**

On 19 September 2024, the Cabinet Legislation Committee:

1 **noted** that, in August 2024, the Cabinet Business Committee (CBC) agreed to unit limits and price control settings for auctions to sell New Zealand units under the New Zealand Emissions Trading Scheme for the years 2025–2029 [CBC-24-MIN-0083];

2 **noted** that CBC agreed to update limits for units and maintain the current price control settings, including the cost containment reserve volumes, with minor changes made to reflect Treasury Budget 2024 inflation forecasts, and to extend the price control settings to 2029;

3 **noted** that the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 will give effect to the decisions referred to in paragraph 1 above;

4 **noted** that before making the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 the Minister of Climate Change is required to comply with sections 3A(b), 3B, 30GC(2), 30GC(3), 30GC(4), 30GC(5), 30GC(6), and 30H(3)(b) of the Climate Change Response Act 2002;

5 **noted** that the Minister of Climate Change advises that the requirements in paragraph 4 have been met;

6 **authorised** the submission to the Executive Council of the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 [PCO 26619/7.0];

7 **noted** that the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024 will come into force on 1 January 2025;

8 **noted** that the Minister of Climate Change recommends making the following amendment regulations under the delegation provided by the Cabinet Economic Policy Committee [ECO-24-MIN-0075]:

8.1 the Climate Change (Auctions, Limits, and Price Controls for Units) Amendment Regulations 2024, to include an improved formula for calculating the collateral that auction participants must submit;

8.2 the Climate Change (Other Removals Activities) Amendment Regulations 2024, to clarify that synthetic greenhouse gases destroyed domestically can be recognised and awarded with NZUs;

8.3 the Climate Change (Stationary Energy and Industrial Processes) Amendment Regulations 2024, to prescribe new default emissions factors (DEFs) for the natural gas sector;

8.4 the Climate Change (Unique Emissions Factors) Amendment Regulations 2024, to correct or clarify:

8.4.1 the reference to the waste DEF in the Climate Change (Waste) Regulations 2010;

8.4.2 the historical waste composition values for reporting emissions from waste over time;

8.4.3 the recognition of offsite destruction of landfill gases;

8.5 the Climate Change (Unit Register) Amendment Regulations 2024, to clarify the definition of a qualified person, and clarify the uses of this definition in subsequent clauses relating to managing holding accounts in the Unit Register;

9 **noted** that, in August 2024, CBC agreed to updates to regulations affecting the geothermal and liquid fossil fuel sectors, including to:

9.1 make the Climate Change (Liquid Fossil Fuels) Amendment Regulations 2024 to prescribe new DEFs for obligation fuels, and to update cross-references to the tariff and excise duties tables;

9.2 make the Climate Change (Unique Emissions Factors) Amendment Regulations 2024 to include new methodologies for recognising the reinjection of "non-condensable gases" back into the geothermal reservoirs.

[CBC-24-MIN-0084]

10 **noted** that the Minister of Climate Change recommends making the Climate Change (Synthetic Greenhouse Gas Levies) Amendment Regulations 2024 to:

10.1 prescribe the price of carbon for the 2025 calendar year to be $62.32 per tonne of carbon dioxide equivalent; and

10.2 prescribe the levy rates for levy goods and motor vehicles using the updated price of carbon for 2025;

11 **noted** that the Minister of Climate Change advises that the requirements of sections 3A, 3B, 30G, 30GA, 30H, 30W, 163, 164, 166, 168, 244, 245, and 246 of the Act have been met in relation to updating the amendment regulations listed in paragraphs 8, 9 and 10 above;

12 **authorised** the submission to the Executive Council of the:

12.1 Climate Change (Other Removal Activities) Amendment Regulations 2024 [PCO 26620/6.0];

12.2 Climate Change (Stationary Energy and Industrial Processes) Amendment Regulations 2024 [PCO 26621/5.0];

12.3 Climate Change (Synthetic Greenhouse Gas Levies) Amendment Regulations 2024 [PCO 26622/6.0];

12.4 Climate Change (Unique Emissions Factors) Amendment Regulations 2024 [PCO 26623/8.0];

12.5 Climate Change (Unit Register) Amendment Regulations 2024 [PCO 26624/6.0];

12.6 Climate Change (Liquid Fossil Fuels) Amendment Regulations 2024 [PCO 26666/3.0];

13 **noted** that the amendment regulations in paragraph 12 above will come into force on 1 January 2025.

Tom Kelly
Committee Secretary

Present:
Rt Hon Winston Peters (Chair)
Hon Nicola Willis
Hon Shane Jones
Hon Brooke van Velden
Hon Dr Shane Reti
Hon Judith Collins KC
Hon Mark Mitchell
Hon Tama Potaka
Hon Casey Costello
Hon Nicole McKee
Hon Matt Doocey
Hon Andrew Bayly
Hon Scott Simpson, MP
Jamie Arbuckle, MP
Todd Stephenson, MP

Officials present from:
Officials Committee for LEG

2025-2029 unit limits and price control settings accordance assessment

The Minister of Climate Change (the Minister) is responsible for making regulations to set the 2025-2029 NZ ETS unit limits and price control settings (NZ ETS settings). Before recommending the regulations, the Minister needs to be satisfied of accordance with the statutory tests outlined in section 30GC of the Climate Change Response Act 2002 (the Act).

Cabinet agreed 2025-2029 settings, which were recommended by the Minister, on 19 August 2024 [CAB-24-MIN-0303 refers]. This document provides officials assessment of the 2025-2029 NZ ETS settings' compliance with the statutory tests in 30GC of the Act, to inform the Minister's assessment of accordance with the statutory tests.

