Summary: Intervention & Options		
Department /Agency: Department of Energy and Climate Change (DECC)	**Title:** Impact Assessment of Proposed Reforms to the Structure of Climate Change Agreements	
Stage: Consultation	**Version: Partial**	**Date: December 2009**
Related Publications: CCA Consultation Document		

Available to view or download at:
http://www.decc.gov.uk/en/content/cms/consultations/cca_scd_cons/cca_scd_cons.aspx

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What is the problem under consideration? Why is government intervention necessary?
Current Climate Change Agreements (CCAs) end on 31 March 2013. The Government announced in the Pre-Budget Report 2007 that, subject to state aid approval, the scheme will continue to 2017. The climate change policy landscape in the UK has changed markedly since CCAs were introduced with, for example, the creation of the EU ETS (2005), the Climate Change Act (2009), and from 2010 the Carbon Reduction Commitment Energy Efficiency Scheme(CRC). Consequently, and in the light of recommendations by the Environment Audit Committee (2008) and outcomes of the DECC Simplification Review,[1] the Government is seeking to simplify CCAs in order to reduce admin costs and enhance the performance of the new CCAs.

What are the policy objectives and the intended effects?
The policy objectives of the options and proposals for changes to CCAs are four fold: (i) simpify the structure of CCAs and thereby make them easier to implement, assess and understand; (ii) reduce, where possible, administration costs; (iii) increase the effectiveness of the agreements in cutting carbon emissions and (iv) make CCAs compatible with the wider climate change architecture. This IA does not assess the costs and benefits and the effectiveness of the CCA scheme per se or of the targets that might be set.

What policy options have been considered? Please justify any preferred option.
A number of proposals to change different elements of the CCA structure have been examined. These proposals have been grouped together in one scenario, scenario A, which is compared to the BAU scenario of no change to the current CCA structure. Scenario A is a narrowing down of options considered in the initial partial IA.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?
The Government will publish a final IA alongside the Government Response to the current consultation in 2010.

[1] Climate Change Instruments: Areas of Overlap and Options for Simplification

Ministerial Sign-off For consultation stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:

....Date: 08 January 2010

Summary: Analysis & Evidence

Policy Scenario: A	Description: Targets are set as under current Agreements, other proposed changes are set out in table 1 below

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	. The majority of costs identified fall on Government (85% or £0.21m) with the remainder falling on business. **The cost arises from firms having to submit performance data yearly instead of biennially.**
£ 0		
Average Annual Cost (excluding one-off)		
£ 0.07m		**Total Cost** (PV) **£ 0.25m**

Other **key non-monetised costs** by 'main affected groups' Business- Marginal one-off costs associated with amending data collection procedures and related IT

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Benefits identified and measured fall to either business or Government with the majority going to business (86% or £0.83m). The main benefits are from aligning the reporting period with EU ETS and splitting the target from participants' EU ETS commitments.
£ 0		
Average Annual Benefit (excluding one-off)		
£ 0.27m		**Total Benefit** (PV) £ 0.97m

Other **key non-monetised benefits** by 'main affected groups' Consistency with wider climate change policy landscape; greater focus by target units on meeting targets; greater flexibility for business that fail to meet targets due to oversight

Key Assumptions/Sensitivities/Risks

Central cost and benefit estimates are flexed +- 10%.

Price Base Year 2009	Time Period Years 4	**Net Benefit Range** (NPV) **£ +0.65 to 0.79m**	**NET BENEFIT** (NPV Best estimate) **£0.72m**

What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	April 2011
Which organisation(s) will enforce the policy?	DECC
What is the total annual cost of enforcement for these organisations?	£ N/A
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£ N/A
What is the value of changes in greenhouse gas emissions?	£ Not
Will the proposal have a significant impact on competition?	No

Annual cost (£-£) per organisation (excluding one-off)	Micro n/k	Small n/k	Medium n/k	Large n/k
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)						(Increase -		
Increase of	£	0.01	Decrease	£	0.2m	**Net Impact**	£	-0.2m

