



BRIEFING

Engagement with Large Emitters on Significant Decarbonisation Projects

Date:	14 December 2022	Priority:	High
Security classification:	In Confidence	Tracking number:	2223-2099 BRF-2388

Action sought		
	Action sought	Deadline
Hon Dr Megan Woods Minister of Energy and Resources	Endorse our proposed approach for negotiating cross-government, bespoke solutions with very large emitters looking to undertake significant decarbonisation projects	15 December 2022
Hon James Shaw Minister of Climate Change	<p>Agree to take a paper to Cabinet in February 2023 seeking approval:</p> <ul style="list-style-type: none"> to enter final negotiations for the support and critical related conditions as will be contained in a final agreement with NZ Steel. to a cross-government framework for supporting significant decarbonisation projects by very large industrial emitters. 	

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:

Approved

Declined

Noted

Needs change

Seen

Overtaken by Events

See Minister's Notes

Withdrawn

Comments



BRIEFING

Engagement with Very Large Emitters on Significant Decarbonisation Projects

Date:	14 December 2022	Priority:	High
Security classification:	In Confidence	Tracking number:	2223-2099 BRF-2388

Purpose

This briefing seeks your feedback on a process for negotiating cross-government, bespoke solutions with very large emitters looking to undertake significant decarbonisation projects. It also provides an update on work to progress a partnership agreement with NZ Steel and a negotiating approach that takes advantage of a suite of available government support.

Recommended action

MBIE, EECA and MFE recommend that you:

- a **Note** that in order to unlock maximum emissions reductions from our very largest emitters the Government will need to negotiate bespoke solutions that may require a range of policy levers

Noted

- b **Note** that there are three key decision points for agreeing to bespoke decarbonisation support packages for very large emitters

- Agreement to the overall cross-government partnership process
- Agreement in principle, to negotiate with a particular very large emitter
- Agreement to a specific deal

Noted

- c **Agree** to our proposed approach for:

- Cabinet to endorse the overall cross-government partnership process (as laid out in Annex 1)
- Cabinet to agree in principle, to the negotiation parameters for a bespoke agreement, where this requirement is triggered
- Relevant portfolio Ministers and the Minister of Finance to authorise each specific deal within the parameters agreed by Cabinet.

Agree / disagree

OR

- d **Indicate** your preferences for how and when to involve Cabinet

- e **Note** that officials are continuing to determine how various Government levers can work together to structure a package with NZ Steel for proposed co-investment in an electric arc furnace

Noted

- f **Agree** to take a joint paper to Cabinet in February 2023 outlining:

- The proposed term sheet for support to NZ Steel for their planned decarbonisation project at the Glenbrook steel mill and seeking Cabinet approval to enter final negotiations for the support and critical related conditions as will be contained in the final agreement
- a cross-government framework for supporting significant decarbonisation projects by very large industrial emitters.

Agree / disagree

Privacy of natural persons

Andrew Caseley
Chief Executive
EECA

13/12/2022

Privacy of natural persons

Sharon Corbett
Policy Director, Energy & Resource Markets
MBIE

13/12/2022

Privacy of natural persons

James Coombes
Manager, Emissions Pricing Policy
MfE

13/12/2022

Hon Dr Megan Woods
Minister of Energy and Resources

..... / /

Hon James Shaw
Minister of Climate Change

..... / /

Background

1. You met with officials from MBIE, MfE and EECA on Thursday 10 November 2022. This meeting canvassed the possibility of entering into an agreement with NZ Steel through the Government Investment in Decarbonising Industry Fund (GIDI), in light of NZ Steel's proposal to invest (with the support of Government) in an electric arc furnace [EECA MEMO 123, BRF-2410 refers].
2. Key outcomes included:
 - a. A strong appetite for reaching an agreement with NZ Steel that takes advantage of a suite of available government support.
 - b. Acknowledgement that bespoke solutions are required for the very largest emitters, with individualised account management of each and a negotiating approach that considers all possible options for any resulting agreements.
3. Officials are developing an account management process for very large emitters (where such an approach is required) seeking support for large decarbonisation projects under the GIDI Fund, including those receiving industrial allocation under the NZ ETS, to ensure coordination is enabled across different government departments and relevant policy levers. This briefing seeks your feedback on this proposal.
4. NZ Steel's parent company, BlueScope will consider whether to progress to a full feasibility study phase for investment in an electric arc furnace in February / March 2023. NZ Steel is seeking a firm commitment of Government support to inform the Board's decision-making.
5. Given these timeframes, we are recommending that Ministers prepare to move forward with considering a funding agreement with NZ Steel.
6. Accordingly, officials recommend that you take a joint paper to Cabinet in February 2023 covering:
 - a. the proposed term sheet for support to NZ Steel for their planned decarbonisation project at the Glenbrook steel mill and seeking approval to enter final negotiations for the support and critical related conditions as will be contained in the final agreement.
 - b. a cross-government framework for supporting significant decarbonisation projects by very large industrial emitters – based on the proposal detailed below.