There are three parts to this document:

Part 1: Approach to this accordance assessment (p 1-4)

This part provides a general description of the approach taken and key assumptions made.

Part 2: Assessment of accordance (p 5-8)

This part assesses accordance of the status quo settings (p 5) and Cabinet's agreed 2025-2029 unit limits and price control settings, including justification for deviation from strict accordance, where relevant.

Part 3: Mandatory matters – in general terms (p 9-17)

This part steps through each of the matters the Minister must consider under section 30GC of the Act before recommending unit settings.

Part 1: Approach to this accordance assessment

Assessing strict and general accordance

1. Before recommending unit settings the Minister must be satisfied that either:

    - the unit settings [strictly] accord with all extant emissions budgets, New Zealand's NDC(s), and the 2050 target (collectively 'emissions goals') (section 30GC(2)); or

    - if the unit settings do not strictly accord with the emissions budgets or the NDC, that the discrepancy is justified after considering prescribed statutory matters (section 30GC(3)).[1]

2. Strict accordance will be demonstrated where the settings can be shown – to a very high probability – to equate with what is required to ensure the emissions generated by sectors covered by the ETS are constrained to the level necessary for those sectors to remain within their allocation of the budgets, NDC, and 2050 target.

3. Predicting the future involves uncertainty, so some judgement is required within the margins, based on best evidence. This means making reasonable assumptions and forecasts about New Zealand's projected emissions trends and the effects of emissions policies. It also means accounting for how well-supplied markets are.

4. In cases where the Minister can justify settings that do not strictly accord, the Act still requires general accordance – settings must ensure a good probability of meeting the targets.

5. The calculation of accordance must consider the whole package of settings (unit limits and price controls) because their effects on unit supply (and ultimately emissions) are interdependent.

6. Determining the ETS share of emission targets in order to test accordance must also occur in combination with an assessment of the predicted emissions impacts of New Zealand's other climate policies and the uncertainties related to those projections. This includes emissions policies for sectors not covered by the NZ ETS (for example agriculture), the role of offshore emissions abatement, and the predicted effects of complementary NZ ETS policies.

7. Determining strict accordance or general accordance requires assessing the likelihood of achieving targets, including assessing the risks and mitigations.

8. We have therefore approached the assessment by using a **combination** of modelling results and the seven step methodology (described in the mandatory matters section below), which includes analysis of relevant information such as projections of emissions in the ETS and non-ETS sectors, estimate of 'surplus' units in the stockpile of privately held units, and broader climate change policies as proposed in the consultation document for the second emissions reduction plan.

Seven step methodology

9. The seven step methodology (see Main matter 30GC(5)(a)) is used to calculate base unit limits. It takes a binary approach to estimating the surplus – units are either surplus or non-surplus, with a large range of uncertainty. It assumes that:

    a. All units that have been assessed to be surplus could come to market and allow for excess emissions

[1] Section 30GC(3) does not envisage deviation from strict accordance with the 2050 target.

b. All units that have been assessed to be non-surplus are unavailable to emitters (i.e. they are non-liquid)

c. NZU prices have no impact on the release or otherwise of stockpiled units (i.e. the size of the surplus and their availability is not influenced by the price).

10. This approach is a simplification of the real world to support a policy process. This methodology takes a precautionary approach to the surplus stockpile, and aims to eliminate the risk it poses by reducing this surplus to zero.

NZ ETS Market Model

11. The ETS market model allows for a more realistic approximation of the real-world situation. It determines demand for NZUs in terms of price-responsiveness, and allows for more of a spectrum of liquidity across units in the stockpile. This means that, if the marginal price of reducing emissions is lower than the expected value of holding the most liquid unit in the stockpile, emitters will choose to reduce emissions rather than purchase a surplus unit for surrender. The practical consequence of this is that the model can show units remaining in the stockpile beyond 2030 without meaning that net emissions necessarily exceed emission budgets. It also means that, in scenarios when the model projects non-surplus units come to market, emissions budgets can be exceeded even if the surplus stockpile is eliminated.

12. As with any model there are limitations in the modelling, and it is unlikely that things will play out precisely as the model suggests. The model was not designed to estimate total net emissions; its focus is on net emissions covered by the NZ ETS. However, the projections from the model can be combined with other information to make a high-level projection of total net emissions. This can help with assessing whether a given combination of unit and price control settings are in accordance with emissions budgets.

Assumptions and uncertainties

13. Current modelling for the second emissions reduction plan (ERP2) suggests that New Zealand can remain within the second emissions budget (EB2), with the policies and strategies proposed for ERP2 contributing to this. There will always be risks to achieving emissions budgets (eg. economic patterns or dry/wet weather years), and the Government will actively manage these risks in forming the final ERP2 and through the EB2 period.

14. There are also other key assumptions:

- Liquidity of the stockpile

  We have made an assessment on the size of the liquid stockpile based on the expected use of NZUs, which was tested through consultation. However, there is a large range of uncertainty in this estimate. The total stockpile could be more liquid than assumed, which could allow excess emissions. Alternatively, the total stockpile may be less liquid than assumed which reduces the risk of it contributing to excess emissions.

- Responsiveness of emitters to price.

  There is limited evidence on how emitters respond to higher NZU prices. If emitters are less responsive than assumed, it would make emissions budgets harder to achieve, and vice versa.