Key:	**Annual costs and benefits: Constant Prices**	**(Net) Present Value**

Summary

1. This impact assessment (IA) assesses the cost and benefits of the proposed changes to the form and content of CCAs. It does not assess the impact of CCA targets on carbon mitigation. The costs and benefits, as set out in the summary sheet above, are the economic resource costs that arise as a consequence of the proposed changes. Costs and benefits are based on best estimates obtained from industry and estimates of costs to government. These are predominately reductions or increases in administration costs. The analysis has not been able to separate out employment taxes (which are a transfer). However, this does not change the relative size of costs and benefits and therefore direction of results.

2. This IA assesses a narrower range of options than the partial IA that accompanied the original consultation document and makes firm proposals on all issues. Only one scenario is compared to the BAU, or counterfactual, of keeping the current CCA agreement structure.

3. The present value of benefits is estimated to be around £0.97m. There is a net benefit from the proposed changes of £0.72m. The majority of this benefit accrues to industry in the form of reduced procedural and admin costs whereas the majority of the additional costs are borne by government. Overall costs and benefits are relatively small.

The Case for Government Intervention

4. A market failure occurs when the free market fails to allocate resources in a way that optimises society's welfare. One example of market failure is climate change resulting from the emission of anthropogenic greenhouse gases (GHGs) into the atmosphere. This negative externality will not be resolved by the free market alone. Government intervention to correct for market failure is justified so long as the benefits of doing so are greater than costs. Government aims to mitigate GHGs in a cost-effective way.

5. The Stern Review on the 'Economics of Climate Change'[2] identified possible solutions to avoid dangerous climate change and concluded that the benefits of strong early action on climate change far out-weighed the economic costs of doing so. Stern outlined three main ways to tackle climate change: (1) carbon pricing through emission trading, taxation or regulation; (2) supporting the development of cleaner more productive technologies; (3) instigating behavioural change. Climate Change Agreements apply the third strand - promoting behavioural change in energy intensive industries in order to achieve cost-effective abatement within the UK.

[2] 'The Economics of Climate Change: The Stern Review' 2007

6. The aim of the proposed changes is to reduce administration costs on business and simplify CCAs

Background

7. In 2001 the Climate Change Levy (CCL) was introduced as a tax on the use of certain fuels in the non-domestic sector. The Government recognised the need for special consideration to be given to energy intensive industries, given their high energy usage and exposure to international competition. Consequently, the CCA scheme was also introduced in 2001, under which eligible energy intensive businesses receive an 80% discount from the CCL in return for meeting energy efficiency or emission reductions targets.

8. Eligibility to enter a CCA was initially confined to energy intensive industries operating a process listed in Part A of Schedule 1 to the Pollution Prevention and Control (England and Wales) Regulations 2000 (SI 2000/1973). In 2006 eligibility was extended to include other energy intensive industries that meet a specific energy threshold and, in certain circumstances, are exposed to international competition.

9. The CCA scheme currently comprises 54 sector associations and about 10,000 facilities, grouped into around 5,000 target units. Targets are negotiated between DECC[3] and sector associations and set at the sector level. Sector associations are responsible for distributing the target amongst the target units within their sectors. Sector associations also assist with CCA applications and manage agreements on behalf of target units.

10. Current estimates suggest that CCAs have been successful in delivering energy efficiency improvements, and hence emission reductions, within the energy intensive sector – by 2010 CCA sector is expected to generate around 11 MtCO_2 savings. These include direct emissions included in the EU ETS cap and indirect emissions (electricity) also included in the EU ETS cap[4]. In addition, in 2008 it is estimated that businesses with CCAs made savings on their energy bills totalling over £1,700m, when measured against baselines.

11. The final target period under the current scheme ends in 2010-11, with the CCL discount paid until 31 March 2013. In the 2007 Pre-Budget Report, the Government announced 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*".

