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Your ref: Aggregates Mkt

10 April 2012

Dear David

**MARKET INVESTIGATION INTO THE SUPPLY OR ACQUISITION OF AGGREGATES,  
CEMENT AND READY-MIX CONCRETE**

Thank you for your letter of 19 March, inviting DECC to provide information relevant to your investigation on this issue. I have identified three policy areas for which I am responsible, and which have the potential to be of interest to you; these are the EU Emissions Trading Scheme, the CRC Energy Efficiency Scheme, and Climate Change Agreements. I am not aware of any other areas of DECC policy which might have an impact on your enquiry.

**EU Emissions Trading System**

The EU Emissions Trading System (EU ETS) is one of the key policies introduced by the European Union to help meet the EU's greenhouse gas emissions reduction target of 8% below 1990 levels under the Kyoto Protocol. It sets a cap on all the emissions from the sectors covered by the EU ETS and enables participants to mitigate emissions and/or trade allowances to cover their emissions. All operators in the EU ETS must monitor and report their emissions. At the end of each year they are required to surrender allowances to account for their actual emissions.

The EU ETS currently covers heavy emitting industries, such as electricity generation, iron and steel, mineral processing industries (including cement manufacture), and pulp and paper processing industries. Phase III (which runs from 2013-2020) will see the replacement of individual Member State caps with the introduction of a centralised, EU-wide cap on emissions, which will decline annually, delivering an overall reduction of 21% below 2005 verified emissions levels by 2020. It also includes provisions for the introduction of new sectors and gases, and harmonised rules on free allocation of allowances with a move toward greater auctioning of allowances.

*Sector coverage*

The activity of the cement sector included in the EU ETS is defined in the Annex I of the EU ETS Directive as *"production of cement clinker in rotary kilns with a production capacity exceeding 500 tonnes per day or lime in rotary kilns with a production capacity exceeding 50 tonnes per day or in other furnaces with a production capacity exceeding 50 tonnes per day"*

### *Free allocation*

In the current phase (2008-12) all operators receive a free allocation of allowances. They may surrender all or part of their free allocation to cover their emissions, and have the flexibility to buy additional allowances if needed or to sell any surplus allowances generated from reducing their emissions below their allocation. Allocation is based on objective and transparent criteria set out in predetermined national allocation plans (NAP)<sup>1</sup> approved by the European Commission.

For Phase III from January 2013, installations will be distributed allowances for free according to harmonised EU rules and product benchmarks that have been set on the basis of the average of the top 10% most greenhouse gas efficient installations in each EU ETS sector in the EU. Sectors deemed at significant risk of relocating production outside of the EU due to the carbon price (i.e. carbon leakage) will receive 100% of the benchmarked allocation for free. (Sectors not deemed at risk will receive 80% of their allocation for free in 2013, declining to 30% in 2020 and 0% (i.e. full auctioning) in 2027.)

Exposure to carbon leakage is determined on the basis of whether the sector meets criteria in the amended ETS Directive. During negotiations of these criteria and associated thresholds, some sectors (such as the cement and lime sectors) put forward an argument to support their case for being deemed at risk of carbon leakage due to very high carbon related cost increases. It was considered that, for these sectors, cost increase as a proportion of GVA was sufficiently high to rapidly alter the sectors' trade intensity and so put them at risk of carbon leakage. A standalone criterion of greater than 30% of GVA was therefore included in the revised EU ETS Directive.

As Table 1 shows, to date the level of free allocation to the cement sector as a whole has exceeded their emissions, meaning that the sector has had a significant surplus of allowances.

**Table 1: Allocations and verified emissions for the UK's cement clinker or lime sector, 2008-2011<sup>2</sup>**

<i>All figures in MtCO<sub>2e</sub></i>	2008	2009	2010	2011
Allocation	14.28	14.31	13.12	13.12
Verified emissions	11.35	8.04	8.33	8.73

Source: European Commission verified emissions data available at [http://ec.europa.eu/clima/policies/ets/registries/documentation\\_en.htm](http://ec.europa.eu/clima/policies/ets/registries/documentation_en.htm)

### *New Entrants*

A proportion of the allowances available for free allocation (5%) are set aside for Phase III in the New Entrant Reserve (NER). This is kept aside for new installations which begin operation in Phase III (technically, 'started normal operation' after 30 June 2011). The Commission will administer the reserve and applications to the NER, though 'Competent Authorities' (i.e. Environment Agency and the devolved equivalents) will act as the point of contact for operators. The free allocation rules and carbon leakage status of the sector will both apply to determining the amount of free allocation available to new entrants.