Cross-government framework for supporting decarbonisation projects by very large industrial emitters

7. You have directed officials to develop a process for co-ordinating cross-government, bespoke solutions with very large emitters who are looking for support to undertake significant decarbonisation projects – drawing on a portfolio approach to government policy levers.
8. A summary of our proposed process is attached as **Annex One**. We invite your feedback on this.

Criteria

9. We propose a flexible process that recognises that the context for any bespoke arrangement with a very large emitter will be unique. Rather than setting strict criteria for identifying which opportunities should trigger a cross-government process, we suggest the GIDI Senior Officials Group (which includes representatives from EECA, MBIE and MfE, with an invitation

to NZ Green Investment Fund (GIF)) discuss and decide this on a case-by-case basis, taking into account:

- a. The scale of opportunity (e.g. impact on emissions budgets);
 - b. The quantum requested;
 - c. The likely involvement of multiple Government entities and
 - d. Indications that the project may require more than one lever (we consider this the most important criterion), for example, because the project would significantly deplete the GIDI fund and impact industrial allocation entitlements.
10. There will likely be scenarios where a very large emitter is seeking a significant amount of Government support (such as through a GIDI partnership for a suite of decarbonisation capital project investments) but the situation may not benefit from or warrant a cross-government partnership process.

Levers

11. We envisage the main levers that would be considered are:
- a. Funding from GIDI;
 - b. Confidential advice & negotiations
 - c. Support to access finance, in particular the role of NZ GIF, if needed.
12. We would also be alert to and advise you of, other types of support that may be needed to better enable a particular ambitious decarbonisation project.
13. Any package offered to a very large emitter via this process will not necessarily include all levers identified above, but through the process, we will consider all possible levers.

Objectives

14. Annex 1 includes a summary of what success for this process would look like, and our draft objectives for any arrangement. We invite your feedback on whether this aligns with your vision for this process and whether there are other objectives you would want any arrangement to meet.
15. Our proposed draft objectives are that:
- a. Any arrangement is likely to unlock emissions reductions that may otherwise be later or lesser;
 - b. Government investment is leveraging rather than displacing private investment; and
 - c. Levers are used in line with policy intent.

Decision-making delegations

16. Following a recommendation from the GIDI Senior Officials' Group that a very large emitter meets the criteria, there are three key decision points for agreeing to bespoke decarbonisation support packages for very large emitters:
- a. Agreement to the overall cross-government partnership process;
 - b. Agreement in principle, to negotiate with a particular large emitter; and
 - c. Agreement to a specific deal.

17. The level of delegation at which these decisions are made will depend on how you are required to or wish to involve Cabinet and will impact the time it takes for any deal to be finalised.
18. If the Senior Officials' Group concludes that a request for Government support does not meet the criteria to require a cross-government decarbonisation package the entity may continue one-on-one negotiation with the appropriate Government entity.

Agreement to the overall cross-government partnership process

19. This process could be agreed upon between relevant Ministers (likely the Minister of Energy and Resources, Minister of Climate Change, and Minister of Finance). However, we suggest you ask Cabinet to agree or note the overall process. This could be done at the same time as updating Cabinet on the proposed support package to be negotiated with New Zealand Steel. This will ensure that other Ministers who may be approached for support by very large emitters are aware of this cross-government process.

Agreement in principle, to negotiate with a particular large emitter

20. We propose to brief you and gain a negotiating mandate when we identify a very large emitter who triggers a cross-government partnership process. At this point, we suggest you seek Cabinet's agreement in principle to negotiate a bespoke support package.
21. We suggest you also seek Cabinet's approval for relevant Ministers to agree on the final package if it is within the delegated parameters. This would enable any negotiations to be concluded swiftly. Alternatively, you could update Cabinet via an oral item, or update any additional relevant Ministers on an as-needed basis.