Proposed changes to CCAs - summary

12. The aim of the proposed changes is to simplify the Agreements, to reduce the administrative burden on both industry and government, and to ensure coherence with other climate change policies, including carbon budgets.

13. A full public consultation took place from March to June 2009 to obtain views on proposals and options for change to the form and content of the Agreements for the new CCA scheme. This IA analyses the costs and benefits of proposals developed in the light of responses to the March consultation document.

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[3] Previously Defra

[4] 2008 data indicates that around 88% of emissions covered by CCAs are also covered by the EU ETS cap. Inter-Government Analysts Group (IAG) guidance sets out a clear methodology for accounting for carbon savings covered by the EU ETS. This states that the ETS cap is binding and that emission reductions in one area will be off-set by increases in another area, unless equal EUAs are retired.

14. The IA analyses how the proposed changes to CCAs, as set out in scenario A, impacts on the administration costs for both industry and government of meeting targets and sets out the potential impact on carbon mitigation. The IA does not assess the costs and benefits of achieving different levels of carbon mitigation. This will depend on target levels rather than changes to CCAs structure. The costs and benefits reflect estimations of administration cost savings and increases for government and industry.

15. All proposals are grouped together in one scenario whose costs and benefits are assessed against the BAU assumption, or counterfactual, of keeping Agreements as currently constituted. Where the proposal is to make no change, relative to current Agreements, there are no additional costs or benefits. Table 1 sets out the proposals under scenario A.

Table 1 Proposals under Scenario A

Scenario A
<u>Target Setting</u> • Targets are set as under the current scheme. • Targets set annually for 2012 to 2015. • Targets for 2014 and 2015 to be reviewed in 2012.
<u>Target Achievement</u> • All target units required to meet their targets either by direct action and/or by purchase of carbon allowances. UK ETS to close. • Risk management tools restricted to purchase of carbon allowances only. • Compliance through purchase of EUAs, or CERs, with target units allowed to bank overachievement for own use only • Provisions for *de minimis* and materiality to be introduced. • Continue to apply the Novem procedure for setting relative targets and measuring performance for relevant sectors and target units, but make application obligatory.
<u>Coverage</u> • Targets to be split where there is an overlap between CCAs and EU ETS, with eligibility for Levy reduction remaining unchanged.
<u>Simplification</u> • 90/10 rule threshold lowered to 70% , but 1/9th provision retained • Only one agreement type to be available, based on Option 2 under the current scheme. • The compliance year to be aligned with that for EU ETS and based on a calendar year for all sectors, with adjustments to the dates for the reconciliation process and eligibility for Levy reduction. • All sectors, whether meeting targets or not, including those with trading groups, required to provide the same data at reconciliation. • Scheme Rules to be established separate from the agreements, to facilitate their adjustment when necessary.

Analysis

16. The monetised costs and benefits of scenario A are given in the Summary Analysis and Evidence sheet above. This section sets out in detail the analysis of individual proposals and their impact on incentives and costs and benefits for government and business. Table 2 below sets out in summary the unrounded present value (PV) estimates for each change where monetary estimates have been possible.

Table 2 Summary results (£)[5]

PV Benefits	**£**
UK ETS closure	64,000
Split targets	471,000
Only one type of agreement	5,000
Common baseline	5,000
Scheme rules separate from Agreement	9,000
Compliance to be aligned with ETS	414,000
Total benefits	**969,000**
PV Costs	
Targets set annually	252,000
Total costs	**252,000**
NPV	**717,000**

Scenario A

Target Setting

<u>Sectors and Target Units free to choose either absolute or relative targets</u>

17. This is a continuation of the current practice. Relative targets are set as an amount of energy or emissions per unit of production. Absolute targets are set as a fixed amount of energy or emissions. One option considered was to move to absolute targets at both sector and target unit level. Following consideration of the expected benefits in terms of additional carbon savings, and taking into account the risks of carbon leakage to non-regulated economies and the difficulties of setting absolute targets as the UK emerges from recession, the Government has decided to keep the status quo option of a choice between absolute and relative targets. However, given the flexibility we have afforded industry on this decision we intend to negotiate targets which are especially challenging, but achievable.