15. The NZ ETS share of emissions budgets 1,2 and 3 and the 2050 target is derived from the demonstration path, outlined in *Ināia tonu nei: a low emissions future for Aotearoa* (the

Commission's advice to the Government on the first emissions reduction plan), which was implicitly adopted by the Government via sector sub-targets through the first emissions reduction plan, updated for changes to the national greenhouse gas inventory. The use of the demonstration path may be considered through decisions on ERP2.

16. Adaptive management is a key part of the annual ETS settings process. It allows the Government to change settings if the market is responding differently to how we expected. However, there are limitations to this. If developments over the coming years suggest that emissions are likely to exceed emissions budgets it will be increasingly more difficult to correct for this because:

    - due to the declining ETS cap, there would be limited auction volume available to respond to any increase in emissions
    - the one-sided nature of auctioning means the government can only supply NZUs, it cannot remove them
    - there is only a small window of time available to develop and implement alternative policies
    - the first years of settings are unable to be changed, unless the special circumstances required under the Act have been met.

Part 2: Assessment of accordance

17. This part assesses accordance of the status quo NZ ETS settings that were given effect in regulations last year. It then assesses accordance of the 2025-2029 NZ ETS settings that Cabinet recently agreed, including justification for deviation from strict accordance, where relevant.

Status quo accordance assessment

18. Status quo settings are not considered to be in strict accordance with emission targets other than EB1. Under status quo settings, modelled central projections indicate that net emissions are within the EB2 budget, once the effects of proposed ERP2 policies are included. This means that, in our best judgement, meeting EB2 is the most likely outcome of the distribution of potential outcomes under status quo settings, and the status quo settings thereby meets a threshold of "good probability". However, it is only possible for net emissions to be consistent with EB2 if a substantial portion (about 40%) of the surplus (as per our current central estimate) remains in the stockpile. The projected presence of this surplus in 2030 under status quo settings represents a particular and significant risk to the achievement of EB2 and EB3, such that the "very high probability" of achievement test required for strict accordance would not be met. Furthermore, the status quo is less resilient to the underachievement of ERP2 policies, with the projected buffer sufficient to absorb ERP2 policy impacts being about 35% lower than assumed.

19. The divergence from strict accordance is not justified for status quo settings. There is no evidence supporting the need to maintain the surplus at such a volume after considering the available matters in the Act. Concerns with market liquidity would already have been seen through submissions and compliance proceedings by the regulator over failures to surrender NZUs. Very few submissions noted liquidity concerns, and the rate of compliance incidents have not changed in recent years.

Assessment of Cabinet's agreed 2025-2029 unit limits and price control settings

20. On 19 August, Cabinet agreed to update the unit limits and price control settings for 2025-2029 [CAB-24-MIN-0303]. The agreed unit limits aim to draw 100% of the current estimate of the surplus stockpile out by 2030 and extend the status quo price control settings to 2029. The tables below provide officials' assessment of accordance of Cabinet's agreed settings with the statutory tests, including justification for deviation from strict accordance, where relevant. [2] This assessment is to support the Minister prior to recommending the making of regulations to give effect to those settings.

[2] Drawing down 100% of the surplus estimate would require net emissions in ETS covered sectors to equal the ETS' share of EB2,

Table 1: Strict accordance assessment of Cabinet's agreed settings with emissions reduction targets. (General accordance assessments and justification for deviation from strict accordance are in Table 2 below).

Strict accordance assessment	Cabinet's agreed settings	Conclusion
Emissions budget 1	Recent projections show New Zealand is on track to meet the first emissions budget. There is a low risk of NZ ETS sector emissions exceeding their share of EB1 based on the updated demonstration path. The continuation of the status quo price control settings (CCR and price floor), support market confidence and are consistent with what is necessary to meet emissions budgets. The cost containment reserve trigger price levels are high enough that there is a very low risk for it to be triggered. However, if the CCR were triggered, the release of additional units would slightly lower the likelihood of achieving emissions budget 1. This is more likely to add additional risk to the achievement of future budgets, rather than EB1 because there is only one year of the EB1 period remaining. The auction price floor level will prevent NZU prices from being lower than needed to achieve the emissions budget, and limits additional units being sold if the market is oversupplied at this price point.	There is a very high probability that EB1 will be achieved, therefore the settings are assessed to be in strict accordance. There is a small risk due to the number of units retained in the stockpile over this period, and therefore the number of units auctioned.
Emissions budget 2	Modelling shows the agreed settings are highly likely to achieve EB2 once additional policies from ERP2 are accounted for. NZ ETS sector emissions are projected to remain within their assumed share of EB2 based on the updated demonstration path. The risk posed by the surplus to NZ ETS emissions in EB2 is mitigated by reducing the central surplus estimate to zero by the end of the EB2 period. Other risks to achievement of EB2 (noting that the second two risks may also go the in the other direction) include: • future inventory changes may increase emissions relative to the fixed emissions budgets; and • the possibility that proposed or existing Government policies are not as effective as expected, or unexpected Government policies may result in increased NZ ETS emissions. All else being equal, the agreed settings are projected to have sufficient buffer to absorb ERP2 policy impacts being about 55% lower than assumed in the model.	There is a very high probability that NZ ETS emissions will stay within their share based on the updated demonstration path, therefore the settings are assessed to be in strict accordance. Drawing down the surplus by the end of the budget period substantially reduces the risk the surplus poses to EB2 as it limits excess emissions, assuming the surplus estimate is accurate and additional units do not come to market. There are also uncertainties, including the abatement that will be delivered by proposed ERP2 policies.

