

Policy and Privacy

In-Confidence

Office of the Minister of Climate Change

LEG - Cabinet Legislation Committee

Emissions Trading Scheme Climate Change (Eligible Industrial Activities) Amendment Regulations 2022

Proposal

- 1 I propose the Cabinet Legislation Committee (LEG) authorise submission of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 to the Executive Council.
- 2 The amendment regulations prescribe the New Zealand Aluminium Smelters Limited (NZAS) final allocative baseline¹ for 2021, and provisional allocative baselines for 2022 and 2023 under the New Zealand Emissions Trading Scheme (NZ ETS).

Relation to government priorities

- 3 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change “demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge” [CBC-20-MIN-0097 refers].
- 4 Enabling a just transition to a low-emissions, climate resilient future is also a government priority. This was emphasised by the CBC when they noted the intention to “put the climate at the centre of government decision-making” and agreed that “climate change requires decisive action by all levels of government, the private sector, and communities” [CBC-20-MIN-0097 refers].

Executive Summary

- 5 A number of regulatory changes are required each year to keep the NZ ETS operating efficiently and accurately.
- 6 Smelting aluminium is an eligible industrial activity under the Climate Change Response Act 2002 (CCRA) and the Climate Change (Eligible Industrial

¹ An allocative baseline specifies how many emission units an eligible activity receives per unit of output. The baseline for NZAS is expressed in New Zealand Units (NZU) per tonne of aluminium produced. Eligible firms receive a provisional allocation based on forecast levels of output. The allocation is finalised once actual output levels are known.

Activities) Regulations 2010 (the Regulations) because it is an emissions intensive activity and there is international trade. Therefore, NZAS is eligible to receive an allocation of emission units to assist it offset the costs of the emissions trading scheme.

7 NZAS is the only aluminium smelter in New Zealand and was receiving the second largest industrial allocation in the NZ ETS².

8 Aluminium smelting has an annual update process for allocation regulations because of NZAS' electricity pricing arrangements and significant electricity use (approximately 15 per cent of New Zealand's electricity demand). This process ensures the annual allocation fairly reflect emissions costs under current policy.

9 The proposed changes to the Regulations is a significant decrease from previous rates of allocation. This is because Cabinet agreed on 13 December 2021 that NZAS was not facing any emissions costs in its current main electricity contract with Meridian Energy Limited [CAB-21-MIN-0530 refers].

10 s 9(2)(b)(ii) [REDACTED]

11 The amendment regulations need to be published in the New Zealand Gazette by 31 March 2022 to allow sufficient time for NZAS to meet the 30 April deadline for allocation applications.

Background

12 A number of regulatory changes are required each year to keep the NZ ETS operating efficiently and accurately.

13 Smelting aluminium is an eligible industrial activity under the CCRA and the Regulations because it is an emissions intensive activity and there is international trade.

14 NZAS is therefore entitled to receive industrial allocation of New Zealand Units (NZUs) to assist it offset the costs of the emissions trading scheme.

15 NZAS' allocation covers the emissions costs from the direct emissions from onsite production, the indirect emissions cost of electricity purchased on the wholesale market and the indirect emissions cost of electricity purchased through electricity supply agreements.

16 Section 161C(4) of the CCRA gives the Minister of Climate Change powers to adjust allocation calculations to take account of electricity-related contracts. NZAS is the only recipient of industrial allocation with adjusted calculations for new contracts.

² In 2020, NZAS was allocated 1.5 million NZUs
³ Based on NZU prices as at 4 February 2022 of \$77.00 NZD

- 17 NZAS has a special process for allocation because of its significant electricity use (approximately 15 per cent of New Zealand's electricity demand) and because for the long-term nature of its contracts with a single generator. Other firms buy electricity at or near spot prices and they receive NZUs to cover electricity generation emissions at a standard rate. NZAS receives a lower, and variable, amount because its exposure to the spot market electricity cost is limited by its contract.
- 18 Allocations to NZAS are based on three variables, being its production of aluminium, its emissions intensity (which is also called the allocative baseline), and the assistance rate. The assistance rate is being phased down 1% per year.
- 19 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 various contracts and from the spot market.
- 20 A provisional allocative baseline is also created for the next year to assist NZAS and the Government with forecasting.
- 21 This complexity and effort protect the Government from under or over-allocating to NZAS, which, as is the case this year, can run to many thousands of emission units.

