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# Cabinet Economic Growth and Infrastructure Committee

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2012 NOV 27

## Minute of Decision

MFE

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### Emissions Trading Scheme: New Zealand Aluminium Smelters Allocative Baseline for 2013 and Beyond

#### Portfolio: Climate Change Issues

On 28 November 2012, the Cabinet Economic Growth and Infrastructure Committee:

- 1 **noted** that on 4 October 2010, the Cabinet Business Committee approved a process to adjust the allocative baselines for New Zealand Aluminium Smelters Limited (NZAS) to reflect the impact of their electricity contracts in place until the end of 2012 [CBC Min (10) 11/6];
- 2 **noted** that a new contractual arrangement for electricity supply will apply to NZAS from 1 January 2013;
- 3 **noted** that, following analysis of the new electricity contract, there exists a need to update allocative baselines for NZAS annually to reflect the impact of the electricity contract in force from 1 January 2013 on the emissions intensity of electricity used;
- 4 **noted** that there exists a need for the updated allocative baselines to be in place in time for NZAS to meet the legislated deadline for application for an allocation of units (of 30 April) each year;
- 5 **agreed** that allocative baselines for NZAS may be updated annually as provided in the specified approach (as outlined in the paper under EGI (12) 253, to ensure that the allocative baselines used for NZAS reflect the impact of the electricity contract in place from 2013 on the emissions price intensity of electricity used;
- 6 **agreed** that the Minister for Climate Change Issues may annually present a paper directly to Cabinet Legislation Committee containing proposals to amend the regulation containing the allocative baselines for NZAS, calculated in accordance with the specified approach;
- 7 **authorised** the Minister for Climate Change Issues to make any minor corrections required to the specified approach to ensure that the allocative baseline used in allocations to NZAS reflect the impact of NZAS' electricity contracts on the emissions price intensity of electricity used;
- 8 **agreed** that no regulatory impact statement be required to accompany the annual legislative proposals containing updates to NZAS allocative baselines in the Climate Change (Eligible Industrial Activities) Regulations;

- 9 noted that the fiscal cost of allocation to NZAS will change year to year <sup>w/h</sup> subject to the annual update of the allocative baseline;  
 S 9(2)(b)(ii)
- 10 authorised the Minister of Finance and the Minister for Climate Change Issues to jointly approve changes to the Vote Climate Change Non-Departmental Other Expense: Allocation of New Zealand Units appropriation, in relation to the updated annual baselines as necessary, in line with the amendment of the Climate Change (Eligible Industrial Activities) Regulations;
- 11 noted that NZAS is presently trying to renegotiate elements of the electricity contract with Meridian Energy, and that should a modified electricity contract be agreed, the Minister for Climate Change Issues expects to seek a copy of the modified contract to determine its consequences for the specified approach;
- 12 noted that the Minister for Climate Change Issues intends to release the relevant parts of the paper under EGI (12) 253 to NZAS in order to maximise certainty over their likely future allocations and to allow them to prepare for the required annual provision of data.

*Janine Harvey*  
 Janine Harvey  
 Committee Secretary

Reference: EGI (12) 253

**Present:**

Hon Gerry Brownlee (Chair)  
 Hon Steven Joyce  
 Hon Anne Tolley  
 Hon Tim Groser  
 Hon Phil Heatley  
 Hon Kate Wilkinson  
 Hon Nathan Guy  
 Hon Craig Foss  
 Hon Amy Adams  
 Hon Chris Tremain  
 Hon Maurice Williamson  
 Hon Simon Bridges  
 Hon Peter Dunne  
 Hon John Banks

**Officials present from:**

Office of the Prime Minister  
 Officials Committee for EGI

**Distribution:**

Cabinet Economic Growth and Infrastructure Committee  
 Office of the Prime Minister  
 Chief Executive, DPMC  
 Director, PAG, DPMC  
 PAG Subject Advisor, DPMC  
 Deborah Roche, PAG, DPMC  
 Secretary to the Treasury  
 Peter Martin, Treasury  
 Chief Executive, MBIE (Economic Development)  
 Bryan Chapple, MBIE  
 Paul Stocks, MBIE  
 Director-General, Ministry for Primary Industries  
 Liz Sinclair, SSC  
 Secretary of Foreign Affairs and Trade  
 Secretary for the Environment (Climate Change)  
 Secretary for the Environment  
 Secretary for the Environment (EPA)  
 Chief Executive, Te Puni Kokiri

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# Cabinet Economic Growth and Infrastructure Committee

EGI Min (15) 3/4

Copy No: 35

## Minute of Decision

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2 6 FEB 2015

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### Industrial Allocation to New Zealand Aluminium Smelters Limited under the New Zealand Emissions Trading Scheme

Portfolio: Climate Change Issues

On 25 February 2015, the Cabinet Economic Growth and Infrastructure Committee:

- 1 **noted** that New Zealand Aluminium Smelters Limited (NZAS) receives an allocation of emission units under the New Zealand Emissions Trading Scheme (NZ ETS);
- 2 **noted** that NZAS has renegotiated its electricity supply contract with Meridian Energy Limited (Meridian), and that its allocation needs to be adjusted;
- 3 **agreed** that NZAS be allocated <sup>with s 9(2)(b)(i)</sup> New Zealand Units (NZUs) per megawatt hour for electricity purchased under its current supply contract with Meridian;
- 4 **noted** that the adjusted allocative baseline for NZAS must be prescribed in regulations before mid-April 2015 to specify NZAS' final allocation for 2014 and provisional allocation for 2015;
- 5 **invited** the Minister for Climate Change Issues to issue drafting instructions to the Parliamentary Counsel Office to prescribe NZAS's final allocative baseline for 2014 and provisional allocative baselines for 2015 and 2016 in accordance with the methodology set out in the paper under EGI (15) 25;
- 6 **agreed** that the paper under EGI (15) 25 be released to NZAS, subject to any material being withheld in accordance with the principles of the Official Information Act 1982;
- 7 **noted** that NZAS is likely to enter into additional electricity supply agreements in the future, significantly smaller than the new contract with Meridian;
- 8 **authorised** the Minister for Climate Change Issues to make adjustments to allocative baselines for NZAS in the future to reflect the NZ ETS costs to NZAS from electricity supply agreements without further reference to Cabinet, except where the financial or policy implications are significant enough to warrant Cabinet consideration.

