



# PROACTIVE RELEASE COVERSHEET

<b>Minister</b>	Hon Simon Watts	<b>Portfolio</b>	Climate Change
<b>Name of package</b>	Proactive release: Update to NZAS allocative baseline Cabinet paper and associated briefing notes	<b>Date to be published</b>	6 August 2024

List of documents that have been proactively released		
<b>Date</b>	<b>Title</b>	<b>Author</b>
6 August 2024	<ol style="list-style-type: none"> <li>BRF-3944 Approval to issue call for data notice to NZAS Ltd.</li> <li>BRF-4093 Approval to issue drafting instructions for the annual update to the allocative baseline for NZAS</li> <li>BRF-4226: Approval to lodge: Climate Change (Eligible Industrial Activities) Amendment Regulations 2024</li> <li>CAB-381 - Climate Change (Eligible Industrial Activities) Amendment Regulations 2024</li> </ol>	Ministry for the Environment
<p><b>Information redacted</b> <b>YES / NO</b></p> <p>Any information redacted in the documents is redacted in accordance with the Ministry for the Environment's policy on proactive release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.</p> <p>No information has been redacted in the document "BRF-4226: Approval to lodge: Climate Change (Eligible Industrial Activities) Amendment Regulations 2024".</p> <p><b>Summary of reasons for redaction</b></p> <p>Some information has been withheld for the reasons of maintaining legal professional privilege.</p>		

## Policy and Privacy

### In-Confidence

Office of the Minister of Climate Change

LEG - Cabinet Legislation Committee

## Climate Change (Eligible Industrial Activities) Amendment Regulations 2024

### Proposal

- 1 I propose the Cabinet Legislation Committee (LEG) authorise submission of the attached Climate Change (Eligible Industrial Activities) Amendment Regulations 2024 to the Executive Council.
- 2 The amendment regulations prescribe the New Zealand Aluminium Smelters Limited final allocative baseline for 2023 and provisional allocative baselines for 2024 and 2025 under the New Zealand Emissions Trading Scheme (NZ ETS).

### Relation to government priorities

- 3 This is a routine operational adjustment that requires Cabinet approval.

### Executive Summary

- 4 The NZ ETS prices emissions across the economy, with emitters surrendering an emissions unit (New Zealand Unit or NZU) for every tonne of emissions. Some industries are more impacted by the NZ ETS where they have high levels of emissions costs compared to revenue and operate in international markets (referred to as emissions intensive and trade exposed industries, or EITE).
- 5 The Government provides allocations<sup>1</sup> of New Zealand Units (NZUs) to EITEs to help meet some of their emissions costs. Free allocation mitigates the risk that EITE industries shift offshore to countries with weaker climate policy to reduce compliance costs. This is known as emissions leakage and could result in global emissions increasing.
- 6 The New Zealand Aluminium Smelters Limited (NZAS) receives an allocation of units annually for carrying out the EITE activity – aluminium smelting.
- 7 NZAS has unique electricity pricing arrangements and significant electricity use. There is an annual process for updating NZAS' allocative baseline<sup>2</sup> in regulations to

<sup>1</sup> Industrial allocation policy is legislated under the Climate Change Response Act 2002 (CCRA) and the Climate Change (Eligible Industrial Activities) Regulations 2010 (the Regulations).

<sup>2</sup> An allocative baseline is the rate at which an EITE activity receives an allocation of units. It can be expressed as NZUs per tonne of output produced. Firms carrying out an eligible activity receive a provisional allocation in advance based on forecast levels of output for the upcoming year. The allocation is corrected a year later once actual output levels are confirmed.

account for this. This process has been carried out since 2010 and ensures that NZAS' annual allocation fairly reflects the emissions costs it faces.