	The Government could introduce additional ERP2 non-ETS policies to further ensure achievement of the budget, and has already directed officials to develop additional policies as a contingency measure. However, there are limitations to this approach as additional policies take time to decide and implement. The price control settings support accordance with emissions budget 2 the same way above on accordance with emissions budget 1. The auction floor price could provide a safety valve against oversupply, if there is a risk that more of the stockpile comes to market, as it prevents further units from being auctioned if the price is below the floor price.	
Emissions budget 3	Removing the surplus by EB3 means the ETS will be able to deliver its share towards the achievement of EB3. Using the updated demonstration path, the ETS share of EB3 is estimated at 38.4M NZUs. After subtracting forecast industrial allocation volume and technical adjustments, 12.3M NZUs remain that could be auctioned. The demonstration path provides one estimate of the share of relative ETS and non-ETS effort for EB3. The Government will have the opportunity to set out its desired share of future ETS effort as part of ERP2 and/or ERP3. This share, together with any relevant policies that might affect the cost and update of mitigation technologies, can be incorporated into future settings decisions as part of the adaptive management approach. The NZ ETS is limited in its ability to drive achievement of EB3 on its own. Other policies and measures expected through the finalisation of ERP2 and development of ERP3 will be required to ensure the achievement of EB3. Modelling shows EB3 is unlikely to be achieved without additional policy measures. However, at this time horizon the modelling projections are highly uncertain. The modelling does not factor in other policies and measures expected through finalisation of ERP2 and the development of ERP3.	There is a very high probability that the ETS will be able to achieve its estimated share of EB3 so is assessed to be in strict accordance with EB3. This is based on: - the complete removal of the surplus before the start of EB3 - preserving the ability for the Government to use its adaptive management tools to ensure the ETS is able to meet its share of the emissions budget In addition, the achievement of EB3 will be supported through: - ERP2 policies playing some part in meeting EB3 - the requirement for ERP3 to set out how EB3 will be met by the Government.
NDC	The agreed settings have been assessed as having a very high probability of meeting EB1 and EB2. These budgets cover a similar period as the NDC. This means the domestic contribution of the ETS is reasonably clear. However, additional policy action outside the NZ ETS will be required to meet the NDC, as NZ ETS settings alone are unable to close the gap between the NDC and EB1/EB2. The precise contribution the NZ ETS needs to make towards meeting the NDC cannot be known until an assessment of non-ETS domestic policies and other actions	The agreed settings are not in strict accordance with the NDC due to the inability for the NZ ETS to achieve the NDC on its own and the lack of actioned access to international mitigation. This differs from the assessment of EB3, which

	including potential arrangements to access international mitigation are complete.	was assessed as being in strict accordance. This is because the NDC is at a shorter time horizon and there is a clear mechanism for the development of non-ETS policies through ERPs. Refer to Table 2 for assessment of general accordance.
2050 target	Emission budgets are intended to be 'stepping stones' towards the 2050 target, and the agreed settings will achieve emission budgets over time, then these settings can be considered in strict accordance. The agreed settings allow for units to be auctioned over 2025-2029, however the effect of those units on the achievement of the 2050 target is not able to be estimated. As explained in Part 3 below, the ETS contribution to the long-lived gases 2050 target is complicated by a significant amount of emissions outside the ETS, as well as the continuation of some industrial allocation past 2050 and the ongoing entitlements and surrenders for ETS forestry.	The agreed settings are assessed to strictly accord with the ETS portion of the 2050 target (insofar as it can be determined at this time). Emission budgets are intended to be 'stepping stones' towards the 2050 target, so their achievement sets up the achievement of the 2050 target.

Table 2: General accordance assessment and justification for deviation from strict accordance.

	Analysis and reasons
NDC	The agreed settings do not strictly accord with the NDC. The agreed settings are in general accordance because they are consistent with the emissions budgets. The divergence from strict accordance is justified because of the findings of the Commission detailed in Part 3 below under the main matter *section 30GC(5)(d): The forecast availability and cost of ways to reduce greenhouse gas emissions that may be needed for New Zealand to meet its targets for the reduction of emissions.* In particular, that achieving the NDC through domestic emission reductions only would require large scale cuts to economic output across Aotearoa New Zealand, which would have significant flow-on effects to jobs, broader society, and the economy. Nor are NZ ETS settings able to close the gap alone – the difference between the NDC and emissions budgets, currently estimated at 93Mt, exceeds the total agreed auction volume for 2025-30 (by 22.9M) and industrial allocation (33.5M) combined. As described in Part 3, the Government's priority is domestic climate action to help meet New Zealand's climate change targets. New Zealand's submission on its first NDC states New Zealand intends to use international market mechanisms, cooperative approaches and carbon markets that enable trading and use of a wide

	variety of units/emission reductions/mitigation outcomes that meet reasonable standards and guidelines. This was affirmed when the Government provided its updated NDC1 to the United Nations on 4 November 2021.[3] s9(2)(f)(iv) [redacted]

[3] The submission is found here

Part 3: Mandatory matters – in general terms

21. There are a number of "other matters" listed in section 30GC of the Act that must be considered when assessing accordance with emissions goals. These matters are detailed in Part 3 below, which provides interpretations and detail for each matter. They also inform the overall assessment made in Part 2.

