



## BRIEFING

### Engagement with very large emitters: approval to finalise first large emitter partnership

<b>Date:</b>	15 May 2023	<b>Priority:</b>	Urgent
<b>Security classification:</b>	Sensitive	<b>Tracking number:</b>	2223-3795

Action sought		
	Action sought	Deadline
Hon Grant Robertson <b>Minister of Finance</b>	Agree the final negotiated package of support to be provided to NZ Steel to co-fund a substantial decarbonisation project and authorise the signing of the Funding Agreement  Note announcement of this agreement is planned for Sunday 21 May	17 May 2023
Hon Dr Megan Woods <b>Minister of Energy and Resources</b>		
Hon James Shaw <b>Minister of Climate Change</b>		

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Andrew Caseley	CE, Energy Efficiency and Conservation Authority	Privacy of natural persons	✓
Sharon Corbett	Policy Director, MBIE Energy and Resource Markets	Privacy of natural persons	

The following departments/agencies have been consulted
Ministry for the Environment, The Treasury

Minister's office to complete:

Approved

Declined

Noted

Needs change

Seen

Overtaken by Events

See Minister's Notes

Withdrawn

Comments



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### Purpose

This briefing describes the key features of the GIDI funding agreement for a partnership with NZ Steel on a significant decarbonisation project and seeks your agreement for EECA to sign the funding agreement.

### Recommended action

The Ministry of Business, Innovation and Employment and the Energy Efficiency and Conservation Authority recommend you:

a **Note** that on 13 March Cabinet:

- i. noted that the Government had been approached by NZ Steel about an opportunity to support a substantial decarbonisation project via the installation of an Electric Arc Furnace (**EAF**) to process scrap steel at the Glenbrook Steel Mill (the **Project**), which would result in significant emissions reductions of around 800,000 tonnes of CO<sub>2</sub>e initially, likely increasing over time;
- ii. agreed that the Crown provide up to \$140 million as a grant via the GIDI fund to NZ Steel for the purchase and installation of an Electric Arc Furnace;
- iii. agreed that the Minister of Energy and Resources and the Minister of Climate Change write to NZ Steel outlining the Government's offer; and
- iv. authorised the Minister of Finance, the Minister of Energy and Resources, and the Minister of Climate Change to agree the final negotiated package of support to be provided to NZ Steel

*Noted*

b **Note** that on Tuesday 21 March Robin Davies, Chief Executive of NZ Steel, wrote to Hon Dr Woods and Hon Shaw advising that, following receipt of the Crown's indicative offer of support, the BlueScope Board had agreed formally to move into the feasibility stage of the project

*Noted*

c **Note** that a funding agreement setting out both parties' rights and obligations has been drafted and once signed will become binding

*Noted*

d Confidential advice to Government

[Redacted content]

*Noted*

e Confidential advice to Government  
[Redacted]  
[Redacted]  
[Redacted]  
[Redacted]

*Noted*

f **Note** that the funding agreement includes the following key features:

- i. Up to \$140m (plus GST) in **GIDI funding** or [Redacted] of the capital cost, whichever is the lesser, structured as follows:
  - Build Funding – up to \$110 million (plus GST), paid progressively on satisfaction of build milestones for the EAF and related progress payments;
  - Commissioning Incentive Funding – \$10 million (plus GST), paid if the EAF is commissioned on or before 1 January 2027 (unless extended due to market disruption events beyond NZ Steel’s control); and
  - Performance Incentive Funding – up to \$20 million (plus GST), paid on a per tonne basis up to specified maximum quantum, subject to NZ Steel exceeding certain emissions reductions targets before 31 December 2030.
- ii. A number of **conditions**, including that necessary amendments to the Climate Change Response Act 2002 and the Climate Change (Eligible Industrial Activities) Regulations 2010 have been made, necessary consents are obtained or confident of being obtained, and a suitable transition framework/group is in place to provide NZ Steel with an ongoing mechanism to engage with the Government on issues relating to the implementation of the EAF and transition from the current operating model to the EAF operating model (with scrap steel supply issues being a key issue that Government officials agree to promptly engage on).
- iii. **Minimum obligations** that NZ Steel must, over a nine-year period (which could extend under defined circumstances), deliver 800,000 tonnes of emissions reductions per annum on average (ie a total of 7.2m tonnes) and achieve at least 400,000 tonnes of domestic steel product despatches per annum on average from steel production at the Glenbrook Mill.
- iv. **Off Ramps** that enable NZ Steel to exit the funding agreement in certain specified circumstances and the clawback provisions that will apply in each defined circumstance.
- v. Provision for **repayment / clawback** of the funding if NZ Steel fails to achieve the Minimum Obligations

