

[IN-CONFIDENCE]

Hon. Simon Watts
Minister of Climate Change
PARLIAMENT BUILDINGS

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Tēnā koe Minister

I am writing to acknowledge the amendments to the Climate Change Response Act 2002 (the Act), which were passed by Parliament on Friday 12 December 2025. This legislative change, along with other recent Government announcements and new information, alters the parameters for the Commission's next advice on the New Zealand Emissions Trading Scheme unit limits and price control settings (NZ ETS settings advice) for 2027–2031. We expect to deliver this advice to you in April 2026, so I am taking this opportunity to note the Commission's understanding of some implications of these developments.

Given the context, I consider it important for the Commission to communicate with you proactively to support a shared understanding and reduce the chance of surprises later in the advice process.

Our approach to advice on the NZ ETS settings

As you are aware, the Commission's role is to provide independent, evidence-based advice to the government of the day.

The Act restricts the Commission's NZ ETS settings advice to recommendations on updating and extending the regulations for government unit auctions. Our advice therefore takes 'as read' the Government's policies on the NZ ETS and its wider climate change response.

The Commission has other statutory deliverables where we monitor and advise on broader aspects of the NZ ETS, other climate policies and emissions budgets.

In mid-2025 the Ministry for the Environment reviewed, with participation of Commission staff, the frameworks and tools used for the NZ ETS settings. This review concluded that the advisory and analytical frameworks used to date remain fit for purpose. In line with this finding, we intend to use the same overall method for our analysis as in previous years. This method provides a process to work through the requirements and considerations in the Act to enable transparent and logical advice, while allowing room to apply judgement in the management of the settings as circumstances change. We

are also looking to make progress on the opportunities identified in that review for the Commission's advice to better support clarity and informed decision-making by ministers and market participants.

Implications of recent legislative and policy changes

Given the overall advisory framework above, we set out below our understanding of some implications of recent developments for the parameters for our NZ ETS settings advice.

Emissions budgets

- Under the amended Act, decisions on revising the first, second and third emissions budgets are deferred until 2027. This means that the current emissions budget levels remain the benchmark with which the NZ ETS settings must accord under the Act.

Emissions projections, policy on agricultural emissions, and the second emissions reduction plan (ERP)

- The latest government emissions projections show agricultural emissions will likely be higher, and NZ ETS-covered emissions lower, over coming years than previously anticipated. There is a gap to meeting the third emissions budget.
- The Act has been amended to lower the 2050 biogenic methane target. The Government also recently announced a policy change to no longer price agricultural emissions from 2030. Since emissions budgets cover all gases and remain unchanged, these developments imply that NZ ETS sectors will have to contribute more reductions to meet emissions budgets, all other things remaining equal.
- The ERP sets out the Government's plan to meet the second emissions budget and provides the context in which the NZ ETS operates. The ERP reflects the Government's judgements about the appropriate scale and pace of climate action, and the acceptable level of impacts on people, communities and the economy. The ERP is a relevant consideration for the NZ ETS settings, including in terms of what the Government's climate policy package means for the level of reductions that could reasonably be expected from sectors covered by the NZ ETS.

Nationally determined contributions (NDCs)

- Parliament has removed the requirement for the NZ ETS settings to accord with NDCs. Therefore our 2026 settings advice will not seek to ensure accordance with NDCs. However, NDCs remain relevant to some aspects of the advice and we will consider them where appropriate as permitted by the amended Act.

Other relevant matters

To be clear our analysis is still underway so we have not yet formed judgements about the final recommendations. In addition to the above, a range of other factors will affect our advice.

In particular, we are required by the Act to take a medium-to-long term view of supply and demand in the scheme. This can lead to consideration of longer-term issues influencing our advice, while some market participants may be more focused on the near term.

At the same time, noting the need for predictability for market participants, we will consider how the NZ ETS settings could be managed to be resilient to uncertainty over the five years covered by the regulations.

Next steps

Clarity of information and predictable policy are essential to the proper functioning of the NZ ETS. To support those aims, the Commission plans to publish explanatory information on its website acknowledging recent legislative changes and Government decisions.

We will discuss with your officials the approach we intend to take to publish this letter, and any reply, consistent with the Commission's standard approach.

Having consulted with Ministry officials, we are planning to deliver our advice on NZ ETS settings for 2027–2031 to your office no later than **23 April 2026**.

Ngā mihi nui


Dame Patsy Reddy
Chair of He Pou a Rangi Climate Change Commission