22. The "other matters" in s 30GC of the Act comprise the "main matters" and the "additional matters". The "main matters" listed in s 30GC(5) are of general application and are used for assessing accordance against emissions goals in Part 2 and/or justifying deviation from strict accordance with the emissions budgets and NDC. The "additional matters" in s 30GC(6) are relevant only to the price control settings.[4]

23. Section 30GC(2) and (3) of the Climate Change Response Act 2002 (the **Act**) states that:

(2) The Minister must be satisfied that the limits and price control settings are in accordance with—

(a) the emissions budget, and the nationally determined contribution for New Zealand under the Paris Agreement, that applies to—

(i) the period for which the limits or price control settings are being prescribed; or

(ii) any period after that, if a budget or contribution exists for that period; and

(b) the 2050 target.

(3) However, they need not strictly accord with the budgets or contributions as long as the Minister is satisfied that the discrepancy is justified, after considering the other matters under this section.

30GC(5) – the Main matters (relevant to unit limits and price control settings)

30GC(5)(a): The projected trends for New Zealand's greenhouse gas emissions in the 5 years after the current year, including:

(i) the anticipated volumes of greenhouse gas emissions to which the emissions trading scheme applies (meaning emissions for which participants are required to submit returns or surrender units under this Act); and

(ii) the anticipated volumes of greenhouse gas emissions to which the emissions trading scheme does not apply.

24. The projected emissions trends for New Zealand's greenhouse gas emissions for the next five years after the current year, as well as for 2024, are as follows:[5]

[4] Price control settings operate at the Government's emission unit auctions and prevent the sale of emission units below a specified minimum price and allow the sale of reserve amounts of emission units at other specified (trigger) prices. The price control settings are comprised of the reserve amount of NZUs for each trigger price, the trigger prices, and the minimum price below which units must not be sold by auction.

[5] These are the ERP2 consultation interim baseline projections from New Zealand's second emissions reduction plan (2026-30) consultation document released in July 2024 and use Intergovernmental Panel on Climate Change Assessment Report 4 conversion factors. New Zealand's Greenhouse Gas Projections are currently being updated to

	2024	2025	2026	2027	2028	2029
Total net emissions (Mt CO_2e)	70.9	68.8	66.6	63.5	61.1	59.1

25. The anticipated volume of greenhouse gas emissions projected to fall within the New Zealand Emissions Trading Scheme (NZ ETS) and outside (non-NZ ETS sectors/sources) in the next five years, as well as for 2024, are as follows: [6]

	2024	2025	2026	2027	2028	2029
Total NZ ETS net emissions (Mt CO_2e)	27.3	25.6	23.4	21.4	19.4	17.4
Total net emissions outside NZ ETS (Mt CO_2e)	43.0	42.9	42.3	41.9	41.6	41.2

26. The established seven step methodology is used to calculate the NZ ETS 'cap' and New Zealand Unit (NZU) volume limits. This involves data on emission budgets, any technical discrepancies, forecast industrial allocation, and use of approved international emission units (if any), to arrive at the limit on NZUs available for auction. Consideration is then made of how much volume is available for auction and how much is retained for supply should the cost containment reserve (CCR) trigger be met. Currently, that CCR volume is based on the output of a separate methodology on estimates of the amount of NZUs already available for surrender (the stockpile) less the number of stockpiled NZUs that are unrelated to hedging for future surrender by emitters (including post-1989 harvest liabilities) or those relating to the pre-1990 forestry allocation plan. That amount is considered the surplus stockpile.[7]

27. If any auction volume remains unsold at the completion of the final auction of the year, that volume is cancelled. Such an outcome would likely mean the stockpile is reduced, because the potential supply to market was less than allowed. People required to surrender NZUs in the following year will have found that supply from their hedged volume or the secondary market. The exact reduction in the stockpile may not be equal to the auction volume not sold because of the potential for different surrender obligations than assumed because of emission reductions. Additionally, the stockpile is impacted by NZUs entering it from removal activities and exiting for surrenders for delayed emission returns, such as through amendments.

28. The unit limits methodology ensures that NZU volumes are aligned with the projected volume of greenhouse gas emissions within the NZ ETS allowed in the budget (which in turn refer to the Commission's demonstration path), and that some of the stockpile is reduced depending on the use of the CCR.[8] Because NZUs available for auction include the CCR volume, if the CCR volume

account for methodology changes and any revisions to emissions reductions policies and are expected to be released by the end of 2024.

[6] Climate Change Commission – Updated demonstration path 2024. Note these figures will not sum the totals in the previous table due to differences in assumptions about what measures are implemented, when they take effect, and what impact they will have.

[7] For this analysis see pages 46 and 47 of CCC_2024-advice-on-NZ-ETS-unit-limit-and-price-control-settings-2025-2029.pdf (climatecommission.govt.nz) and 20240228_Technical-Annex-1_Unit-limit-settings.pdf (climatecommission.govt.nz).

[8] The demonstration path is described in the Commission's 2021 report Ināia Tonu Nei: A low Emissions Future for Aotearoa New Zealand

is released, the overall limit will not be exceeded. However, this does not mean the budget will not be exceeded, because of the existing surplus stockpile.

29. In 2024, the Commission made changes to the calculation of unit limits. The Commission noted there had been a large increase in their surplus estimate for various reasons. Instead of increasing the CCR volume as a result, it recommended the CCR volume not be changed from the existing regulations.

30. The Commission also repeated advice from 2023 that an identified discrepancy between emissions reported in New Zealand's Greenhouse Gas Inventory and those reported in the NZ ETS – relating to liquid fossil fuels– needed to be addressed in the unit limits calculations.

