



# EVENT BRIEFING

## Meeting with NZ Steel

|                                 |                  |                         |           |
|---------------------------------|------------------|-------------------------|-----------|
| <b>Date:</b>                    | 22 February 2023 | <b>Priority:</b>        | High      |
| <b>Security classification:</b> | Sensitive        | <b>Tracking number:</b> | 2223-2686 |

| Action sought   |  |                  |
|---|--|------------------|
|   | Action sought  | Deadline         |
| Hon Dr Megan Woods<br><b>Minister of Energy and Resources</b> | <b>Note</b> the background information and suggested talking points ahead of your meeting with NZ Steel on Thursday 23 February from 3.30 – 4.00 pm. | 23 February 2023 |

| Contact for telephone discussion (if required) |  |                            |             |
|--|--|----------------------------|-------------|
| Name   | Position                                   | Telephone                  | 1st contact |
| Sharon Corbett                                 | Policy Director, Energy & Resource Markets | Privacy of natural persons | ✓           |
| Scott Russell                                  | Team Leader, Industrial Use Policy         | Privacy of natural persons |             |

| The following departments/agencies have been consulted                     |
|--|
| Energy Efficiency and Conservation Authority, Ministry for the Environment |

Minister's office to complete:

- |   |  |
|---|--|
| <input type="checkbox"/> Approved             | <input type="checkbox"/> Declined            |
| <input type="checkbox"/> Noted                | <input type="checkbox"/> Needs change        |
| <input type="checkbox"/> Seen                 | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn           |

Comments



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### Purpose

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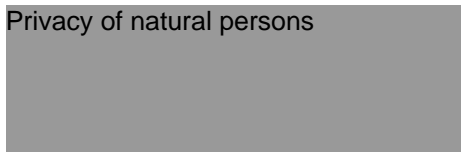
To provide you with information and talking points ahead of your meeting with Robin Davies, Chief Executive of NZ Steel, regarding the potential Government Investment in Decarbonising Industry (GIDI) project to install an Electric Arc Furnace (EAF) at NZ Steel's Glenbrook site.

### Recommendations

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The Ministry of Business, Innovation and Employment recommends that you:

- a **Note** the background information and suggested talking points ahead of your meeting with NZ Steel on Thursday 23 Feb from 3.30 – 4.00 pm *Noted*
  
- b **Forward** this briefing to the Minister of Climate Change *Noted*

Privacy of natural persons  


Sharon Corbett  
**Policy Director, Energy & Resource Markets**  
Buildings, Resources and Markets MBIE

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

22 / 02 / 2023

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## Background

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1. You have agreed to meet with Robin Davies, Chief Executive New Zealand & Pacific of NZ Steel.
2. The purpose of the meeting is to discuss progress on the potential Government Investment in Decarbonising Industry (GIDI) project to install an Electric Arc Furnace (EAF) at NZ Steel's Glenbrook site, and the complementary policy supports that NZ Steel has requested.
3. New Zealand Steel Limited (NZ Steel) is currently New Zealand's only domestic steel producer. It is a subsidiary of the BlueScope group, an ASX listed company. NZ Steel produces approximately 660,000 tonnes of steel each year and supplies approximately 70% of New Zealand's domestic steel consumption.
4. NZ Steel currently manufactures steel through a globally unique process by deriving molten iron from iron sand and coal using a series of multi-hearth furnaces, kilns and melters. The molten iron, with added scrap steel, (from NZ Steel's own processes), is then fed into an oxygen furnace to produce steel. This production process is an inherently emissions intensive activity, primarily due to the consumption of coal to produce molten iron.

### NZ Steel's ask to date

5. In 2022 NZ Steel requested financial support for **Commercial Information** capital investment in an Electric Arc Furnace.
6. It has proposed a combination, or sole use of, either grant funding through the GIDI Fund or bespoke treatment of its industrial allocation under the New Zealand Emissions Trading Scheme (NZ ETS) to create a comparative 'return on investment'.
7. NZ Steel has also raised other policy support it would like the Government to consider and is seeking to establish a mechanism to maintain an ongoing dialogue with the government on any issues which arise during the EAF project which may have a material impact on the viability of its investment.
8. Regulatory matters NZ Steel may seek further engagement on include:
  - a. Support to access scrap steel
  - b. **Confidential advice to Government**
  - c. Industrial allocation matters
  - d. Resource consenting.

### Key priorities for this meeting

9. This meeting is an opportunity to support continued momentum in negotiations. It is also an opportunity to reaffirm the Government's priorities within this project, including demonstrable value for money, and to show that the deal will deliver over the long term (i.e., that the emission reductions are real, significant, and the plant will continue to operate over the medium term).
10. The meeting is also an opportunity to hear how NZ Steel has been progressing:
  - a. Its own internal feasibility work
  - b. The development of a plan for access to scrap steel
  - c. Conversations with its parent company (BlueScope).
11. Based on discussions to date, we expect NZ Steel may raise:
  - a. The request for changes to product categories under the NZ ETS and in particular, industrial allocations and the timing for these changes **Commercial Information**

- b. The request for a Steel Decarbonisation Transition Group, with representatives from NZ Steel and key ministries/agencies (e.g., MBIE, MfE, EECA) on any possible regulatory matters that would impact their assumed business case for the investment.
- c. Timelines for NZ Steel and the Government to reach final agreement, assuming Cabinet approves the proposed level and form of support, and the BlueScope Board proceeds to full feasibility based on negotiations to date.

## Update on negotiations

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### GIDI funded component

#### *The process to date*

- 12. EECA has been actively engaging with NZ Steel since October 2022 when NZ Steel presented a proposal to Government <sup>Confidential advice to Government</sup> for the capital costs of an EAF at Glenbrook.
- 13. Since then, due diligence has been completed and ongoing interaction has occurred on a range of items, as we have sought to better understand NZ Steel's request, and on key matters requiring discussion to better understand what is required for the BlueScope board decision to proceed to full feasibility.
- 14. NZ Steel is aware that a Cabinet paper is being prepared, and that the Government is unlikely to offer <sup>Commercial Information</sup>
- 15. In more recent weeks NZ Steel and EECA have been working on the detail of a proposed Term Sheet setting out the key Terms of a proposed Funding Agreement, which will cover such matters as:
  - a. the proposed level of funding support and nature of this support
  - b. the conditions that will apply to any funding agreement and dates by which these must be satisfied
  - c. the minimum obligations required for Government support e.g., abatement quanta and timing
  - d. what defines default events and the repayment/clawback provisions related to these
  - e. security over the payments made over the course of the project given the clawback provisions
  - f. off ramps which can be activated by NZ Steel <sup>Commercial Information</sup>
  - g. change of Control provisions
  - h. term of the Agreement.

*NZ Steel appears to have reacted positively to the proposed range; however the potential view of the BlueScope Board remains difficult to gauge*

- 16. EECA (after Ministerial approval) has presented a "best foot forward" offer to NZ Steel based on:
  - a. A lower of <sup>Commercial</sup> of project cost or \$110m
  - b. A commissioning incentive payment of a further \$10m if commissioned by 1 January 2027

- c. A proportionate carbon abatement performance incentive of up to \$20m if the amount of carbon abated by 31 Dec 2030 exceeds 3.2 million tonnes up to maximum of an extra 800,000 tonnes (i.e., \$25 per tonne of extra carbon abated).
17. Should all incentives be met, including specified levels of abatement, then the maximum support payment would arise, being the lower of:
    - a. Comm per cent of the final capital cost of the project, or
    - b. \$140 million.
  18. It has been made very clear this is subject to Cabinet approval and is very much a “best foot forward offer.” While our continued work with NZ Steel on the term sheet implies that it views the proposal favourably, it is difficult to know with certainty whether the proposal will be sufficient to prompt the BlueScope Board to proceed with the investment.

## Industrial allocation

### *Request for legislative and regulatory changes to receive an accurate allocation for the EAF*

19. NZ Steel is currently eligible to receive industrial allocation (free emissions units) for the emissions costs associated with its current operations to reduce the risk of emissions leakage.
20. If the EAF becomes operational, the Climate Change Response Act 2002 (CCRA) and associated regulations would not accommodate the provision of industrial allocation for the emissions costs associated with this new technology.
21. Legal professional privilege
22. Additionally, the current activity definition NZ Steel use (in the Climate Change (Eligible Industrial Activities) Regulations 2010), is defined as the manufacture of iron and steel where iron sand is the predominant feed material. This precludes allocations for iron and steel products that are derived from large amounts of scrap steel which would be the case if the EAF becomes operational.
23. The Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill (the Bill) proposes changes to NZ ETS industrial allocation policy and had its First Reading on Tuesday evening.
24. NZ Steel will likely bring this issue to the attention of the Select Committee.
25. Part of this Bill includes provisions to allow new ‘activities’ to receive an allocation where no data exists prior to operation. Constitute contempt of Court/House of Representatives
26. NZ Steel wants legislative and regulatory certainty before the General Election to guarantee an allocation for the output of the EAF. However new regulations cannot be made to include new EAF products without the passing of the Bill (including the addition of new provisions) and this is not expected until the middle of this year.
27. The Government cannot provide any certainty that the legislative and regulatory changes that NZ Steel is seeking will be in place before the General Election. Officials can continue to engage with NZ Steel on the regulatory updates needed to the activity definition and data preparation work prior to the Bill passing (pending notification to the Select Committee).
28. MfE agrees in-principle that NZ Steel should receive an allocation for the emissions costs associated with the EAF. The only certainty that can be given to NZ Steel at this stage is both officials’ and Ministers’ support that the necessary changes are considered by the Select Committee.

*Request to receive a 'wedge' of industrial allocation to provide a return on investment*

29. NZ Steel also suggested that industrial allocation policy could be used to make up part, or all, of its requested funding for the EAF.
30. This would be achieved by providing allocations as if it was continuing its current iron making process, and not the lower emitting EAF process. This would amount to an intentional over-allocation.
31. This is not currently possible under the CCRA, and officials do not advise this because it is inconsistent with the purpose of industrial allocation and would create considerable precedent risk.
32. You have already agreed with the Minister of Climate Change not to pursue this option, and this has been communicated to NZ Steel.

### **Supply of scrap steel**

33. NZ Steel's ability to procure sufficient scrap steel supply is key to delivering the EAF project and expected emissions reductions.
34. NZ Steel would initially operate the EAF under a hybrid model where a combination of recycled scrap steel and molten iron produced using the existing process is used as the input feed. Under this scenario, NZ Steel would be able to reduce its annual emissions by 800,000 tonnes of carbon dioxide equivalent (CO<sub>2</sub>e) relative to current levels.
35. NZ Steel expects to be able to increase the portion of recycled scrap used as input feed over time, as additional scrap supply is secured, with a long-term target of reaching a 'full EAF' scenario. At that point the remaining iron plant would be shut down and input feed would consist of recycled scrap steel supplemented by imported pig iron.
36. If NZ Steel can achieve the full EAF scenario, then a further reduction in emissions would be achieved of 900,000 tonnes of CO<sub>2</sub>e per annum.

### **Negotiations**

37. NZ Steel has clarified that it is not seeking any specific regulatory outcomes in relation to scrap steel supply at this time. Instead, it seeks to establish a forum/process for engagement between NZ Steel and key officials regarding relevant policy settings and their impact on the EAF project.
38. It proposes the creation of a Steel Decarbonisation Transition Group, established via an MOU, which has representatives from NZ Steel and key ministries/agencies (e.g., MBIE, MfE, EECA) and meets semi-regularly to discuss the progress of the EAF project and share information regarding policy settings that might impact the EAF operation.
39. The draft Cabinet paper provided to you on Friday 17 February includes a proposal to communicate to NZ Steel, via letter, the Government's intent to progress work in tandem to NZ Steel's feasibility assessment on issues including maintaining an open dialogue between NZ Steel and the Government on the additional policy issues NZ Steel has raised as significant for the overall EAF investment [2223-2659 refers].

*There is a risk that the Government's support for NZ Steel crowds out investment by alternative steel producers, and particularly scrap steel recycling firms.*

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40.

41. Officials are seeking advice through departmental consultation on potential competition implications for the scrap steel market which could arise from government support to NZ Steel. In the meantime, you might like to seek clarification from NZ Steel on its progress in exploring scrap steel supply contracts, and how it intends to contribute to the effective functioning of that market should an EAF be installed.

## Next steps

42. Once Cabinet has made decisions, EECA will move into negotiating a final agreement with NZ Steel. The draft Cabinet paper provided to you on Friday 17 February seeks approval to authorise the Ministers of Energy and Resources, Climate Change and Finance to approve a final deal with NZ Steel, including a financial contribution of up to \$140 million.
43. The BlueScope Board is meeting on 13-15 March to discuss whether the project should move into the next stage (full feasibility study). The level of support being offered by the Crown is likely to be a significant factor in that decision.
44. Officials have not yet discussed a communications approach with NZ Steel in any detail, (i.e. assuming Cabinet approves the proposed level and form of support, how and when any public announcements of a deal might be made). An appropriate announcement timing may be after a conditional agreement is struck (depending on the conditions). However, to date NZ Steel has indicated that it does not see BlueScope deciding on a conditional agreement until

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## Annexes

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Annex One: Biography of attendees

Annex Two: Suggested talking points

## Annex One: Biography of attendees

|  |  |
|--|--|
|  A portrait of Robin Davies, a middle-aged man with short dark hair, wearing a dark suit jacket, a light blue shirt, and a blue tie. He is smiling slightly and looking towards the camera. | <p><b>Robin Davies, Chief Executive New Zealand &amp; Pacific, Bluescope</b></p> <p>Robin has a depth of international and operational experience, having worked for Tata Steel Europe prior to joining BlueScope in 2008. He held a number of roles in New Zealand before moving to Ohio in 2017 as President North Star BlueScope Steel. Returning to New Zealand in 2020, Robin took up the role of General Manager Sales &amp; Marketing NZPI / General Manager Pacific Steel, and since February 2021 has been Chief Operating Officer.</p> |
|  A portrait of Jason Dale, an older man with a balding head, wearing a dark suit jacket over a patterned shirt. He is smiling and looking towards the camera.                              | <p><b>Jason Dale, Chief Financial Officer, NZ Steel</b></p> <p>Jason Has been the CFO with NZ Steel since 2019. He was previously CFO with fleet management start-up, EROAD.</p>   |



## Annex Two: Suggested talking points

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### Government's priorities

You may wish to say to NZ Steel:

- *This is an exciting project with considerable emissions reduction potential, yet the ask also represents a significant quantum of Government funding.*
- *It is important that any co-funding provided represents significant public value for money.*

### Terms of the deal

You may wish to say to NZ Steel:

- *What progress have you made in conversations with your parent company?*
- *The Crown will be looking to ensure the emissions reductions achieved through this deal are significant. How confident are you that you will be able to achieve the proposed emissions reductions?*
- *I understand you are seeking the establishment of a transition group to discuss regulatory matters. We are still considering this but I want to confirm what you see the purpose of this group as being?*

### Industrial Allocation

Regarding industrial allocation for the products of an EAF:

- *I understand your concern about the legislative and regulatory uncertainty relating to the ability to receive industrial allocation for products of an EAF.*
- *The Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Bill has been referred to the Select Committee and any changes to the Bill now need to be referred to them.*
- *Because it is with the Select Committee, the Government cannot provide any certainty regarding legislative or regulatory changes you are after.*
- Confidential advice to Government

Regarding the request for intentional overallocation, or a 'wedge':

- *The Government will not support the 'wedge' to provide a return on investment because it is inconsistent with the purpose of industrial allocation and contains considerable precedent risk.*

### Scrap Steel

You may wish to say to NZ Steel:

- *I understand that NZ Steel's ability to procure sufficient scrap steel supply is key to delivering the EAF project and expected emissions reductions.*
- *How are you planning to secure sufficient and reliable access to scrap steel? What is your understanding of the scrap steel market in New Zealand and any challenges here?*

## Announcements

You may wish to ask NZ Steel:

- *Have you given thought to how and when we might announce a deal should we come to an agreement?*
- *Would it be at the point of reaching conditional agreement? Is there any likelihood of BlueScope's board considering a conditional deal **Commercial Information** ?*