18. The vast majority, around 94% of target units under the current scheme have relative targets. As a percentage of emissions 65% are covered by relative targets. Relative targets are set per unit of output. Thus, a relative carbon target may require a firm to improve its efficiency from 100kg CO2 per unit of output to 98kg CO2 per unit of output, for example. If the firm fails to meet this target then it will have to purchase additional allowances to make up any shortfall. On the other hand if the firm improves efficiency, to say 96kg CO2 per unit of output, then it will have over-achieved against its target and can bank this overachievement for later own use[6]. However, relative targets do not guarantee emission reductions and can result in increased total emissions from a CCA

[5] Total benefits may not be the sum of the constituent parts set out in Table 2 owing to rounding.

[6] A similar analysis applies if an energy target is set

sector when output increases, even when targets are met. This potential was main driver for considering absolute targets.

19. The rationale for CCAs is to incentivise cost-effective mitigation that would not be incentivised through carbon pricing alone. Setting a robust target is crucial to achieving this outcome. For a given target, other things being equal, if output were to expand more than anticipated we would expect absolute targets to provide a greater incentive to reduce emissions as the cost of expansion rises if firms need to purchase allowances to cover increased emissions. Such a scenario also implies increased costs of growth.

20. DECC committed in the Low Carbon Transition Plan (LCTP) to review the potential of CCAs to deliver at least 8MtCO_2 saving from non-traded sector emissions in carbon budget periods 2 and 3. This commitment did not make any assumption on whether targets were absolute or relative but assumed that the same level of saving could be incentivised under both types of target as the abatement was cost-effective, i.e. firms would save money by making these efficiency improvements. The commitment assumed that CCAs cover around 18MtCO_2 non-traded emissions per year. This assumption was subject to a large degree of uncertainty when it was made. It will be tested and updated in light of new analysis due to be completed before the start of the new CCA negotiations.

21. As set out above absolute targets increase the costs of expansion, when output expands more than industry expected when negotiating a target, and thus provide an additional incentive to cut emissions. However, *a priori* there is no reason to expect that absolute targets will result in greater savings.

22. Without detailed analysis of the cost structure and demand profile of firms it is not possible to accurately estimate the extent to which absolute targets will result in greater carbon savings when output expands more than anticipated.

23. Considering the previous performance of sectors which have chosen absolute as opposed to relative targets gives an indication of the possible impact of continuing to allow sectors a choice in the type of target they opt for.

24. The Steel sector, for instance, has an absolute target, but steel throughput (a measure of output) rose over the period of CCA coverage. However, the food and drink, paper and cement sectors, which all chose a relative target, all experienced a fall in throughput over the same period and their emissions fell 29%. This demonstrates that, even though there is an incentive for sectors which are experiencing a fall in output to choose absolute targets, they might still choose a relative target. Similarly, the stringency of a relative target might make absolute targets attractive to sectors that expect to expand their throughput. Therefore, there is little reason to assume that absolute targets would necessarily bring about greater emissions reductions than those from sufficiently tight relative targets.

25. Therefore the main driver of the costs and benefits is the level of ambition within the agreements, rather than the choice of absolute vs relative targets. The impacts of the policy in general will only be known when the target negotiations have completed. .

<u>Targets periods should be set annually (2012, 2013, 2014, and 2015)</u>

26. It is proposed that target periods should be set annually, rather than every two years as under the current scheme. During target periods the performance of target units is measured against targets in a process known as reconciliation. Reconciliation requires target units to prepare and submit data to sector associations, which collate and pass the information to DECC for checking. With around 5,000 target units, this is administratively burdensome. However, most sectors require target units to submit performance data

annually, and in some cases more often, to establish sector performance. Annual reporting would therefore not significantly add to the administrative burden on the majority of sector associations, but there would be an additional burden on DECC.

