Department for Business, Energy & Industrial Strategy

GOVERNMENT RESPONSE

to the Discussion Paper on the Climate Change Agreements Target Review 2016 and Buy-out Price Review

9 December 2016

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This publication is available for download at www.gov.uk/government/publications.

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Executive Summary

I. This document is the Government Response to the “Discussion Paper on the Target Review 2016 and Buy-out Price Review”. The Discussion Paper was published on 5 August 2016 and was open for responses until 23 September 2016.

II. The buy-out price was set in 2012 at £12 per tonne of carbon dioxide equivalent (£12/tCO_2e) and has remained at that price since. It was set at this level to strike a balance between having a strong incentive to abate and the financial impact on participants. In return for meeting targets we estimated participants would save in total around £300 million on their Climate Change Levy (CCL) costs each year, with the scheme running until March 2023.

III. The Discussion Paper set out three options for the buy-out price for the remaining Target Periods of the scheme Target Period 3 (TP3, 1 January 2017 - 31 December 2018 and Target Period 4 (TP4, 1 January 2019-31 December 2020) and sought views and evidence to inform the Government’s decision.

IV. The Discussion Paper received 40 responses. The vast majority of respondents were Climate Change Agreement (CCA) participants and favoured retaining the current £12/tCO_2e buy-out price. Many of the respondents raised arguments around the difficulties resulting from an increase in the cost of paying buy-out fees in the current economic climate.

V. We have carefully considered the responses and decided that the buy-out price should be increased broadly in line with the Retail Price Index (RPI) to £14/tCO_2e for TP3 and TP4 to restore its value in real terms and to strike an appropriate balance between a strong incentive to abate emissions and the financial impact on participants. A statutory instrument has been laid to provide for the new £14/tCO_2e buy-out price for TP3 and TP4.

VI. The Environment Agency will provide written notice to all participants by e-mail that their Climate Change Agreements are varied so that for failures to meet a target for TP3 or TP4, the buy-out price will be calculated on the basis of £14/tCO_2e for each tonne by which a target is missed. The Environment Agency will update the CCA Operations Manual to reflect this change.

VII. A number of participants made requests for changes to the scheme rules. We have considered these points and confirm that the Government does not intend to make further changes to scheme rules (with the exception of those relating to buy-out) at this time.

VIII. The Department now announces that, in line with the decision for other sectors, the sawmilling and data centres sectors will not be taken forward for detailed review.

Introduction

1. CCAs are voluntary agreements made between UK industry and Government to reduce energy use and carbon dioxide emissions. In return, the participants receive a discount on the Climate Change Levy (CCL) added to their electricity and fuel bills - currently a 90% reduction on electricity and 65% on gas and other taxable commodities. The scheme supports Government's objectives to deliver affordable and secure energy and decarbonisation while also helping the productivity and growth agendas.

2. The Government has previously estimated that participants would save in total around £300 million on their CCL costs each year[1], with the CCA scheme running until March 2023. We estimate that if scheme participants meet their targets for 2013-2020, this would reduce emissions of carbon dioxide by 22 megatonnes of carbon dioxide equivalent ($MtCO_2e$)[2].

3. Participants can remain compliant with the CCA scheme and retain their entitlement to the reduced rates of CCL by meeting their energy efficiency or carbon reduction targets or by paying a fee termed "buy-out". This is payable on each tonne of carbon dioxide equivalent (tCO_2e) by which a participant falls short of meeting their target.

4. The price for buy-out was set in 2012 at £12/tCO_2e and has remained at that price since the start of the current CCA scheme. It was set at this level to strike a balance between having a strong incentive to abate (i.e. to introduce measures to meet energy or carbon saving targets) and the financial impact, including any competitiveness issues, on participants.

5. The background to publication of the Discussion Paper is set out below. The Government Response to the Consultation on Simplification, 2011, said that "the buy-out price will be reviewed at the Target Review scheduled for 2016". The Government Response to the CCA Target Review 2016: Discussion Paper and Call for Evidence confirmed that intention, and that we would consider in the 2016 review the extent of buy-out use in TP1 (2013-14). In TP1, 49% of Target Units[3] did not meet their targets and needed to pay buy- out to retain access to CCL discounts. The Government's Response to the Business Energy Efficiency Tax Landscape Review

[1] https://www.gov.uk/government/news/industry-agree-stretching-energy-efficiency-targets-with-government
[2] https://www.gov.uk/government/publications/climate-change-agreements-cca-scheme-updated-estimates
[3] If a participant has more than one eligible facility in the same sector it could hold individual CCAs for each facility, or choose to group them together under one CCA. The target could then be shared across the grouped facilities. Once a facility, or group of facilities, holds a CCA, it is referred to as a Target Unit

also confirmed that the CCA Target Review would include the review of the buy-out price for TPs 3 and 4 (2017-18 and 2019-20).

