



# Industrial allocation: determining eligibility for new activities

<b>Date Submitted:</b>	20 October 2022	<b>Tracking #:</b> BRF-2309	
<b>Security Level:</b>	Policy and Privacy In-Confidence	<b>MfE Priority:</b>	Urgent

	<b>Action sought:</b>	<b>Response by:</b>
Hon James SHAW Minister of Climate Change	<b>Agreement and/or feedback</b> on proposed eligibility process for new activities	25 October 2022

<b>Actions for Minister's Office Staff:</b>	Return the signed report to MfE.
<b>Number of appendices and attachments: #1</b>	Appendix 1: Section 84C(3) of the Climate Change Response Act 2002

## Key contacts

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

# Industrial allocation: determining eligibility for new activities


## Key Messages

1. Cabinet agreed that eligibility for new activities<sup>1</sup> be assessed against criteria outlined in section 84C(3) of the Climate Change Response Act 2002 (the Act), and that this replace the current eligibility tests (for new activities only) [CAB-MIN-22-0250 refers]. See **Appendix 1** for the section 84C(3) criteria.
2. However, in drafting the amendment Bill (to enable implementation of the industrial allocation reform), we identified a gap in this approach. We need a way to collect data to assess eligibility (including setting levels of assistance), and to calculate allocative baselines if an activity is deemed eligible. Consideration of section 84C(3) of the Act does not address this issue.
3. Both a level of assistance and allocative baseline are needed to determine the amount of industrial allocation a firm receives for carrying out an eligible activity.
4. To address this issue, we seek your agreement to retain the emissions intensity and trade exposures tests for new activities. This would mean new activities are subject to both the tests for existing eligible activities and the requirement for the Minister of Climate Change (the Minister) to consider criteria in section 84C(3) of the Act, which Cabinet agreed to in July 2022.
5. We propose that the Minister have the flexibility to specify which, and how many, financial years from which data is collected to inform an eligibility assessment and to calculate its allocative baseline(s). A minimum of one financial year would be required.
6. We expect new firms would have forecast data as part of their business plan to commence operation in New Zealand. Therefore, we also propose that the Minister have the flexibility to require a mix of forecasts and/or actual data, where a firm does not have a full set of data for the number of financial years specified by the Minister.
7. To help manage the uncertainty of using forecast data and the subsequent fiscal risks to the Crown, we propose that where forecast data is used (in full or in part) to provide an initial amount of allocation:
  - the level of assistance will be initially set at the level of assistance for moderately emissions-intensive activities (this is 58% in 2022), regardless of whether the outcome of the eligibility assessment indicates the activity should be classed as highly emissions intensive;
  - applicants providing forecast data must provide a specified number of years' worth of actual financial-year data before a specified period of operation is complete. The number of years and the period of operation are specified by the Minister. This actual

---

<sup>1</sup> We define 'new activities' as those seeking eligibility, whether or not they are already operating in New Zealand

data will inform a reassessment of the activity's emissions intensity (including setting an updated level of assistance) and allocative baseline(s); and

- once a reassessment of the activity's eligibility and allocative baseline(s) that uses actual data is complete, the initial allocation based on forecasts (in full or part) is compared with the allocation based on actual data, and any under- or over-allocation is washed-up.
8. The proposed approach balances the need for an objective eligibility test for new activities that is practical with the need to assess leakage risk in the context of New Zealand's wider climate change commitments and obligations.
  9. We also seek your agreement to share the draft Bill with the Environmental Protection Authority and the Electricity Authority.
  10. s 9(2)(f)(iv)  

  11. We seek your agreement or any feedback by 25 October so we can provide you with the draft Cabinet paper and draft Bill by 27 October. Subject to your approval, we will include this policy proposal in the draft amendment Bill and draft Cabinet paper.

