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MPA Briefing - Climate Change and Energy Policy Update

Introduction

Over the last few months there has been a flurry of activity in the area of climate change and energy policy at both the European and UK level. This briefing provides an update on what has been going on, the implications and who will be affected. Links are provided in the footnotes for further information.

1. EU Emission Trading System (EU ETS)[1]

Background: EU ETS is currently in its second phase which runs from 2008 to the end of 2012. Free emissions allowances are granted to participants based on historic emissions. If an installation emits less than its allocated allowances, its owner can use the excess to either off-set higher than expected emissions at other installations in its UK portfolio; bank the allowances into Phase III (2013 to 2020) or sell them on the open market.

Phase III of the EU ETS will deliver two-thirds of the EU's unilateral 20% emissions reduction target by 2020 on 1990 levels. This equates to 21% reduction by 2020 compared to the 2005 verified emissions baseline under the EU ETS.

For the UK, the EU ETS will cover about 48% of national carbon dioxide (CO_2) emissions from Phase III[2].

In Phase III a greater amount of allowances (permits to emit) will be sold at auction although this will only affect power generators and those sectors not designated as vulnerable to carbon leakage (i.e. it becomes cheaper to move production and carbon emissions off-shore and import the product). Both cement and lime are listed as vulnerable to carbon leakage but this decision will be reviewed again before 2014.

For sectors not directly affected by the scheme the consequences are higher electricity costs as power generators pass on the cost of emitting.

Who is affected by the scheme: Major emitters of CO_2 who are listed on schedule 1 of the emissions trading directive. For MPA this includes cement and lime as listed activities. Under Phase III of the scheme the definition of combustion has been broadened so that activities with a thermal net rated input >20MW are covered by the Directive. However, installations <35MWth (excluding emissions from biomass) may have the option to opt out if their emissions are <25,000tCO_2.

[1] http://www.environment-agency.gov.uk/business/topics/pollution/32232.aspx
[2] http://www.decc.gov.uk/en/content/cms/emissions/eu_ets/phase_iii/phase_iii.aspx

Small emitter opt out: Small emitters (installations <35MWth with emissions <25,000tCO_2) could only opt out into an equivalent scheme, which in the UK is likely to be EU ETS 'lite', after both Climate Change Agreements and the Carbon Reduction Commitment Energy Efficiency Scheme were both rejected by DECC as suitable alternatives. The EU ETS 'lite' opt-out agreement would take the form of a binding commitment to reduce an installations emissions by a certain amount each year compared to a baseline. Installations would continue to hold an EU ETS permit and report according to EU ETS monitoring and reporting rules. However, DECC are looking at using a risk based approach to verification which would not necessarily be required on an annual basis. Larger Asphalt plants are within the scope of EU ETS Phase III.

Next steps: The draft UK National Implementation Measures (NIMs) that set out what allocation each installation will receive in Phase III has been sent to operators for scrutiny by 28th October. Following this consultation period the UK will finalise allowance allocations and submit the NIMs to the European Commission (by the end of 2011).

Running parallel to this and starting in October 2011 a consultation on the Article 27 small emitter opt out is expected. This will be the time for small emitters to choose whether or not they will opt out of EU ETS into an equivalent scheme.

2. Climate Change Levy (CCL)/ Climate Change Agreements (CCA)[3]

Background: The climate change levy (CCL) applies to all listed energy and fossil fuels used by businesses but there are certain exclusions/reductions. One reduction in the level of tax is via the participation in a Climate Change Agreement (CCA).

CCA's allow energy-intensive industries to obtain a 65% discount from the Climate Change Levy, provided they meet challenging targets for improving their energy efficiency or reducing their carbon emissions.

The first set of climate change agreements, introduced in 2001, affected only cement and lime within the MPA membership. Obligations under those agreements will remain until the agreements expire at the end of March 2013.

In the 2011 Budget the Chancellor confirmed that CCAs would continue until 2023 and that from 2013 the reduced rate for electricity will be set at 20% of the levy rate for those with CCAs.