- 8 Based on electricity data recently provided by NZAS, the proposed final allocative baseline for 2023 and the provisional allocative baselines for 2024 and 2025 is 2.042. This is a minor increase from the provisional allocative baseline for 2023.
- 9 If NZAS' 2023 provisional allocative baseline is not updated to a final allocative baseline this year, then the baseline used in NZAS' 2023 allocation correction would default to a much higher baseline of 10.1304 in Schedule 2 of the Regulations. This baseline does not factor in NZAS' current electricity contract and assumes a higher exposure to the emissions price through electricity purchases.
- 10 Updating the baseline now means that NZAS will receive an estimated provisional allocation of 586,316 units which account for on-site emissions attributed to the transformation of aluminium oxide to aluminium and other minor emissions sources. This will cost the Crown \$42.8 million at current NZU prices.
- 11 In contrast, if no updates are made to the baseline, NZAS would receive an estimated 2.9 million units. This would cost the Crown approximately \$212 million at current prices.
- 12 NZAS has been consulted on the changes to the regulations and has agreed with the calculation of the updated allocative baseline for aluminium smelting.
- 13 The amendment regulations need to be notified in the New Zealand Gazette by 2 April 2024 to allow them to come into effect following the 28-day notification period and for NZAS to meet the 30 April deadline for allocation applications.
- 14 There will be another update to NZAS' allocative baseline in 2024. This will roll together an update to account for new production, emissions and revenue data as part of the work to implement the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Act 2023, and an update to the electricity allocation factor as part of a new annual process, . The impact of these future updates is expected to be more significant than the baseline adjustment in this paper. I will seek Cabinet's approval for amendment regulations before November 2024.

## Background

- 15 Several regulatory changes are required each year to keep the NZ ETS operating effectively and efficiently.
- 16 Aluminium smelting is an emissions intensive activity and aluminium is traded internationally so is an eligible EITE activity under the CCRA and the Regulations.
- 17 NZAS is entitled to receive industrial allocation of New Zealand Units (NZUs) to offset the costs of the NZ ETS.
- 18 NZAS' allocation covers the emissions costs associated with direct emissions from the transformation of aluminium oxide to aluminium, a small amount of Liquefied Petroleum Gas (LPG), and the indirect emissions cost of electricity purchases.
- 19 Section 161C(4) of the CCRA grants the Minister of Climate Change powers to adjust allocation calculations to take account of electricity-related contracts. NZAS is

currently the only recipient of industrial allocation with adjusted calculations for contracts.

- 20 NZAS has a special process for allocation because of its significant electricity use and because of the nature of its electricity supply contract with Meridian. Other EITE firms buy electricity at or near spot prices and receive NZUs to cover costs passed through for electricity generation emissions at a standard rate. NZAS receives a lower, and variable, amount of NZUs because its exposure to spot market electricity costs is limited and changes annually.
- 21 Previous analysis of its current electricity contract with Meridian has shown that NZAS faces no NZ ETS cost component through the price it pays for electricity under this contract. This has resulted in NZAS' allocative baseline being reflective of predominately process emissions with some emissions costs from liquid fossil fuel and gas usage.
- 22 Allocations to NZAS are based on three variables: the production of aluminium, the emissions intensity (the allocative baseline), and the assistance rate applicable to highly emissions intensive industries. The respective assistance rate is 0.86 for 2024 and is being phased down by 1 percentage point per year this decade.
- 23 NZAS' allocative baselines for the previous and current years are adjusted every year according to how much electricity NZAS consumed in the previous year under its contracts and from the spot market. A provisional allocative baseline is also created for the next year to assist NZAS and the Government with forecasting. This annual operational and technical update protects the Crown from over-allocating or under-allocating NZUs to NZAS.

## Analysis

### NZAS allocative baseline update

- 24 Cabinet has previously authorised the Minister of Climate Change to adjust NZAS' allocative baseline to reflect the NZ ETS costs from electricity consumption without referring to Cabinet, except where financial or policy implications are significant enough to warrant Cabinet consideration [ENV-18-MIN-0051 and CAB-18-MIN-0628].
- 25 I used this delegation to approve drafting instructions for the amendment regulations, which are detailed in the following table.<sup>3</sup> Once regulations are drafted, Cabinet approval is required to submit the regulations to the Executive Council.

Year	Current Allocative Baselines (NZUs/tonne of product)	Proposed Allocative Baselines (NZUs/tonne of product)
2023	2.034 (provisional)	2.042 (final)
2024	2.034 (provisional)	2.042 (provisional)
2025	Not set	2.042 (provisional)

- 26 Updates to the final and provisional baselines are based on electricity consumption data provided by NZAS.

<sup>3</sup> Updates are proposed for years 2023-2025 only. Prior years are provided to illustrate the change in allocative baseline resulting from decisions in relation to NZAS' main electricity contract.



- 27 The final 2023 allocative baseline is higher than was set provisionally because NZAS purchased marginally more electricity from the spot market than in 2022<sup>4</sup>.
- 28 Updates to the provisional baselines for 2024 and 2025 are based on NZAS' 2023 consumption data which they noted as a reasonable forecast of their electricity purchases.