*Noted*

g **Agree** the final package of support to be provided to NZ Steel, outlined in this paper

*Hon Robertson: Agree / Disagree*

*Hon Dr Woods: Agree / Disagree*

*Hon Shaw: Agree / Disagree*

h **Authorise** EECA, through its Chief Executive, to sign the funding agreement with NZ Steel, binding the Crown to the agreement

*Agree*

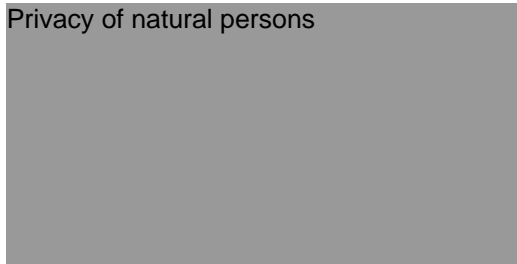
i **Note** the project will be announced publicly, at Glenbrook on Sunday 21 May

*Noted*

- j **Note** the draft terms of reference annexed to this briefing for an officials' group to provide a forum for discussion of key policy and implementation issues with NZ Steel

*Noted*

Privacy of natural persons



Andrew Caseley  
**Chief Executive**  
EECA

15 / 05 / 2023

Privacy of natural persons



Sharon Corbett  
**Policy Director**, Energy &  
Resource Markets  
MBIE

15 / 05 / 2023

Hon Grant Robertson  
**Minister of Finance**

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Hon Dr Megan Woods  
**Minister of Energy and Resources**

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Hon James Shaw  
**Minister of Climate Change**

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## Background

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1. As you are aware, New Zealand Steel has sought Government support for a significant decarbonisation project (the Project) to partially, and potentially (subject to scrap steel availability) fully, replace its existing, emissions-intensive oxygen steelmaking furnace with an electric arc furnace (EAF), which would produce low-emissions steel from molten scrap steel.
2. On 13 March 2023 Cabinet considered this proposal and noted that it would result in significant emissions reductions of around 800,000 tonnes of CO<sub>2</sub>e annually, likely increasing over time. The Project is expected to contribute approximately 5.3 per cent of the required emissions reductions within Emission Budget Two (2026–2030) and approximately 3.4 per cent of the total required within Emission Budget Three.
3. Cabinet also noted that in addition to emission reductions, NZ Steel's installation of an EAF would have other economic, environmental and resilience benefits to New Zealand, including: continuation of employment for New Zealanders; greater economic activity and supply chain resilience relative to a potential import model; avoidance of emissions leakage; energy grid resilience (as the EAF will be an interruptible energy demand source, able to switch off at times of peak energy demand); and support for waste minimisation and circular economy objectives.
4. Cabinet agreed that the Crown provide up to \$140 million as a grant via the Government Investment in Decarbonising Industry (GIDI) fund to NZ Steel for the Project. Cabinet noted that at Commercial Information of \$140 million, the project is forecast to have an asset lifetime marginal abatement cost (MAC) of \$16.20 to 31 December 2046 (based on a 20-year asset life), which compares favourably to the MACs of other GIDI-funded projects, and to the MAC of offshore mitigation.
5. It was necessary for Cabinet to make this decision before the exact terms of the agreement were negotiated, because the BlueScope Board was meeting on 13–15 March and had indicated it needed certainty about the Government's co-funding in order to decide whether to progress to a full feasibility study of the Project.
6. As agreed by Cabinet, on 13 March the Minister of Energy and Resources and the Minister of Climate Change wrote to NZ Steel outlining the Government's offer. On 21 March, Robin Davies, Chief Executive of NZ Steel, replied advising that, following receipt of the Crown's indicative offer of support, the BlueScope Board had agreed formally to move into the feasibility stage of the project.
7. In the following weeks the Energy Efficiency and Conservation Authority (EECA) and New Zealand Steel have negotiated the detailed terms of the Crown's contribution. A funding agreement setting out both parties' rights and obligations has been drafted and once signed will become binding.