Agreement to a specific deal

22. Once we are close to finalising an agreement with a large emitter on decarbonisation support offers and the milestones the entity commits to, we propose to brief you again and seek your agreement on the final package. We will advise you on the options we have considered and the rationale for our proposed agreement with the large emitter.
23. This is another decision point where there is the opportunity to involve Cabinet, either to note or agree to the deal. Our preference is for a more agile process where relevant Ministers can agree on the final deal without seeking Cabinet approval, however, we seek your preferences around this.

Operationalising the framework will require information-sharing arrangements between agencies

24. Given the commercially sensitive nature of some information, we are exploring the need for a formal Memorandum of Understanding to be developed between agencies. In addition, we are including a standing agenda item at the regular GIDI senior officials' meetings to discuss engagements with the very largest emitters.
25. Recognising that to date our advice has focused on GIDI and the NZ ETS and that very large emitters may seek support through other mechanisms in future, we will continue to identify other parts of government which may be receiving requests for support and will seek to include relevant officials in the proposed process where appropriate.

Next steps to progress a funding agreement with NZ Steel

26. Officials are continuing to determine how various Government levers can work together to structure a package with NZ Steel for co-investment in an electric arc furnace.

Government Investment in Decarbonising Industry Fund

- 27. As part of their detailed request for GIDI funding, NZ Steel provided a full business case briefing to EECA and KPMG on Monday 21 November.
- 28. EECA continue to undertake due diligence on the GIDI proposal from NZ Steel with the support of KPMG and Bell Gully on any Agreement content. Within this process, EECA has asked other government agencies (e.g. MfE on NZ ETS industrial allocation) for input where appropriate and will be providing periodic updates to all involved. Treasury will also be involved at the appropriate time.

New Zealand Emissions Trading Scheme

- 29. As part of its original proposal for government funding to support its investment, NZ Steel requested a delay to future reviews (after the initial update to allocative baselines scheduled for 2024) of its allocative baselines, so that it could retain its level of industrial allocation for a period as a 'return on investment'.
- 30. The purpose of industrial allocation is to mitigate the risk of emissions leakage, not to provide financial support or to directly incentivise investments in decarbonisation.
- 31. It is possible to delay future updates to allocative baselines to provide a 'return on investment' for decarbonisation projects by large industrial emitters. But this depends on the entity not changing its activity significantly or adding new products (i.e., altering its production model in a way that departs from the current activity and product descriptions used to calculate industrial allocation).

32. Negotiations [Redacted]

Using NZ ETS overallocation to support NZ Steel's investment is unlikely to be an option

- 33. Overallocation typically occurs where firms carrying out an eligible activity receive an allocation based on an allocative baseline (emissions cost per unit of product) that is larger than the firm's actual emissions cost per unit of product. This could be the result of a firm reducing its emissions and therefore the emissions costs associated with that product.
- 34. In the case of NZ Steel, their decarbonisation project is expected to result in a new product (molten steel) with less emissions costs per unit. Steel production involves several products which receive an allocation. Each has a different allocative baseline (emissions cost per unit of product). To achieve continued industrial allocation as requested by NZ Steel would require:

a. Confidential advice to Government [Redacted]

b. Confidential advice to Government [Redacted]

35. Legal professional privilege [Redacted]

36. Confidential advice to Government

[Redacted]

NZ Steel's investment will still require an update to its industrial allocation settings

37. Officials have engaged several times with representatives of NZ Steel to better understand the interactions between the NZ ETS and its possible investment. Confidential advice to Government

[Redacted]

38. Officials are scheduled to meet with NZ Steel again on 7 December to discuss this further and can confirm our understanding in early 2023.

Impact of allocating NZUs on the Crown's finances and the NZ ETS cap

39. Ministers sought advice from officials on how New Zealand Units (NZUs) are accounted for in the Crown's accounts.

40. NZUs have a market value because they confer the right to emit 1 tonne of carbon dioxide equivalent and there is an expectation that the government will honour the rights or value of an NZU at future point in time. Giving away NZUs therefore is a cost on the Crown's books because the government is providing something with a market value for free.

Basics of NZU accounting

41. The government records the number of NZUs allocated to the market, and surrendered to the Crown account, to keep track of the size of the NZ ETS liability. The liability is essentially the amount of money the government would spend buying back all the units sitting in the market at a point in time (i.e. it is dependent on the number of units existing in the market, multiplied by the secondary market price at a point in time).

