



BRIEFING

Engagement with very large emitters: investment package for significant decarbonisation proposal

Date:	9 February 2023	Priority:	High
Security classification:	Sensitive	Tracking number:	MBIE: 2223-2539 MFE: BRF-2716

Action sought		
	Action sought	Deadline
Hon Dr Megan Woods Minister of Energy and Resources	Discuss the items outlined in this briefing with officials on Monday 13 February	15 February 2023
Hon James Shaw Minister of Climate Change	(Hon Dr Woods) Forward this briefing to the Minister for the Environment	

Contact for telephone discussion (if required)		
Name	Position	Telephone
Andrew Caseley	EECA Chief Executive	Privacy of natural persons
Sharon Corbett	Policy Director, MBIE Energy and Resource Markets	Privacy of natural persons
James Coombes	Manager, MfE Emissions Pricing Policy	Privacy of natural persons

The following departments/agencies have been consulted

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 Withdrawn |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



BRIEFING

Engagement with very large emitters: investment package for significant decarbonisation proposal

Date:	9 February 2023	Priority:	High
Security classification:	Sensitive	Tracking number:	MBIE: 2223-2539 MFE: BRF-2716

Purpose

You are meeting with officials on Monday 13 February from 4.00–4.30 pm.

Officials are seeking your direction on several elements of a proposed package of support to NZ Steel on a significant decarbonisation project to progress a Cabinet paper.

Recommended action

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

- a **Discuss** the items outlined in this briefing with officials on Monday 13 February

Noted

- b **(Hon Dr Woods) Forward** this briefing to the Minister for the Environment

Agree / Disagree

Privacy of natural persons

Andrew Caseley
Chief Executive
EECA

..... / /

Privacy of natural persons

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

..... / /

Privacy of natural persons

James Coombes
Manager, Emissions Pricing Policy
MfE

09 / 02 / 2023.

Hon Dr Megan Woods
Minister of Energy and Resources

..... / /

Hon James Shaw
Minister of Climate Change

..... / /

Background

1. We have received a detailed proposal from NZ Steel requesting a mix of both financial and policy support to invest in an electric arc furnace (EAF) at its Glenbrook steel mill, resulting in significant emissions reductions from its steelmaking processes [MBIE Briefing 2223 – 2099 refers]. This request and options to progress negotiations with NZ Steel are explored in this briefing.
2. NZ Steel's parent company, BlueScope, will decide in March 2023 whether to progress to a full feasibility study for investment in an electric arc furnace, at a cost of around Commercial Information. NZ Steel has emphasised that a key factor in this decision will be the degree of progress made in discussions with Government to confirm financial support and relevant policy certainty. NZ Steel has stated that without significant Government support, there is a real risk BlueScope may choose to terminate the project.
3. NZ Steel is requesting a funding contribution of Commercial Information of the capital cost of procurement and installation of the EAF. It has proposed a combination, or sole use of, either grant funding through the Government Investment in Decarbonising Industry Fund (GIDI) or bespoke treatment of its industrial allocation to create a 'return on investment'.
4. It has also signalled an interest in continued discussion with Government on several policy issues it considers important to its business case. These are discussed further below.
5. Officials have conducted due diligence on NZ Steel's proposal, and analysed options for how a package of support could be structured, taking a portfolio approach to the government's policy levers.
6. To date, our efforts have focused on the Government Investment in Decarbonising Industry (GIDI Fund), industrial allocation policy settings under the New Zealand Emissions Trading Scheme (NZ ETS), support to access green finance, particularly the New Zealand Green Investment Finance, and alternative non-grant funding options such as those commonly used by Kānoa – Regional Economic Development & Investment Unit.
7. We are seeking your direction on several outstanding questions prior to finalising the draft Cabinet paper and have included a proposed agenda to support discussion. In particular, we wish to discuss:
 - a. the **findings of our analysis** on the appropriate overall contribution from the Crown to NZ Steel
 - b. your initial views on the **mechanism/s for providing support**, including:
 - i. the appropriate GIDI co-funding ratio;
 - ii. how the deal could reflect the industrial allocation issues raised by NZ Steel;
 - iii. appetite to explore non-grant levers;
 - iv. other policy areas in which NZ Steel is seeking engagement with government; and
 - c. your preferences on **how we progress the negotiation**.