Analysis

- 22 Cabinet has previously authorised the Minister of Climate Change to make adjustments to 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].
- 23 I used this delegation to approve drafting instructions for the amendment regulations, which are detailed in the following table.

Year	Current Allocative Baselines (before change)	Proposed Allocative Baselines (with updates)
2021	5.130 (provisional)	2.120 (final)
2022	5.130 (provisional)	2.005 (provisional)
2023		2.005 (provisional)

- 24 The significant change between the 2021 allocative baselines is due to a review of NZAS' electricity agreement with Meridian Energy Limited. On 13 December 2021, Cabinet agreed NZAS was not facing any emissions costs in the contract with Meridian [CAB-21-MIN-0530 refers]. That decision removes almost all of NZAS' entitlement for allocation from consuming electricity.
- 25 The 2022 provisional baseline is a lower value than the 2021 final baseline due to the forecast production data provided by NZAS not including future spot-market purchases of electricity.

- 26 The provisional allocative baselines for 2022 and 2023 (2.005 NZU/t) are based on NZAS' electricity consumption forecast for 2022 as provided by them.

Timing and 28-day rule

- 27 It is intended that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 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 deadline for allocation applications.
- 28 Consideration of this paper at the 17 March LEG Committee meeting means that no waiver from the 28-day rule is required.

Regulations Review Committee


- 29 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 319.

Certification by Parliamentary Counsel

- 30 These regulations have been certified by the Parliamentary Counsel Office as being in order for submission to Cabinet and are attached at Appendix 1.

Financial Implications

- 31 The changes proposed in this paper will have a positive impact on the Crown's operating balance. The proposed changes will decrease the number of NZUs received by NZAS per tonne of aluminium compared to the 2022 March Baseline Update forecast, thereby reducing expenses for the Crown.

- 32 s 9(2)(b)(ii)
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- A large rectangular area of the document is redacted with grey bars, covering approximately four lines of text.

Legislative Implications

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

Impact Analysis

Regulatory Impact Statement

- 34 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 2010⁴ informed the decision to annually update NZAS' allocative baselines.

Climate Implications of Policy Assessment

- 35 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

- 36 The proposed amendments have no population implications.

Human Rights

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

Consultation

- 38 There are no statutory consultation requirements for these regulations in the Climate Change Response Act 2002. In line with Cabinet Manual requirements, NZAS was consulted about, and agreed with, the calculation of the baselines in the proposed amendment regulations.
- 39 The Treasury, Ministry for Primary Industries, and the Ministry of Business, Innovation and Employment were consulted on this paper. The Department of Prime Minister and Environmental Protection Authority have been informed. Where specific comments were provided, they are reflected in this paper.
- 40 NZAS and the Environmental Protection Authority will be notified when the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 are published. No other parties are affected.

Proactive Release

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

Recommendations

The Minister of Climate Change recommends that the Committee:

- 1 **Note** that Cabinet has previously authorised the Minister of Climate Change to make adjustments to the allocation level for the 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

⁴ As published on the Treasury's website: [New Zealand Emissions Trading Scheme: Industrial Allocation - 29 June 2010 - Regulatory Impact Statement - Ministry for the Environment \(treasury.govt.nz\)](#)

significant enough to warrant Cabinet consideration [ENV-18-MIN-0051 and CAB-18-MIN-0628];

- 2 **Note** that while the financial implications from the proposed adjustments in this paper are significant, these result from my application of Cabinet's decision in December 2021 on the emissions costs in the updated electricity agreement between NZAS and Meridian Energy Limited
- 3 **Note** that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 will give effect to the decisions referred to in recommendation 1 above
- 4 **Note** that these amendments need to come into effect before the 30 April 2022 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
- 5 **Note** that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 will result in a decrease in the Crown's expenditure of approximately \$71.9 million in 2021/2022
- 6 **Authorise** the submission to the Executive Council of the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022
- 7 **Note** that it is intended that the Climate Change (Eligible Industrial Activities) Amendment Regulations 2022 come into force 28 days after the date of their notification in the New Zealand Gazette.

Authorised for lodgement

Hon James Shaw

Minister of Climate Change

**Appendix 1: Climate Change (Eligible Industrial Activities) Amendment
Regulations 2022**

Proactively released