**Amendments avoid under- or over-allocation of emission units to NZAS**

- 29 If NZAS' 2023 provisional allocative baseline is not updated to a final allocative baseline this year, then the baseline used in NZAS' 2023 allocation correction would default to a much higher baseline of 10.1304 in Schedule 2 of the Climate Change (Eligible Industrial Activities) Regulations 2010. This baseline does not factor in NZAS' electricity contract and assumes a higher exposure to the emissions price through electricity purchases.
- 30 Updating the allocative baselines now means that NZAS will receive an estimated provisional allocation of 586,316 units which account for on-site emissions attributed to the transformation of aluminium oxide to aluminium and other minor emissions sources. This will cost the Crown \$41 million at an NZU price of \$70. In contrast, if no updates are made to the baseline, NZAS would receive an estimated 2.9 million units, costing the Crown approximately \$203 million.
- 31 My recommended updates to the allocative baselines for aluminium smelting are based on evidence of the emissions costs faced by NZAS under their existing contract. They are consistent with the purpose of industrial allocation policy and the statutory objectives of the NZ ETS. The application of existing methodologies and processes provides for market confidence in decision making on the NZ ETS.

*Legal advice (legally privileged)*

- 32 9(2)(h)
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**Additional matters that will affect future updates to NZAS' allocative baselines**

*Implementation of the industrial allocation amendment act*

- 33 Work on implementing the Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Act 2023 is currently underway. As part of this process, new data on direct and indirect emissions per tonnes of aluminium produced has been sourced from NZAS. This may result in further changes to NZAS' allocative baseline in 2024. These changes will impact NZAS' final allocation for 2024 and provisional allocation for 2025 onwards. Cabinet decisions on changes to the baseline will be sought later this year.

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<sup>4</sup> The provisional baseline is based on confirmed electricity usage from the previous calendar year.

*A new process for annual updates to the electricity allocation factor*

- 34 The Climate Change Response (Late Payment Penalties and Industrial Allocation) Amendment Act 2023 established a new annual process for updating the electricity allocation factor (EAF). The EAF is used to estimate the indirect emission costs associated with purchasing electricity from the spot market. The first update to the EAF will be carried out later in 2024 and will have an impact on NZAS' final allocative baseline for 2024 and provisional allocative baseline for 2025 as it purchases a small amount of electricity outside of its contract with Meridian..

*A renegotiated electricity supply contract*

- 35 The electricity supply contract between NZAS and Meridian Energy Limited is being renegotiated. The indirect emissions costs faced by NZAS under any new contract will be studied by my officials once the contract is finalised. I will then seek Cabinet approval to reflect any new emission costs in NZAS's allocations from 2025.

**Timing and 28-Day rule**

- 36 It is intended that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2024 come into force 28 days after the date of their notification in the New Zealand Gazette. The amendment regulations need to be in force to allow sufficient time for NZAS to meet the 30 April 2024 deadline for allocation applications.
- 37 Consideration of this paper at the 21 March LEG Committee meeting means that no waiver from the 28-day rule is required.

**Cost-of-living Implications**

- 38 No cost-of-living implications have been identified as a result of these amendments.

**Financial Implications**

- 39 This update has resulted in an increase to NZAS' allocative baseline. However, due to production figures lower than what was forecast for 2023<sup>5</sup>, the update will result in NZAS owing the Crown an estimated 1,217 New Zealand Units (approximately \$85,000 at a price of \$70 per NZU).
- 40 Further to this, updating the allocative baselines now prevents the allocative baseline for aluminium smelting reverting to the default baseline of 10.1304 prescribed in Schedule 2 of the regulations. This avoids a significant over-allocation of NZUs to NZAS at an additional cost to the Crown of approximately \$164.5 million at an NZU price of \$70.

**Compliance**

- 41 The regulations comply with each of the following:
- 41.1 the principles of the Treaty of Waitangi;
  - 41.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993;

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<sup>5</sup> NZAS' unaudited final production of 333,870t of aluminium

- 41.3 the principles and guidelines set out in the Privacy Act 2020;
  - 41.4 relevant international standards and obligations;
  - 41.5 the Legislation Guidelines (2021 edition), which are maintained by the Legislation Design and Advisory Committee.
- 42 The Minister of Climate Change may recommend the making of regulations under s 161A(1)(c) of the Climate Change Response Act 2002 to prescribe allocative baselines. In accordance with s 161C(4) of the Act, the Minister may adjust a specified emissions figure (and consequently, their allocative baseline) after taking into account certain electricity-related contracts. No specific statutory prerequisite exists for the making of regulations under s 161A(1)(c). However, s 3(2) of the Act requires persons exercising a power or discretion under the Act to do so in a manner that is consistent with the purpose of the Act. This requirement has been met.

### **Regulations Review Committee**

- 43 No grounds have been identified for the Regulations Review Committee to draw the disallowable instrument or regulations to the attention of the House of Representatives as a Standing Order requirement.

### **Certification by Parliamentary Counsel**

- 44 The draft regulations were certified by the Parliamentary Counsel Office (PCO) as being in order for submission to Cabinet.

### **Legislative Implications**

- 45 Regulatory amendments to the Climate Change (Eligible Industrial Activities) Regulations 2010 will be required to implement the proposed changes.

### **Impact Analysis**

#### *Regulatory Impact Statement*

- 46 Cabinet has previously agreed that no Regulatory Impact Analysis will be required to accompany the annual legislative proposals containing updates to NZAS' baselines in the amended regulations [CAB Min (12) 43/6 refers]. A Regulatory Impact Analysis completed in June 2010<sup>6</sup> informed the decision to annually update NZAS' allocative baselines.

#### *Climate Implications of Policy Assessment*

- 47 The Climate Implications of Policy Assessment (CIPA) team at the Ministry has been consulted. They confirmed the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

### **Population Implications**

- 48 The proposed amendments have no population implications.

<sup>6</sup> As published on the Treasury's website: [New Zealand Emissions Trading Scheme: Industrial Allocation - 29 June 2010 - Regulatory Impact Statement - Ministry for the Environment \(treasury.govt.nz\)](#)

## Human Rights

- 49 There are no inconsistencies between the proposed amendments with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## Use of external Resources

- 50 No external resources were engaged in the preparation of the policy advice in this paper.

## Consultation

- 51 There are no statutory consultation requirements for these regulations in the CCRA. In line with Cabinet Manual requirements, NZAS was consulted about, and agreed with, the calculation of the baselines in the proposed amendment regulations.
- 52 The Treasury, Ministry for Primary Industries, and Ministry of Business, Innovation and Employment were consulted on this paper. The Department of Prime Minister and Cabinet and the Environmental Protection Authority were informed. Where specific comments were provided, they are reflected in this paper.

## Communications

- 53 NZAS and the Environmental Protection Authority will be notified when the Climate Change (Eligible Industrial Activities) Amendment Regulations 2024 are notified in the New Zealand Gazette. No other parties are affected.

## Publicity

- 54 The amended regulations will be notified in the New Zealand Gazette and published on the NZ Legislation website following Cabinet approval.

## Proactive Release

- 55 I propose to proactively release this paper on the Ministry for the Environment's website in full, subject to redactions equivalent to those under the Official Information Act 1982, once amendment regulations are published.

## Recommendations

I recommend that the Cabinet Legislation Committee:

- 1 **Note** that Cabinet has previously authorised the Minister of Climate Change to make adjustments to the allocation level for New Zealand Aluminium Smelter Limited (NZAS) to reflect the New Zealand Emissions Trading Scheme (NZ ETS) costs to NZAS from electricity consumption without referring to Cabinet, except where the financial or policy implications are significant enough to warrant Cabinet consideration [ENV-18-MIN-0051 and CAB-18-MIN-0628]
- 2 **Note** that I have determined recommended adjustments to the allocation level for NZAS, based on evidence of emission cost pass through, consistent with the purpose of industrial allocation policy and the statutory objectives of the NZ ETS.
- 3 **Note** that NZAS has been consulted on the proposed adjustment to its allocation level and agrees with the adjustment.



- 4 **Note** that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2024 will give effect to the decisions referred to in recommendation 2 above.
- 5 **Note** that these amendments need to come into effect before the 30 April 2024 so that NZAS can apply for its NZ ETS allocation under the industrial allocation provisions of the Climate Change Response Act 2002 by this deadline
- 6 **Authorise** the submission to the Executive Council of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2024
- 7 **Note** that it is intended that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2024 come into force 28 days after the date of their notification in the New Zealand Gazette.

Authorised for lodgement

Hon Simon Watts

Minister of Climate Change

## Appendices

Appendix 1: Emissions Trading Scheme Climate Change (Eligible Industrial Activities)  
Amendment Regulations 2023