Annotated Agenda

A. Findings to date on the appropriate funding contribution from the Crown

Due diligence suggests the appropriate government contribution is lower than the ^{Commercial Info} capital cost sought by NZ Steel but ^{Confidential advice & negotiations}

8. EECA engaged KPMG to complete due diligence on the funding request received from NZ Steel. KPMG analysed what would be sufficient to make the EAF the commercially preferred option for NZ Steel compared to alternatives (such as importing steel) and would represent good public value.
9. The analysis suggests that the level of financial support sufficient to make the EAF investment commercially viable for NZ Steel sits between ^{Confidential advice to Government} NZD, and that a Crown contribution of ^{Confidential advice to G} **\$140m NZD** may be appropriate for the reasons set out in the paragraph below. Importantly, this analysis is sensitive to a range of financial assumptions, which NZ Steel may assess differently.
10. A Crown contribution of ^{Confidential advice to C} 140m could be justified on the basis of:
 - a. ^{Confidential advice to Government}
 - b. The emissions reductions the Crown would in effect be purchasing represent good value for money.
 - i. At the ^{Confidential advi} funding level of \$140m, the forecast marginal abatement cost (MAC) to the Crown would be \$30.81 per t CO₂e under the 50/50 EAF scenario (a hybrid model where a combination of recycled scrap steel and molten iron produced using the existing process is used as the input feed) and based on forecast emission savings to 2035.
 - ii. If NZ Steel can secure sufficient scrap steel supply to transition to the full EAF scenario, the MAC on forecast emission savings to 2035 would be \$25.25 per t CO₂e. These figures are in line with the average abatement cost of \$25 - \$30 per CO₂e tonne of recent GIDI fund rounds. Additional emission benefits beyond 2035 would provide an upside to the Crown's investment, as the MAC calculations only factor in emissions reductions during the nine years in which it is proposed a minimum commitment to ongoing operations and emissions reductions could be sought from NZ Steel.
 - c. The Crown would no longer need to allocate a significant number of NZUs to New Zealand Steel. This saving can be seen as offsetting the cost of contributing to the EAF. By reducing emissions domestically, the Crown reduces the number of international units required to meet the Nationally Determined Contribution which would have a corresponding reduction in the financial cost to the Crown.
 - d. The installation of the EAF would bring wider NZ-INC benefits, such as
 - i. Continuation of employment for New Zealanders ^{Commercial Information}
 - ii. Greater economic activity than under an importation model;

- iii. Avoidance of emissions leakage, as there is a substantial likelihood that imported steel would be blast furnace produced with a high underlying emissions profile;
- iv. Supply chain resilience by retaining domestic production of steel; and
- v. Energy grid resilience (via an EAF production process for 'interruptible load', which can be turned off when the electricity system is under pressure).

We seek direction on:

- *Would Ministers be comfortable with an overall Crown contribution to NZ Steel in the range of [Confidential advice to Government] \$140m?*

B. What are the mechanism/s through which the Crown should provide support?

*It would be possible to provide the entire Crown contribution through the **GIDI Fund***

[Confidential advice to Government] \$140m could be justified through the GIDI Fund, provided suitable safeguards are in place for the achievement of the proposed emission benefits.

- 12. This range represents a co-funding ratio of [Confidential advice to Government] [Confidential advice to Government] Prior investments offered co-funding up to approximately 50 per cent, with the average Crown funding contribution at 37 per cent of the total capital investment, though there is no mandated cap.
- 13. Paragraph 10 sets out the rationale for a co-funding ration of [Confidential advice to Government] [Confidential advice to Government]
- 14. [Confidential advice to Government] (\$140m) equates to 21% of the expanded GIDI fund to 30 June 2026 in return for approximately 27% of the total emissions abatement that GIDI needs to contribute to the ERP emission budgets before 2030.