### **Cabinet has delegated you authority to approve the final package of support**

8. Cabinet authorised the Minister of Finance, the Minister of Energy and Resources, and the Minister of Climate Change to agree the final negotiated package of support to be provided to NZ Steel, subject to it being within scope of the options described in the Cabinet paper, and not exceeding \$140m in grant funding.
9. The final negotiated deal is within the parameters agreed by Cabinet and is ready for your approval.

## We are asking you to agree the final negotiated package of support as a priority given the planned announcement on Sunday 21 May

10. Confidential advice to Government [REDACTED]
11. Confidential advice to Government [REDACTED]
12. Confidential advice to Government [REDACTED] In order for the planned announcement on 21 May to go ahead, you will all need to agree to the final negotiated package of support described below by Wednesday 17 May.

## There are a number of features in the final negotiated deal to bring to your attention

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13. This section sets out the key terms of the funding agreement that has been negotiated between EECA and NZ Steel.

### *GIDI Funding*

14. The GIDI co-funding of up to \$140 million (plus GST) (**GIDI Funding**) is for bona-fide and agreed capital costs of the Project. The total co-funding contribution will be the lower of [REDACTED] Commercial Information of the final capital costs of the Project or \$140m. To incentivise timely commissioning of the EAF and delivery of significant emissions reductions before the end of 2030 (i.e., when New Zealand's Paris commitments crystallise), the GIDI Funding is structured as follows:
- Build Funding* – up to \$110 million (plus GST), paid progressively on satisfaction of build milestones, for the EAF, aligned with NZ Steel's outgoings;
  - Commissioning Incentive Funding* – \$10 million (plus GST), paid if the EAF is commissioned on or before 1 January 2027 (unless extended due to market disruption events beyond NZ Steel's control); and
  - Performance Incentive Funding* – up to \$20 million (plus GST), paid subject to NZ Steel exceeding certain emissions reductions targets before 31 December 2030 (full payment of the performance funding will occur if an additional 800,000 tonnes are abated in excess of the 3.2m tonnes minimum obligations required in this period) by NZ Steel. Consistent with the EECA Funding being for capital costs of the Project, the Performance Incentive Funding will be paid upfront on the same date as the Commissioning Funding Incentive (refer to 5b above) but is subject to repayment / clawback if the targeted over-performance is not achieved (see "repayment / clawback" below).
15. As is the case for all EECA projects, NZ Steel is required to fund the difference between the EECA Funding and total Project capital costs (i.e., co-funding is a requirement of the Project), and NZ Steel bears any cost overruns/funding shortfalls of the Project.