31. It is likely that the discrepancy results from over-reporting emissions in the Inventory. It is possible the Inventory will need adjustment for the liquid fossil fuel discrepancy. As a result, it is possible that emissions budgets were set higher than they might have been otherwise.

32. The projections inform the calculation of the NZ ETS settings and underpin the modelling, which are both key components of the accordance assessment.

30GC(5)(b): The proper functioning of the emissions trading scheme

33. There are several aspects of 'proper functioning', which are considered below.

Regulatory predictability

34. The NZ ETS provides a price signal by setting a cap on emissions and letting trading of NZUs occur. A stable emissions price, with regulatory certainty, provides a signal to invest in abatement and removals and to change actions towards less emissions intensive activities.

35. The NZ ETS should therefore operate in a transparent and durable manner that allows participants to form expectations about future market conditions. This is assisted by the Act restricting the ability of the Minister to amend settings for the next two years,[9] which builds confidence in the NZ ETS market and encourages investment in cost-effective opportunities for domestic emissions abatement. The first two years can be amended in specific circumstances, including if the CCR units are released.

Role of additional measures

36. The first ERP and the consultation document for the second ERP have noted the NZ ETS needs to be complemented by additional measures to address market barriers and failures. The consultation document for the second ERP suggests that research and development, removing regulatory barriers, and addressing market failures such as lack of information will allow targets and budgets to be achieved at least cost.

37. The success or failure of the implementation of additional measures has a bearing on the functioning of the NZ ETS. For example, the supply of NZUs is impacted through reforms to industrial allocation policy, although there is a possibility that adjustments to auction supply could result.

[9] However, on 13 July 2023, the High Court ordered the Minister to remake the 2022 NZ ETS settings decisions. This enabled (and required) reconsideration of settings for 2023, 2024 and 2025.

Participants' ability to manage obligations

38. NZ ETS unit settings should allow the NZ ETS to function as intended. This includes auctions that operate as designed every year[10], and NZ ETS participants being able to attain and surrender NZUs to meet NZ ETS obligations.

39. An important part of managing obligations and NZ ETS costs for participants is their ability to bank NZUs (stockpile) in their accounts in the NZ ETS Register. A large quantity of NZUs has accumulated in private accounts, with the current quantity of privately held NZUs at 145 million units.[11] There is uncertainty in the size of the surplus stockpile. The Commission estimated it in their 2024 advice as between 51.1 – 84.3 million NZUs, while an updated MfE estimate puts it at between 46.8 – 85.6 million NZUs.

40. The stockpile is reduced when NZUs are surrendered to match reported emissions by participants.[12] It is added to through auctions and receipt of allocations and entitlements. The stockpile represents future rights to emit.

41. The Government has previously prescribed unit limits that 'draw down' the liquid component of the stockpile through reduced auction volumes to 2030. That draw down volume rests in the CCR, although in 2024 the Commission's recommendation for the CCR volume did not include all the draw down stockpile volume – some of this volume would simply be withdrawn from the limit on units available. The success of the draw down is therefore dependent on the CCR volume not being sold. If the CCR is sold to participants, then under current policy, this would mean the auction volumes in later years need to reduce more than currently planned to claw back that volume.

42. A quicker draw down of the surplus stockpile (than to 2030) would significantly reduce auction volumes in the near term, which could risk impacts to the functioning of the market through damaging liquidity, which would impact prices and the ability of participants to comply with surrender obligations. It would also have fiscal impacts through lowered auction volumes.

Role of price controls

43. The CCR functions as a market 'shock absorber', reducing the risk of unacceptable emissions costs by increasing supply, but also as a guide to maximum NZU prices for participants.

44. The CCR volume can be sold to auction participants if trigger prices are hit in auctions. Those prices are intended to be well outside the NZU prices necessary to achieve emission budgets.

45. Should the CCR volume be released, the risk to emission budgets is maintained for longer because that surplus remains available. In its 2024 advice, the Commission reassessed whether the previous timeframe to reduce the surplus to zero (2030) remains appropriate and whether special circumstances exist to enable recommending changes to the first two years of the unit limit settings (2025 and 2026). It advised that the approach of aiming to reduce the surplus by 2030 remains appropriate to support accordance with emissions budgets, and that the special circumstances to amend the 2025 and 2026 existing settings apply to address the surplus.

46. The other prescribed auction price control is the auction reserve price (ARP). The ARP is the price below which the Government will not sell units at auction. Its purpose is to act as a safety

[10] At least, until auctions are no longer required because of the reduced ETS cap

[11] Number of NZUs held as of 30 June 2024, Privately held units | EPA

[12] Or cancelled, but very little of this occurs. See the Environmental Protection Authority webpage on unit cancellations.

valve that helps guard against NZU prices dropping below what is needed for meeting emissions budgets.

47. As required by the Act, the Commission considered a range of matters when it first made its ARP recommendations and subsequently each year in reconsidering the settings.[13] The Commission wrote that the two most critical issues for ARP settings were the minimum emissions price levels consistent with meeting emissions budgets, and when it would be appropriate for the Government to withhold units and reduce unit supply below the planned auction volume.