We seek direction on:

- *What level of GIDI co-funding are Ministers comfortable with including in a negotiation with NZ Steel?*

*We also analysed NZ Steel's request for the Crown to create a bespoke 'wedge' of **overallocation via the emissions trading scheme***

- 15. NZ Steel are seeking an enhanced amount of allocation (intentional over-allocation) for a guaranteed period to make up any shortfall in GIDI funding below 100 per cent to provide a return on investment.
- 16. Officials do not advise allowing NZ Steel to receive an enhanced allocation to provide a return on investment. It would be inconsistent with the purpose of industrial allocation, the integrity of NZ ETS and cause considerable precedent risk. As above, there is a case for GIDI to provide the full support required for commercial investment by NZ Steel, without intentional over-allocation being provided to NZ Steel. Additional support through bespoke NZ ETS treatment is therefore unnecessary.

*It would also be possible to include **non-grant mechanisms**, but there are risks attached to complicating the negotiation*

19. Bespoke treatment of NZ Steel's industrial allocation to provide a return on investment could be pursued through legislation changes, however officials do not advise this. Officials have begun investigating alternative options beyond grant funding, should Minister's wish to progress a package of funding options, beyond GIDI, in negotiations with NZ Steel.
20. While it is almost certainly necessary to provide some support in the form of a grant to make the investment in an electric arc furnace commercially viable for NZ Steel, it may be possible to offer a package deal where grant funding is complemented by other funding support.
21. Support beyond grants could take the form of debt or equity financing, including options such as loans that have concessionary interest rates, are forgivable in some circumstances, have deferred repayment timeframes (e.g., no repayments for ten years) or other concessionary terms. Support could also involve equity financing provided via a special purpose vehicle (SPV) that serves to reduce risk to NZ Steel and enables the Crown/taxpayers (or potentially iwi) to benefit from the profits, should the investment reach a certain level of profitability.
22. The Crown has provided structured support of this type before through Kānoa – Regional Economic Development & Investment Unit across a number of funds. Such support would not be as attractive to NZ Steel as straightforward grant funding, but it may be able to help to close a gap between what NZ Steel is seeking, and what the Crown is prepared to offer in the form of a grant. However, non-grant support would also add complexity and implementation costs to any deal and (in the case of profit sharing) may require a higher upfront contribution from the Crown to offset the future profits foregone.
23. We have not to date explored these options with NZ Steel, and the company has emphasized its interest in only grant funding, or the use of industrial allocation settings, as a support mechanism for its EAF investment.
24. There is a risk that seeking to introduce non-grant funding options into the negotiation at this stage may slow or stall negotiations.
25. The non-grant options all have different functions and fiscal implications. If Ministers wish, we can explore non-grant options further and raise this possibility with NZ Steel.

We seek direction on:

- *What are Ministers' appetites to explore non-grant funding mechanisms in negotiation with NZ Steel?*

We considered the role **Green finance** on commercial terms (eg through NZ GIF) and determined it is not needed for this particular deal

- 26. We have considered the role of New Zealand Green Investment Finance (NZ GIF) in a package of proposed support for NZ Steel. NZ Steel has indicated that access to capital is not a barrier for its proposed project and has not expressed interest in a negotiated package of support including financing from NZ GIF (or any other source of commercial capital).
- 27. However, there is a role for Government in supporting access to green finance for other very large emitters as part of any future negotiated package for other entities. As part of due diligence on future requests for support, the Government should look to clarify that green financing options have been sought before progressing negotiations for grant funding options.
- 28. Legal professional privilege

NZ Steel has also raised **other policy support** it would like the Government to consider, but these issues feel secondary to the question of financial support

- 29. NZ Steel has also signalled an interest in continued discussion with Government on several policy issues it considers important to its business case. These include:
 - i. Support on the availability of scrap – Negotiations
 - ii. Confidential advice & negotiations
 - iii. Confidential advice & negotiations
 - iv. Confidential advice & negotiations
- 30. Free and frank opinions

Negotiations

C. Negotiation approach

32. Ministers now have several options on how to progress negotiations with NZ Steel.
33. All options could include a commitment to progress work in tandem to NZ Steel's feasibility assessment:
- a. Negotiations [REDACTED]
 - b. to maintain 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.