### *Conditions to GIDI Funding*

16. The conditions to EECA providing the GIDI Funding reflect the nature and scale of the Crown's contribution to the Project. The majority of the conditions must be satisfied (or waived by the relevant party) [REDACTED] Commercial Information, including:
- fully executed transaction documents;

- b. written confirmation from the BlueScope Board that (among other things) the Project is approved (including confirmation on committed co-funding), the feasibility study is complete and approved (with a copy provided to EECA for a red flag review), and it is satisfied with the procurement/supply arrangements and regulatory settings in respect of the Project;
- c. all necessary approvals obtained by EECA's decision-makers (i.e. authorisation from Cabinet and relevant Ministers); and
- d. all necessary consents for the EAF are obtained by NZ Steel (e.g., resource consents from Auckland Council). Commercial Information  
 [Redacted]

17. In particular, NZ Steel required that two specific conditions be included for it to enter into the funding agreement. Those conditions are that NZ Steel confirms that:

- a. necessary amendments to the Climate Change Response Act 2002 and the Climate Change (Eligible Industrial Activities) Regulations 2010 have been enacted by Commercial Information  
 [Redacted] to include appropriate changes to the relevant steel manufacturing activity/product classes and allocative baselines to specifically anticipate the Project; and
- b. a suitable transition framework/group (i.e., the "officials' group") is in place to provide NZ Steel with an ongoing mechanism to engage with the Government on issues relating to the implementation of the EAF and transition from the current operating model to the EAF operating model (with scrap steel supply issues being a key issue that Government officials agree to promptly engage on in the event NZ Steel notifies us that it cannot access sufficient scrap steel to meet its minimum obligations ).

18. Free and frank advice & negotiations  
 [Redacted]

19. We have developed a draft Terms of Reference for the officials' group, which is attached as Annex 1. Availability of scrap steel is (at the request of NZ Steel) mentioned explicitly as an issue on which government officials will engage with NZ Steel if it is unable to access an adequate supply, as the availability of scrap steel is core to the viability of the EAF and the potential future expansion from 50% to 100% steel production through the EAF.

20. We have not provided any indications or commitments about whether or how the Government could intervene to support access to an adequate supply of scrap steel; our only commitment is to engage with NZ Steel on this matter if needed. Confidential advice to Government  
 [Redacted] If access to scrap steel appears likely to be an issue, we will signal this early to Ministers and provide a rigorous analysis of the appropriate role for Government and the possible implications of any action the Government could take.

21. The officials' group will also provide a forum for relevant departments and NZ Steel to discuss policy settings with implications for the EAF and transition. It will also provide an avenue for officials to raise matters of interest to the Crown, such as impacts on the workforce.

22. Confidential advice to Government

[Redacted]

#### *NZ Steel's minimum obligations to retain all of the GIDI Funding*

23. To retain all of the GIDI Funding, NZ Steel must deliver the following minimum obligations (**Minimum Obligations**) over a nine-year period:

- a. *Emissions Reduction Obligation* – deliver 800,000 tonnes of emissions reductions per annum on average (measured against a baseline of its average annual emissions over a specified appropriate period. In essence, delivering 7,200,000 tonnes of emissions reductions in total over nine years; and
- b. *Steel Production Obligation* – achieve at least [Commercial Information] tonnes of domestic despatches (a production metric reported on in BlueScope's annual reports) per annum on average from steel production at the Glenbrook Mill. In essence, achieving at least [Commercial Information] tonnes of domestic despatches in total over nine years. In addition, NZ Steel must use commercially reasonable endeavours to meet New Zealand domestic steel demand, in particular where demand is higher than [Commercial Information] tonnes of domestic despatches per annum.

24. Compliance with the Minimum Obligations is tested three, six and nine years after the EAF is commissioned, and adjustments to (or grace periods in respect of) the Minimum Obligations will be agreed by the parties if a market disruption event beyond NZ Steel's control affects NZ Steel's ability to meet those obligations. However, any adjustment or grace period will not (i) change the obligation to deliver 7,200,000 tonnes of emissions reductions in total, or (ii) extend the operating phase of the EAF for the purposes of the funding agreement beyond 12 years.