48. The Commission's 2022 recommendations on the value of the ARP were determined through economic modelling, which took into account:

- The Government's decisions about setting emissions budgets. These were based on emissions pathways and judgements about acceptable costs for meeting budgets that reflected both reducing gross emissions and using forests to absorb carbon dioxide.
- Consistency with the Government's first emissions reduction plan (ERP1), which recognised the need, and stated intention, to reduce gross emissions.
- That gross emissions reductions are needed to meet the first and second emissions budgets. It is not possible to achieve these budgets solely by using forests to compensate for gross emissions, due to the time lag between planting and forests starting to sequester carbon.
- The Commission judged that due to the NDC, the ARP should be at levels that help the Government avoid selling NZUs at prices lower than the likely cost of offshore mitigation.
- The NDC requires significant further abatement beyond emissions budgets, to be met by purchasing offshore mitigation.
- If domestic reductions are easier than expected, overachieving emissions budgets is in the national interest – each tonne reduced at home means one less tonne to buy overseas.
- Conversely, if the Government sold NZUs for less than what will need to be paid for offshore mitigation, the fiscal and economic costs of meeting the NDC would increase.

49. Other issues to consider in relation to the ARP would be the effect changes to ARP levels could have on sentiment and market confidence.

50. The NZ ETS settings have been assessed based on the descriptions above and support proper functioning of the scheme.

30GC(5)(c): International climate change obligations and instruments or contracts that New Zealand has with other jurisdictions to access emissions reductions in their carbon markets

51. New Zealand's first Nationally Determined Contribution (NDC1) under the Paris Agreement outlines the contribution New Zealand will make towards delivering on the goals of the Paris Agreement. NDC1 was updated on 31 October 2021. The new NDC sets a headline target of a 50 per cent reduction of net emissions below gross 2005 level by 2030.

52. NDC1 covers the period 2021-2030 and is economy-wide, covering all sectors and all greenhouse gases. NDCs under the Paris Agreement are international targets that can be met

[13] Climate Change Commission's advice on ETS settings for 2023-2027

through a combination of domestic action and additional international cooperation. The Government's priority is domestic climate action to help meet New Zealand's climate change targets. New Zealand's submission on its first NDC states New Zealand intends to use international market mechanisms, cooperative approaches and carbon markets that enable trading and use of a wide variety of units/emission reductions/mitigation outcomes that meet reasonable standards and guidelines. This was affirmed when the Government provided its updated NDC1 to the United Nations on 4 November 2021.[14]

53. New Zealand has no current instruments or contracts with other jurisdictions to access emissions reductions in their carbon markets. Discussions and analysis of opportunities are continuing.

54. Assessment of accordance with the NDC is a key component of Part 2.

30GC(5)(d): The forecast availability and cost of ways to reduce greenhouse gas emissions that may be needed for New Zealand to meet its targets for the reduction of emissions

Emissions budgets

55. ERP1 and the consultation document for ERP2 contain more detailed information on the policies and actions for reducing emissions and meeting targets.

56. For the proposed ERP2, an economy wide model was used to test the sufficiency of proposed policies and actions. The modelling assumes a price path in which prices continue to rise to $75 in 2028 but then fall to a long-run price of $50/t (in 2023-dollar values) from 2035. The average NZU price for the first six months of 2024 was $60.

57. The consultation document for the ERP2 contains an assessment of New Zealand's progress on meeting the first three emissions budgets. It states interim projections show that we are expected to stay within EB1 and EB2 but are not currently forecast to be within EB3. It notes that tackling climate change means governments will always have to manage uncertainty and respond to both opportunities and challenges.

58. The assessment of NZ ETS settings against emission targets include the expected impacts of proposed ERP2 policies. The impacts from policies discontinued from ERP1 are also included; that is, if removing a policy will result in increased emissions, those numbers are used in the modelling.

59. Projections are significantly impacted by inventory methodological change. For example, the accordance assessment for ETS settings in 2023 noted that projections indicated a wide buffer for the achievement of emissions budget three. Inventory methodological change this year has reversed that situation.

60. In its 2022 advice on settings, the Commission modelled the range of NZU prices it considered would be necessary to achieve the abatement and removals for meeting emission budgets using different scenarios.[15] Figure 5 on page 11 of the modelling report illustrates the output. The Commission identified that the range of NZU prices needed under those scenarios in 2030 is from $70 to $260.

[14] The submission is found here

[15] Technical Annex 2 to the Commission's 2022 advice

NDC

61. As noted above, the NZ ETS settings are insufficient to achieve the NDC. The Treasury and Ministry for the Environment's *Climate Economic and Fiscal Forecast* report, published in April 2023, noted that although they cover the same period, emissions budgets 1 and 2 are set at a different level to NDC1, and offshore mitigation will be needed to meet NDC1.[16] The report describes a wide range of potential prices and material uncertainty but gave an example range of $41 to $227 per tonne of carbon dioxide equivalent (tCO2e). That report provides a full study of the difficulties and uncertainties with accessing offshore mitigation to meet the NDC.

62. In addition, the Commission has considered the impacts of substantially tighter NZ ETS settings that would further support meeting the NDC through domestic efforts only.[17] It noted the following impacts:

- Require large scale cuts to economic output across Aotearoa New Zealand, which would have significant flow-on effects to jobs, broader society, and the economy.
- Potentially undermine public support for the transition and reduce Aotearoa New Zealand's resilience and ability to put in place solutions to make continual and lasting emissions reductions.
- Environmentally and socially sustainable jobs, a productive economy and the wellbeing of the people who live here are vital for future generations and sustainable prosperity over the long term.
- From an intergenerational equity perspective, excessively fast cuts to emissions would have a legacy impact on the quality of life for younger generations as families are left without employment or essential services.
- This pace of change would also disproportionately affect Iwi/Māori in terms of the Māori economy, given its large agricultural base, and Māori workforce who are disproportionately represented in agricultural and manufacturing industries.