Buy-out Price Review: Discussion Paper

6. The Discussion Paper set out options for the buy-out price for the remaining Target Periods (TPs) of the scheme. For TP1 (2013-14) and TP2 (2015-16), the buy-out price is £12/tCO_2e, the level at which it was set in 2012. The Discussion Paper set out three options for the buy-out price for TP3 and TP4 (2017-18 and 2019-20):

   - Option 1 – Increase the buy-out price to £17/tCO_2e for TP3 and TP4;
   - Option 2 – Increase the buy-out price broadly in line with the Retail Price Index to £14/tCO_2e for TP3 and TP4;
   - Option 3 – Retain the present buy-out price of £12/tCO_2e for TP3 and TP4.

7. We sought views and evidence to inform our review of the buy-out price for TP3 and TP4. The Discussion Paper sought responses to two questions, to inform our consideration of the options:

   - Question 1 – Would a change to the buy-out price increase carbon savings under the CCA scheme by providing a sharper financial incentive to meet targets? Please provide evidence.
   - Question 2 – Which price option – Option 1, 2 or 3 – do you think would be most appropriate for the buy-out price? Please provide evidence.

8. The view was stated in the Discussion Paper that a higher price would likely provide a sharper financial incentive to meet targets; however it may impact business competitiveness.

9. It was noted that participants who meet their TP4 targets, or who pay buy-out in respect of any underperformance against their TP4 targets, will continue to benefit from CCA discounts until the present CCA scheme ends on 31 March 2023. Since CCL rates have increased annually since 2012 in line with the Retail Price Index (RPI), the CCA discount has increased annually in line with the Retail Price Index (RPI) and will continue to do so until 2018-19. In 2019-20 the CCA discount will increase further to reflect the above RPI increase in CCL rates. The CRC allowance price has also increased since 2012 and will continue to increase in line with RPI until the scheme ends in 2019[4].

[4] https://www.gov.uk/government/collections/crc-energy-efficiency-scheme; Government has announced its intention to increase the CRC allowance prices by RPI.

10. Option 2 was the Government's preferred option, an increase in the buy-out price from £12/tCO_2e, the level at which it was set in 2012, to £14/tCO_2e – a level that is broadly in line with RPI, ensuring that the cost of buy-out remains the same in real terms as when it was set in 2012. In respect of this option it was reiterated that the value of the CCL discount has increased since 2012 and will continue to increase by RPI, with an increase above RPI in 2019-20. We stated that it therefore seems reasonable that the value of the buy-out fee should also be increased for TP3 and TP4. Additionally, it was noted that an increase in line with RPI would also be consistent with the approach taken to increasing the CRC allowance price and a range of other taxes and Government schemes. The Discussion Paper asked for responses to questions to be supported by evidence.

Summary of Responses to the Discussion Paper

11. The Discussion Paper received 40 responses - 27 from sector associations[5], 3 from consultancies, 8 from CCA participants and 2 from individuals[6]. On the whole those who responded to the consultation were participants in the scheme. A list of those respondents is provided at Annex A.

12. In addition, a stakeholder event on the Discussion Paper was held on 7 September, attended by 18 sector associations and CCA participants. This provided an opportunity to stakeholders, including all CCA scheme participants who were invited, to ask questions on the Discussion Paper.

13. The responses to Questions 1 and 2 from the written responses to the Discussion Paper that were received are set out below:

Question 1 – Would a change to the buy-out price increase carbon savings under the CCA scheme by providing a sharper financial incentive to meet targets?

14. The vast majority of respondents favoured retaining the buy-out price at £12/tCO_2e for TP3 and TP4, arguing that any increase in the buy-out price from £12 would not lead to an increase in carbon savings.

15. Specific issues raised by respondents included[7]:

- changing the price would have little or no effect on energy-saving decisions, other than perhaps in marginal cases;
- CCA targets, rather than the buy-out price, provide a business focus on energy efficiency measures;
- the buy-out price was viewed more as a penalty;
- businesses found it hard to forecast their emissions because they were largely driven by varying customer demand which made it hard to calculate the cost-effectiveness of efficiency investments;
- the current buy-out price provides sufficient financial incentive to meet targets.

