

Climate Change Regulations 2012 and the Scheme Administration Charges: opportunity to comment

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Summary

1. This note accompanies the publication of the draft regulations, the Climate Change Regulations 2012, and the Government response to the consultation on simplifying the Climate Change Agreements (CCAs) Scheme. The Regulations appoint the Environment Agency as the Administrator of the scheme, and give it powers for this purpose. The Regulations also set out what a scheme participant will have to pay if they have underachieved against their target (Buy-out mechanism) and includes details of the proposed new penalty regime for non-compliance under the scheme.
2. The September 2011 consultation proposed the introduction of a Buy-out mechanism as a risk management option for CCA Target Units. Under the present scheme, CCA Target Units can purchase and retire carbon allowances through the UK Emissions Trading Scheme (UK ETS) to offset any failure to meet their targets. UK ETS will be closed in Spring 2012 and the Buy-out mechanism has been proposed as a replacement risk management tool. The proposal received substantial support in the previous consultation and further detail on the mechanism can be found in Section 2.
3. The introduction of a new penalty system was also proposed in the September 2011 consultation as a proportionate and fair way to address circumstances where the terms of the voluntary agreements had not been abided by, but where termination of the agreement and subsequent loss of CCL discount was deemed too harsh a response. The proposals are set out in detail here.
4. In addition we present proposals for the charging scheme which will be implemented by the EA for the new scheme, on a cost recovery basis.
5. Any comments on the Regulations or the proposed charges outlined here, should be directed to the CCA Team at ccaconsultation@decc.gsi.gov.uk by **16 March 2012**. DECC will also invite stakeholders to a meeting to discuss these matters on 20 February 2012.

1 Regulations

6. The Climate Change Regulations 2012 provide for the Environment Agency (EA) to act as the administrator for the new CCAs and ensures that they have powers to undertake management of sector level agreements (umbrella agreements) and Target Unit agreements (underlying agreements). The powers include:
 - a) Operation of an electronic registry which will be used for CCA administration and communication. Sector Associations and Target Units will have accounts which will hold information which is currently held in paper form by Government. Each participant will be able to access information relating to their agreement. The EA will be responsible for providing the IT system, opening and maintaining accounts and ensuring its security.
 - b) Entering into CCAs with sector associations and Target Units.
 - c) Publication of certificates listing facilities participating in CCAs. These lists will be posted on the EA website and will be updated following the issue of a variation certificate.
 - d) Establishing eligibility of companies seeking to enter into CCAs.
 - e) Completing reconciliation where Target Unit performance against targets is assessed and operating a Buy-out mechanism as a risk management measure.
 - f) Operating a penalty regime for minor infringements. This differs from the present scheme which provides only for decertification or termination of agreements which can be heavy handed for minor infringements
 - g) Power to terminate agreements for failure or repeated failure to comply with obligations under CCAs. For example a Target Unit failing completely to comply with obligations (other than failure to meet targets) at reconciliation will have its agreement terminated.
7. The Secretary of State will
 - a) Negotiate Targets at the beginning of the new scheme; and
 - b) Conduct a target review in 2016
8. The First Tier Tribunal will hear appeals against penalties as well as terminations.
9. The draft regulations accompany this consultation paper as a separate document. Government is seeking comments from interested parties into the proposed content of the regulations and administration of the new CCAs. A separate consultation on the provisions to be contained in the agreements will follow in the Spring.

2 The Buy-out Mechanism

2.1 Background

10. Under the present CCAs, participants have a risk management option open to them in the form of trading using the UK Emissions Trading Scheme (UK ETS). By purchasing additional allowances through trading, the Target Units are deemed to have passed their targets and they will remain within the scheme. Target Units that over-perform against their targets 'earn' allowances that they can ring-fence for their own use or trade with other UK ETS participants. The UK ETS is scheduled to close in 2012 and will not be available for the new agreements scheduled to commence in 2013.
11. A risk management option will be made available to Target Units under new CCAs, but this will take the form of a Buy-out mechanism. A fee calculated on underachievement against targets will be paid to the Environment Agency (EA) who will be the administrator for the new agreements. By the payment of the Buy-out fee, the Target Unit will be allowed to remain in the scheme.

2.2 The Mechanism

12. The Buy-out mechanism will be used at reconciliation, where performance against targets is assessed at the end of each target period. The Buy-out mechanism may also be used during the target period where errors have been identified, for example following an audit. (This is in addition to any applicable penalty.)
13. Regulation 12 of the *draft regulations "The Climate Change Agreements Regulations 2012"* ("the draft regulations") sets out what a scheme participant will have to do if they have failed to meet their target and wish to retain their Climate Change Levy discount.
14. Those participants failing to meet their targets will be notified by the EA following submission of reporting data. Notification of the amount of the Buy-out fee to be paid will be dispatched to the Target Unit. This will account for any banked overachievement (see below). There will be a 15 working day period, within which the Target Unit will need to pay the Buy-out fee in order to be recertified. Following payment, the EA will update the IT system and the Target Unit will be recertified for the next target period.
15. If the Target Unit fails to pay the necessary Buy-out fee within the 15 working day time frame they will be subject to decertification or termination of their agreement for failure to meet their target. EA will inform the Target Unit via a decertification or termination notice. Government considers that with the new system of the Buy-out there may be no need for both decertification and termination processes, and the scheme could be simplified by allowing for only termination. This is because the buy-out mechanism provides certainty that those Target Unit's who wish to comply will be able to retain the Levy discount. This is a significant change from the previous situation with UKETS, where the possibility existed (never in practice realised) that there would be insufficient allowances in UKETR for a target unit to adjust for its underachievement.

2.3 Use of Overachievement

16. There is the potential for a Target Unit to overachieve against their target. Therefore, if for example, a Target Unit met its target with 100 tonnes of carbon to spare, the surplus will be recorded in the EA IT system and will be used to offset any underperformance at a later date. The way overachievement is handled within a bubble (an agreement of multiple facilities) will be covered in guidance.

2.4 Calculation of the Buy-out fee

17. For the first two target periods, the Buy-out fee will be set at £12/ tonne applicable to the amount of carbon by which the Target Unit has missed its target.

18. For example, if a Target Unit fails to meet their target by 100 tonnes carbon then the fee would be $100 \times £12 = £1,200$. If the Target Unit has no banked overachievement, then it will have to meet the full payment of £1,200.

19. If, however, the Target Unit has previously banked overachievement then this will be used towards meeting the target. Using the example above, with 60 tonnes of banked overachievement, the fee payable would be $(100 - 60) \times £12 = £480$. In the same example, but where 150 tonnes of overachievement had been previously banked, no fee would be payable, and 50 tonnes overachievement would remain in the IT system.

2.5 Use of the Buy-out outside Reconciliation

20. The Buy-out mechanism may be used following corrections to base-line or reporting data. Such corrections can arise at any time during a target period, but usually following an audit.

21. The Buy-out mechanism will operate in the same way as during reconciliation but no banked overachievement will be used to offset the correction. In addition, there may be a penalty fine payable (see next section). This is necessary to avoid any gaming and to incentivise the correct reporting at reconciliation.

3 Penalties

3.1 Overview

22. The Introduction of a more nuanced penalty scheme was proposed in the September 2011 consultation, "Consultation on simplifying the Climate Change Agreements Scheme". The Government has decided to take forward the proposal on penalties as set out in the consultation.

23. This penalty system will provide a more proportionate and flexible response than is available in the current scheme. In the current scheme there are no intermediate measures of enforcement, only decertification or termination which result in complete loss of the Levy discount. Regulation 15 of the draft regulations sets out the infringements that will be subject to a penalty and how these will be calculated. These are also described below.

24. The level of the penalty has been designed in accordance with Macrory principles¹, and in particular to be fair, proportionate and an effective incentive to encourage compliance.

3.2 Category 1 Infringements

25. These are designed to cover minor infringements of the underlying agreement, which can be rectified and do not warrant termination if rectified. (Failure to rectify these matters may result still in termination as a second stage.) The list below sets out those infringements that will be covered under category 1 penalties.

- Failure to provide the target period information to the administrator using the Register by the last working day in April following the end of a target period;
- Failure to provide any other information to enable the administrator to determine that the account Target Unit is meeting its target or complying with the terms of its climate change agreement requested at any time by the administrator by the date specified in the request;
- In purported compliance with the requirement to provide any other information provides inaccurate information; or
- Failure to notify the administrator within 20 working days of any changes which would result in a variation of the underlying agreement.

26. In each of the cases the EA will issue a notice setting out the deadline for remedy (if appropriate) and payment of the penalty. If by the time the deadline is reached the EA is not satisfied that sufficient progress has been made in remedying the matter it may terminate the Agreement. It remains the case that failure to comply with the terms of the Agreement may lead to termination.

27. The level of penalty to be applied under one of the above infringements is the greater of £500 or based upon 10% of the approximate value of the CCL discount. All penalties will be applied at the TU level.

28. The value of the CCL discount is taken as a scaling factor, recognising that CCAs cover a huge range of different scaled organisations, whose benefits from the scheme vary by several orders of magnitude. The monetary benefit to participants of underpaid CCL ranges from hundreds to millions of pounds. We have chosen the value of the CCL discount received by the participant as the basis for setting penalties, rather than emissions incurred by the participant and reported in CCAs, as the latter may not be a good proxy for the value of the agreement to the participant for a number of reasons. These are:

- Participants may receive CCL discount on the consumption of fuel that will not be reported in CCAs in the new scheme;

¹ (Macrory (2006) 'Regulatory Justice: Making Sanctions Effective')

- Not all fuel types consumed and, therefore, generating CO₂ reported by participants attract the CCL. For these fuels there is, therefore, no CCL discount;
- The CCL payable (and therefore levy discount that can be claimed) per unit of CO₂ emitted varies across the different fuel types attracting the CCL.

29. However, the exact level of the CCL discount for each Target Unit is a matter for HMRC, and the Administrator will not have access to this data. Therefore, we propose that an approximation to the value of the participant's CCL discount will be used as the basis for the penalty value which will be recorded in the Agreement. This penalty value will remain fixed for the duration of the Agreement.

30. The calculation of the approximate value of the CCL discount will be based on the total fuel by fuel type reported by the TU in the base year. This will include all fuels on site which are eligible for the CCL (including those covered by EU ETS). The fuels which attract the Climate Change CCL will then be multiplied by the CCL rate for each fuel as published by HMRC in 2013 and then by the applicable CCL discount factor applying to each fuel, again in 2013. When this is done for all fuels consumed by the TU in the Base Year, which attract the CCL, and summed, the result is the approximate value of the agreement to the TU. Each of these fuels are then summed together and multiplied by 10%, this will then give the penalty to be applied to the TU.

31. The calculation is laid out below.

Assumed value of agreement to TU * [(Electricity * Electricity CCL Rate * Electricity Discount factor²) + (Fuel₁ attracting CCL * CCL Rate₁ * Fuel₁ Discount Factor) + (Fuel₂ attracting CCL * Rate₂ CCL * Fuel₂ Discount Factor) + ... (Fuel_n attracting CCL * Rate_n CCL + Fuel_n Discount Factor]

Where Electricity Discount Factor = 0.9 and,

Fuel Discount Factor_{1-n} = 0.65

32. For Category 1 infringements, the penalty value will therefore be the greater of £500 and

10% * Assumed value of agreement to TU

3.3 Category 2 Infringements

33. The second category of penalties is scalable in relation to the size of the infringement. It will be applied to participants who are found to have misreported data. This will include baseline data and target period data. This penalty will be applied at the TU level. The penalty will be the greater of £500 or £12 per tonne of CO₂ of the quantity of emissions that were inaccurately reported. This penalty is not exclusive to the misreporting of emissions and will apply to cases where there are found to be errors in the data used to calculate targets. In the latter case, the correct data will be used to recalculate the target and the position of the TU against this

² This is the currently 65% but will increase to 90% in April 2013.

recalculated target reassessed. If the TU is found to underperform against the recalculated target, then the underperformance will be converted to CO₂ and a penalty of £12 per tonne of CO₂ will be applied.

34. Payment of this penalty will be in addition to any need to use the buy-out mechanism to meet targets. This is needed to maintain an incentive to report correctly at reconciliation.

4 Fees and Charges

4.1 Overview

35. The Government will hand over the administration of CCAs to the Environment Agency (“EA”), and will transfer the costs of administering the agreements from the taxpayer to the participants. The costs of scheme administration will be recovered via a charging scheme implemented by the EA. The Government will provide (via primary legislation) the administrator with powers to make and review such a scheme following approval by the Secretary of State. A single set of charges will apply throughout the UK.

36. The general principles underlying any charges are that they must be fair and reflect the actual cost of the work, they must be calculated consistently and they must be easy for charge payers to understand. The EA, in addition, must adhere to the following principles:

- Income from charging schemes can be spent only on the individual functions that they relate to.
- Charges should recover only the costs that the Secretary of State considers appropriate.
- Charges should fairly reflect the cost of administration.
- Any over-spend or under-spend from a charging scheme must be taken into account when annual charges are set for the next financial year.

4.2 Calculation of administrative costs and proposed charges

37. Administration of CCAs will be light touch. A new web-based IT system is to be developed that will allow participants themselves to register, amend details and undertake other actions. The proposed charges detailed below reflect this change.

38. The EA have modelled the estimated costs over the first target period and, based on the current number of participants, have derived the proposed charges shown in Table 1. Costs were calculated by taking into account those currently incurred by DECC, existing technical consultancy costs, estimates of operational costs to maintain the IT system and the EA’s internal costs of taking payments and providing support. The EA anticipate costs between £1.2m and £1.6m per annum and that proposed charges are calculated at the higher end of this range until roles and responsibilities are finalised.

39. Included in this estimate are office and energy costs and support services necessary for front-line operational work (such as finance, procurement and legal). It also includes all the financing costs (such as Rate of Return and depreciation) which the EA are required by HMT to recover. These represent approximately 28% and 5%, respectively, of the total cost.

40. Government has scrutinised these costs and worked with the EA to determine the types of charge needed to recover costs for administering CCA as fairly as possible. Two options for charge types are proposed:

- **Option 1** Simple flat-based annual subsistence charges for both Sector Associations and Target Units. These would cover all costs associated with holding an agreement, including where a variation to an agreement is undertaken.
- **Option 2** Simple flat rate annual charges for Sector Associations and Target units with a separate charge for variations.

41. **Views are specifically invited on the relative merits of these two proposals.** The advantage of the first option is that it keeps the charging scheme extremely simple and reduces the cost to charge payers. It saves administration cost for the EA in eliminating fee handling for variations. In the event that a company wishes to make a variation they will also be spared having to make a separate financial transaction. In effect, the total cost of administering variations is shared evenly across all participants. The advantage of the second option is that it is a fairer way of recovering costs as some sectors make more changes to their agreements than others.

42. The annual subsistence charge would be payable in full during any financial year in which an agreement is held, with no pro-rata calculation if an agreement is terminated, suspended or de-certified part way through a particular year. The justification for this is that the amount of subsistence work involved is largely unaffected by a Target Unit joining or leaving the scheme part way through a year. This will keep the scheme simple, reduce billing administration, and keep operational costs down. A flat rate charge is proposed as current experience suggests that administrative effort is unrelated to the scale of emissions.

43. The table below sets out details of the types of charge, amount payable and work covered by the charge.

Charge Type	Charge Amount	Payment Type	Work covered by charge
Option 1			
Sector Association subsistence charge	£1000	Annual flat rate charge	Register account opening and helpdesk Compliance audits (approximate audit rate of 10% per year averaged out over the 2013 to 2023 period) IT system maintenance, hosting and security costs (some third party)

			<p>Provision of guidance and industry communications</p> <p>Reporting to DECC and HMRC</p> <p>Taking payments and enquiries</p>
Target Unit subsistence charge	£370	Annual flat rate charge	<p>Register account opening and helpdesk</p> <p>Compliance audits (approximate audit rate of 10% per year averaged out over the 2013 to 2023 period)</p> <p>Compliance and monitoring work and reconciling targets</p> <p>Processing variations</p> <p>Processing suspensions, terminations and de-certifications</p> <p>IT system maintenance, hosting and security costs (some third party)</p> <p>Provision of guidance and industry communications</p> <p>Reporting to DECC and HMRC</p> <p>Taking payments and enquiries</p>
Option 2			
Sector Association subsistence charge	£1000	Annual flat rate charge	As Sector Association charge above
Target Unit subsistence charge	£350	Annual flat rate charge	As Target Unit charge above but without 'Processing variations'
Variation charge	£75	One-off charge on making a change to an agreement other than a change in contact details	<p>Liaison between DECC, Target Unit and relevant Sector Association in amending agreement for re-issue</p> <p>Taking payments and enquiries</p>

44. The above charges are not significant when compared to the cost of industry compliance with CCAs, or the financial benefit gained by the discount in the CCL (average £60k per Target Unit). The proposed charges also compare favourably to the EA's other more complicated and mandatory carbon emission-related regulatory regimes. Annual subsistence charges for EU

ETS permit Target Units are between £2,550 and £4,080, and similar charges for CRC participants are £1,290 per year.

4.3 Future charges and efficiency in administration

45. The EA have a statutory duty to review income and expenditure each year to ensure that it recovers fully the cost of administration. HMT must be satisfied that no over- or under-recovery occurs, and where it does, that charge levels are adjusted accordingly. Any change to the type of charges, or charge levels proposed in the future will be subject to a full public consultation in accordance with Cabinet Office guidance, and approved by the Secretary of State. EA accounts are audited annually by the National Audit Office.
46. The EA are committed to achieving a number of medium term efficiency savings following an initial need to build-up expertise on CCAs. It is likely that with a new IT system there will be a period of adjustment in the first target period, as well as an initial rise in enquiries from industry as it adapts to the new structure of agreements, eligibility rules and Buy-out mechanism. It is hoped that charge levels can be maintained at this proposed level throughout the first target review period and that inflationary pressures can be absorbed as the level of assistance needed by industry (and particularly new sectors and Target Units) subsides. The actual charges and costs incurred however will be reviewed on an annual basis by DECC and HMT.

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