27. Benefits
    - Will encourage target units to continually focus on energy which could lead to reduced energy bills and potentially generate greater carbon savings.
    - Will be consistent with other climate change instruments (EU ETS and CRC have annual targets).
    - Potential to generate allowances each year from over-achievement, which can banked for future own use.
28. Costs:
    - The cost to DECC of administering reconciliation is around £127,000.
    - Unlikely to be significant additional costs for target units since most report annually to sectors.
    - There would be some additional costs to sectors in that they would formally have to report data to DECC more often. These are expected to around £22,000 for each additional reconciliation.

<u>Targets for 2014 and 2015 be reviewed in 2012</u>

29. There were two target reviews under the current scheme (2004 and 2008) which were held to ensure targets continued to represent the potential for cost effective energy efficiency improvements or carbon savings. Targets will be set for the new scheme in 2010. It is proposed that all sector targets for 2014 and 2015 be reviewed in 2012.

30. The reviews currently take account of 'any changes in technical or market circumstances'. The Government considers that all relevant information should be taken into account and, in particular, proposes to include two additional factors – the performance of sectors in previous target periods and, if appropriate, the status of the carbon market (but see proposal on compliance through purchase of EUAs or CERs).

31. Targets for new CCAs will be set in 2010. Target reviews can only be based on new additional information which, in 2012, would include performance in the 2010 target period. Carrying out the review at a later date would reduce the time available for business to implement measured to meet any revised target, which could increase costs. Minimising this potential impact needs to be balanced with the opportunity of setting potentially more robust targets.

32. There are no additional costs or benefits, relative to BAU, associated with this proposal since under BAU we assume that a review of targets also takes place. The benefit of having a review is that it ensures that targets fully reflect the potential for cost effective savings.

Target Achievement

<u>All target units required to meet their targets either by direct action or by purchase of carbon allowances</u>

33. It is proposed that, in order to qualify for the CCL discount, all target units must meet their targets, either through direct action or buying carbon allowances.

34. Under the current scheme, target units can qualify for the reduced CCL even if they fail to meet their targets. This is because where a sector meets its target, all target units within that sector are deemed to have met their target. The economic rationale for

changing to an all target-unit basis is that the value of the emissions savings will be at least as great, and probably greater, compared to the sectoral approach. This is because overachievement by some target units will not be allowed to offset underachievement by others within year, but can be banked for future compliance by the individual target unit.

35. The current approach was criticised by the Environmental Audit Committee on both economic grounds (value for money for the tax payer) and on equity grounds (variable treatment between target units).

36. In the 2008 target period around 224 target units would have failed to meet their targets if their sector had not passed and they would have had to purchase around 186,500 tonnes of carbon.

37. Benefits:
    - Greater value for money for the tax-payer as each target unit is required to meet its target.
    - Equity of treatment between target units and no free riding.
    - It would encourage greater focus by all target units on meeting targets, potentially leading to greater energy and emissions savings.

38. Costs:
    - Requiring all target units to meet their targets could result in potentially more market transactions. These additional transaction costs are expected to be negligible.

<u>Risk management tools should be restricted to purchase of carbon allowances only</u>

39. It is proposed that carbon trading be the only risk management tool.

40. There are legitimate reasons why a target unit may fail to meet its target, and the penalty can be severe - loss of CCL discount for 2 years. The current scheme provides three risk management tools as a means of meeting the target if direct efforts fail: fuel supply disruption; regulatory constraint; and carbon trading.

41. The fuel supply disruption provision allows for an increase in energy use to be disregarded where this is due to unexpected disruption to energy supply. The regulatory constraint provisions allow a target unit to be re-certified where actions imposed by regulators that were not known when the target was set prevented the target from being met. Both these provisions are rarely used. In the case of relevant constraint, this is possibly because of the costs involved in providing the necessary evidence, and the fact that carbon prices have been very low. Both these risk management tools have the effect of weakening targets, which is difficult to justify as given UK carbon budgets. Carbon trading has been the main risk management tool.

