

# **Government Response to Consultation on the Form and Content of New Climate Change Agreements**



# Consultation on the Form and Content of New Climate Change Agreements

## Government Response

### SECTION I: INTRODUCTION

1. This document sets out the Government response to the second consultation on the form and content of new Climate Change Agreements.

#### Background

2. The existing Climate Change Agreements scheme ends on 31 March 2013, the final date on which the reduced rates of Climate Change Levy (often referred to as Levy discount) may be claimed. The Government announced in the Pre Budget Report in 2007 that **“the scheme will continue until 2017, subject to State aid approval, and [it] will discuss with business the most effective way of taking this forward”**.
3. On 12 March 2009 a consultation document, entitled “Consultation on the Form and Content of New Climate Change Agreements”, was published (the first consultation document) seeking views on options and proposals for change to the existing Climate Change Agreements. On 21 December 2009 a consultation document, entitled “Second Consultation on the Form and Content of Climate Change Agreements”, was published (the second consultation document) seeking views on a single proposal for new Climate Change Agreements. You are advised to read these consultation documents, in conjunction with this Government response, since they set out the detailed background to the decisions taken by Government.

#### Consultation process

4. Before and during consultation DECC explored the policy and implementation issues with sector associations at Plenary Meetings in March 2008, September 2009 and January 2010, themed focus groups and in bilateral meetings with individual sector associations and groups of associations.

## Implementing new CCAs

5. Alongside this document, the Government is publishing a consultation on proposals for the detailed drafting of the Umbrella and Underlying Agreements and of Scheme Rules for implementing the policy decisions set out in this document for the new scheme. This consultation can be found at <http://www.decc.gov.uk/en/content/cms/consultations/>. The deadline for submission of comments on this consultation is 18 May 2010.
6. The Government is still considering its options for contracting out delivery and for the introduction of a scheme of charging for the administration of Climate Change Agreements (see paragraphs 21 and 22 of the first consultation document). Should DECC decide to proceed with a scheme of charging, it will consult on a detailed proposal in due course.

## This document

7. This document is structured as follows:
  - Section I: Introduction (this section)
  - Section II: The Form and Content of New Climate Change Agreements (which sets out the Government decision)
  - Section III: Elements of the Decision (in which the rationale for the Governments decision for each element is given)
  - Annex I: Summary of Responses to Proposals the Second Consultation Document
  - Annex II: List of Organisations that Responded to the Second Consultation

## SECTION II: THE FORM AND CONTENT OF NEW CLIMATE CHANGE AGREEMENTS

8. The Government has carefully considered and taken into account all views expressed in all submissions to the first and second consultations. Having done so, and in the light of its overall objectives for climate change mitigation, the Government has decided that Climate Change Agreements under the new scheme will be based on those in the current scheme, but subject to the changes set out in the second column of the table below. Detailed comments on the different elements are given in Section III.

**Table 1: Form and Content of New Climate Change Agreements**

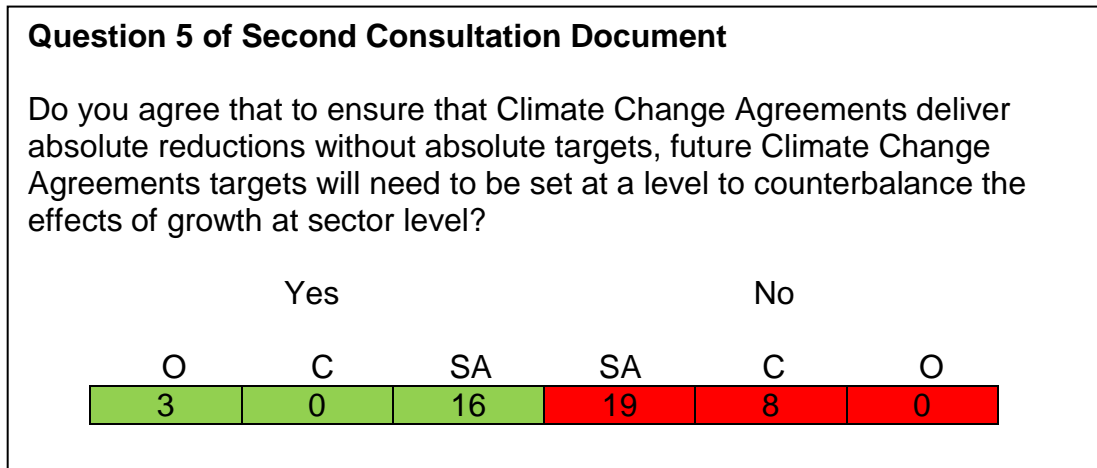
Current Climate Change Agreements	New Climate Change Agreements
A. Targets units allowed the choice between absolute and relative targets. Sector targets determined by the currency of the majority of the energy used in the target units within the sector.	A. No change to target currency options. The Government will aim to negotiate targets for the new CCAs that will counterbalance the effects of predicted growth in CCA sectors. [See paragraphs 9 to 14]
B. Targets set biennially, those meeting targets qualifying for Levy discount for the following two years.	B. Targets to be set annually, for 2012 to 2015, those meeting targets qualifying for Levy discount for the following year. [See paragraphs 15 to 17]
C. Targets reviewed in 2004 and 2008.	C. DECC to carry out a paper review of targets for 2014 and 2015 in 2012, to be followed by a full review with sector associations if deemed appropriate. [See paragraphs 18 to 20]
D. Target units in sectors that meet targets are deemed to have met targets irrespective of individual performance.	D. All target units to be required to meet their targets either by direct action or by purchase of allowances. Sector targets no longer required to be met. [See paragraphs 21 to 24]
E. Three risk management tools: purchase of carbon allowances; provisions on regulatory constraints; provisions on fuel supply disruption.	E. Risk management to be limited to purchase of carbon allowances and provisions on fuel supply disruption. [See paragraphs 25 to 27]
F. Carbon trading through the UK ETS.	F. Compliance with negotiated targets through purchase of Certified Emission Reductions. Automatic banking of over-achievement by target units, for OWN USE ONLY against future targets. UK ETS to be closed and all remaining allowances cancelled. [See paragraphs 28 to 37]
G. No <i>de minimis</i> or materiality provisions.	G. Introduction of <i>de minimis</i> and materiality provisions. [See paragraphs 38 to 42]
H. Novem procedure applied to relevant	H. Novem procedure to apply for relevant