*J. Harvey*  
Janine Harvey  
Committee Secretary

Reference: EGI (15) 25

Distribution: (see over)



**Present:**

Rt Hon John Key  
Hon Bill English (Chair)  
Hon Gerry Brownlee  
Hon Steven Joyce  
Hon Paula Bennett  
Hon Simon Bridges  
Hon Dr Nick Smith  
Hon Tim Groser  
Hon Michael Woodhouse  
Hon Todd McClay  
Hon Craig Foss  
Hon Jo Goodhew  
Hon Nicky Wagner  
Hon Louise Upston  
Hon Te Ururoa Flavell

**Officials present from:**

Office of the Prime Minister  
Officials Committee for EGI

**Distribution:**

Cabinet Economic Growth and Infrastructure Committee  
Office of the Prime Minister  
Chief Executive, DPMC  
Director, PAG, DPMC  
PAG Subject Advisor, DPMC  
Carolyn van Leuven, PAG, DPMC  
Secretary to the Treasury  
Jane Frances, Treasury  
Chief Executive, MBIE (Economic Development)  
Cath Atkins, MBIE  
Chief Executive, MBIE (Energy and Resources)  
Secretary for the Environment  
Secretary for the Environment (EPA)  
Minister of Foreign Affairs  
Secretary of Foreign Affairs and Trade  
Director-General, Ministry for Primary Industries  
Secretary for the Environment (Climate Change)  
Chief Executive, TPK  
Chief Parliamentary Counsel  
Legislation Coordinator

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Ministry for the Environment  
Manatū Mō Te Taiao

To: Hon Simon Bridges, Acting Minister for Climate Change Issues  
Cc: Hon Tim Groser, Minister for Climate Change Issues

**ETS Regulations: Background on Synthetic Greenhouse Gas Levy and NZAS Baseline Update**

Other Dept Tracking Number:		MfE Tracking Number:	13-B-00445
Date Submitted:	12 MAR 2013	MfE Priority:	Non-urgent
Security Level:	COMMERCIAL: IN CONFIDENCE	Number of Attachments:	1
Action Sought:	Nil - note only	Response/Signature Needed by:	N/A

**Ministry for the Environment Contacts**

Position	Name	Telephone		1st Contact
		(cell)	(work)	
Principal author				
Responsible Manager (Acting)				✓
Director (Acting)	Peter Brunt		04 439 7575	

W/lt 59(2)(a)

**Executive Summary**

1. The main purpose of this briefing note is to provide you with a short background on two ETS regulation proposals set out in the attached paper for the Cabinet Legislation Committee:
  - a. The introduction of the synthetic greenhouse gas (SGG) levy regulations
  - b. The NZ Aluminium Smelters (NZAS) allocative baseline update amendment regulation
2. We request that you lodge the attached Cabinet paper with the Cabinet Office by 10 a.m. 18 March 2013, to be considered by the Cabinet Legislation Committee on 21 March 2013.
3. Out of Scope
4. Allocative baselines specify how many emission units an eligible emission intensive trade exposed activity receives per unit output under the ETS. They are established in regulations. The NZAS allocative baseline update amendment regulation gives effect to a Cabinet decision to continue annual updates to the NZAS baseline [CAB Min (12) 43/6 refers]. It reflects the effect of NZAS's electricity contract on their ETS electricity price exposure.

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Out of scope

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**Situation Analysis**

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Out of scope

7. In late 2012 Cabinet agreed to extend a process where the Minister was able to present a paper directly to LEG so NZAS can apply for their allocation of units within the statutory timelines for application. The attached Cabinet paper sets out the statutory prerequisites for the NZAS allocative baseline update for 2013 and seeks authorisation from Cabinet to submit the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013 to the Executive Council.

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**Advice**

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*Synthetic Greenhouse Gas Levy: Background*

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Out of scope

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Out of Scope

*NZAS Allocative Baselines Annual Update: Background*

12. Eligible emissions intensive trade exposed (EITE) activities receive an allocation of emission units under the ETS. An allocative baseline specifies how many units an activity receives per unit of output. The allocative baseline is specified in regulations and the allocation is implemented by the Environmental Protection Authority. Those undertaking eligible activities receive a provisional allocation in advance, based on forecast levels of output. The allocation is finalised once outcomes are known.
13. NZAS is New Zealand's largest electricity using firm by a considerable margin. The Act enables the Minister for Climate Change Issues to enquire into electricity contractual arrangements for electricity users above a threshold. NZAS is the only firm whose electricity use exceeds this threshold, and the effect of their electricity contract has been examined by specialist electricity industry advisers.
14. In 2010, Cabinet approved a process where the Minister could take a paper directly to LEG to update the NZAS allocative baseline each year to reflect the actual impact of the firm's electricity contracts on ETS electricity related costs. The actual impact of the electricity contracts was, on average, expected to reduce the ETS impact on the firm and the results from the first 3 years showed the contracts reduced the ETS impacts on electricity costs by a factor of about 3 or 4 compared to other users. Modelling results also included the possibility of some greater than average outcomes, but these were low probability events. The special process was needed to enable the allocative baseline to be in place in time for NZAS to apply for their allocation of units under the EITE provisions of the ETS.
15. A new electricity contract was in place from 2013, and following examination of the contract structure, late in 2012 Cabinet agreed to extend the process of updating the NZAS baseline using an updated model. The amendment regulation uses this model to provide a provisional baseline for 2013.
16. NZAS' allocative baseline is specified in regulation 7(4) of the Climate Change (Eligible Industrial Activities) Regulations 2010. This update finalises the 2012 baseline at 2.062 tCO<sub>2</sub>e/tAI, down from the 2012 provisional baseline of 3.318 tCO<sub>2</sub>e/tAI, and establishes provisional baselines for 2013 and 2014 at 7.812 tCO<sub>2</sub>e/tAI and 4.628 tCO<sub>2</sub>e/tAI respectively. The nature of the electricity contract means that the baseline will change from year to year.