42. Benefits:
    - Will require all target units to focus on carbon reduction potential increasing the overall saving delivered by the scheme.
    - For government and business there will be reduced costs in not having to evaluate claims under the fuel supply or relevant constraints provisions.

43. Costs:
    - There are no additional costs to government
    - For target units there could be an increased need to buy carbon allowances. However, based on historical evidence this is likely to be minimal as other risk management tools have not been used.

UK ETS to be closed. Compliance to be achieved through purchase of EU ETS allowances (EUAs) or Certified Emission Reductions (CERs)

44. UK ETS is heavily over-supplied with allowances. To carry them forward to the new scheme would seriously undermine its environmental objectives. The Government therefore proposes to close UK ETS at the end of the current CCA scheme and cancel any remaining allowances. With the allowance price currently standing at around 50p it is anticipated that the value of allowances will fall further towards the end of the scheme and the vaste majority of allowances would not find a market. Cancellation of allowances is there likely to be at negligible cost to industry.
45. The Government has considered allowing CCA participants to trade in the CRC Energy Efficiency Scheme, but the risks of over-achievement in CCAs destabilising that market are considered too great. Establishing a new stand-alone scheme for CCAs would carry the same risks of over-supply of allowances as under the current UK ETS. Various options to control the generation and use of allowances in such a scheme were considered but all were found to be administratively difficult and burdensome to implement. The Government therefore proposes that CCA operators may achieve compliance through the cancellation of EUAs or CERs and that over-achievement may be banked for own use only during a later target period.
46. Benefits:
    - Removal of UK ETS reduces costs for Government. This is estimated to be around £20k p.a.
    - A higher allowance price will act as a stimulus to achieve targets through investment in energy efficiency measures.
47. Costs:
    - Where industry needs to buy allowances for compliance, these will be at a higher cost than under UK ETS

Provisions for de minimis and materiality should be introduced

48. The current penalty for failure to meet targets is loss of Levy reduction for 2 years, which can be extremely costly to businesses. There is no *force majeure* provision. This has been a successful incentive. In the 2006 target period, over 99% of facilities were re-certified.

49. Some failures to met targets are due to administrative oversight, where a small number of allowances have not been bought by the due date. It is therefore proposed to introduce a ***de minimis*** provision, under which operators that failed to meet targets by up to 1% of their target would be given an additional 10 working days to purchase the relevant number of allowances in the shortfall. In addition, it is proposed to introduce a **materiality** provision where failure to meet targets is greater than 1% but no more than 2%. In these circumstances, the operator would be required to purchase the total number of allowances in the shortfall within 10 working days of notification by DECC and, for that part of the failure to meet targets beyond 1%, make a payment equivalent to £40 for each allowance.

50. Benefits:
    - Greater flexibility for those businesses that fail to meet targets due to administrative oversight.
    - Both provisions would reduce the administrative burden on business and Government be removing the need for appeals against decertification.
51. Costs:
    - Provisions place no additional costs on business or Government.

Coverage

Targets should be split where there is an overlap between Climate Change Agreements and EU ETS, with eligibility for Levy reduction remaining unchanged

52. This proposal will simplify the procedure for dealing with emissions from targets units that are covered by both CCAs and EU ETS.

53. A number of target units are partially covered by CCAs and EU ETS. Within the area of overlap, over-achievement could result in a double benefit, while under-achievement could result in a penalty under both schemes. To avoid this, under the current scheme there is a double counting mechanism under which any EU ETS surplus is netted off from the CCA performance. This mechanism is complex and administratively burdensome, and industry has called for it to be replaced by splitting CCA targets, provided that this does not result in any change in eligibility for Levy reduction. In order to be re-certified for CCL discount the target unit would have to meet its EU ETS obligations AND meet its negotiated CCA target from energy use not directly covered by the EU ETS.