[5] Trade sector bodies co-ordinating scheme participation on behalf of their members.
[6] The responses did not seek to directly address the questions posed in the discussion paper and have not been included in subsequent analysis.
[7] Sometimes in response to Question 1, sometimes in response to Question 2.

Question 2 – Which price option – Option 1, 2 or 3 – do you think would be most appropriate for the buy-out price?

- Option 1 - Increase the buy-out price to £17/tCO_2e for TP3 and TP4

16. No respondents chose the option of increasing the buy-out price to £17/tCO_2e as the most appropriate option for the buy-out price for TP3 and TP4. Some warned of an adverse impact on business competitiveness of such an increase.

- Option 2 – Increase the buy-out price broadly in line with the RPI to £14/tCO_2e for TP3 and TP4 (Government's preferred option)

17. A very small number of respondents chose this option as the most appropriate option for the buy-out price for TP3 and TP4. This was on the basis that it was 'the fairest option', that the tax relief 'still far outweighs the cost of having to buy-out' and that this would be a reduction in its value in real terms for the remainder of the CCA scheme, which would 'reduce the financial pressure to meet targets'.

- Option 3 – Retain the present buy-out price of £12/tCO_2e for TP3 and TP4

18. The vast majority of respondents were in favour of retaining the current £12/tCO_2e buy-out price. Many of these respondents raised arguments around the difficulties resulting from an increase in the cost of paying buy-out in the current economic climate.

    Specific issues raised by respondents included[8]:

    - that any increase would merely increase the cost of compliance and would reduce their ability to compete in a global market;
    - adverse market conditions as a result of global competition and the financial crisis of 2008;
    - business concerns had been heightened as a result of the referendum on UK membership of the European Union;
    - an increase in the buy-out price would reduce the investment capital available to deliver further savings at this point in the policy;
    - there were no further cost-effective savings available to some businesses or sectors;

[8] Sometimes in response to Question 1, sometimes in response to Question 2.

- targets were not achievable due to the operation of a scheme rule (e.g. target type, currency or baseline, or due to changes such as changed customer demand);
- £12/tCO_2e was the buy-out price that was in the CCA Underlying Agreements and a decision to change the price comes too late to implement any new energy saving measure before TP3.

Government's Response

19. We have carefully considered the responses and decided that the buy-out price should be increased broadly in line with RPI to £14/tCO_2e for TP3 and TP4. This restores its value in real terms to what it was when set in 2012 and is a level which strikes an appropriate balance between a strong incentive to abate emissions and the financial impact on participants.

20. We have taken into account that participants who remain compliant with the Scheme will continue to benefit from CCA discounts until the present CCA scheme ends on 31 March 2023. We have also noted that CCL rates have increased since 2012, will continue to increase annually in line with the Retail Price Index (RPI) until 2018/19 and will increase above RPI in 2019/20 to reflect the announced closure of CRC. The value of the CCL discount available to CCA participants in TP3 and TP4 will therefore have increased significantly since 2012.

21. We have also taken into account that a significant number of respondents raised general concerns about adverse competitiveness impacts of any increase to the buy-out price and a vast majority favoured retaining the buy-out price at £12/tCO_2e. Though the increase to £14/tCO_2e would have an impact on the participants who use buy-out in TP3 and/or TP4, participants did not provide strong and compelling evidence of specific impacts on competitiveness of this real-terms adjustment that would justify remaining at £12/tCO_2e, given the increased value of the CCL discount.

22. We believe it is plausible that in future Target Periods (as was the case in TP1) that the majority of Target Units would pay no buy-out. For those paying buy-out, it is also plausible that these additional costs would generally be small in the context of the value of the discount and in the context of a participant's overall energy bill, though we acknowledge it could be large for a small number.

23. While some respondents told us that the buy-out price does not incentivise abatement, we have taken into account that a number of respondents agreed that the current buy-out price does incentivise abatement to some extent.

24. Some respondents who disputed the incentive effect were not clear about the criteria they apply to determine which measures are cost effective. It was not clear to us that respondents' identification of measures was aligned with the additional energy efficiency measures which the CCA scheme aims to incentivise in return for the significant CCL discount. This position was reinforced by some respondents who specifically mentioned seeking shorter payback periods – for example, through references to no more "low hanging fruit" measures that could be implemented or lack of any more "low cost saving opportunities" or "short term quick gain low investment" measures. This suggests that at least some participants may not be

considering implementation of energy efficiency measures which we would consider realistic for the scheme.[9]

25. We have also considered the evidence presented that respondents claim that they cannot meet their targets for technical reasons or because of a lack of measures. We consider that increasing the buy-out price to maintain its cost in real terms at 2012 levels merely maintains the strong incentive to abate at the level at which it was originally set in real terms.