W/H 59(2)(b)(ii)

12 months. The 2013 provisional allocative baseline of 7.812 tCO<sub>2</sub>e/tAI is about 81% of the allocative baseline that would apply if no contracts were in place.

## Risks and Mitigations

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18. The NZAS baseline when finalised could potentially <sup>with s9(2)(b)(ii)</sup> MfE has indicated to NZAS that discussions will be required about the emission price to apply to the model prior to finalising the 2013 baseline in February/March 2014, if low prices and price divergence between different classes of emission units persist.

## Consultation

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19. The attached Cabinet paper was consulted on with Ministry for Primary Industries, the Ministry of Business Innovation and Employment, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Treasury, Inland Revenue, New Zealand Customs Service, the New Zealand Transport Agency and Te Puni Kokiri. The Department of Prime Minister and Cabinet and the Environmental Protection Authority were also informed.

## Next steps

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20. Subject to your approval, the attached paper needs to be lodged with the Cabinet Office by 10 a.m. 18 March 2013, to be considered by the Cabinet Legislation Committee on 21 March 2013.

21.

Out of scope



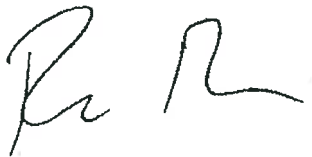
**Recommended Action**

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**We recommend that you:**

- a) Note that the accompanying Cabinet paper is due with the Cabinet Office by 10 a.m. 18 March 2013

Out of scope



Peter Brunt  
Acting Director, Climate and Risk Directorate

12/3/13

Date



Hon Simon Bridges  
Acting Minister for Climate Change Issues

13/3/13

Date

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**Commercial: In Confidence**

**Office of the Minister for Climate Change Issues**

**Chair**

**Cabinet Legislation Committee**

**Emissions Trading Scheme – Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013 and Amendment to the Climate Change (Eligible Industrial Activities) Regulations 2010**

**Proposal**

1. I propose that the Cabinet Legislation Committee authorise the submission to the Executive Council of the following regulations:
  - a. Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013; and
  - b. Climate Change (Eligible Industrial Activities) Amendment Regulations 2013.

**Executive Summary**

2. This paper is divided into two parts. Part 1 proposes a new set of regulations needed to give effect to the changes that the Climate Change (Emissions Trading and Other Matters) Amendment Act 2012 (the Amendment Act) made for Synthetic Greenhouse Gases (SGGs). These are that SGGs in goods and vehicles are to be managed by a levy on SGG use rather than directly participating in the ETS.
3. Part 2 amends the Climate Change (Eligible Industrial Activities) Regulations 2010 to update the allocative baseline for New Zealand Aluminium Smelters (NZAS) to reflect the operation of their new electricity contract that came into force in 2013.

**Background**

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7. The Act also provides for transitional assistance to emissions-intensive and trade-exposed industrial activities, to maintain competitiveness and prevent carbon leakage due to the fact that not all our trading partners have implemented a similar price on carbon. Assistance is given to eligible industrial activities through the allocation of emission units.
8. The regulations proposed in Part 2 of this paper will implement an earlier decision to update the allocative baseline for NZAS each year. This is necessary to reflect the impact of their electricity contract on how electricity related ETS pass through to the company. Both the NZAS provisional allocation and the SGG levy will be based on emission unit prices experienced in 2012.

**Part 1: Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013  
- Levy on goods and motor vehicles containing HFC or PFC**

**Policy**

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<sup>1</sup> GWP is a term used to measure the effect of a gas compared to an equivalent amount of carbon dioxide. The most common HFC used in New Zealand is HFC-134a, which has a GWP of 1430.

**Statutory Prerequisites**

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*out of scope*

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Timing

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Consultation prerequisites

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Regulatory impact analysis

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Out of Scope

## Publicity

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## **Part 2: Climate Change (Eligible Industrial Activities) Amendment Regulations 2013 – Updating the NZAS allocative baseline**

### Policy

31. The paper *Emissions Trading Scheme: New Zealand Aluminium Smelters Allocative Baseline for 2013 and Beyond* was considered by Cabinet's Economic Growth and Infrastructure Committee on 28 November 2012 and approved by Cabinet on 3 December 2012 [CAB Min (12) 43/6 refers]. This paper establishes a modified process for updating the New Zealand Aluminium Smelters (NZAS) allocative baseline each year to reflect the effect of the prevailing electricity contracts [CBC Min (10) 11/6 refers].
32. Eligible emission-intensive trade-exposed activities receive an allocation of emission units under the ETS. An allocative baseline specifies how many units an activity receives per unit of output. The allocative baseline is specified in regulations and the allocation is implemented by the Environmental Protection Authority. Those undertaking eligible activities receive a provisional allocation in advance, based on forecast levels of output. The allocation is finalised once outcomes are known.
33. NZAS is New Zealand's largest electricity using firm by a considerable margin. The Act enables the Minister for Climate Change Issues to enquire into electricity contractual arrangements for electricity users above a threshold. NZAS is the only firm whose electricity use exceeds this threshold, and the effect of their electricity contract has been examined by specialist electricity industry advisers.
34. NZAS's long term electricity contract is complex and potentially results in variable degrees of pass through of ETS electricity price impacts. These impacts can range from considerably lower than for other electricity users to potentially higher on a year by year basis. A new electricity supply contract is in place from 2013, replacing three legacy contracts. Examination of the effect of the new contract indicated that it was necessary to continue with a process of annual updates to the NZAS allocative baseline to ensure their allocative baseline reflects the actual effect of the electricity contract in a particular year.
35. Cabinet agreed to an annual updating process for NZAS's allocative baseline, in which the Minister for Climate Change Issues may annually present a paper directly to the Cabinet Legislation Committee for amendment regulations. Cabinet also agreed on a process for modelling and updating NZAS's allocative baseline [CAB Min (12) 43/6 refers]. This process has been followed.
36. NZAS, as a mandatory ETS participant, must meet the deadline for surrendering units on 31 May 2013. To allow units to be issued to NZAS in

time to meet this deadline, it is highly desirable that NZAS's allocative baseline is published in a timely manner. The anticipated timeline is:

- i. 28 March 2013: The revised allocative baseline is expected to be published in the New Zealand Gazette;
  - ii. 30 April 2013: Absolute deadline for NZAS to apply for its annual allocation of emissions units; and
  - iii. 31 May 2013: Deadline for NZAS to surrender emission units.
37. Cabinet also authorised a process for the Minister of Climate Change Issues and the Minister of Finance to jointly approve changes to the Vote Climate Change Non-Departmental Other Expense: Allocation of New Zealand Units appropriation [CAB Min (12) 43/6 refers]. This would allow for changes if the updated NZAS allocative baseline was higher than previously anticipated. This is not required this year. However, it may be necessary in the future.
38. The Parliamentary Counsel Office has now drafted regulations that amend regulation 7(4) of the Climate Change (Eligible Industrial Activities) Regulations 2010. The changes finalise the 2012 baseline, establish a 2013 provisional baseline (along with placeholder baselines for further out in case the next update does not occur for some reason) are as follows:

Year	Current Allocative Baseline Regulation	Replacement Allocative Baseline Regulation
2012	Provisional (3.318)	Final (2.062)
	Final (3.318)	
2013		Provisional (7.812)
		Final (7.812)
2014		Provisional (4.628)

39. The 2012 final allocative baseline (expressed as tCO<sub>2</sub>e/tAl produced) has decreased to 2.062 from the earlier provisional allocation of 3.318, reflecting NZAS's actual 2012 data and lower emission prices. The 2013 provisional baseline of 7.812 is markedly higher than earlier baselines which originated from the earlier contracts and model, but is still less than full ETS price pass-through.

W(14 S 9(2)(b)(ii)



### **Statutory prerequisites**

40. The Climate Change (Eligible Industrial Activities) Amendment Regulations 2013, are made under section 161A(1)(c)(i) of the Act. There are no statutory prerequisites associated with this regulation-making power.

### **Timing and 28-day rule**

41. This paper seeks a waiver of the 28-day rule for the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013 to allow the amendment regulations to come into force as soon as practicable. I am seeking the waiver of the 28-day rule as the amendment regulations have little or no effect on the public and will enable NZAS to apply for allocations using the appropriate allocative baseline, before applications close on 30 April 2013.

### **Regulatory Impact Analysis**

42. Cabinet has previously agreed that no Regulatory Impact Analysis will be required to accompany the annual legislative proposals containing updates to NZAS's allocative baseline in the amendment regulations [CAB Min (12) 43/6 refers].

### **Publicity**

43. The information provided to enable the allocative baseline to be re-estimated is highly commercially sensitive. Therefore, NZAS will be directly notified. No general publicity is needed as no other participants are directly affected.

### **Consultation with NZAS**

44. NZAS were consulted throughout the development of the Part 2 regulations.
- i. NZAS was involved in agreeing to the model outlined in CAB Min (12) 43/6.
  - ii. NZAS provided information complying with the 6 December 2012 Gazette notice (Gazette No. 147, p 4290) that called for electricity contract related information.
  - iii. NZAS was given the opportunity to comment on the updated model output.

### **Compliance**

45. Regulations from Part 1 and 2 of this paper are consistent with each of the following:
- i. Principles of the Treaty of Waitangi;
  - ii. The New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
  - iii. Principles and guidelines set out in the Privacy Act 1993;
  - iv. Relevant international standards and obligations; and

- v. The Legislation Advisory Committee Guidelines on Process and Content of Legislation.
46. The allocative baselines have been updated in accordance with the approach authorised by Cabinet [CAB Min (12) 43/6 refers], enabling this proposal to be presented directly to the Cabinet Legislation Committee.

**Regulations Review Committee**

47. I do not consider that there are grounds for the Regulations Review Committee to draw the regulations from Part 1 and 2 of this paper to the attention of the House under Standing Order 310.

**Certification by Parliamentary Counsel**

48. These regulations were certified by the Parliamentary Counsel Office as being in order for submission to Cabinet. The Parliamentary Counsel Office's certification notes the 28-day rule has not been complied with for the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013.

**Consultation (general)**

49. This paper was prepared by the Ministry for the Environment. The Ministry for Primary Industries, the Ministry of Business, Innovation, and Employment, the Ministry of Foreign Affairs and Trade, the Ministry of Transport, the Treasury, Inland Revenue, the New Zealand Transport Agency, the New Zealand Customs Service, and Te Puni Kōkiri were consulted. The Department of Prime Minister and Cabinet and the Environmental Protection Authority were also informed.

**Recommendations**

I recommend that the Cabinet Legislation Committee:

**Part 1: Climate Change (Synthetic Greenhouse Gas Levies) Regulations 2013**

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out of scope



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Out of Scope

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**Part 2: Climate Change (Eligible Industrial Activities) Amendment Regulations 2013**

14. Note that on 3 December 2012, Cabinet approved the process for making annual adjustments to New Zealand Aluminium Smelter's allocative baselines, reflecting their electricity contract beginning on 1 January 2013 [CAB Min (12) 43/6 refers]

15. Note that this process has been followed in updating the NZAS's allocative baselines;

16. Note that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013 give effect to the decision referred to in recommendation 14 above;

17. Note that a waiver of the 28-day rule is sought:

- a. so that the regulations can come into force on 28 March 2013
- b. on the grounds that the amendment regulations have little or no effect on the public and will enable NZAS to apply for allocations

using the appropriate allocative baseline, before applications close on 30 April 2013;

18. **Agree** to waive the 28-day rule so that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013 can come into force on 28 March 2013;

19. **Authorise** the submission to the Executive Council of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2013.



Hon Simon Bridges  
Acting Minister for Climate Change Issues

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Ministry for the Environment  
Manatū Mō Te Taiao

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18 MAR 2014

To: Hon Tim Groser, Minister for Climate Change Issues

**NZ Emissions Trading Scheme Implementation: Decision required on an interim allocative baseline methodology for aluminium smelting undertaken by New Zealand Aluminium Smelters (NZAS)**

Other Dept Tracking Number:		MfE Tracking Number:	14-B-00165
Date Submitted:	10 MAR 2014	MfE Priority:	Non-urgent
Security Level:	IN CONFIDENCE	Number of Attachments:	1
Action Sought:	Approval/Agreement	Response/Signature Needed by:	Tuesday, 18 March 2014.

**Ministry for the Environment Contacts**

Position	Name	Telephone (cell)	Telephone (work)	1st Contact
Principal author				
Responsible Manager		w/h 5 9(2)(a)		✓
Director	Kay Harrison		04 439 7579	

**Executive Summary**

1. This briefing seeks your agreement to implement an interim methodology that will set New Zealand Aluminium Smelters' (NZAS) ETS allocative baselines for 2013-2015.
2. Aluminium smelting is an eligible industrial activity under the Climate Change Response Act 2002 (CCRA). NZAS is the only participant carrying out this activity and receives an allocation of New Zealand units. This allocation is calculated using the allocative baseline prescribed in the Climate Change (Eligible Industrial Activities) Regulation 7(4).
3. NZAS renegotiated the terms of its electricity contract with Meridian Energy Ltd (Meridian) last year. Changes to the contract mean that the methodology used to calculate NZAS' ETS allocative baseline need to be updated to reflect the terms of the revised contract.
4. The Ministry for the Environment (the Ministry) and NZAS have not reached a common position on a revised long-term allocative baseline methodology. Both parties recognise that an interim methodology is needed to finalise the baseline for 2013 and set provisional baselines for 2014 and 2015 within legislated timeframes. The interim methodology proposed in this paper is supported by NZAS.
5. The interim methodology uses NZU prices rather than secondary certified emission reduction unit (sCER) prices which the existing methodology has used. The use of NZU prices will w/h 5 9(2)(b)(ic)
6. The impact on the Crown's fiscal balance, relative to earlier forecasts, is a decrease of \$554,000 in the financial year 2013/14 and a decrease of \$327,000 in the financial year 2014/15.
7. We will need to develop the allocative baseline methodology for the rest of the term of the contract through to 2030 with NZAS in late 2014. Following these discussions a recommendation will be prepared for your consideration before the end of 2014.



8. Further information about allocative baselines and the interim methodology is provided in Appendix 1.

### **Advice**

9. Your agreement to the interim methodology is required so that NZAS can apply for its annual allocation of units within legislated timeframes. The interim methodology finalises NZAS' allocative baseline for 2013 and sets provisional allocative baselines for 2014 and 2015. We will provide you with an amendment regulation to submit to the Cabinet Legislation Committee which will implement the interim methodology.
10. The elements of the interim methodology are as follows:
- For the first 6 months of 2013, before the renegotiated contract came into effect, the allocative baseline methodology previously approved (in 2012) applies along with the use of NZU prices;
  - For the second half of 2013 and the entirety of 2014 and 2015, the methodology will consist of:
    - The estimated cost impact on electricity use at a factor of  $\text{CO}_2/\text{MWh}$
    - $w/14 \quad 59(2)(b)(ic) \rightarrow$
    - other previously agreed rules will apply where necessary.
11. The process of annually updating the NZAS allocative baseline was previously approved in 2010 and confirmed with a revised model in 2012 [CBC Min (10) 11/6 and CAB Min (12) 43/6 refer]. These decisions authorise you to take a regulation proposal directly to the Cabinet Legislation Committee. The proposed interim methodology enables the timetable of baseline updates to be completed on time.

### **Risks and Mitigations**

12. The interim methodology provides the most accurate method presently available for setting the relevant baselines. However, the interim methodology will be inaccurate relative to whatever long-term methodology is finally approved. This is because the long-term methodology will incorporate information that was not available when the interim methodology needed to be finalised.
13. The 2015 provisional allocative baseline is only included to cover the eventuality that the annual update cannot occur for some reason. The provisional baselines for 2014 and 2015 will be corrected when they are finalised in 2015 and 2016 respectively.
14. We have notified NZAS that the interim methodology implies no precedent regarding subsequent discussions on a long term methodology for the NZAS allocative baseline. Therefore, the risk of NZAS giving precedence to the interim approach is reduced.
15. Applications for allocations of units must be made by 30 April of each year, so the amended regulation needs to be in place before that time. Approval of the above methodology should enable the regulation proposal to be considered by the Cabinet Legislation Committee on 9 or 16 April 2014. These deadlines should be achievable because the drafting is straightforward.

### **Legal risk**

16. While the proposed methodology is interim in nature and likely to change, it is the most accurate method available at the point in time when regulations prescribing the final 2013 baseline and the provisional 2014 and 2015 baselines need to be recommended. The methodology is also supported by NZAS.

17.  $w/14 \quad 59(2)(h)$



## Financial, Regulatory and Legislative Implications

18. The table below shows the forecast unit allocation under both the present methodology and the proposed interim methodology, and the impact of the interim methodology on the fiscal balance.
19. The increase in the 2013/14 allocation is primarily caused by low emission prices and the effect of a 3-year emission price lag in the present methodology that applied for the first half of 2013. This increase would have been more substantial without the move to NZU prices from sCER prices, and without the application of the interim methodology from the second half of 2013.

Interim approach impact on the allocation of units to NZAS and the Crown's fiscal balance					
	2013/14 (in millions)	2014/15 (in millions)	2015/16 (in millions)	2016/17 (in millions)	2017/18 (in millions)
Existing forecast unit allocation to NZAS					
Forecast unit allocation under interim methodology					
Impact on unit allocation					
Fiscal Impact on Operating balance at \$8.10/unit					

w/H 9(2)(f)(ii)

## Consultation

20. The Ministry of Business, Innovation & Employment, the Treasury, and the Environmental Protection Authority (EPA) have been kept informed of the progress of discussions with NZAS. We have incorporated comments that the EPA provided on a draft of this briefing. The Treasury agree with the interim methodology and provided input into the financial section of the briefing.

## Next steps

21. Subject to your approval of the interim methodology, we will provide you with a paper and regulations to submit to the Cabinet Legislation Committee prescribing the final allocative baseline for 2013, and the provisional allocative baselines for the 2014 and 2015 calendar years.
22. We will identify an appropriate long-term allocative baseline methodology and resume discussions with NZAS later in the year. We will provide you with a recommended methodology for your consideration and approval by the end of 2014. The 2014 baseline can then be finalised in the normal way early in 2015. The 2015 provisional baseline is expected to be updated in 2015 and finalised using the approved methodology in 2016.
23. There is no mechanism in the CCRA to require over-allocated units to be repaid. If the status quo were to remain in place,

w/H 59(2)(b)(ii)

## Recommended Action

### We recommend that you:

- a) Agree that the following interim approach be applied to the calculation of the allocative baseline for New Zealand Aluminium Smelters (NZAS) for the 2013, 2014 and 2015 years:

- the previously agreed (in 2012) methodology will be applied in order to set the finalised baseline figure for the first half of 2013, with the inclusion of NZU emission prices;
- the final baseline figure for the second half of 2013 and provisional figures for 2014 and 2015 will be set using an interim methodology that has the following features:
  - the estimated cost impact of electricity use is recognised at a factor of  $tCO_2/MWh$ ;
  - the use of NZU emission prices in the model (instead of sCER prices);
  - other previously agreed rules will apply as necessary;

Yes / No

- b) Agree to instruct Parliamentary Council Office to draft amendments to the Climate Change (Eligible Industrial Activities) Regulations 2010 to prescribe the final allocative baseline for 2013 and the provision allocative baselines for 2014 and 2015, for NZAS, calculated using the interim approach.

Yes / No

- c) Note that if you approve the interim methodology, we will draft a paper for you to submit directly to the Cabinet Legislation Committee seeking approval to make the amendments, as previously authorised by Cabinet [CBC Min (10) 11/6 and CAB Min (12) 43/6 refer];


- d) Note that the amendments to the allocative baseline need to be enacted by mid-April 2014 in time for NZAS to apply for its annual allocation of units;

- e) Note that we will recommend the appropriate methodology to apply from 2014 onwards and will resume discussions with NZAS later in the year; and

- f) Note that a recommendation on the methodology to be used from 2014 onwards will be prepared for your consideration by the end of 2014.

  
Kay Harrison  
Director, Climate Change

Date 10/3/14

  
Hon Tim Groser  
Minister for Climate Change Issues

Date 17/3/14



## Appendix 1: Further information

### *NZAS receives an allocation of New Zealand Units*

1. As a business engaged in an eligible emissions intensive trade exposed (EITE) activity, New Zealand Aluminium Smelters (NZAS) receives an allocation of New Zealand units (NZUs) under the ETS. An allocative baseline must be in place to enable the ETS industrial allocation to occur.
2. An allocative baseline specifies how many NZUs those undertaking an eligible activity receive per unit of output. These baselines are specified in regulations (for NZAS in Climate Change (Eligible Industrial Activities) Regulation 7(4)). The allocation is administered by the Environmental Protection Authority.
3. Those undertaking eligible activities receive a provisional allocation in advance, based on forecast levels of output. The allocation is finalised once outcomes are known in the following calendar year. Allocative baselines take into account not only on-site emissions but also some off-site emissions such as the impact of the ETS on electricity prices.

### *Revised electricity supply contract requires a new methodology for calculating the allocative baseline*

4. NZAS purchases its electricity through a long-term contract with Meridian Energy Limited. From the beginning of 2013, electricity supply was purchased via a single supply contract finalised in 2007. In August 2013, NZAS and Meridian Energy Limited announced that some terms of the 2007 contract had been renegotiated and that the changes applied for electricity purchased from 1 July 2013 until the end of the contract in 2030.
5. On 12 September 2013, you used your powers under the CCRA to obtain a copy of the renegotiated electricity contract. The contract has been considered by an electricity industry consultant who has advised that the contract will require a new methodology for calculating the price impact of the ETS on NZAS's electricity costs.
6. The renegotiated contract ...  
with 59(2)(b)(ii)
7. NZAS is being consulted on approaches to modifying the allocative baseline methodology with these discussions focussing on establishing a methodology that adequately reflects NZAS' ETS costs.
8. Both the Ministry and NZAS recognise that an interim methodology is needed to finalise the baseline for 2013 and set provisional baselines for 2014 and 2015, within legislated timelines. The interim methodology proposed in this paper is supported by NZAS.

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Ministry for the Environment  
Manatū Mo Te Taiao

To: Hon Tim Groser, Minister for Climate Change Issues

Background for Cabinet paper: Emissions Trading Scheme: Climate Change (Eligible Industrial Activities) Amendment Regulations 2014

Other Dept Tracking Number:		MfE Tracking Number:	14-B-00449
Date Submitted:	28 MAR 2014	MfE Priority:	Urgent
Security Level:	IN CONFIDENCE	Number of Attachments:	3
Action Sought:	Submit the attached paper to the Cabinet Office by 3 April 2014 for consideration by LEG on 9 April 2014.	Response/Signature Needed by:	10am Thursday 3 April 2014.

Ministry for the Environment Contacts

Position	Name	Telephone (cell)	Telephone (work)	1st Contact
Principal author				<input checked="" type="checkbox"/>
Responsible Manager		w/4 592(a)		
Director	Kay Harrison		04 439 7579	

Executive Summary

1. This briefing note provides you with a short background on the proposed Climate Change Response Act 2002 (CCRA) regulations to update the allocative baseline for New Zealand Aluminium Smelters (NZAS).
2. An earlier Cabinet decision provides you with the authority to take an annual regulation paper directly to Cabinet's Legislation Committee (LEG) to update the NZAS allocative baseline [CAB Min (12) 43/6 refers].
3. Earlier in March 2014 you agreed to the use of an interim methodology to apply when updating the NZAS allocative baseline for this year [14-B-00165 refers]. The interim methodology was required following the announcement of the renegotiation of the electricity contract between NZAS and Meridian Energy Limited in August 2013.
4. The Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 will update the NZAS allocative baselines using the interim methodology you approved.
5. The Parliamentary Counsel Office (PCO) has drafted the amendment regulations and the regulation is appended to this paper.
6. We request that you lodge the attached Cabinet paper with the Cabinet Office by 10 a.m. 3 April 2014, to enable it to be considered by LEG on 9 April 2014.



## Advice

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7. Allocative baselines specify how many emission units an eligible emission intensive trade exposed activity receives per unit of output under the Emission Trading Scheme (ETS). They are prescribed in the Climate Change (Eligible Industrial Activities) Regulations 2010.
8. The attached Cabinet paper sets out the statutory prerequisites for the NZAS allocative baseline update for 2014 and seeks authorisation from Cabinet to submit the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 to the Executive Council.
9. The amendment regulations update the allocative baseline for New Zealand Aluminium Smelters (NZAS) to finalise NZAS' 2013 allocative baseline, and to establish NZAS' provisional allocative baselines for 2014 and 2015.
10. The interim methodology provides the most accurate method presently available in the time available for setting the relevant baselines. However, the interim methodology will be inaccurate relative to whatever long-term methodology is finally approved. This is because the long-term methodology will incorporate information that was not available when the interim methodology needed to be finalised.
11. The provisional baselines for 2014 and 2015 will be corrected when they are finalised in 2015 and 2016 respectively. The 2015 provisional allocative baseline is only included to cover the eventuality that the annual update cannot occur for some reason.

## Risks and Mitigations

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12. There is a risk of NZAS giving precedence to the interim methodology in subsequent discussions. We have mitigated this risk by notifying NZAS that the interim methodology implies no precedent regarding subsequent discussions on a long term methodology for the NZAS allocative baseline. NZAS were consulted during the development of the interim methodology and support it.

## Legal risk

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13. The proposed amendments to the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 are consistent with each of the following:
  - i. Principles of the Treaty of Waitangi;
  - ii. The New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
  - iii. Principles and guidelines set out in the Privacy Act 1993;
  - iv. Relevant international standards and obligations; and
  - v. The Legislation Advisory Committee Guidelines on Process and Content of Legislation.
14. The allocative baselines have been updated in accordance with the approach authorised by Cabinet [CAB Min (12) 43/6 refers], enabling this proposal to be presented directly to LEG.
15. While the proposed methodology is interim in nature and likely to change, it is the most accurate method available at the point in time when regulations prescribing the final 2013 baseline and the provisional 2014 and 2015 baselines need to be recommended. The methodology is also supported by NZAS.
- 16.

W/H S 9(2)(h)

## Financial, Regulatory and Legislative Implications

17. The table below shows the forecast unit allocation under both the present methodology and the proposed interim methodology, and the impact of the interim methodology on the fiscal balance.
18. The 2013 final allocative baseline has increased to 10.441 from the provisional allocative baseline of 7.812.

w/h s9(2)(b)(ic)

This level of allocation can be met from within existing appropriations.

Interim approach impact on the allocation of units to NZAS and the Crown's fiscal balance					
	2013/14 (in millions)	2014/15 (in millions)	2015/16 (in millions)	2016/17 (in millions)	2017/18 (in millions)
Existing forecast unit allocation to NZAS					
Forecast unit allocation under interim methodology					
Impact on unit allocation					
Fiscal Impact on Operating balance at \$3.10/unit					

## Consultation

19. The attached Cabinet paper was consulted on with Ministry for Primary Industries; the Ministry of Business Innovation and Employment; the Ministry of Foreign Affairs and Trade; the Treasury; and Te Puni Kokiri. The Department of the Prime Minister and Cabinet and the Environmental Protection Authority were also informed.
20. NZAS were consulted during the development of the interim methodology and support it.

## Next steps

21. Subject to your approval, the attached paper needs to be lodged with the Cabinet Office by 10 a.m. 3 April 2014, to be considered by the LEG on 9 April 2014.

**Recommended Action**

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**We recommend that you:**

- a) **Submit that the accompanying paper to the Cabinet Office by 10 a.m. 3 April 2014.**



**Kay Harrison  
Director, Climate Change**

**Date 27/3/14**



**Hon Tim Groser  
Minister for Climate Change Issues**

**31/3/14**

**Date**

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Office of the Minister for Climate Change Issues

Chair

Cabinet Legislation Committee

Emissions Trading Scheme: Climate Change (Eligible Industrial Activities)  
Amendment Regulations 2014

Proposal

1. I propose that the Cabinet Legislation Committee authorise the submission to the Executive Council of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014, made under section 161A(1) of the Climate Change Response Act 2002 (the Act).

Executive Summary

2. The amendment regulations prescribe the New Zealand Aluminium Smelters (NZAS) final allocative baseline for 2013 and provisional allocative baselines for 2014 and 2015.

Background

3. The amendment regulations proposed in this paper implement earlier decisions to update the allocative baseline for NZAS each year [CAB Min (12) 43/6 refers]. In August 2013 NZAS announced it had renegotiated its electricity contract with Meridian Energy Limited. I have approved an interim methodology for this update so that the allocative baselines reflect the revised terms of the contract.
4. An allocative baseline specifies how many emission units an activity receives per unit of output. For NZAS the allocative baseline is expressed in tonnes of CO<sub>2</sub> equivalent per tonne of aluminium produced. The allocative baseline is prescribed in regulations and the allocation is implemented by the Environmental Protection Authority. NZAS receives a provisional allocation in advance, based on forecast levels of output. The allocation is finalised once actual outputs are known.

Policy

5. Approval to annually update the NZAS allocative baseline was previously granted in 2010 and confirmed with a revised model for a new electricity contract in 2012 [CBC Min (10) 11/6 and CAB Min (12) 43/6 refer]. These decisions authorise me to submit amendment regulations directly to the Cabinet Legislation Committee for consideration each year, and this process has been followed.
6. I have approved an interim methodology to be used to determine the NZAS allocative baseline, included in the amendment regulations. The interim methodology ensures the allocative baselines reflect the impact of the

renegotiated electricity contract on NZAS' emission price intensity of electricity used, as previously agreed by Cabinet [CAB Min (12) 43/6 refers].

7. Officials will undertake further analysis and discussions with NZAS about a long term methodology covering the term of the electricity contract to 2030. I will recommend a long term methodology to reflect the effect of the renegotiated electricity contract on the NZAS baseline later this year.
8. NZAS, as a mandatory New Zealand Emissions Trading Scheme participant, must meet the deadline for surrendering units on 31 May 2014. Prior to this NZAS needs to apply for its annual allocation. Therefore it is highly desirable that NZAS' allocative baseline is published in a timely manner. The anticipated timeline is:
  - i. 17 April 2014: The revised allocative baseline is expected to be published in the New Zealand Gazette;
  - ii. 30 April 2014: Deadline for NZAS to apply for its annual allocation of emissions units; and
  - iii. 31 May 2014: Deadline for NZAS to surrender emission units.
9. The Parliamentary Counsel Office has drafted regulations that amend regulation 7(4) of the Climate Change (Eligible Industrial Activities) Regulations 2010. The changes prescribe the 2013 allocative baseline and establish a provisional allocative baseline for 2014 and 2015 for NZAS.

Year	Current Allocative Baseline Regulation	Replacement Allocative Baseline Regulation
	(tonnes CO <sub>2</sub> per tonne of aluminium)	
2013	Provisional (7.812)	Final (10.441)
	Final (7.812)	
2014	Provisional (4.628)	Provisional (5.985)
2015		Provisional (5.980)

10. The 2013 final allocative baseline has increased to 10.441 from the provisional allocative baseline of 7.812.

W(H 59(2)(b)(i))

11. The 2014 provisional allocative baseline of 5.985 is above the estimate made in 2013 (of 4.628). This occurred because the interim methodology is inherently different to the previous methodology. The 2014 and 2015 baselines will be finalised next year using a long term methodology to be decided later this year.

#### Consultation (general)

12. This paper was prepared by the Ministry for the Environment. The Ministry for Primary Industries; the Ministry of Business, Innovation, and Employment; the Ministry of Foreign Affairs and Trade; the Treasury; and Te Puni Kōkiri were



consulted. The Department of the Prime Minister and Cabinet and the Environmental Protection Authority were also informed.

### **Consultation with NZAS**

13. NZAS were consulted throughout the development of the regulations. They:
- i. discussed the implications of the renegotiated contract with officials;
  - ii. provided input to and support the interim methodology applied; and
  - iii. were provided with the draft allocative baselines.

### **Financial implications**

14. This regulation proposal increases the allocation to NZAS compared with earlier forecasts, but it can be accommodated within the existing appropriation.

### **Compliance**

15. The amendment regulations are consistent with each of the following:
- i. Principles of the Treaty of Waitangi;
  - ii. The New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
  - iii. Principles and guidelines set out in the Privacy Act 1993;
  - iv. Relevant international standards and obligations; and
  - v. The Legislation Advisory Committee Guidelines on Process and Content of Legislation.
16. The allocative baselines are being updated in accordance with the approach authorised by Cabinet [CAB Min (12) 43/6 refers], enabling this proposal to be presented directly to the Cabinet Legislation Committee.

### **Timing and 28-day rule**

17. This paper seeks a waiver of the 28-day rule for the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 to allow the amendment regulations to commence the day after they are notified in the New Zealand Gazette. I am seeking the waiver of the 28-day rule as the amendment regulations have little or no effect on the public and will enable NZAS to apply for allocations using the appropriate allocative baseline, before applications close on 30 April 2014.

### **Statutory prerequisites**

18. The Climate Change (Eligible Industrial Activities) Amendment Regulations 2014, are made under section 161A(1) of the Act. There are no statutory prerequisites for prescription of allocative baselines.



### **Regulations Review Committee**

19. I do not consider that there are grounds for the Regulations Review Committee to draw the regulations in this paper to the attention of the House under Standing Order 310.

### **Certification by Parliamentary Counsel**

20. These regulations were certified by the Parliamentary Counsel Office as being in order for submission to Cabinet. The Parliamentary Counsel Office's certification notes the 28-day rule has not been complied with for the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014.

### **Regulatory Impact Analysis**

21. Cabinet has previously agreed that no Regulatory Impact Analysis will be required to accompany the annual legislative proposals containing updates to NZAS's allocative baseline in the amendment regulations [CAB Min (12) 43/6 refers].

### **Publicity**

22. NZAS and the Environmental Protection Authority will be notified when the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 are made. This will enable NZAS to apply for a final allocation for 2013 and for this application to be processed within the statutory timeframes.

## Recommendations

23. The Minister for Climate Change Issues recommends that the Committee:
1. **Note** that Cabinet approved the process for making annual adjustments to New Zealand Aluminium Smelter's allocative baselines, reflecting its electricity contract beginning on 1 January 2013 [CAB Min (12) 43/6 refers];
  2. **Note** that this process has been followed in applying an interim methodology to update NZAS's allocative baselines;
  3. **Note** there are no statutory prerequisites for the prescription of allocative baselines;
  4. **Note** that a waiver of the 28-day rule is sought:
    - a. so that the regulations can come into force the day after they are notified in the New Zealand Gazette;
    - b. on the grounds that the amendment regulations have little or no effect on the public and will enable NZAS to apply for 2013 allocations before applications close on 30 April 2014;
  5. **Agree** to waive the 28-day rule so that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 can come into force the day after they are notified in the New Zealand Gazette;
  6. **Note** the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 prescribe a final allocative baseline for 2013 and provisional allocative baselines for 2014 and 2015 for NZAS;
  7. **Agree**, I, the Minister of Climate Change Issues, recommend to the Governor-General that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014 be made; and
  8. **Authorise** the submission to the Executive Council of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2014.

  
\_\_\_\_\_  
Hon Tim Groser  
Minister for Climate Change Issues

31/3/14

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