

EXPLANATORY MEMORANDUM TO
THE CLIMATE CHANGE AGREEMENTS (ADMINISTRATION) (AMENDMENT
AND RELATED PROVISION) REGULATIONS 2016

2016 No. 1189

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy (BEIS) and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 The purpose of this statutory instrument is to amend the terms relating to the buy-out fee for future Target Periods that must be included in the agreements in the Climate Change Agreements Scheme (the “CCA Scheme”). The amendment means that the agreements must provide that, for Target Period 3 (TP3) and Target Period 4 (TP4) (1 January 2017 to 31 December 2018 and 1 January 2019 to 31 December 2020 respectively), the buy-out fee is calculated on the basis of £14 per tonne of carbon dioxide equivalent (/tCO₂e) by which a target is missed. This instrument maintains the position that, for Target Period 1 (TP1) and Target Period 2 (TP2) (1 January 2013 to 31 December 2014 and 1 January 2015 to 31 December 2016 respectively), the buy-out fee is calculated on the basis of £12/tCO₂e by which a target is missed.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 Section 30 and Schedule 6 to the Finance Act 2000 make provision for the Climate Change Levy (CCL) to be charged on certain supplies of energy. Part IV of Schedule 6 to the Finance Act 2000 makes provision for a reduced rate of CCL to be charged if a facility which receives supplies of energy is certified as being covered by a Climate Change Agreement (CCA) for a certification period. Part IV of Schedule 6 to the Finance Act 2000 also makes provision for a CCA to be a combination of an umbrella agreement and an agreement that, in relation to the umbrella agreement, is an underlying agreement.
- 4.2 A facility can only be certified as being covered by a CCA if, in the previous certification period, it has made satisfactory progress towards meeting energy use or emissions targets set out in a CCA. This means that participants in the CCA Scheme are only entitled to receive the reduction in the rate of the CCL if they have made satisfactory progress towards meeting their targets. Part IV of Schedule 6 also

provides that satisfactory progress towards meeting targets may be based on satisfying alternative requirements provided for by the CCA.

- 4.3 Section 207 and Schedule 31 to the Finance Act 2012 amended Schedule 6 to the Finance Act 2000 to confer powers on the Secretary of State to make regulations for the administration of the CCA Scheme. These include powers to make regulations:
- specifying terms which must be included in underlying agreements and umbrella agreements (including terms providing that the absence of progress towards meeting any targets may be made up for by payment of a fee to the administrator); and,
 - conferring power on the administrator to vary such agreements to take account of any changes in the terms specified by regulations as terms which must be included in agreements from time to time.
- 4.4 The Climate Change Agreements (Administration) Regulations 2012 (SI 2012/1976) (the 2012 Regulations) provide that an underlying agreement must include terms that, if a target unit has failed to meet a target, the obligation to make progress towards meeting targets may instead be satisfied by the payment of a buy-out fee to the administrator. In particular, the 2012 Regulations provide that underlying agreements must include terms to the effect that the buy-out fee is calculated on the basis of £12/tCO₂e by which a target is missed.
- 4.5 This instrument amends the 2012 Regulations with regard to the terms that must be included in underlying agreements relating to the buy-out fee, to the effect that those terms must provide that the buy-out fee is to be calculated on the basis of:
- £12/tCO₂e by which a target is missed where the administrator makes a finding that a target for TP1 or TP2 has been missed;
 - £14/tCO₂e by which a target is missed where the administrator makes a finding that a target for TP3 or TP4 has been missed.
- 4.6 This instrument also amends the 2012 Regulations to provide that terms relating to the buy-out fee in umbrella agreements also must provide that, where the administrator makes a finding that a target for TP3 or TP4 has been missed, the buy-out fee is to be calculated on the basis of £14/tCO₂e by which a target is missed.
- 4.7 This instrument also confers power on the administrator to vary existing CCAs to take account of the changes to the terms specified for inclusion in CCAs relating to the buy-out fee.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