26. We have taken into account the argument that an increased buy-out price would reduce investment capital for energy efficiency investments. However, Government believes that the available funding for investment decisions for TP3 and TP4 should not be impacted by the funds for any buy-out which would be payable over two years after the start of the Target Period. Investments to meet targets would need to have been made (and financed) well in advance of this time for each Target Period. Respondents have been aware of the targets they have agreed to meet for TP3 since 2012 and also of the Government's intention to review buy-out in 2016.

27. We have considered the arguments around whether this is the right time to review buy-out price. Government has been clear throughout the scheme that buy-out price would be reviewed in 2016 and the targets participants need to meet to avoid buy-out price have been known since 2012.

28. In all the circumstances, we consider that an increase to £14/tCO_2e for TP3 and TP4 to maintain the value of the buy-out price in real terms is the most appropriate option and will continue to strike the right balance between a strong incentive to abate and the financial impact on participants who do not meet their targets.

Additional points raised in responses to the Discussion Paper

29. A number of participants made requests for changes to the scheme rules – e.g. rules on target type (absolute/relative) and baseline year. They argued that these rules can influence whether or not they meet their targets.

30. We have considered these points. Changes to these rules, while they would benefit some participants, could disadvantage other participants – perhaps causing them to underperform against their targets. The principle of stability and predictability is an important feature of the CCA scheme which was clearly stated in the October 2014 Discussion Paper on CCA Target Review. The conclusion of the Business Energy Tax Landscape Review on CCAs - that the existing eligibility criteria for the CCA

[9] For example the six-year pay-back criterion that was used to guide setting of sector commitments in 2012.

scheme should be retained until at least 2023 – was also in line with the principle of stability and simplicity of the CCA scheme.

31. We confirm that the Government does not intend to make further changes to scheme rules (with the exception of those relating to buy-out) at this time.

Update on Target Review, including Datacentres and Sawmilling Sectors

32. The Discussion Paper announced the Department's decision not to take sectors forward for detailed target review. The Discussion Paper also indicated that separate arrangements would apply to sawmilling and data centres as new sectors to the CCA, joining in 2014. The Department now announces that, in line with the decision for other sectors, the sawmilling and data centres sectors will not be taken forward for detailed review.

Next Steps

33. A statutory instrument laid on 9 December 2016 provides for the new £14/tCO_2e buy-out price for TP3 and TP4.

34. The Environment Agency will provide written notice to all participants by e-mail that their Climate Change Agreements are varied so that for failures to meet a target for TP3 or TP4, the buy-out price will be calculated on the basis of £14/tCO_2e for each tonne by which a target is missed. The Environment Agency will update the CCA Operations Manual to reflect this change. This means that CCA operators must work on the basis of the buy-out price being £14 for each tonne of carbon dioxide equivalent by which a target is missed for targets for TP3 and TP4,

35. The Environment Agency will also issue revised Umbrella Agreements and Underlying Agreements in due course.

36. This does not affect the position that, for failures to meet a target for TP1 or TP2, the buy-out fee will be calculated on the basis of £12/tCO_2e for each tonne by which a target is missed.

Annex A: List of Respondents

The 40 respondents to the Discussion Paper are listed below:

Agricultural Industries Confederation

Anesco

British Calcium Carbonate Federation

British Ceramic Confederation

British Coatings Federation

British Compressed Gases Association

British Meat Processors Association

British Plastics Federation

British Poultry Council

British Tyre Manufacturers' Association

Chemical Industries Association

Cleveland Potash Limited

Confederation of Paper Industries

Confederation of Forest Industries

Craft Bakery Association (formerly National Association of Master Bakers)

Dairy UK

Dart Products Europe Ltd.

Eaton

EEF (the Manufacturers' Organisation)/ UK Steel

FABRA UK

Food and Drink Federation

Food Storage & Distribution Federation

Formica Limited

Grupo Antolin Leamington Ltd.

INEOS Chemicals Grangemouth Limited

Metal Packaging Manufacturers Association

Moy Park JBS

MPA – Mineral Products Association

PAFA

Private individuals (2)

Surface Engineering Association

Textile Services Association

The Society of Motor Manufacturers and Traders Ltd.

The Spirits Energy Efficiency Company

UK Leather Federation

Utilitywise PLC

British Non-woven Manufacturers Association

Wood Panel Industries Federation

WSeddel Swift Distribution Ltd

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