## Recommendations

We recommend that you:

- a. **note** that Cabinet agreed that eligibility for new activities be assessed against criteria outlined in section 84C(3) of the Climate Change Response Act 2002 (the Act) [CAB-MIN-22-0250 refers]
- b. **note** that some activities may have been operating in New Zealand for a short (eg one year) or longer period (eg five years), or have not operated in New Zealand before and therefore some firms may not have a full set of actual emissions, revenue and production data to inform an eligibility assessment or to calculate allocative baselines
- c. **note** that we need a way to collect data to determine the level of assistance and calculate allocative baselines for any new activity, to determine the amount of industrial allocation a firm would receive
- d. **agree** to retain the emissions intensity and trade exposure tests for new activities, in addition to the requirement to consider criteria in section 84C(3) of the Act

Yes/No

- e. **agree** that the Minister of Climate Change has the flexibility to:
  - i. specify the number of, and which, financial years for which data must be provided (a minimum of one financial year would be required)
  - ii. allow the use of forecast data (in full or part) where a firm may not have a full set of data

Yes/No

- f. **note** that the data referred to in recommendation e will be used to inform an eligibility assessment and, where the activity is granted eligibility, that data is used to calculate its allocative baseline(s)
- g. **agree** that where forecast data is used (in full or in part) to inform an eligibility assessment, calculate allocative baselines, and determine an initial amount of allocation that:
  - i. activities deemed eligible will be initially classed as moderately emissions intensive for the purpose of setting a level of assistance (58% in 2022)
  - ii. applicants must provide a specified amount of actual financial year data before a specified period of operation is complete to inform a reassessment of emissions intensity (including setting an updated level of assistance) and recalculation of its allocative baseline(s)

iii. the initial allocation based on forecasts (in full or part) is compared to the allocation based on actual data, and any under- or over-allocation is washed up

Yes/No

h. **agree** to share the draft Bill with the Environmental Protection Authority and Electricity Authority

Yes/No

i. s 9(2)(f)(iv) [Redacted]

j. **indicate** if you would like to meet with officials to discuss on 25 October

Yes/No

### Signature

Scott Gulliver Principal Analyst – Climate Mitigation <b>Climate Change Directorate</b>	<i>Approved electronically</i>
---	--------------------------------

Hon James SHAW Minister of Climate Change	
Date	

Proactively released under the provisions of the Official Information Act 1982

## Purpose

12. We seek your agreement to a revised approach to:
  - a. assess eligibility for industrial allocation for new activities, including setting levels of assistance, and
  - b. calculate allocative baselines for new activities.
13. Cabinet previously agreed to policy decisions on industrial allocation reform in July this year. However, we overlooked the practicalities of assessing eligibility, setting levels of assistance, and calculating allocative baselines, and a revised approach is needed to ensure a complete Bill is introduced. Cabinet agreement will be needed to a revised approach.
14. We seek your agreement and any feedback by 25 October to support us to provide you with the draft Cabinet paper and Bill by 27 October.
15. We are currently working with Parliamentary Counsel Office (PCO) on how to incorporate this proposal into the Bill seeking changes to the Act to enable the reform of industrial allocation (the reform) and supporting Cabinet paper. Subject to your approval, we will notify PCO.

## Context

16. In July, Cabinet agreed to review and update allocative baselines and to reassess eligibility for industrial allocation using data from the financial years 2016/17 – 2020/21 [CAB-MIN-22-0250 refers].<sup>2</sup> The aim of this is to address overallocation of industrial allocation due to allocations being based on decade-old data from financial years 2006/07 – 2008/09.

### *Cabinet agreed an approach to assessing eligibility for new activities*

17. Industrial allocation aims to mitigate the risk of emissions leakage by supporting at-risk-industry to meet some of its emissions costs. Granting eligibility for industrial allocation to new activities may be better for global emissions if production were to occur in New Zealand under an emissions trading scheme and emissions cap instead of other jurisdictions lacking comparable climate policy. It could support us to retain, or lead to more, employment opportunities and broader economic activity in New Zealand.
18. We define new activities as any activity not included as an existing eligible activity in the Climate Change (Eligible Industrial Activities) Regulations 2010 at the point of application for eligibility. New activities can be broadly grouped into two categories:
  - a. an activity that exists in New Zealand but isn't currently eligible. We would expect firms carrying out these activities to have a full or partial set of actual emissions, production, and revenue data; and
  - b. an activity that does not currently exist in New Zealand. We **do not** expect firms carrying out these activities to have a full set of actual emissions, production, or revenue data.

---

<sup>2</sup> Firms can choose to have data from either 2019/2020 or 2020/21 excluded from calculations of allocative baseline and reassessment of eligibility to help smooth distortions resulting from COVID-19.

19. The Act as currently drafted allows new activities to seek eligibility. However, there is no process for determining the basis for allocation if activities were not carried out in the specified financial years.
20. To tidy up this ambiguity and to make the eligibility process more rigorous, Cabinet agreed in July that new activities continue to be able to seek eligibility for industrial allocation but using criteria in section 84C(3) of the Act. See **Appendix 1** for the list of criteria from section 84C(3).
21. In addition to the increased rigour of the criteria, we thought this would also provide a way to navigate the fact that new activities would likely not have suitable data to use for the eligibility test currently legislated (emissions intensity and trade exposure tests) and to calculate allocative baseline(s), if found eligible.

*However, a gap remains in this agreed approach to assessing eligibility and calculating allocative baselines*

22. We have not previously advised you on how to determine the level of assistance, or how a newly eligible activity's allocative baseline(s) would be calculated given it would likely have no data to provide for this purpose. This was an oversight that the proposal below rectifies. Because the calculation of industrial allocation requires the input of both a level of assistance and allocative baseline(s), a data gap exists in the approach agreed by Cabinet.
23. Emissions and revenue data are required to determine the eligibility of an activity (which assigns a level of assistance based on whether the activity is moderately or highly emissions intensive). Emissions and production data are required to set an allocative baseline(s) for an activity – and these are both needed regardless of whether the activity is new or not.
24. New activities may not exist in the new transitional base years<sup>3</sup>, or they may seek eligibility in the future when they are at risk of emissions leakage. Therefore, the Minister of Climate Change will need the ability to specify the amount of, and which, financial years to require data from to inform an eligibility assessment and, if eligibility is granted, to calculate the activity's allocative baseline(s).
25. We identified this policy gap through the process of drafting the Bill.

## **Analysis and advice**

*Updated proposal for new activities seeking eligibility*

26. To support the assessment of a new activity's eligibility, we propose to retain the emissions intensity and trade exposure tests, along with the requirement for the Minister of Climate Change to consider section 84C(3) of the Act.<sup>4</sup>

---

<sup>3</sup> The financial years 2016/17 – 2020/21 are proposed as a transitional provision to support the review and update of allocative baselines and reassessment of eligibility for existing eligible activities.

<sup>4</sup> The use of criteria under 84C(3) would not apply to the one-off reassessment of eligibility for existing eligible activities – consistent with decisions that Cabinet has already made.

27. The emissions intensity and trade exposure tests would be the same tests used to reassess eligibility for existing eligible activities and will enable government to determine an appropriate level of assistance for a new activity.
28. The need for new activities to provide data (and which may be non-existent at the time of enquiry) will be addressed by using forecasts (in full or part) as described in the next two sections.
29. The criteria in section 84C(3) of the Act, will be considered alongside the emissions intensity and trade exposure tests, as already agreed by Cabinet. This will retain the more rigorous eligibility test. Officials will undertake further work on how an assessment against criteria outlined in section 84C(3) will work.

*Enabling the Minister's flexibility to specify data requirements for new activities*

30. There may be instances where an activity in New Zealand has been operating only for a short period (for example 1-2 years), and therefore may not have a full set of financial year data to inform an eligibility assessment and calculate allocative baseline(s).
31. There may also be instances where an activity has been operating for a longer period (for example five years) but does not seek eligibility for industrial allocation until some years in the future. We would want the Minister to be able to seek data from the most recent years, in which the activity was operational, to accurately reflect its emissions profile. This requires the Minister to have flexibility to set these at the point the activity seeks eligibility.
32. Although some firms intending to carry out, or already carrying out, a new activity may not have the data needed to inform an eligibility assessment (to determine a level of assistance) and to calculate allocative baseline(s), we expect that a firm would at minimum have forecast production, emissions and revenue data as part of a business plan.
33. To support a policy approach that is flexible enough to accommodate activities seeking eligibility that don't operate in New Zealand yet, or have operated in New Zealand either for a short or longer period, we propose that the Minister has the flexibility to:
  - a. specify which, and how many, financial years firms must provide data from, and that this must be a minimum of one year's worth of financial year data; and
  - b. allow a mix of actual and forecast data (or all forecast data) where this may be needed to make up the required number of financial years.

*Requirement for new activities to provide actual data*

34. There are risks in assessing eligibility and providing industrial allocation to a firm based on forecast data. Firms could overstate their emissions costs, or understate their production or revenue which may result in firms receiving more industrial allocation than if their allocations were based on actual data.
35. We propose that after a specified number of years of operation, firms in new activities, where forecast data was used, would be required (via a call for data) to provide a specified number of (minimum 1) years' worth actual data to assess its eligibility and allocative baseline(s). The specified number of years in both instances would be at the discretion of the Minister.

36. If it was found the activity's eligibility was incorrectly assigned, or if its allocative baseline was over- or understated this would be rectified in a wash-up process. The Crown would reimburse the firm or vice versa, as appropriate.
37. To further mitigate the risk of over-allocation, where activities are deemed eligible based on forecast data (regardless of whether they are assessed as moderately emissions intensive or highly emissions intensive), the level of assistance will be initially set at the level of assistance for moderately emission-intensive activities (58% in 2022). The correct level of assistance would be incorporated in the wash-up process.

*We considered alternative options for dealing with this gap*

38. An alternative option for dealing with this policy gap is to request that the Select Committee seek submissions on the issue as part of submissions on the Bill as a whole. However, we do not advise introducing a Bill with a policy gap like this as it will be more challenging for submitters to engage on policy proposals during the Select Committee process if no drafting is available to scrutinise.
39. We considered alternative options to our policy proposal but these either would not ensure that future decisions for granting eligibility to new activities are considered in the context of wider climate change goals or would not require an objective test to reflect the activity's risk of emissions leakage. We have not detailed these here.

## **Other considerations**

### *Consultation and collaboration*

40. We are currently consulting with other departments on this proposal via the draft Cabinet paper and Bill. We have indicated that the proposal is subject to your feedback and approval.
41. This proposed approach and the approach agreed by Cabinet in July were not publicly consulted on in 2021. This consultation sought feedback on whether new activities should be able to seek eligibility for industrial allocation. Feedback on this question was diverse. Some did not support new sources of emissions in New Zealand, whilst other argued for support to ensure alignment with other countries.

### *Risks and mitigations*

#### *Potential over-allocation based on forecast data*

42. The key risk contained in this revised proposal is the possibility that forecast and actual data differ, for example, because firms may purposely skew their forecast data to benefit from over-allocation. This risk is mitigated by the fact that firms will be required to provide actual data at a point in the future, upon which a wash-up process will correct any errors (intentional or not) in the forecast data. This would correct over-allocation (and under-allocation) due to differences between the forecasts and actuals.
43. Analogous to this, current legislation allows existing eligible activities to receive a provisional allocation based on production from the previous calendar year for an allocation in the current calendar year. The final allocation adjustment that occurs the following year corrects this with actual production data. This is deemed an appropriate way to provide firms an allocation in advance while ensuring that changes in production can be corrected.

44. Our proposal to use forecasts for production, emissions and revenue, does pose a greater risk of discrepancy between the initial and final allocation provided. Regardless, the eventual wash-up will ensure the allocation is correct.
45. There is also a risk that a firm that has received an allocation based on forecast data closes before the wash-up. Although the firm would still be compelled to pay back their units, there is still a possibility the Crown is unable to claw this back.
46. If this risk is realised, to help reduce the fiscal impacts and to reduce a firm's windfall gains, all new activities deemed eligible based on forecasts data will only be provided with the moderate level of assistance initially and subject reassessment referenced in paragraph 42.
47. Any other remaining issues with the Bill (including the process of new activities to seek eligibility) can be further refined during Select Committee.

### *Treaty analysis*

48. A formal treaty analysis for this advice has not been carried out. The impacts of this revised eligibility proposal for new activities could affect firms employing a high proportion of Māori and who seek eligibility in future. There are no impacts on existing eligible activities and any Māori interests related to those activities.

### *Legal issues*

- s 9(2)(h)
- 

### *Financial, regulatory and legislative implications*

51. There are no additional financial implications of our proposed approach as these changes seek to clarify an existing process for new activities to seek eligibility for industrial allocation. There are financial implications for any new activity being granted eligibility for industrial allocation. This is the case under current policy settings. However, these are difficult to estimate without receiving expressions of interest or eligibility applications from potentially eligible activities.
52. This proposal to clarify the process for new activities to seek eligibility for industrial allocation will require changes to the Act. These can be progressed through the Bill seeking changes to the Act to enable the reform.
53. Officials will update the Regulatory Impact Statement to support this proposed approach to assessing eligibility for new activities. We will have this ready, including the Regulatory Impact Assessment Panel's reassessment, in time to lodge the Cabinet paper seeking approval to introduce the Bill.

54. Any changes to the Climate Change (Eligible Industrial Activities) Regulations 2010 to reflect this policy change would only be needed following a new activity attaining eligibility.

### **Approval to share the Bill outside the Crown**

55. The Cabinet Office circular CO(19) 2 provides guidance on releasing draft government legislation outside the Crown. It advises that the Minister responsible for the relevant draft government legislation must approve its release outside the Crown in all circumstances.<sup>5</sup> We seek your approval to consult on the draft Bill with the Environmental Protection Authority and Electricity Authority for the Ministerial and Cabinet process.

---

<sup>5</sup>The Attorney-General must also approve the release of draft Government legislation outside the Crown. Approval from the Attorney-General is not required where the draft legislation will be released, on an in-confidence basis and subject to legal professional privilege, to a Crown entity for the purposes of consultation that is required by legislation or that is appropriate for the purposes of the Cabinet or Ministerial approval process.

## Next steps

56. The next steps are summarised in the table below.

Milestone	Key dates
Officials provide a draft LEG paper and draft Bill	Thursday 27 October
Ministerial consultation	Tuesday 1 November -15 November
Lodge	Thursday 17 November
Cabinet Committee (ENV or LEG, subject to your approval, we will need the Cabinet Committee to be able to make policy decisions and approve introduction of the Bill)	Wednesday 23/Thursday 24 November
Cabinet	Monday 28 October
Introduction into the House	Tuesday 6 December (TBC)

57. Officials will undertake further work on the process for assessing new activities against criteria outlined at section 84C(3) of the Act.

58. s 9(2)(f)(iv)



## Appendix 1: Section 84C(3) of the Climate Change Response Act 2002

Subsections of 84C(3) are outlined below. Subsections a to i and k will be relevant for determining eligibility for industrial allocation for new activities. Subsection j is not proposed for inclusion. This is because section 5ZOB relates to changes to the phase-out rates of allocation not eligibility for new activities.

- a) *Any targets or budgets set for reducing emissions of greenhouse gases; and*
- b) *New Zealand's nationally determined contributions under the Paris Agreement; and*
- c) *the level of risk of emissions leakage (increase emissions overseas as a result of emissions reductions in New Zealand, for example, an activity being relocated outside of New Zealand to reduce the emissions-related costs for the activity), based on –*
  - i. *the emissions-related costs and policies in competing jurisdictions; and*
  - ii. *the markets for international trade in the products produced by the activity; and*
  - iii. *the ability of affected eligible persons to pass on increased costs to customers; and*
- d) *the risk that the value of the allocation for the activity will exceed the cost of meeting the emissions trading scheme obligations in relation to the activity; and*
- e) *other sources of supply into the emissions trading scheme, including offshore emissions reductions; and*
- f) *the availability of low-emission technologies related to the activity; and*
- g) *international climate change obligations; and*
- h) *the proper functioning of the emissions trading scheme; and*
- i) *the cost to the taxpayer of providing allocations for the activity; and*
- j) *the recommendations made by the Climate Change Commission under section 5ZOB; and*
- k) *any other matters that the Minister considers relevant.*