sectors and target units for setting relative targets and measuring performance.	sectors and target units for setting relative targets and measuring performance, but with application obligatory. [See paragraph 43 to 46]
I. Where there is overlap between Climate Change Agreements and EU ETS a double counting mechanism is applied.	I. Climate Change Agreement targets to be split into two elements: a requirement to meet any EU ETS obligation through that scheme; and a negotiated target. Only over-achievement against the negotiated target can be banked by target units for own use against future targets (see F). Eligibility for Levy discount to remain unchanged. [See paragraphs 47 to 54]
J. Where the eligible energy of a facility is 90% or more of the energy use of the site, the energy use of the entire site is deemed eligible. Where the eligible energy is less than 90% of the energy use of the site, only the eligible energy may qualify for Levy discount with, under certain conditions, up to an additional 1/9 <sup>th</sup> uplift.	J. To re-set the threshold to 70% and retain the provision for the additional 1/9 <sup>th</sup> . [See paragraphs 55 to 56]
K. Two types of agreement based on the so-called "Option 2" and "Option 3" agreements.	K. One type of agreement only, based on the current "Option 2" agreement. [See paragraphs 57 to 59]
L. Sectors allowed to choose a target period starting on 1 October, 1 November, 1 December or 1 January.	L. All target periods to be on a calendar year basis with suitable adjustments to the deadlines for reconciliation and Levy discount period. [See paragraphs 60 to 61]
M. Sectors failing to meet targets required to provide more detailed information at reconciliation than sectors that pass.	M. All sectors to provide the more detailed information at reconciliation. [See paragraphs 62 to 64]
N. Most rules of the scheme embodied in the agreements themselves.	N. Establish Scheme Rules, linked to the agreements through a suitable clause, with the content of the agreements limited to that which is necessary to establish the relationship between the parties to the agreements. [See paragraph 65 to 66]

## SECTION III: ELEMENTS OF THE DECISION

**A. Target units to choose between absolute and relative targets, Sector to take the currency of the largest energy use in the sector. Relative targets to be set at a level to ensure absolute savings.**

### Results of Second Consultation



9. 59% of respondents (54% of sector associations) disagreed with the proposal to set relative targets at a level to ensure absolute savings on the grounds that it would place a constraint on production/growth/investment and risk carbon leakage. In addition it was argued that this took no account of the impact of the recession and of the difficulty in predicting future growth levels. If implemented, a number of respondents highlighted a need to take into account sectors in decline.

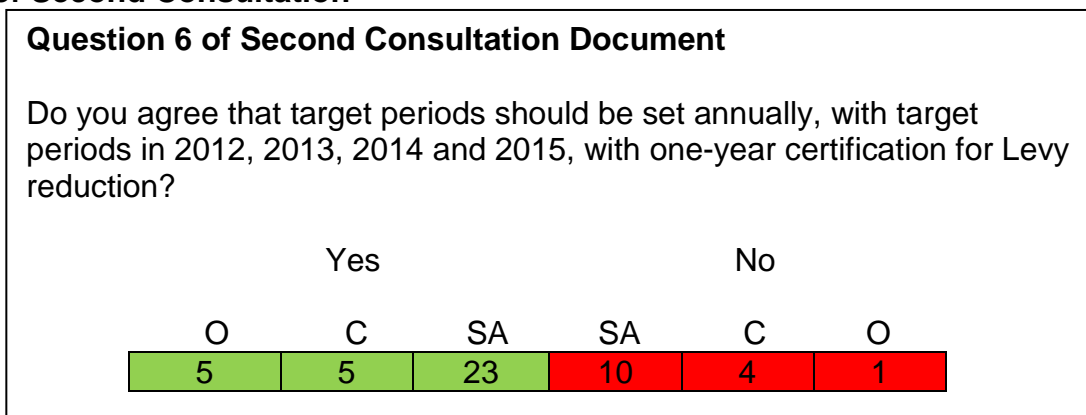
### Government response

10. The first consultation document set out three options for target currency, including absolute targets for all target units and retaining the existing choice of currencies. The Government acknowledged a number of the arguments presented by industry against setting absolute targets for all, in particular the potential risks of carbon leakage and the difficulty of setting absolute targets as the country emerges from recession. Consequently it decided not to move to absolute targets for all target units for the life of this new scheme (to 2017), but this will be reviewed in the context of wider consideration of future instruments for energy intensive industry.
11. However, one of the arguments deployed by industry against absolute targets was that relative targets have historically delivered significant absolute savings and were likely to continue to do so. Sectors therefore argued in plenary meetings that the correct way to achieve absolute reductions in emissions was through the target setting process: setting targets that offset the expected growth rates for sectors.
12. The Government accepts as historical fact that relative targets have produced absolute emission reductions in the past, but, in the context of carbon budgets, there is a need for added certainty that this will be the case in the future.

13. The Government recognises that predicting growth is not straight forward and recognises that the impact of the recession will have to be taken into consideration. Nevertheless, it fully expects that appropriate targets can be agreed in the normal process of negotiation with sector associations, during which all evidence presented by sector associations on growth projections and other matters can be taken into account.
14. The Government therefore aims to negotiate targets for the new CCAs that will counterbalance the effects of predicted growth in CCA sectors.

## B. Targets to be set annually.

### Results of Second Consultation



15. 69% of respondents (70% of sector associations) agreed with this proposal. Those that disagreed cited the increase in administration and compliance costs, although many of those that agreed also recognised that this might be an issue. A further argument against was that a non-target year provides a window in which energy efficiency equipment can be installed and the resultant temporary fall in efficiency would not affect performance against targets.

### Government response

16. The Government recognises that for some sectors there will be an increase in administrative costs, although limited evidence of this was provided. However, it is also clear that for the majority of sectors this will be minimal. The Government accepts that increasing the number of target periods increases the potential need to purchase additional carbon allowances for compliance. However, it considers this potential additional cost to be a further incentive to businesses to meet targets through direct means, rather than through the purchase of allowances. Plant upgrades will be largely dictated by other factors than milestone years and it could equally be argued that energy efficiency measures should be implemented as soon as possible rather than waiting for a non-reporting year.
17. The Government remains convinced that the benefits of setting targets annually (greater incentive on businesses to focus continually on energy efficiency issues and greater coherence with related climate change instruments) outweigh the potential increased costs to businesses and has decided to implement the proposal.



**C. DECC to carry out a paper based review of targets for 2014 and 2015 in 2012, to be followed by a full review with sector associations if deemed appropriate.**

**Results of Second Consultation**

<b>Question 8 of Second Consultation Document</b>					
Do you agree that there should be a target review in 2012 for the 2014 and 2015 targets?					
Yes			No		
O	C	SA	SA	C	O
3	7	24	11	2	1

18. Although 71% of respondents (69% of sector associations) agreed with this proposal a number of these, and those that disagreed with the proposal, highlighted the cost of a target review exercise (one sector, with around 230 target units put this at a total of £550k for its sector as a whole) and argued that little additional information would be available compared with that which was used to set targets in 2010. In addition, a number suggested that target reviews increased business uncertainty and could lead to reluctance to invest. One respondent suggested a paper review should be undertaken before a decision is taken as to whether a full review is necessary. Clarification was also sought on the factors to be taken into account, and how new entrants would be handled, in any review.