### *Small emitters*

Article 27 of the ETS Directive contains provisions for Member States to choose to opt small emitters (with annual GHG emissions less than 25,000tCO<sub>2</sub> and, where the installation undertakes combustion activities, thermal input below 35MW) out of the EU ETS in Phase III. The UK is seeking to take advantage of this option in order to reduce the burden of the EU ETS on eligible installations, consistent with the Government's broader agenda on better regulation.

<sup>1</sup> The allocation methodology rules used by the UK in Phase II are set out in Appendix C of the UK's NAP: [http://www.decc.gov.uk/assets/decc/what%20we%20do/global%20climate%20change%20and%20energy/tackling%20climate%20change/emissions%20trading/eu\\_ets/euets\\_phase\\_2/phase\\_2\\_nap/nap-appendix-c-allocationmethodologyrules.pdf](http://www.decc.gov.uk/assets/decc/what%20we%20do/global%20climate%20change%20and%20energy/tackling%20climate%20change/emissions%20trading/eu_ets/euets_phase_2/phase_2_nap/nap-appendix-c-allocationmethodologyrules.pdf)

<sup>2</sup> Disaggregated installation level data can be found in the Annex.

We have therefore submitted to the European Commission policy proposals for an *Opt-Out Agreements Scheme*<sup>3</sup>. In line with the requirements of the revised ETS Directive, this aims to deliver greenhouse gas emissions savings equivalent to the ETS but through a simpler scheme with less burdensome administrative requirements compared to the EU ETS.

To be eligible for the opt-out an installation must be classified as an incumbent to Phase III<sup>4</sup>. Our estimates suggest that around 50 installations in the aggregates industry will be eligible for the Phase III opt-out with around 20 incumbent installations not eligible. None of the EU ETS installations that manufacture of cement clinker are eligible to opt out. Once the Commission has approved the UK's opt out list (expected in the coming weeks) there will be no scope to add installations to this list; the EU ETS Directive does not allow for new entrants to access the scheme.

### **CRC Energy Efficiency Scheme**

The CRC Energy Efficiency Scheme is a mandatory emissions trading scheme for large organisations, whose qualifying electricity consumption in the qualifying year exceeds 6000MWh. There are three key elements to the scheme, which all take place annually:

- The requirement for each participating organisation to report accurately to the Environment Agency on energy consumption, which is then converted into emissions.
- The requirement to purchase allowances to cover their emissions. The allowance price for this year will be £12 per tonne of CO<sub>2</sub>.
- Finally, all participants have their performance published in a league table ranking them according to their energy efficiency performance.

CRC participants therefore incur two types of costs through participating in the scheme – administrative costs (e.g. through reporting) and allowance purchase costs.

Under current CRC rules, in order to try and avoid overlaps between the CRC and Climate Change Agreements, there is a rule exempting organisations which have Climate Change Agreements (CCAs) from various parts of the CRC. These “CCA exemption” rules allow either an entire CRC participant, or part of a CRC participant, to be exempt from some of the administrative costs, and also crucially from the allowance purchase elements of the CRC. In simplified terms, this “CCA exemption” is granted to an organisation if over 25% of its emissions are covered by a Climate Change Agreement.

This can lead to differential impacts within a sector (e.g. the aggregates sector). It is our understanding that some organisations within the aggregates sector do have operations covered by a CCA, and therefore also have a CCA exemption that applies to them. And others do not have operations that are covered by a CCA, and therefore they have to comply in full with the requirements of the CRC.

We are currently in the process of undertaking an ambitious simplification of the CRC scheme. Our recently published consultation can be found at [http://www.decc.gov.uk/en/content/cms/emissions/crc\\_efficiency/crc\\_efficiency.aspx](http://www.decc.gov.uk/en/content/cms/emissions/crc_efficiency/crc_efficiency.aspx). In this consultation (paras 80-93), we have proposed that the current CCA exemption rules should be changed. We propose to do this through removing CCA facilities from the CRC entirely, and also removing the organisation-wide CCA exemption rule. This should both reduce administrative burdens, and reduce any potential differential impacts within a sector.

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<sup>3</sup> <http://www.decc.gov.uk/assets/decc/11/cutting-emissions/eu-ets/3895-the-uks-policy-proposal-for-a-small-emitter-and-h.pdf>

<sup>4</sup> An incumbent is an installation that either i) obtained a greenhouse gas emission permit before 30th of July 2011, or ii) was in fact operating on/before that date and had obtained all other relevant environmental permits.