54. This proposal would establish two elements to the CCA: emissions covered by the EU ETS and a negotiated CCA target. The emissions covered by the EU ETS would be the direct and process emissions of the facility, including any emissions resulting from Combined Heat and Power plant covered by EU ETS, whether or not located on the same site or owned by a third party, that supplies the facility. The negotiated CCA target would not be associated with these emissions since they are included in the overall EU ETS cap. The negotiated CCA target would be made up of any indirect emissions, any direct or process emissions not covered by the EU ETS and emissions related to any Combined Heat and Power plant that supplies the facility that is not subject to EU ETS. The negotiated target would be determined by negotiation between sector associations and DECC, as now.

55. In 2008 around 59% of direct emissions covered by CCAs were also direct or process emissions covered by the EU ETS. These emissions are being targeted by two policy instruments which is unnecessary and inefficient. The proposed change would address this inefficiency in the policy framework and simplify administrative procedures to the benefit of industry .

56. Benefits:
    - This proposal removes the need to use the double-counting mechanism which is complex and burdensome for target units, sector associations, and Government. Savings from reduced admin costs are expected to be around £125,000 p.a.
    - Clear separation between EU ETS obligation and CCA target should incentivise efficient mitigation under each mechanism.

57. Costs:
    - There are no additional costs to Government sector associations or target units.
    - There are no additional costs to target units or sectors.

If relative targets continue, the Novem procedure for setting targets and measuring performance should continue to be used in relevant sectors and target units, but on an obligatory basis

58. The Novem procedure applies only to relative targets and is needed in order to set targets for sectors and target units with a diverse range of products for which it is difficult to establish a common throughput measure (e.g. for a company that sells paint by the litre and painted products by the square metre). Where Novem is used to set targets, it is also used to assess performance and its application usually results in an adjusted target, which may be more or less stringent than the original target. Under the current scheme sectors and target units can chose whether or not to apply the original target or the Novem adjusted target. This effectively results in a weakening of the target since the sector or target unit will choose the weaker option.

59. The Government proposes to continue to apply the Novem procedure to relevant sectors and target units, but to require that its application be obligatory. In this way, the adjusted target will continue to reflect the degree of effort required by the sector or target unit assumed in the original target.

60. Benefits:
   - This proposal will ensure targets continue to be challenging and effective.

61. Costs:
   - Obligatory application of Novem could result in effectively tighter targets for some target units.
   - There will be no additional cost to Government.

Simplification

<u>90/10 threshold lowered to 70%, 1/9th provision retained</u>

62. The Government proposes to keep the 90/10 rule but to reduce the threshold from 90% to 70%. We would expect marginally more energy to qualify for CCL discount as a result of this change but the impact is expect to be very small. The change should also increase the opportunity for abatement options but the impact is again expected to be very small.

63. We do not expect the change to have any material impact on costs for either industry or government. There will be marginal benefits to industry in extending the amount of energy to which the Levy discount will apply and in a reduced need to sub-meter. There will be marginal benefits to both industry and Government in reduced administrative costs.

<u>Only one agreement type should be available, based on Option 2 under the current scheme</u>

64. There are two types of agreement under current CCAs. For sectors with “Option 2” agreements, the underlying agreement is between the target unit and the Secretary of State. Under “Option 3” agreements, the underlying agreement is between the target unit and the sector association, approved by the Secretary of State. The terms of the agreements are in all other respects identical.

65. The Government considers that there is no useful purpose served by having two types of agreement and therefore proposes to issue a single type of underlying agreement between the Secretary of State and target units.

66. Benefit:
   - More consistency and transparency of the agreements in structure and operation.

- Reduced administration burden to DECC in checking data. This is estimated to be around £1,500 per annum[7].