Option 1

- Progress with all support provided via GIDI– with a co-funding ratio of up to [REDACTED] per cent (Confidential advice to E [REDACTED] 140m).
- This option would facilitate the swiftest progress in negotiations and presents the most certainty that NZ Steel would advise the BlueScope Board to move to the next stage of feasibility study on the EAF investment.
- However, it does present risk by setting a precedent as to the amount of GIDI grant funding received by a very large emitter. There also remains a risk that NZ Steel/BlueScope will reject any counter offer and maintain it needs Negotiations [REDACTED]

Option 2

- Progress with a support package in which GIDI contributes an amount reflecting a co-funding ratio of up to Negotiations [REDACTED]
- This could be supplemented with an offer to NZ Steel to continue negotiations for a higher overall total contribution made up of alternative financial support such as those outlined in the section on non-grant funding options above.
- This option increases the risk that negotiations slow or stall or that NZ Steel/BlueScope judges it not worthwhile to pursue negotiations and drops the EAF project.
- However, it does allow for government to progress a package of options in any eventual agreement with NZ Steel, and potentially helps mitigate the precedent setting effect of Commercial Information [REDACTED]

Option 3

- A final option is to provide an indication of the amount Ministers currently assess to constitute a defensible investment by the Crown (i.e., Negotiations \$140m), but without any formal commitment, and indicate that the Crown needs to work through NZ Steel's other asks and see the outcome of the full feasibility study before committing.
- This option buys more time before confirming any offer but there is a risk the BlueScope Board would find it an insufficient commitment and allow the deal to fall through.

We seek direction on:

- *Which option Ministers wish to present to Cabinet in the attached Cabinet paper.*
- *How you would like to manage decision-making and approval of this deal, and future significant deals of this kind?*
- *How Ministers might wish to progress negotiations in the next stage of discussion with NZ Steel:*
 - *If Minister's wish to progress with all support provided via GIDI (option 1) it would be appropriate to maintain the existing cross-agency coordination approach - whereby EECA lead negotiations on a GIDI arrangement, reporting to the Minister of Energy and Resources, with existing MBIE support. It also makes sense to maintain MfE arrangements to report to the Minister for Climate Change on ETS settings.*
 - *If Ministers wish to offer NZ Steel continued negotiations involving additional non-grant measures, then we recommend seeking Cabinet agreement to formalise the negotiation mandate and establish a cross-government negotiation team.*
- *We also propose that Ministers meet with Robin Davies of NZ Steel, shortly following today's meeting (Monday 13 February) to get more clarity on what information NZ Steel requires from Government to progress to the next stage of feasibility assessment. We would like to discuss the potential interplay between a Ministerial meeting with NZ Steel and the negotiations underway.*

Next steps

34. We are aiming to provide a revised draft of the Cabinet paper for your review before proceeding to departmental and ministerial consultation as per the timetable below:

13 Feb	Ministers Meet
16 Feb	Draft Cabinet paper to Ministers for weekend bag
20 Feb	Feedback from Ministers on Cabinet paper
21 Feb – 28 Feb	Concurrent targeted departmental and ministerial consultation
2 March	Final Cabinet paper lodged
8 March	DEV Cabinet Committee
13 March	Cabinet – followed by update to NZ Steel on Crown's approach
13-15 March	BlueScope board meeting and decision on whether to progress to full feasibility study of an EAF

Annexes

Annex One: Agenda

Annex One: Agenda

Monday 13 March 4.00 – 4.30 pm

Meet: 6.8EW

Attendees:

Hon Dr Megan Woods

Hon David Parker

Hon James Shaw

Officials from MBIE, EECA, MfE

Agenda

Item 1: Findings to date on the appropriate funding contribution from the Crown

Item 2: What are the mechanism/s through which the Crown should provide support?

Item 3: Negotiation approach