25. The Minimum Obligations were heavily negotiated and seek to ensure the performance of two critical obligations by NZ Steel – (1) delivery of significant emissions reductions for New Zealand, and (2) retention of domestic steel-making in New Zealand – whilst also ensuring that EECA did not have unduly burdensome oversight on NZ Steel's business and operations.

#### *Off-Ramps*

26. Due to the long-term nature of the funding agreement and the scale of change that the EAF will have on its current business and operating model, NZ Steel required the ability to exit the funding agreement in certain, limited scenarios (**Off-Ramps**). The Off-Ramps, at a high-level, are:

- a. *Year 4 Off-Ramp* – at any time four years after the EAF is commissioned, NZ Steel demonstrates that steel-making at Glenbrook is no longer economically viable;
- b. *Regulatory Change Off-Ramp* – at any time, the Government makes an adverse change to the regulatory settings relevant to the Project that NZ Steel demonstrates has directly resulted in a serious detrimental effect on NZ Steel's (i) ability to meet the Minimum Obligations, or (ii) financial performance for two consecutive years; and
- c. *Scrap Steel Off-Ramp* – at any time two years after the EAF is commissioned, NZ Steel demonstrates that, having used its best endeavours or as a consequence of a breach or default by a counterparty under a scrap metal supply contract, it has been unable



(for 12 months, with no change expected for a further 12 months) to obtain sufficient scrap metal required to meet the steel production Minimum Obligation at a price equal to export price parity.

27. The Off-Ramps were heavily negotiated, are pitched at a deliberately high threshold, have a number of requirements that need to be satisfied, and involve a significant level of impact on NZ Steel in order to be accessed. EECA also ensured, through negotiations, that the use of an Off-Ramp results in repayment / clawback of EECA Funding from NZ Steel (the amount of which is commensurate with EECA's involvement in the scenario leading to the Off-Ramp's use) – as explained below.
28. In the event that NZ Steel utilises an Off-Ramp, the funding agreement will prohibit NZ Steel from using any alternative method of steel production that would be more emissions intensive than use of the EAF in accordance with the Minimum Obligation defined in the funding agreement. This provision will ensure the abatement achieved through the funding agreement survives termination of the funding agreement via use of an Off-Ramp.
29. Confidential advice to Government  
[Redacted]

#### *Repayment / clawback of GIDI Funding*

30. If NZ Steel fails to achieve the Minimum Obligations (subject to certain tolerances) or is the subject of a market-standard default event (e.g., insolvency), then EECA has the right to elect to terminate the funding agreement and seek repayment / clawback the GIDI Funding.
31. Similarly, if NZ Steel follows the correct process and elects to use an Off-Ramp, then EECA has the right to seek repayment / clawback of the GIDI Funding.
32. The funding agreement contains formulae which prescribe the amount of GIDI Funding that is to be repaid / clawed back in each scenario. The key tenet is that NZ Steel must repay the amount equivalent to (or a proportion of) the value of its unabated emissions at the time of the event, which means that NZ Steel's repayment obligation declines as it delivers more emissions reductions. In addition to the application of these formulae the amount repayable will also depend on which Off-Ramp is used to terminate the agreement:
  - a. *Year 4 Off-Ramp* – 100% of the Build funding and Commissioning funding is repayable, plus interest;
  - b. *Regulatory Change Off-Ramp* – 50% of the Build funding and Commissioning funding is repayable, without interest
  - c. *Scrap Steel Off-Ramp* – 50% of the Build funding and Commissioning funding is repayable if the Off-Ramp is used before 31 December 2030; 75% of the Build funding and Commissioning funding is repayable if the Off-Ramp is used after 31 December 2030. Interest is payable regardless of whether this occurs before or after 31 December 2030.
33. Free and frank opinions  
[Redacted]
34. Commercial Information  
[Redacted]

35. In the event of EECA using the clawback provisions any money repaid to the Government would likely be returned to the Climate Emergency Response Fund. If the GIDI Fund is still in operation at the time of repayment, it may also be possible for the money to be returned directly to GIDI.