- 7.1 The Climate Change Levy (CCL) is a tax on the supply of a range of fuels including electricity, natural gas, liquefied petroleum gas and solid fuels when supplied for use by the business and public sectors. It was introduced on 1 April 2001.
- 7.2 The CCA Scheme is a voluntary scheme pursuant to which CCA Scheme participants have entered into agreements with the Government to reduce their energy use or emissions and, in exchange, are entitled to pay reduced rates of the CCL. The reduced main rates of CCL to which compliant CCA Scheme participants are entitled are currently 10% of the full main rates of the CCL for electricity and 35% of the full main rates of the CCL for gas and other taxable commodities.
- 7.3 The CCA Scheme supports the Government's objectives to deliver affordable and secure energy and decarbonisation while also helping productivity and the growth agenda.
- 7.4 Government has previously estimated that participants would save in total around £300 million on their CCL costs each year¹, with the CCA Scheme running until March 2023. The Government has estimated that if participants meet their agreed energy efficiency or carbon reduction targets for 2013-2020 this would reduce emissions of carbon dioxide by 22 mega-tonnes of carbon dioxide equivalent (22MtCO₂e)².
- 7.5 In the CCA Scheme, the agreements between sector associations, which are industry sector representative bodies for the eligible industry sectors in the Scheme, and the administrator are called umbrella agreements. Agreements between operators and the administrator are called underlying agreements, while 'Target Unit' means the facility or group of facilities to which an underlying agreement applies.
- 7.6 CCA operators can remain compliant with the CCA Scheme and retain their entitlement to the reduced rates of CCL either by meeting agreed energy efficiency or carbon reduction targets or by paying the buy-out fee. The buy-out fee is payable on each tonne of carbon dioxide equivalent by which a Target Unit falls short of meeting any target for a Target Period. There are four Target Periods in the CCA Scheme for which Target Units are required to meet their targets, covering the four two-year periods from 2013 to 2020 inclusive. Alternatively, operators who do not meet their targets may choose not to pay the buy-out fee and instead leave the CCA Scheme. If a Target Unit overachieves against its target for a Target Period, there will be a surplus, being the amount by which the reduction in emissions has exceeded the target.
- 7.7 The buy-out fee was set in 2012 at £12/tCO₂e and has remained at that level since the start of the current CCA Scheme in 2013. 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 impact on business competitiveness, on participants who fail to meet their targets.

¹ DECC Press release, 'Industry agree stretching energy efficiency targets with government', 2 April 2013.

² 'Climate Change Agreements (CCA) Scheme: updated estimates reflecting the results of the first target period (2013-14)', 9 December 2016.

- 7.8 Government announced in 2011³ that the buy-out fee would be reviewed in 2016. The Government's intention to review the buy-out fee in 2016 for TP3 and TP4 was confirmed by the Government in October 2014⁴ and again in March 2016⁵.
- 7.9 The policy intent behind this statutory instrument is to increase the buy-out fee broadly in line with inflation to £14/tCO₂e for TP3 and TP4⁶, to maintain in real terms the incentive to abate. An increase broadly in line with the retail price index (RPI) is consistent with the approach taken with respect to a range of other taxes and Government schemes.
- 7.10 Operators who comply with the Scheme (either by meeting their targets or by paying the buy-out fee) will benefit from the reduced rates of CCL until the present CCA Scheme ends on 31 March 2023. As CCL rates have increased since 2012 in line with the RPI, the value of the CCL reduced rates available to CCA participants has also increased annually in line with the 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.
- 7.11 Accordingly, regulation 3 amends the specified terms which must be contained in underlying agreements relating to the buy-out fee for future Target Periods to the effect that any buy-out fee for Target Period 3 and Target Period 4 will be calculated on the basis of £14 for each tonne of carbon dioxide equivalent by which a target has been missed.
- 7.12 This maintains the position that, for failures to meet a target for TP1 or TP2, the buy-out fee is calculated on the basis of £12 for each tonne of carbon dioxide equivalent by which a target has been missed. This instrument also maintains the position that the calculation of the buy-out fee takes any surplus into account only if the administrator finds that the target unit has failed to meet its target at any time beginning with the 1st May in the year following the end of a Target Period and ending immediately before the next certification period.
- 7.13 In practice, umbrella agreements have contained the same terms relating to the buy-out fee as underlying agreements. For consistency between umbrella agreements and underlying agreements, regulation 4 specifies provision for future Target Periods that any buy-out fee terms in umbrella agreements must provide that any buy-out fee for TP3 or TP4 will be calculated on the basis of £14 for each tonne of carbon dioxide equivalent by which a target has been missed.
- 7.14 This instrument also provides that the administrator has the power to vary existing umbrella agreements and underlying agreements to take account of these changes to the specified terms relating to the buy-out fee, and will give notice in writing to the other parties of this variation to the terms relating to the buy-out fee. Regulation 5 also provides that, if the administrator varies an umbrella agreement, it must also vary the underlying agreements with which it forms a combination of agreements. This will ensure consistency between the umbrella agreements and the underlying agreements,

³ 'Government Response to the Consultation on Simplification', 2011

⁴ 'Climate Change Agreements Target Review 2016: Discussion Paper and Call for Evidence', 2014.

⁵ 'Government's Response to the Business Energy Efficiency Tax Landscape Review', March 2016.