## **Climate Change Agreements (CCAs)**

CCAs provide a reduction in the amount of Climate Change Levy (an energy tax) that is paid by those eligible for an Agreement, and who meet the energy efficiency improvements set out in the Agreement. Industries in certain energy intensive sectors are eligible for CCAs, as set out at <http://www.decc.gov.uk/en/content/cms/emissions/ccas/eligibility/eligibility.aspx>. This includes cement production, slag grinding, lime and potash. All operators who carry out eligible processes may join an Agreement, regardless of their size or corporate structure. There is a link to CRC exemptions which is noted above.

I hope this information is helpful. All the contents of this letter are already public. If you would like further detail on any points, or to discuss the issues raised, please let me know.

Yours sincerely

Niall Mackenzie

## ANNEX

**Table 2: Allocations and verified emissions for UK installations in the cement clinker or lime sector, 2008-2011**

All figures in tCO <sub>2</sub> e	2008		2009		2010		2011	
	Allocation	Verified emissions	Allocation	Verified emissions	Allocation	Verified emissions	Allocation	Verified emissions
Barrington Works	288,626	260,645	288,626	-	288,626	-	288,626	-
Batts Combe Lime Kiln	159,587	127,056	159,587	11,644	159,587	20,096	159,587	23,602
Corus, Shapfell Works	498,370	328,736	498,370	242,904	498,370	264,247	498,370	257,718
Hindlow Lime	218,046	194,389	218,046	151,341	218,046	167,116	218,046	136,474
Ketton Works	1,030,991	869,666	1,030,991	657,215	1,030,991	673,125	1,030,991	699,113
Lafarge Cement - Northfleet Works	1,187,203	315,638	1,187,203	-	-	*	-	*
Lafarge Cement UK PLC	713,911	630,241	713,911	433,499	713,911	428,066	713,911	499,231
Lafarge Cement UK PLC	722,179	616,346	722,179	549,218	722,179	609,849	722,179	632,364
Lafarge Cement UK PLC	687,736	561,197	687,736	44,942	687,736	-	687,736	-
Lafarge Cement UK PLC	362,287	288,793	362,287	248,889	362,287	285,115	362,287	323,933
Lafarge Cement UK PLC	353,925	328,728	353,925	211,787	353,925	210,005	353,925	201,087
Lafarge Cement UK PLC	1,052,774	943,215	1,052,774	864,764	1,052,774	913,035	1,052,774	994,770
Lhoist UK Limited	179,367	143,992	179,367	121,279	179,367	146,888	179,367	163,950
Medway	-	-	-	-	-	*	-	*

All figures in tCO <sub>2</sub> e	2008		2009		2010		2011	
	Allocation	Verified emissions	Allocation	Verified emissions	Allocation	Verified emissions	Allocation	Verified emissions
Melton Ross Limeworks	346,540	265,436	346,540	208,166	346,540	211,429	346,540	257,788
Padeswood Works	763,572	496,397	763,572	279,437	763,572	160,542	763,572	218,448
Quinn Cement Works	438,565	269,279	438,565	26,483	438,565	13,064	438,565	5,965
Ribblesdale Works	1,152,676	520,145	1,152,676	360,836	1,152,676	497,858	1,152,676	509,495
Rugby Works	935,418	1,146,539	935,418	1,097,291	935,418	1,079,429	935,418	1,118,419
Specialty Minerals Lifford	23,033	13,214	23,033	13,013	23,033	14,053	23,033	15,183
Shoreham Power Station	584,530	1,044,619	584,530	960,770	584,530	956,535	584,530	984,985
South Ferriby Works	553,859	470,528	553,859	328,375	553,859	295,129	553,859	277,293
Thrislington Works Lime Kiln Plant	380,885	255,545	380,885	221,516	380,885	241,966	380,885	245,581
Tunstead Cement	749,644	541,655	780,553	544,747	780,553	589,153	780,553	607,188
Tunstead Lime	425,950	326,848	425,950	220,353	425,950	210,244	425,950	225,338
Whitwell Works	471,092	395,249	471,092	241,833	471,092	347,941	471,092	336,105

Key: \* = No allocation has been made / No Emissions have been verified; - = Zero (0) units have been allocated and/or verified

Source: European Commission verified emissions data available at [http://ec.europa.eu/clima/policies/ets/registries/documentation\\_en.htm](http://ec.europa.eu/clima/policies/ets/registries/documentation_en.htm)