#### *Term of the Funding Agreement*

36. The funding agreement expires on the later of:
- 31 December 2035 (i.e., the end of the third Emissions Budget period) and
  - 9 and a half years after the date the EAF is commissioned (subject to any agreed adjustments, which may extend the agreement for a maximum Term of 12 years, and unless ended earlier through termination).
37. The term will not end earlier if NZ Steel delivers 7,200,000 tonnes of emissions reductions in total earlier than envisaged so it will continue for at least 9 years from the date of commissioning which will preserve such clauses as the domestic steel production.

### **We advise you to approve the final negotiated package of support**

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38. We recommend you approve the final package of support, and authorise EECA, through its Chief Executive, to sign the funding agreement with NZ Steel, binding the Crown to the agreement
39. The potential benefits of the project as outlined in the Cabinet paper still hold, and none of the terms and conditions of the agreement prejudice the Crown's position from the position presented to Cabinet.
40. Confidential advice to Government

### **Next steps**

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#### **An announcement is planned for 21 May**

41. Subject to your approval, EECA through its Chief Executive will sign the funding agreement with NZ Steel and the project will be announced publicly, at Glenbrook on Sunday 21 May.
42. We are working with the offices of Hon Dr Woods and Hon Shaw on the communications collateral to support the announcement, including speeches, a press release, and reactive Q&As.

#### **The deal should go largely unconditional Commercial Information, and be fully unconditional by Commercial Information subject to NZ Steel having satisfaction with the conditions precedent or waiving them**

43. Most of the conditions set out in the funding agreement must be satisfied by Commercial
44. Key risks to the deal going unconditional include Confidential advice to Government

**The Ministry for the Environment will continue to work with NZ Steel to ensure it has sufficient certainty of how both the EAF and non-EAF parts of its operations will be treated under the Emissions Trading Scheme**

45. Confidential advice to Government [Redacted]

Confidential advice to Government [Redacted]

46. Confidential advice to Government [Redacted]

Confidential advice to Government [Redacted]

47. Confidential advice to Government [Redacted]

48. Confidential advice to Government [Redacted]

Confidential advice to Government [Redacted]

49. Confidential advice to Government [Redacted]

50. Confidential advice to Government [Redacted]

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<sup>1</sup> Commercial Information [Redacted]

**We are establishing an officials’ group to provide a forum for discussion of key policy and implementation issues with NZ Steel**

- 51. In line with the condition described in paragraph 17.b, we are establishing an officials’ group, which will provide a forum for discussion of key policy and implementation issues with NZ Steel.
- 52. The draft terms of reference for the group, which have been shared with NZ Steel, are attached as Annex 1. We will keep Hon Dr Woods and Hon Shaw informed of any key issues discussed by the group.

**NZ Steel will proceed with its final feasibility study and work to secure consents**

53. NZ Steel is undertaking a final feasibility study, which – as described in their 21 March letter to Hon Dr Woods and Hon Shaw – involves firming up technology solutions and further development of capital cost estimates. It will also work to secure scrap steel supply arrangements and progress resource consenting requirements.

54. Commercial Information [Redacted]

55. Commercial Information [Redacted]

a. Commercial Information [Redacted]

b. Commercial Information [Redacted]

c. Commercial Information [Redacted]

56. Commercial Information & Confidential information entrusted to the Government [Redacted]

57. NZ Steel has committed to providing regular updates to EECA regarding the progress to secure the consents including disclosure of any issues (albeit currently unanticipated) that would represent a material challenge to securing the necessary EAF consents.

**Annexes**

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Annex One: Terms of Reference for the Officials’ Group

## Annex One


### ***Officials Group for NZ Steel Decarbonisation: Draft Terms of Reference***

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Confidential advice to Government



Confidential advice to Government



Confidential advice to Government



Confidential advice to Government



Confidential advice to Government



Confidential advice to Government

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