⁶ £14/tCO₂e represents an increase in the buy-out price that is broadly in line with RPI, averaged over TP3 and TP4.

and will also ensure that both sector associations and operators are given written notice of the variation.

- 7.15 When this statutory instrument comes into force, the administrator will give notice in writing to operators and sector associations that all existing underlying agreements, and all existing umbrella agreements which contain a term relating to the buy-out fee, are varied to the effect the buy-out fee will be calculated on the basis of £14/tCO₂e by which a target for TP3 and TP4 is missed.
- 7.16 As this instrument relates to administration of a scheme which is technical and specific to CCA participants, the level of public interest is likely to be limited.

Consolidation

- 7.17 The instrument makes amendments to the Climate Change Agreements (Administration) Regulations 2012. The Department is not planning to consolidate these pieces of legislation.

8. Consultation outcome

- 8.1 On 5 August 2016 BEIS published a 'Discussion Paper on the Climate Change Agreement Target Review 2016 and Buy-out Price Review'. The Discussion Paper was open for responses for seven weeks, until 23 September 2016. In addition, a stakeholder event on the Discussion Paper was held on 7 September 2016.
- 8.2 The Discussion Paper set out three options for the buy-out fee for the remaining Target Periods (TP3 and TP4) of the CCA Scheme, and sought views and evidence to inform the Government's decision.
- 8.3 The Discussion Paper received 40 responses. The vast majority of respondents were participants in the Scheme and favoured retaining the current £12/tCO₂e buy-out fee. Many of these respondents raised arguments against increasing the buy-out fee, including around the difficulties resulting from an increase in the cost of paying buy-out in the current economic climate.
- 8.4 Government has considered these responses. Government has taken into account that a significant number of respondents raised general concerns about adverse competitiveness impacts of any increase to the buy-out fee and a large majority favoured retaining the buy-out price at £12/tCO₂e by which a target is missed. Though the increase to £14/tCO₂e by which a target is missed 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/tCO₂e, given the increased value of the CCL discount. Government had considered an increase to £17/tCO₂e in the discussion paper but had not had this as the preferred option. Government has noted that going above maintaining the value of the buy-out price in real terms might upset the balance between incentive to abate and financial impact on participants.
- 8.5 Government has also considered the arguments presented by respondents that they cannot meet their targets for technical reasons or because of a lack of measures. Government considers that increasing the buy-out price to maintain its cost in real terms merely maintains the strong incentive to abate at the level at which it was originally set in real terms.

- 8.6 The ‘Government Response to the Discussion Paper on the Climate Change Agreements Target Review 2016 and Buy-out Price Review’, published online on gov.uk on 9 December 2016, considered these responses.

9. Guidance

- 9.1 The Government Response, which is being published on gov.uk, sets out that it has laid this instrument which changes the terms which must be included in agreements relating to the buy-out fee, to the effect that the buy-out fee for participants will be calculated on the basis of £14/tCO₂e by which a target is missed for targets for TP3 and TP4. The Government will also publish revised templates for umbrella agreements and underlying agreements on gov.uk which include these changes.
- 9.2 Before this instrument comes into force, this policy change will also be drawn to the attention of operators and sector associations through a written communication issued by the administrator (the Environment Agency) to all participants, referring to the Government Response. The Operations Manual for the CCA Scheme, which is available on the gov.uk website will also, in due course, be updated by the administrator to reflect this change.

10. Impact

- 10.1 The impact on businesses from increasing the buy-out fee generally in line with RPI will be broadly neutral in real terms. There is no impact on charities or voluntary bodies as the legislation does not apply to these bodies.
- 10.2 There is no impact on the public sector.
- 10.3 An Impact Assessment has not been prepared for this instrument. This is on the grounds that the buy-out fee is a payment in relation to a tax and therefore treated as non-regulatory.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses which are participants of the CCA Scheme.
- 11.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 11.3 The basis for the final decision on what action to take to assist small businesses took into account that the buy-out fee is simply being increased broadly in line with the RPI to restore its value in real terms to the level at which it was set in 2012.

12. Monitoring & review

- 12.1 This instrument is the result of a review of the buy-out fee.
- 12.2 This instrument is exempt from the requirement under section 28(2) of the Small Business, Enterprise and Employment Act 2015 to make provision to carry out a review as it falls within the exception in section 28(3) of that Act.
- 12.3 No further monitoring or review is planned. The amended buy-out fee will apply with respect to the targets for the final two Target Periods of the CCA Scheme, from 2017 to 2020, and its application is therefore time-limited.

13. Contact

- 13.1 Robert Clay at the Department for Business, Energy and Industrial Strategy.
Telephone: 0300 068 6086 or email: robert.clay@beis.gov.uk can answer any queries regarding the instrument.