2050 target

63. ETS settings must accord with emission budgets which are stepping stones towards achieving the 2050 target. There are two risks to achieving the target.

64. Firstly, the consultation document for the proposed second ERP notes that there is a risk that from the mid-2030s onwards the NZ ETS may not encourage enough reductions or removals to achieve and sustain net zero for subsequent years. This is because a significant amount (about 7.5Mt per annum or 20 per cent) of long-lived emissions (eg, agricultural nitrous oxide) will remain outside the ETS. Secondly, under current settings, some industrial allocation recipients will continue receiving some NZUs for free beyond 2050.

65. The Government's ERP2 consultation document notes the Government has committed to establishing pricing of on-farm emissions no later than 2030, which may need to be geared to addressing the risk to our net zero target. The Government may also signal additional policies in the final ERP2 (on top of those proposed in consultation) to further reduce emissions reduction and removals. This would put New Zealand in a stronger position to meet the 2050 target. These include options to create durable incentives for forestry removals outside the ETS, for

[16] Climate Economic and Fiscal Forecast Report 2022

[17] Climate Change Commission's advice on ETS settings for 2023-2027

example via further exploring the potential to support afforestation on Crown land, in addition to existing ETS incentives.

66. The Commission noted in its assessment of accordance that this issue (the long-lived emissions outside the ETS and the impact on achieving the 2050 target) is not something *"… that can be addressed or corrected for by amending the NZ ETS unit limit and price control settings; therefore, we do not consider that this future policy gap undermines the recommended settings"*.[18] The Government agrees with this view.

67. The forecast availability and cost of ways to reduce greenhouse gases justifies the divergence of the recommended settings from strict accordance with the NDC, as described in Part 2.

30GC(5)(e): The recommendations made by the Climate Change Commission under section 5ZOA

68. The Commission's *Advice on NZ ETS unit limits and price control settings for 2025-2029*[19] was tabled in the House and made public on 12 March 2024.

69. Specific recommendations on ETS settings were:

- A significant reduction in auction volumes due to the Commission's estimate of the surplus growing from 49 million units to 68 million units at the end of September 2023.
- That special circumstances allow changes to the first two years of unit limit settings. Adjusting from 2025 supports the scheme to align with existing emissions budgets.
- Maintaining the current price control settings, adjusted for inflation and extended to 2029
- Other technical adjustments to account for inventory methodological changes and industrial allocation.

70. The Commission commented that opportunities existed for the Government to overachieve emission budgets. In particular, it noted planned industrial decarbonisation would be additional to the policies contemplated when emission budgets were set. The ETS cap could be reduced to lock in that reduction in emissions. The Commission noted this would reduce the cost of meeting the NDC and provide a risk management opportunity for domestic targets.

71. The Commission's 2024 advice and underpinning analysis informed the development of the recommended NZ ETS settings.

30GC(5)(f): Any other matters that the Minister considers relevant.

72. Under section 5X(4) of the Climate Change Response Act, the Minister of Climate Change is required to ensure that emissions budgets are met. 9(2)(h) [redacted]

[18] See pages 11 and 12 of https://www.climatecommission.govt.nz/public/ETS-advice/2024/20240228_Technical-annex-2_Assessment-of-accordance.pdf

[19] The Commission's 2024 advice

30GC(6) – Additional matters (relevant to price control settings only)

30GC(6)(a): The impact of emissions prices on households and the economy

73. Price controls are not intended to be major drivers of NZU price movement on the NZ ETS secondary market. The price of NZUs in the market is set through supply and demand expectations, so NZUs supplied by Government influence the NZU price but do not solely determine it. NZ ETS settings provide guidelines for NZU prices, while leaving room for the market to discover appropriate NZU prices for the target level of emissions reductions.

74. NZU prices currently have a modest impact on households and on inflation. At a price of $60 per NZU, costs resulting from the NZ ETS are equivalent to about 0.6% of household gross income on average, about $520 per household. An increase of $10 per NZU increases annual expenditure by about $87 for the average household ($1.67 per week) and increases consumer inflation by 0.1%.

75. Recent Treasury analysis found that 72–84 per cent of low-income households receive some form of indexed payment, which compensates for 40–80 per cent of increasing costs from emissions pricing.[20] The Commission recommends that the overall impacts on households and the economy are better managed through separate measures that directly target households than through NZ ETS settings.[21]

76. The impact of emissions prices on households and the economy informed the recommended price control settings.

30GC(6)(b): The level and trajectory of international emissions prices (including price controls in linked markets)

77. There is a wide variation in the level and trajectory of international emission prices. Appendix 2 of the Commission's 2022 advice provided an extensive summary of emission prices in other countries. The Commission noted in its 2024 advice that its recommended price settings remained consistent with that summary and with changes to emissions pricing schemes since then. The status quo price control settings are comparable to the efforts of New Zealand's peers from developed countries, as noted in the Commission's 2024 advice. Additionally, it noted that its recommended auction reserve prices remain at levels that would avoid regrets from auctioning units at prices likely to be below the cost the Government may face to purchase offshore mitigation to meet the first NDC.

78. The level and trajectory of international emissions prices were considered in when assessing the recommended price control settings.

30GC(6)(c): Inflation

79. The proposed price control settings have been adjusted for inflation. Inflationary impacts of emissions pricing are addressed in the impacts on households and the economy above.

[20] The Treasury. Household cost-of-living impacts from the Emissions Trading Scheme and using transfers to mitigate regressive outcomes (AN 24/02).

[21] For example, see p30 of the Commission's 2023 advice