67. Cost:
    - The proposal is not expected to increase costs for either Government or business.

The compliance year should be aligned with that for EU ETS and based on a calendar year for all sectors, with adjustments to the dates for the reconciliation process and eligibility for Levy reduction

68. When CCAs were introduced, sector associations could choose a target period covering 12 months starting at the beginning of any month between October and January. Consequently, there is a range of target periods, only some of which align with EU ETS. In the consultation on the report "Climate Change Instruments: Areas of Overlap and Options for Simplification", 87% of respondents supported the alignment of the monitoring, reporting and verification requirements of CCA and EU ETS.

69. The Government therefore proposes to establish a common target period for all sectors under the new CCA scheme, based on that for the EU ETS, i.e. a calendar year. This will be accompanied by necessary adjustments to associated deadlines. In particular, sector associations will be required to submit reporting data by 31 March and, for those that meet targets, the certification period (for Levy reduction) will begin on 1 June. As a consequence of the changed certification period, and in order to avoid any hiatus in eligibility for Levy reduction, for those target units that have agreements under the current scheme that enter into agreements under the new scheme, the end of the certification period under the current scheme will be extended from 31 March 2013 to 31 May 2013, subject to State aid approval.

70. Benefits:
    - A reduction in the administrative burden on businesses in terms of recording, reporting and provision of data for audit purposes, since much of the information required under the schemes is common (e.g. data on fuel used in combustion). Savings are estimated to be around £125,000 per annum.

71. Cost:
    - There may be one off costs associated with amending data collection procedures and related IT for target units and sector associations. No estimates have been made but cost is expected to be marginal.

All sectors, whether meeting targets or not and whether operating a trading group or not, should be required to provide the same data at reconciliation

72. Currently, sectors that meet targets are required initially to provide less reporting data than those that fail. In addition, sectors that operate carbon trading on a group basis are not required to provide information on the effective trading of individual target units. However, DECC has found that, in many cases, considerable additional information is required to test whether the sector and target units have met their targets. In addition, the absence of full data makes it difficult for DECC to analyse and monitor performance of the scheme as a whole. It is therefore proposed that all sectors be required to provide the same information, including on the effective trading position of all target units.

73. Benefits:
    - Facilitates better understanding by DECC of individual sector performance and comparative performance between sectors.

[7] Administration costs relate predominately staff costs here and elsewhere in the IA unless otherwise stated

74. Cost:

- We foresee little or no additional administrative burden or financial cost to business. Most, if not all, sector associations already collect this information in order to assess sector performance.

<u>Scheme Rules should be established separate from the agreements, to facilitate their adjustment when necessary</u>

75. Current umbrella and underlying agreements are stand alone (other than linkages between the two levels of agreement) and contain all the detail necessary to implement the agreements. Any change to the scheme requires the approval of all operators (around 5,000). This is administratively burdensome and proves difficult where a minority of parties to the agreements disagree. This makes the agreements inflexible and potential improvements, to the benefit of industry and Government, are not pursued.

76. The Government therefore proposes to establish Scheme Rules, separate from the agreements, which can be amended by the Secretary of State following appropriate consultation. This would, for example, facilitate the correction of errors or the introduction of improvements to the functioning of the scheme. The agreements themselves would focus only on the specific details relevant to the legal relationship between the parties to the agreements.

77. Benefits:

- Reduced administrative costs to Government and admin burdens on sector associations, estimated to be around £2,300 per annum.

78. Costs:

- We do not foresee any additional cost to Government or business with this proposal

Conclusion

79. This IA has assessed the impact on resource costs to the UK of changing the content and form of CCA as set in the December 09 consultation document. The costs and benefits identified and estimated are increase or decrease in administration costs. The intention of the proposed changes is to make CCAs simpler and reduce admin burden. The analysis suggests that the impact of the proposed changes as set out in scenario A is positive, overall costs are reduced.

80. An assessment of the impact new CCAs could have on reducing carbon has not been made in this IA. How much carbon is saved from the CCA sector will be determined predominately by the targets that are set.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	Yes	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes