



Approval to issue drafting instructions for the annual update to NZAS's allocative baseline

Date Submitted:	2 February 2023	Tracking #: BRF-2626	
Security Level	Policy and Privacy In-Confidence	MfE Priority:	Urgent

	Action sought:	Response by:
Hon James SHAW, Minister of Climate Change	Agree to issue drafting instructions to the Parliamentary Counsel Office to update the New Zealand Aluminium Smelter's allocative baseline	9 February 2023

Actions for Minister's Office Staff	Return the signed report to MfE.
Number of appendices and attachments	Nil appendices and attachments

Key contacts

Position	Name	Cell phone	1st contact
Principal Author	Anna Coomber		
Responsible Manager	Scott Gulliver	s 9(2)(a)	✓
Director	Melody Guy		

Approval to issue drafting instructions for the annual update to NZAS's allocative baseline

Key Messages

1. This paper seeks your approval to instruct the Parliamentary Counsel Office (PCO) to draft amendment regulations to update the allocative baseline for aluminium smelting by New Zealand Aluminium Smelters Ltd (NZAS). The allocative baseline is used to calculate the number of New Zealand Units (NZUs) NZAS receives annually through industrial allocation.
2. Aluminium smelting has a special process for allocation because of the electricity pricing arrangements NZAS has with Meridian. Each year a call for data is issued to NZAS seeking updated electricity data which is used to calculate an updated allocative baseline. This annual technical update protects the Crown from over or under-allocating NZUs to NZAS.
3. Based on the data recently provided by NZAS, the proposed change to the final allocative baseline for 2022 is a minor increase from the provisional 2022 allocative baseline.
4. We will provide you with a paper to take to the Cabinet Legislation Committee (LEG) meeting on 16 March 2023 so that NZAS can apply to the Environmental Protection Authority (EPA) for an allocation of units by the deadline of 30 April 2023.

Recommendations

We recommend that you:

- a. **Note** that Cabinet has previously authorised the Minister of Climate Change to adjust the allocative baseline for NZAS, to reflect the 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].
- b. **Note** the current allocative baselines and proposed updates listed in the table below.

Year	Current Allocative Baselines (before change)	Proposed Allocative Baselines (with updates)
2022	2.005 (provisional)	2.048 (final)
2023	2.005 (provisional)	2.034 (provisional)
2024	Not set	2.034 (provisional)

- c. **Note** that the amendments proposed in this paper finalise the 2022 allocative baseline, update the 2023 provisional allocative baseline, and create a 2024 provisional allocative baseline.
- d. **Agree** to instruct Parliamentary Counsel Office to draft amendments to the Climate Change (Eligible Industrial Activities) Regulations 2010 to prescribe the final allocative baseline for 2022 as 2.048 and the provisional allocative baselines for 2023 and 2024 as 2.034 for aluminium smelting by NZAS.

Yes/No

Signature

Scott Gulliver Principal Policy Analyst Climate Business Group	Approved electronically
Hon James SHAW Minister of Climate Change	
Date	

Purpose

1. This paper seeks your approval to issue drafting instructions to PCO to draft amendment regulations to the Climate Change (Eligible Industrial Activities) Regulations 2010 to update the aluminium smelting allocative baseline that applies to NZAS.

Context

2. NZAS is a mandatory participant in the NZ ETS for the activity of aluminium smelting and is required to surrender NZUs to the Crown each year, corresponding to its direct industrial process emissions.
3. Some firms in industries that are emissions intensive and exposed to international trade (eg, those business that compete with overseas businesses) are eligible to receive an allocation of NZUs, referred to as an industrial allocation. The allocation reduces competitive disadvantage with offshore firms subject to weaker climate policy, with the intent to reduce the risk of NZ's industry moving offshore, or losing market share, which would cause economic regrets, and the potential for increased global emissions.
4. NZAS receives an industrial allocation as it is both emissions intensive and trade exposed. The allocation is for NZAS's emissions costs from: direct process emissions, a small amount of fossil fuel use, and indirect emissions from electricity use.
5. NZAS has a special process for allocation because of its significant electricity use (approximately 12-13 per cent of New Zealand's electricity demand) and because of the size of its electricity contracts. Other firms buy electricity at or near spot prices and receive NZUs to cover electricity emissions costs at a standard rate. NZAS receives a lower, and variable, amount because its exposure to the spot market electricity cost is limited by its supply contracts.
6. NZAS' allocative baselines for the previous and current years are adjusted according to how much electricity NZAS actually consumed in the previous year under its contracts and from the spot market. Each of these sources have different electricity allocation factors (EAF), which themselves can change as agreements are amended.
7. Annually updating NZAS' baselines with updated electricity information protects the Government from under or over-allocating units to NZAS.

Analysis and advice

8. We recommend that you approve the drafting of amendment regulations by the PCO to adjust the allocative baselines for NZAS for 2022-2024. The 2022 baseline has been finalised now that the year is complete. The provisional baseline for 2023 has been updated and is correct based on NZAS' projected electricity consumption data.
9. Cabinet has previously authorised the Minister of Climate Change to adjust the allocation level for NZAS, to reflect the 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 refer].

10. The final allocative baseline for 2022 is higher than was set provisionally because NZAS purchased a higher than anticipated portion of its electricity outside of its main contract (ie, on the spot market). Additionally, the 2023 provisional allocative baseline set last year assumed no electricity purchases outside the main contract. NZAS now anticipates a small amount of purchasing on the spot electricity market in 2023 and the increase to the allocative baseline for 2023 reflects this.
11. The provisional allocative baselines for 2023 and 2024 are based on NZAS' electricity consumption forecast for 2023 as provided by them. The table below shows the current allocative baselines on the left and the proposed adjustments on the right.

Year	Current Allocative Baselines (before change)	Proposed Allocative Baselines (with updates)
2022	2.005 (provisional)	2.048 (final)
2023	2.005 (provisional)	2.034 (provisional)
2024		2.034 (provisional)

12. Once the allocative baseline is updated, NZAS will apply for its final allocation for the 2022 calendar year and provisional allocation for 2023 before the end of April 2022. The amount transferred with respect to the final allocation application is the difference between:
- the provisional allocation received for 2022 last year (based on NZAS' expected aluminium production multiplied by the provisional allocative baseline) and
 - the final allocation (actual aluminium production for the year multiplied by the final allocative baseline).
13. The combined impact of a small increase in aluminium production¹ and the adjustment to the allocative baseline is that NZAS will receive approximately 18,000 additional units for 2022 above what were transferred last year as provisional allocation.
14. The Environmental Protection Authority will, at the same time as making the final allocation for 2022, provide NZAS with its provisional allocation for 2023.

¹ Based on NZAS' unaudited 2022 production figures

Other considerations

Consultation and collaboration

15. NZAS was informed on the calculation of the baselines in the proposed amendment regulations and agreed with the calculated values.

Risks and mitigations

16. Your decision on issuing drafting instructions is needed now so that NZAS can, by the deadline of 30 April 2022, apply to the Environmental Protection Authority for its final allocation for 2022 and its provisional allocation for 2023.

Legal issues

17. There are no legal issues associated with the proposals in this briefing note.

Financial, regulatory and legislative implications

18. The small change in allocative baseline will have a minor impact on the industrial allocation received by NZAS. Amendment regulations will need to be made during March to enable NZAS to apply for its industrial allocation using the correct 2022 allocative baseline before the 30 April deadline.

Next steps

19. Subject to your agreement, the PCO will draft amendment regulations giving effect to the change.

When	What	Who
9 Feb 2023	Agree to issue drafting instructions to PCO, provide any feedback on draft Cabinet paper	Minister's office
9 Feb 2023	We provide you with a draft Cabinet paper to take to LEG for agreement to the amendment regulations drafted by PCO	
15 Feb – 1 March	Ministerial consultation for draft Cabinet paper	Minister's office
9 March	Lodge for LEG	Minister's office
16 March	LEG meeting	Cabinet