**Government response**

19. The Government remains convinced of the need to ensure that targets remain challenging for the life of the agreements. Nevertheless, it is recognised that a full target review is a time consuming and costly exercise, both for industry and for government. The Government has therefore decided that DECC should carry out a paper based review of targets in 2012, only to be followed by a full review (i.e. Government to propose revised targets and full negotiations with sectors) should this be deemed appropriate. DECC will seek sufficient quality information from sector associations in order to carry out the paper review. Should there be insufficient information supplied to reach a judgement, or if a paper based review indicates that existing targets are no longer challenging, a full review would be carried out for all relevant sectors.

20. The factors to be taken into account in carrying out any review are set out in the draft Scheme Rules (see Rule 7). New entrants will be treated as they are now (i.e. negotiation of any change in target would be based on the sector membership at reconciliation in the immediately preceding target period and any revised target would then be adjusted to reflect the current membership).

## D. To benefit from Levy discount, all target units must meet targets either directly or through the purchase of carbon allowances

### Results of Second Consultation

Question 10 of Second Consultation Document					
Do you agree that all operators should be required to meet their targets, or purchase carbon allowances, to qualify for Levy discount?					
Yes			No		
O	C	SA	SA	C	O
4	8	26	9	1	0

21. 79% of respondents (74% of sector associations) agreed with this proposal. Those that disagreed did so mainly on the grounds of increased compliance costs for some target units (particularly due to the removal of group trading) and a resulting weakening of the role of sector associations. There was a call from some respondents for provisions for group trading to continue.

### Government response

22. The Government continues to believe that there are four important benefits to be derived from implementing this proposal:

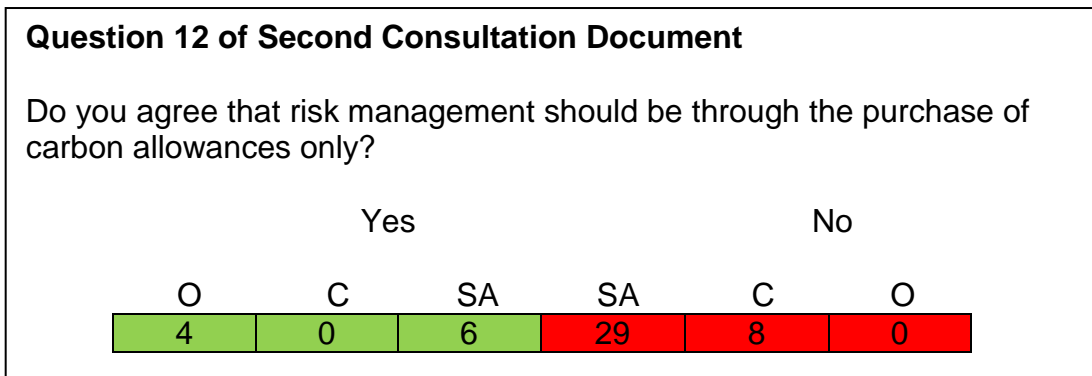
- Value for money for the taxpayer (current arrangements allow target units to benefit from the Levy discount even when not meeting targets, if the sector passes);
- Equitable treatment for all target units (each would be responsible for meeting their own targets);
- A stronger signal to target units to be active in meeting their targets; and
- Simplicity and clarity to external parties.

23. The Government is not convinced that the implementation of this proposal would significantly weaken the role of sector associations given that most sector associations already operate successfully under these terms. Under this system, coupled with the decision on emissions trading, there would be no role for group trading arrangements as currently operated by some sectors. However, there is no reason why sector associations should not continue to coordinate or facilitate the purchase of allowances to meet targets across the sector, if they wished to do so.

24. The Government has therefore decided to implement this proposal.

## E. Risk management to be limited to purchase of carbon allowances and provisions on fuel supply disruption

### Results of Second Consultation



25. 79% of respondents (83% of sector associations) disagreed with this proposal. Most expressed concern related to fuel supply disruption and the potential for this to happen due to a potential shortfall in generating capacity and a shortage of gas storage capacity. While national disruption of fuel supply would reduce energy consumption, it would also reduce production and impact negatively on relative targets. Those that wished to retain the provisions on relative constraints argued that it was unreasonable for industry to take on the risk resultant from Government policy.

### Government response

26. The Government recognises that in the event of fuel supply disruption this would impact positively on the achievement of absolute targets but potentially could impact negatively on the achievement of relative targets, increasing the costs of the target units concerned. Consequently, in the interests of equality of treatment, the Government has decided to retain the provisions on fuel supply disruption.
27. The Government considers it unlikely that significant legislative changes would be unknown when targets are set that might impact on target achievement during the four target periods of the new scheme. Any such changes could, however, be taken into consideration when targets are reviewed in 2012. Consequently the Government has decided not to retain the provisions on relevant constraints.

## F. Compliance to be through transfer to DECC of Certified Emission Reductions; over-achievement may be banked for own use only against future targets; UK ETS to close with the cancellation of all remaining allowances

### Results of Second Consultation

Question 14 of Second Consultation Document					
Do you agree that compliance with negotiated targets should be through purchase of EU ETS allowances or Certified Emission Reductions; that target units should be allowed to bank over-achievement for OWN USE ONLY against future targets; and that UK ETS should be closed and all remaining allowances cancelled?					
Yes			No		
O	C	SA	SA	C	O
2	0	7	28	9	2

- 28.81% of respondents (80% of sector associations) disagreed with this proposal. There were a range of reasons given. Many respondents prefer the retention of a trading scheme for Climate Change Agreements, arguing that this would reward over-performance and hence provide a stimulus to investment by improving the payback on improvement projects. There was also concern that the cost of purchasing internationally traded allowances would be higher than using a dedicated trading scheme.
29. Should the Government decide to use internationally traded allowances, there was some preference for the use of EU ETS allowances over Certified Emissions Reductions, given that the future of the latter was uncertain due to on-going negotiations for an international climate change agreement. Others considered that operators should be given the flexibility to use either type of allowance. Some respondents also disagreed with a requirement that operators be required to purchase allowances, instead of using allowances already held.
30. There were some concerns about how the provision on banking of over-achievement for own use would work. In particular, a number of respondents disagreed with the requirement for verification before use, which could be very costly, particularly for small and medium sized enterprises. Banking for own use would also not be an incentive to over-achievement if the target unit never had need to use the arrangement.
31. Many respondents disagreed with the cancellation of allowances remaining, should UK ETS be closed. They argued that genuine allowances were a valuable asset created by Climate Change Agreements holders and should be carried forward (e.g. for own use) in whole or in part, or that some form of compensation should be made.

### Government response

32. No new arguments have been presented against the closure of UK ETS on 31 December 2012 and the cancellation of any remaining allowances, beyond those given in responses to the first consultation. For the reasons set out in the second consultation

document (see paragraphs 56 to 63 of that document) the Government has decided to implement this proposal.

33. The Government continues to believe that a new stand-alone scheme is likely to become quickly oversupplied and consequently undermine the environmental objectives of the scheme (low allowance prices reducing the incentive to invest in energy efficiency measures – see paragraphs 58 and 59 of the second consultation document), and has decided to provide for compliance under the new scheme to be via the purchase of internationally traded allowances, with a provision for banking of over-achievement for own use.
34. The Government has decided that only Certified Emissions Reductions may be used for compliance purposes. This is principally because of the rules on how the UK meets its share of the EU target to reduce emissions by 20% by 2020. Under the new Climate Change Agreements scheme, targets will be split between an EU ETS element and a negotiated target. The purchase of allowances relates only to compliance with the negotiated target. This negotiated target is outside the EU ETS, and therefore falls under the rules contained in the EU Effort Sharing Decision. Under the rules in the EU Effort Sharing Decision, the UK is not able to use EU ETS allowances to meet its EU non-traded target, while Certified Emissions Reductions could be so used, if necessary. There are, however, implications for the UK's carbon budgets in allowing participants to use Certified Emissions Reductions for compliance purposes given the zero limit on internationally traded allowances outside the EU ETS and Carbon Reduction Commitment which exists for the first budgetary period (2008-2012). We will therefore need to consider further how the use of Certified Emissions Reductions by Climate Change Agreements participants affects performance against carbon budgets.
35. DECC's view is that Certified Emissions Reductions will be available for use; those issued prior to 2012 will remain available for use for compliance beyond the 2012 deadline, and we are confident that Clean Development Mechanism will continue post 2012 as part of a comprehensive international agreement. Progress in the international negotiations this year would further increase certainty. If however, the supply of Certified Emissions Reductions were to become limited, it would be possible for the Climate Change Agreements scheme rules to be amended in order that a different type of allowance could be used. We will therefore keep this under close review.
36. The Government has considered the concerns raised by some respondents that the cost of verifying over-achievement would lead to this provision not being used, particularly by small and medium sized enterprises. Verification is a requirement under the current scheme for two main reasons: UK ETS is a fully fledged trading scheme; and there was an obligation placed on the UK for verification under State aid approval. Given that trading is not proposed, the Government has decided that self-verification should apply, subject to normal audit procedures.
37. It is apparent from responses to the second consultation document that there is a range of questions, and misunderstandings, as to how these arrangements will operate in practice. Some of the principles are set out in the draft Scheme Rules, which are published for consultation alongside this response (see paragraph 5 above). However, for the sake of clarity, the Government envisages that these arrangements will apply as set out in Box 1.

**Box 1: Proposed Arrangements for Compliance Through the Transfer of Certified Emissions Reductions to DECC. Arrangements for Banking of Over Achievement for Own Use**

**A. Transfer of Certified Emissions Reductions to DECC**

1. These arrangements apply to target units only. Sector targets do NOT have to be met. Sector targets become a means to assign targets to target units only.
2. If a target unit exceeds its target it may decide to become compliant through transferring the required number of verified Certified Emissions Reductions to DECC (receipt mechanism yet to be determined). There is no obligation to purchase Certified Emissions Reductions from any particular source. Previously held Certified Emissions Reductions may be used and transferred to DECC.
3. Group purchasing (but not trading) schemes may be established to reduce transaction costs.

**B. Arrangements for Banking of Over-achievement for Own Use**

1. Banking of over-achievement will be at target unit level only.
2. Target units can be made up of more than one facility (i.e. the current arrangements where facilities under the same operator may combine to form a single target unit (a bubble) will continue).
3. Over-achievement will be automatically banked through the reconciliation process. No action will be required by the target unit beyond submission of the required reconciliation data.
4. Banked over-achievement may be used only by the target unit that has banked it to off-set, in whole or in part, the amount by which it exceeds targets in a subsequent target period.
5. Banked over-achievement may be used without verification, but will be subject to audit through the normal audit procedures.
6. It will be the responsibility of target units to keep a full record of banked over-achievement, including any used, so that they are always fully aware of total net banked over-achievement available to them. If they have insufficient banked over-achievement to achieve compliance in any target period, they may transfer to DECC the number of Certified Emissions Reductions necessary to make up the difference between the target plus the banked over-achievement and the amount by which the target unit still exceeds the target. Failure to do so could result in decertification.
7. Banked over-achievement will be forfeit if an agreement is terminated or where a target unit is decertified after having failed to take advantage of the de minimis/materiality provisions, where these provisions apply.
8. Banked over-achievement is retained if a target unit is decertified where the de minimis/materiality provisions do not apply.
9. Where a multi-facility target unit is disaggregated, in whole or in part, the target unit may decide how any banked over-achievement is distributed and must notify DECC of its decision. Failure to notify DECC of the decision will result in the banked over-achievement remaining with the original target unit.
10. Where a facility with banked over-achievement joins a bubble, the bubble may benefit from that over-achievement.

## G. Introduction of provisions on *de minimis* and materiality

### Results of Second Consultation

Question 16 of Second Consultation Document					
Do you agree that a <i>de minimis</i> and a materiality provision should apply with the limits set at 1% and 2% of target respectively and, in the case of materiality, a payment of £40 per allowance?					
Yes			No		
O	C	SA	SA	C	O
3	9	34	0	0	0

38. All respondents agreed with this proposal.

39. Some concern was expressed about the use of the terms *de minimis* and materiality, which may cause confusion with similar terms used under EU ETS. One respondent also suggested that failure to transfer allowances from a trading account to a compliance account should be given a period of grace.

### Government response

40. The terms *de minimis* and materiality will not be used in the Scheme Rules to avoid any confusion.

41. There will be no trading account, as there will be no trading scheme (see Section F above). Consequently the only evidence that DECC will have is the transfer to it of Certified Emissions Reductions.

42. The Government has decided to implement this proposal.

## H. Novem procedure for setting relative targets and measuring performance against them to apply to relevant target units on an obligatory basis

### Results of Second Consultation

Question 19 of Second Consultation Document					
Do you agree that Novem should continue to be applied, but in an obligatory way, for relevant sectors and target units?					
Yes			No		
O	C	SA	SA	C	O
2	9	29	3	0	1

43. 91% of respondents (91% of sector associations) agreed with this proposal. Those that did not agree wanted the use of Novem to be optional, and for it to be possible to apply it at the target unit level, but not at sector level.

**Government response**

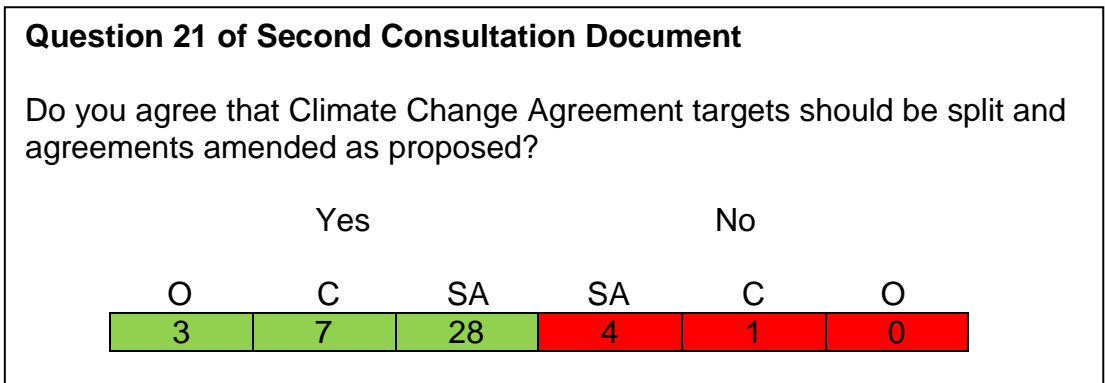
44. The use of Novem will be optional for those target units and sectors where it would be appropriate to apply. Where a relevant target unit or sector decides to apply Novem as indicated in its underlying agreement, it will be obligatory for the results of its application to be implemented at each reconciliation.

45. The use of Novem is limited to those target units that do not have one common throughput measure that accurately represents all their production. Where a sector contains a target unit using Novem, a sector throughput could not be computed to establish a simple relative sector target. Consequently sectors containing a target unit using Novem must either have a sector target that is based on Novem, or is absolute.

46. The Government has decided to implement this proposal.

**I. Climate Change Agreement targets to be split into two elements: a requirement to meet any EU ETS obligation; and a negotiated target.**

**Results of Second Consultation**



47. 88% of respondents (88% of sector associations) agreed with this proposal. There were a number of concerns expressed both from those that disagreed with it and those that agreed.

48. There were some concerns about the impact on target setting. In particular it was noted that EU ETS Phase III would come into force in 2013 and that this could affect Climate Change Agreements targets in the context of the move to the broad definition of combustion and the rules on opt out for small emitters. The latter would not be determined before target negotiations in 2010. In addition, for many of those in EU ETS the negotiated target would be limited to electricity, for which there was said to be limited scope for further efficiencies.

49. There were some issues related to Combined Heat and Power. Concern was expressed that where supply from such an EU ETS Combined Heat and Power plant failed and energy taken from utility companies, the performance of the facility in relation to the negotiated target would appear to deteriorate. A number of issues were also raised regarding ideas currently being explored by DECC with some sector associations about alternative ways of treating third party Combined Heat and Power under the new scheme.



50. Other concerns raised included:

- Splitting targets would reduce encouragement for more efficient use of energy under EU ETS;
- Possible State aid approval issues; and
- The need for the 70/30 rule to apply to total reckonable energy use of the facility (i.e. both the EU ETS element and the negotiated target)

### **Government response**

51. The Government recognises the uncertainty over the rules for EU ETS phase III and that, in some cases, the negotiated target will apply to electricity use only. However, the Government believes that these issues can be satisfactorily addressed either in the target setting process or, if necessary, in the target review in 2012.

52. Government expects that the availability of CHP plant is guaranteed contractually and that users anticipate some downtime and have arrangements in place. If the failure of the CHP plant is due to wider issues then the disruption of supply rules will apply (paragraph 26). With regard to the ideas DECC has been exploring on the treatment of third party Combined Heat and Power, DECC will discuss with industry any proposed change in approach before a decision might be taken to implement it. These arrangements will be covered in guidance.

53. On the other issues:

- Splitting targets should not reduce encouragement for more efficient use of energy under EU ETS. That encouragement comes from having allowances to sell under the EU ETS scheme. The situation is no different to the current arrangements under Climate Change Agreements, where any net over-achievement under EU ETS is netted off the Climate Change Agreements target, making the target tighter and avoiding the potential for double benefit;
- The Government will resolve any State aid issues before implementation; and
- The 70/30 rule will apply to total reckonable energy use of a facility.

54. In the light of the above and the strong support for this proposal, the Government has decided to implement it.

**J. To revise the 90/10 rule and establish a new threshold of 70%**

**Results of Second Consultation**

**Question 23 of Second Consultation Document**

Do you agree that the 90/10 rule should be amended to lower the threshold to 70% while retaining the 1/9<sup>th</sup> provision?

Yes			No		
O	C	SA	SA	C	O
3	9	33	2	0	0

55.96% of respondents (94% of sector associations) agreed with this proposal.

**Government response**

56. Given the overwhelming support for this proposal, the Government has decided to implement it.

**K. To establish one type of agreement only, based on the current “Option 2” agreement.**

**Results of Second Consultation**

**Question 25 of Second Consultation Document**

Do you agree that there should be only one type of agreement based on the current Option 2?

Yes			No		
O	C	SA	SA	C	O
4	9	32	3	0	0

57. 93% of respondents (91% of sector associations) agreed with this proposal. Those that disagreed were concerned on two issues: that the change would weaken the role of sector associations; and that confidential information might be released either inadvertently or under Freedom of Information legislation, which could distort competition.

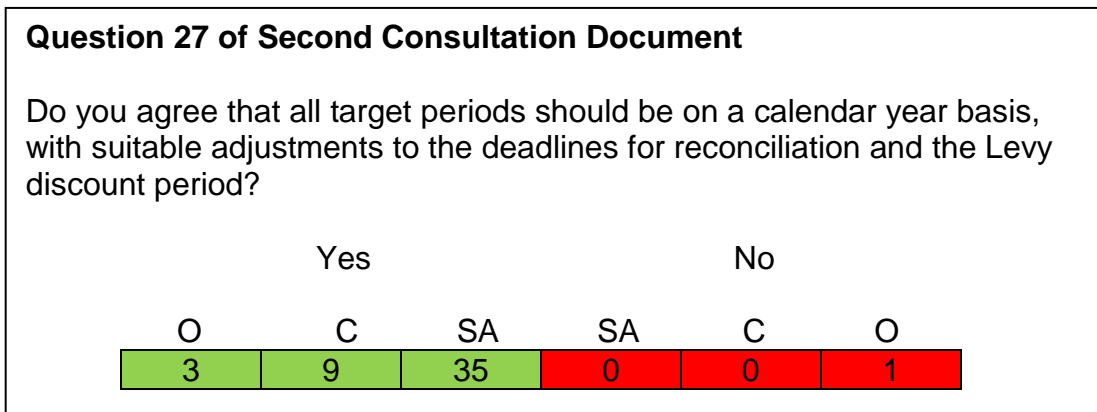
58. Given that most sector associations currently operate under Option 2 agreements, the Government is not convinced that requiring all sectors to operate under these agreements would significantly weaken the role of the sector associations concerned.

59. As a general position, DECC would release emissions data at both sector and target unit level, without consultation. With regard to other information, both the Freedom of Information Act 2000 and the Environmental Information Regulations 2004 contain exemptions regarding the handling of commercially confidential information. DECC would consult the sector

association or operators concerned before deciding whether or not to release the information. However, there is no 100% guarantee that government would be able to withhold such information. Under both the Act and the Regulations we would have to carry out a public interest test on a case by case basis to see if the information should be withheld or released.

**L. All target periods to be on a calendar year basis with suitable adjustments to the deadlines for reconciliation and Levy discount period**

**Results of Second Consultation**



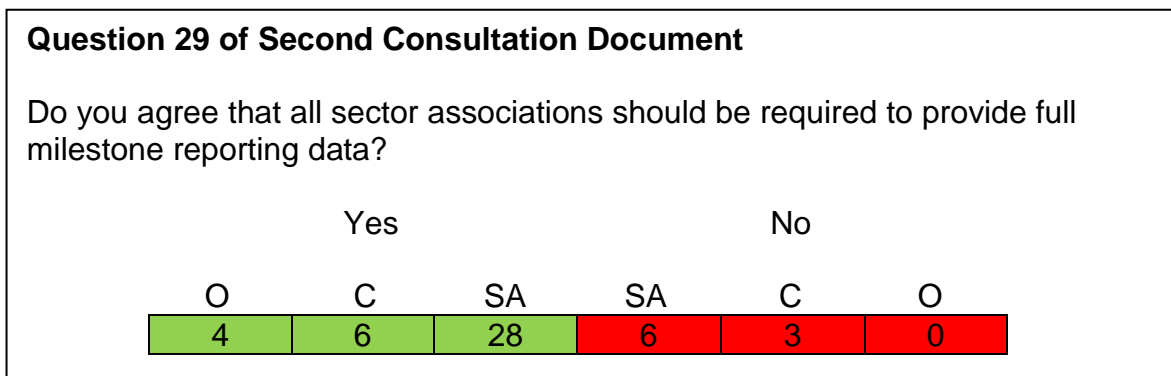
60.98% of respondents (100% of sector associations) agreed with this proposal.

**Government response**

61. Given the overwhelming support for this proposal, the Government has decided to implement it.

**M. All sectors to provide the same information at reconciliation, including the effective trading position of all target units, whether meeting targets or not**

**Results of Second Consultation**



62. 81% of respondents (82% of sector associations) agreed with this proposal. Most of those that disagreed were concerned about the risk of release of confidential information, particularly under Freedom of Information legislation. Others argued that data on individual target units was not required, particularly if sector targets were met.

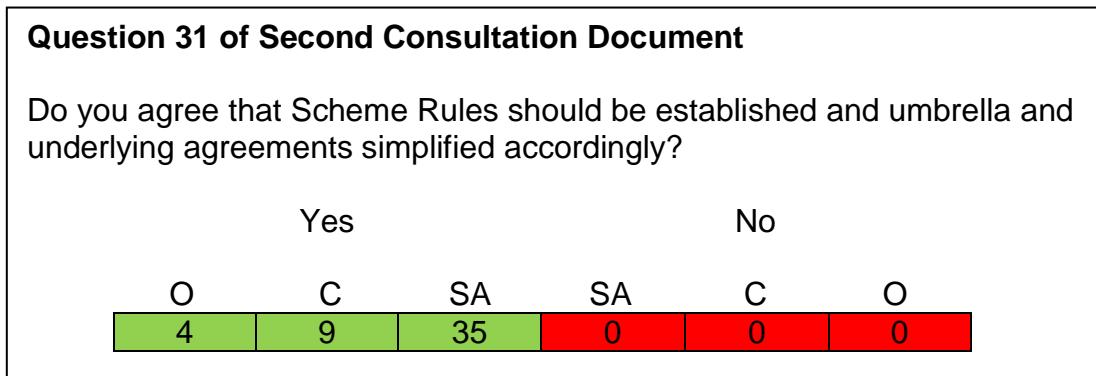
**Government response**

63. There have been no instances of commercially sensitive information being released to the public under the current scheme. Target unit data is necessary given the requirement that all target units must meet their targets (see Section D, paragraphs 21 to 24, above). There is no longer a requirement that sector targets must be met. Sector targets under the new scheme will simply be a means to attribute targets to target units and to enable performance to be reported.

64. The Government has decided to implement this proposal.

**N. Establish Scheme Rules with the content of the agreements limited to that which is necessary to establish the relationship between the parties to the agreements.**

**Results of Second Consultation**



65. 100% of respondents agreed with this proposal. However, some respondents wanted the Scheme Rules to be adopted prior to target negotiations and others requested information on the procedures for amending them.

**Government response**

66. The Government has decided to establish Scheme Rules and a draft is published alongside this response for consultation (see paragraph 5). The consultation covers the issue of procedures for amending the Rules.

**ANNEX I: SUMMARY OF RESPONSES TO PROPOSALS IN THE SECOND CONSULTATION DOCUMENT**

Question	Consultation Response	Main Arguments Employed/Comments Made
<b>Section II: Proposed Package of Changes</b>		
Q1 Do you consider this package to be balanced? If not, please set out your reasons why, including the administrative burden and financial cost.	53% (59% of sector associations) agreed	
	47% (41% of sector associations) disagreed	<p>Most comments related to individual elements of the package, rather than the balance, and included:</p> <ul style="list-style-type: none"> <li>• Concern that the package would restrict growth, impact on competitiveness and encourage carbon leakage.</li> <li>• Financial loss through closure of UK ETS.</li> <li>• Ending of trading would reduce management 'buy-in' for energy efficiency projects.</li> </ul>
Q3. Are there any linkages between the elements of the proposed package that have not been taken into consideration and which present problems of implementation or any consequences that derive from the package as a whole that do not derive from the individual parts?	59% (58% of sector associations) agreed	<p>Most comments did not address the issue of linkages, but expressed views on individual elements of the package. These included:</p> <ul style="list-style-type: none"> <li>• Splitting of targets may create market distortions.</li> <li>• Likely overall increase in administration costs.</li> </ul>
	41% (42% of sector associations) disagreed	

### Section III: Consideration of the Individual Elements of the Package

#### A. Target units to choose between absolute and relative targets, Sector to take the currency of the largest energy use in the sector

Q5. Do you agree that to ensure that Climate Change Agreements deliver absolute emission reductions without absolute targets, future Climate Change Agreement targets will need to be set at a level to counterbalance the effects of growth at sector level?	40% (46% of sector associations) agreed	<ul style="list-style-type: none"> <li>Relative targets will help to recover to pre-recession rates without incurring unilateral carbon costs for efficient growth.</li> </ul>
	60% (54% of sector associations) disagreed	<ul style="list-style-type: none"> <li>Would hinder growth and investment.</li> <li>Would increase carbon leakage.</li> <li>Need to take account of the recession.</li> <li>Difficulty in predicting future growth.</li> <li>Unavailability of technology for achieving energy reductions.</li> <li>Need to take account of sectors in decline.</li> </ul>

#### B. Targets to be set annually

Q7. Do you agree that target periods should be set annually, with target periods in 2012, 2013, 2014 and 2015, with one-year certification for Levy reduction, as set out in paragraphs 41 to 45?	69% (69% of sector associations) agreed	<ul style="list-style-type: none"> <li>Will provide a more stable market</li> <li>Encourage more focus to reduce energy consumption</li> <li>Additional benefit for target units that meet their targets</li> </ul>
	31% (31% of sector associations) disagreed	<ul style="list-style-type: none"> <li>Increased administrative burden and compliance cost</li> <li>No non-target period in which to install new equipment or change operation</li> </ul>

<b>C. Targets for 2014 and 2015 to be reviewed in 2012</b>		
Q9. Do you agree that there should be a target review in 2012 for the 2014 and 2015 targets, as set out in paragraphs 46 to 47?	71% (69% of sector associations) agreed	
	29% (31% of sector associations) disagreed	<ul style="list-style-type: none"> <li>• Little additional data available beyond that used to set targets in 2010.</li> <li>• Increased administrative burden.</li> <li>• Hinders investment by increasing business uncertainty.</li> </ul> <p style="text-align: center;"><b>Alternative Proposal</b></p> <ul style="list-style-type: none"> <li>• To have a desk based review and only carry out a full review if appropriate.</li> </ul>
<b>D. To benefit from Levy discount, all target units must meet targets either directly or through the purchase of carbon allowances</b>		
Q11. Do you agree that all operators should be required to meet their targets, or purchase carbon allowances, to qualify for Levy discount, as set out in paragraphs 48 to 51?	79% (74% of sector associations) agreed	
	21% (26% of sector associations) disagreed	<ul style="list-style-type: none"> <li>• Increased compliance costs.</li> <li>• Increased administrative burden for DECC and the sector associations.</li> <li>• Removal of trading groups increases the complexity of the scheme, and discriminates against single site companies, and weakens role of sector associations.</li> <li>• Trading of over achievement should continue.</li> </ul>
<b>E. Risk management to be through purchase of carbon allowances only</b>		
Q13. Do you agree that risk management should be	21% (17% of sector associations) agreed	

<p>through the purchase of carbon allowances only, as set out in paragraphs 52 to 54?</p>	<p>79% (83% of sector associations) disagreed</p>	<ul style="list-style-type: none"> <li>• Regulatory constraints needed for unforeseen legislative changes.</li> <li>• High risk of fuel supply disruption in the future (shortfall in generating capacity/ shortage of gas storage).</li> <li>• Loss of provision on fuel supply disruption would discriminate against those with relative targets.</li> <li>• Would increase costs of compliance, reducing finance for investment in energy efficiency measures.</li> </ul>
<p><b>F. Compliance to be through the purchase of EU ETS allowances or Certified Emission Reductions; over-achievement may be banked for own use only against future targets; UK ETS to close with the cancellation of all remaining allowances</b></p>		
<p>Q15. Do you agree that compliance with negotiated targets should be through purchase of EU ETS allowances or Certified Emission Reductions; that target units should be allowed to bank over-achievement for OWN USE ONLY against future targets; and that UK ETS should be closed and all remaining allowances cancelled, as set out in paragraphs 55 to 63?</p>	<p>19% (20% of sector associations) agreed</p>	<ul style="list-style-type: none"> <li>• Some respondents expressed a preference for EU ETS allowances over Certified Emissions Reductions, due to the uncertain future of the latter.</li> <li>• Some preferred flexibility to use either type of allowance.</li> </ul>
	<p>81% (80% of sector associations) disagreed</p>	<ul style="list-style-type: none"> <li>• Trading rewards over-achievement and improves payback on improvement projects, thereby encouraging investment.</li> <li>• Would increase compliance costs compared to a dedicated trading scheme.</li> <li>• Opening an EU ETS trading account would result in increased costs and complexity for companies, particularly SMEs.</li> <li>• Target units should be allowed to use their own EUETS allowances/Certified Emissions Reductions, and not be required to purchase from others.</li> <li>• Banked over-achievement for OWN USE ONLY would discriminate against small businesses due to cost of verification.</li> <li>• The definition of 'OWN USE' should cover facilities owned by the same company and operated as a single target unit.</li> <li>• Cancelling verified UK ETS allowances would penalize early action taken by companies and artificially increase the cost of carbon. They are a valuable asset. They should be carried forward to the new scheme.</li> </ul>



<b>G. Introduction of provisions on <i>de minimis</i> and materiality</b>		
Q17. Do you agree that a <i>de minimis</i> and a materiality provision should apply with the limits set at 1% and 2% of target respectively and, in the case of materiality, a payment of £40 per allowance, as set out in paragraphs 64 to 66?	100% agreed	<ul style="list-style-type: none"> <li>Reduction of the payment under materiality to £40 welcomed.</li> <li>Better approach to deal with minor infringements or oversights on CCA reporting.</li> </ul>
	0% disagreed	<ul style="list-style-type: none"> <li>Proposal still not likely to cover cases of unintentional oversights in trading.</li> <li>The terms “de minimis” and “materiality” could cause confusion with similar terms used under EU ETS.</li> </ul>
<b>H. Novem procedure for setting relative targets and measuring performance against them to apply to relevant target units on an obligatory basis</b>		
Q19. Do you agree that Novem should continue to be applied, but in an obligatory way, for relevant sectors and target units, as set out in paragraph 67?	91% (91% of sector associations) agreed	<ul style="list-style-type: none"> <li>Good way of managing risk.</li> </ul>
	9% (9% of sector associations) disagreed	<ul style="list-style-type: none"> <li>Should be optional; not obligatory.</li> <li>Should be possible to apply Novem at target unit level but not at sector level.</li> </ul>
<b>I. Climate Change Agreement targets to be split into two elements: a requirement to meet any EU ETS obligation; and a negotiated target</b>		
Q21. Do you agree that Climate Change	88% (88% of sector associations) agreed	A number of those supporting this proposal did express some of the concerns identified below.

<p>Agreement targets should be split and agreements amended as proposed in paragraphs 68 to 71?</p>	<p>12% (12% of sector associations) disagreed</p>	<ul style="list-style-type: none"> <li>• How would targets be set for 2012 given the proposed changes to EU ETS Phase III (broad definition of combustion; opt out for small emitters).</li> <li>• Splitting targets would reduce encouragement for more efficient use of energy under EU ETS.</li> <li>• Limited scope for savings from electricity use.</li> <li>• Setting split targets will be difficult.</li> <li>• 70/30 rule should apply to total reckonable energy use of the facility (i.e. both the EU ETS element and the negotiated target).</li> </ul>
<p><b>J. To revise the 90/10 rule and establish a new threshold of 70%</b></p>		
<p>Q23. Do you agree that the 90/10 rule should be amended to lower the threshold to 70% while retaining the 1/9<sup>th</sup> provision, as set out in paragraphs 72 to 76?</p>	<p>96% (94% of sector associations) agreed</p>	<ul style="list-style-type: none"> <li>• It will reduce administrative burden</li> </ul>
	<p>4% (6% of sector associations) disagreed</p>	<ul style="list-style-type: none"> <li>• Lowering the threshold likely to result in less participants in the CRC scheme; consequences should be analysed?</li> </ul>
<p><b>K. To establish one type of agreement only, based on the current “Option 2” agreement</b></p>		
<p>Q25. Do you agree that there should be only one type of agreement based on the current Option 2, as set out in paragraphs 77 to 78?</p>	<p>94% (91% of sector associations) agreed</p>	
	<p>6% (9% of sector associations) disagreed</p>	<ul style="list-style-type: none"> <li>• Concern over the protection of commercially confidential information, in particular in the context of the Freedom of Information Act and the Environmental Information Regulations.</li> <li>• Weakening of the role of some sector associations</li> </ul>

**L. All target periods to be on a calendar year basis with suitable adjustments to the deadlines for reconciliation and Levy discount period**

Q27. Do you agree that all target periods should be on a calendar year basis, with suitable adjustments to the deadlines for reconciliation and the Levy discount period, as set out in paragraphs 79 to 80?	98% (100% of sector associations) agreed	<ul style="list-style-type: none"> <li>Government should consider collating all environmental reporting requirements into one process; reducing administrative burden and avoiding errors.</li> </ul>
	2% (0% of sector associations) disagreed	

**M. All sectors to provide the same information at reconciliation, including the effective trading position of all target units, whether meeting targets or not**

Q29. Do you agree that all sector associations should be required to provide full milestone reporting data, as set out in paragraphs 81 to 82?	81% (82% of sector associations) agreed	<ul style="list-style-type: none"> <li>Concern over the protection of commercially confidential information, in particular in the context of the Freedom of Information Act and the Environmental Information Regulations.</li> </ul>
	19% (18% of sector associations) disagreed	

**N. Establish Scheme Rules with the content of the agreements limited to that which is necessary to establish the relationship between the parties to the agreements**

Q31. Do you agree that Scheme Rules should be established and umbrella	100% agreed	<ul style="list-style-type: none"> <li>Will reduce bureaucracy</li> </ul>
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<p>and underlying agreements simplified accordingly, as set out in paragraph 83?</p>	<p>0% disagreed</p>	<ul style="list-style-type: none"> <li>• Changes to the rules should be discussed with target units and sector associations before implementation</li> <li>• Rules should be published before the start of the target negotiations to be able to see the impact on companies' performance</li> </ul>
<p><b>Section IV: Other Issues Covered by the First Consultation Document</b></p>		
<p>Q32. Please provide any comments on Section IV of the Consultation Document</p>	<p>N/A</p>	<ul style="list-style-type: none"> <li>• A common start date should be chosen in a way that does not give a false impression of the extent to which industry is reducing emissions.</li> <li>• Climate Change Agreement rules should actively incentivise Combined Heat and Power installation.</li> </ul>

## Annex II: List of Organisations That Responded to The Second Consultation

### **Sector Associations**

EEF (representing UK Steel)  
ADS Group Ltd (Aerospace)  
Agricultural Industries Confederation  
Aluminium Federation Ltd  
Association of Wallcovering Manufacturers  
British Beer and Pub Association  
British Ceramic Confederation  
British Compressed Gases Association  
British Glass Manufacturers' Confederation  
British Plastics Federation  
British Poultry Council  
British Printing Industry Federation  
British Soft Drinks Association  
British Tyre Manufacturers' Association  
Cementitious Slag Makers Association  
Chemical Industries Association  
Confederation of British Metalforming  
Confederation of Paper Industries  
Dairy UK  
Food and Drink Federation  
Target 2010 Ltd (Foundries)  
Kaolin and Ball Clay Association  
Maltsters' Association of Great Britain  
Metal Packaging Manufacturers Association  
Mineral Products Association - Cement  
Mineral Wool Energy Savings Company Ltd  
National Microelectronics Institute  
National Farmers Union - Pigs, Poultry Meat, Poultry Eggs & Horticulture  
Non Ferrous Alliance  
Packaging and Industrial Films Association  
Spirits Energy Efficiency Company  
Food Storage and Distribution Federation  
Surface Engineering Association  
The Society of Motor Manufacturers and Traders Limited  
UK Renderers Association

### **Companies with CCAs**

SABIC UK Petrochemicals Ltd  
Goonvean Ltd  
British Lead Mills  
Cemex UK Operation Ltd  
INEOS Chlor Limited  
Vale Inco Europe Limited  
Tarmac Limited  
Rio Tinto Alcan  
Ibstock Brick Ltd

**Other**

Nat Source Europe Ltd

Scottish and Southern Energy

Environment Agency

Scottish Environment Protection Agency

FEC Services Ltd

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