42. When an NZU is allocated into the market for free (either through forestry allocation, industrial allocations, or other removals) it is an expense to the Crown, and the allocation is recorded as an increase in the NZ ETS liability on the Crown's balance sheet.

43. An NZU surrendered by an NZ ETS participant is regarded as revenue to the Crown which is recorded as a decrease to the NZ ETS liability on the balance sheet.

44. Auctioned units are accounted differently. The sale of an NZU is fiscally neutral because the cash sale nets off the increase in the NZ ETS liability. When the unit is eventually surrendered, the liability decreases and the cash asset from the unit sale is left.

45. At each balance date, an average or month-end market price is recorded, and the size of the NZ ETS liability is revalued. This is recorded a gain or loss on the Crown's operating statement.

Fiscal implications

46. The size of the NZ ETS liability has a range of impacts on the Crown's fiscals, including on the operating balance and net worth.

47. The liability is not considered in the government's key fiscal indicator, net core Crown debt (borrowings less liquid financial assets). Therefore, it does not negatively impact on the long-term debt objective outlined in the Government's fiscal strategy.

48. The primary fiscal implication of handing out free NZUs is the negative cash impact from the loss of potential auction revenue.
49. There could be fiscal implications to giving out NZUs above the NZ ETS cap as described below.

Implications on budgets and the NZ ETS cap

50. The NZ ETS cap is the primary metric which determines the number of units that are auctioned each year. The NZ ETS cap is informed by our emissions budgets which are aligned with New Zealand's emissions targets. Unit sources under the NZ ETS cap are industrial allocations and auctioned units.
51. The volume of units available for auctioning is the difference between the NZ ETS cap, and forecasts of industrial allocation (and some other minor adjustments).
52. If the government decided to give NZUs to industries to incentivise decarbonisation investments, either through intentional over-allocation, or another ETS mechanism – these units would be included under the NZ ETS cap and therefore auction volumes would correspondingly decrease. As described above, the only material fiscal implication of this is the negative cash impact from loss of auction revenue.
53. In a scenario where the NZ ETS cap was breached by a sudden increase in industrial allocation, or a large provision of units provided to incentivise decarbonisation (assuming there was not enough time to adjust auction volume to allow this under the cap) – the government would be required to back these to ensure our legislated budgets are met. This could be through the purchase of offsets (either domestically or internationally), and this would come at an additional cost to the government.

New Zealand Green Investment Finance (NZ GIF)

54. Access to capital is not a barrier for NZ Steel's proposed project, so a negotiated package of support is unlikely to include support for access to finance. However, access to green finance providers, and the role for Government in supporting this, could be considered alongside other mechanisms as part of any future negotiated package for other entities.

Next steps

55. We seek your feedback on our proposed process for negotiating cross-government, bespoke solutions with very large emitters looking to undertake significant decarbonisation projects.
56. Officials recommend that you take a joint paper to Cabinet in February 2023 outlining:
 - a. the proposed term sheet for support to NZ Steel for their planned decarbonisation project at the Glenbrook steel mill and seeking approval to enter final negotiations for the support and critical related conditions as will be contained in the final agreement.
 - b. a cross-government framework for supporting significant decarbonisation projects by very large industrial emitters – based on the proposal detailed below.
57. We will begin drafting a Cabinet paper to achieve this based on your feedback on this paper.

Annexes

Annex One: Cross-government process for engaging with very large emitters

Annex One: Cross-government process for engaging with very large emitters

DRAFT

Cross-government partnership process for engaging with large emitters

Why this process?

- Very large emitters are beginning to approach Ministers and agencies requesting support to decarbonise
- Very large emitters may need bespoke and co-ordinated multi-lever support and incentives from government in order to decarbonize swiftly and successfully
- Government needs to consider possible supports for very large emitters as a coherent package to ensure the most effective deployment of different levers
- The scale of potential emissions reductions warrants a bespoke process

What would success look like?

- Fast and significant **emissions reductions** from very large emitters
- Government can **move at pace** to support industry but any bespoke arrangements **stand up to scrutiny**
- Ministers, agencies and large emitters have **role clarity**, all necessary context and shared expectations about how to advance a discussion about possible Government support
- Individual support packages for large emitters are **fit for purpose** and meet a common set of design principles