Government is currently consulting on the new phase of CCAs. It has been proposed that targets in the new CCA agreements will be based on the non-EUETS element of the site/target unit. This is to remove the overlap between the two schemes. This means that for most sites the targets will be based on electricity use only. It is expected that negotiations to set targets in the new agreements will start in summer 2012.

Who is affected by the scheme: CCAs are currently only eligible for IPPC/EPR Part A1 and A2 processes.

[3] http://www.decc.gov.uk/en/content/cms/emissions/ccas/ccas.aspx

3. Carbon Reduction Commitment Energy Efficiency Scheme (CRC)[4, 5]

Background: The Carbon Reduction Commitment (CRC) Energy Efficiency Scheme is a mandatory scheme to improve energy efficiency and therefore cut CO_2 emissions in large public and private sector organisations. These organisations are responsible for around 10% of the UK's CO_2 emissions.

CRC began in 2010. Organizations have to provide data on their emissions and then purchase CO_2 allowances that meet their emission in each compliance year. The performance of all participants is published in a league table, the first of which is due in October 2011. The price mechanism of the scheme will take effect from 2011/12 with the first sale in 2012.

Budget 2011 confirmed that 2011/2012 allowances will be priced at £12 per tonne of carbon dioxide. The Government will publish draft regulations to implement allowance sales later in 2011.

Who is affected by the scheme: Organisations qualify as participants if, during the 2008 calendar year, they had at least one half-hourly electricity meter (HHM), settled on the half hourly market and if they consumed at least 6,000 MWh (megawatt hours) through all half-hourly meters. Organizations <6000MWh HHM still have to register.

Participation is on a group organization basis so sites that are not above the half hourly metered threshold may still be required to participate even if other parts of their organization have obligations under the scheme.

The CRC Energy Efficiency Scheme (Amendment) Order 2011 came into force on 1 April 2011. The amendment required footprint and annual reports to be submitted by 31 July 2011.

Simplification proposals: The CRC scheme has been criticized for being overly complex. On 30th June 2011 DECC published a paper: "Simplifying the CRC Energy Efficiency Scheme: Next Steps"[6]. The deadline for comments on the proposals is 2nd September 2011. In summary the proposals aim to[6]:

- provide greater business certainty by introducing two fixed price sales a year (one forecast and one retrospective), rather than auctions of allowances in a capped system, in the second phase.
- allow for greater flexibility for organisations to participate in 'natural business units';
- reduce the administrative burden (in particular by reducing the number of the fuels reported from 29 to 4; using only electricity measured by settled half hourly meters (HHMs) for qualification purposes; ending the requirement for footprint reports; and other practical measures such as requirements on maintaining records);

4 http://www.decc.gov.uk/en/content/cms/emissions/crc_efficiency/crc_efficiency.aspx
5 http://www.environment-agency.gov.uk/business/topics/pollution/126698.aspx
6 http://www.decc.gov.uk/assets/decc/11/cutting-emissions/crc-efficiency/2088-simplifying-crc-next-steps.pdf

- reduce scheme complexity (by removing the complex residual percentage rule ('90% rule') and CCA exemption rules, but aiming to achieve broadly the same outcomes)
- reducing overlap with other schemes (so that businesses covered entirely by CCAs do not need to register; no longer requiring EU ETS installations to purchase allowances for electricity supplies).

4. Carbon Price Floor (CPF)[7]

The CPF applies directly to electricity generators. The Government has set a carbon price floor of £16/tCO_2 in 2013 escalating to £30/tCO_2.

The CPF translates into fossil fuel levies that in 2013 will equate to £4.94/tCO_2. Indicative rates for 2014-15 and 2015-16 will be equivalent to £7.28/tCO_2 and £9.86/tCO_2 respectively. MPA has calculated that in 2013 this will add around £4.6m (£2.5m on cement alone) to members electricity bills and that this will double by 2015-2016.

Generators will be affected in 2013 and will pass the cost on to consumers at the earliest opportunity.

5. Energy Taxation Directive[8]

The current taxation of energy products directive places minimum tax obligations on member states for specific fuels. Mineralogical processing is supposed to be outside the scope of the minimum tax levels but the UK taxes mineralogical processes via the climate change levy anyway.

The UK obligations on minimum energy taxation are met through the climate change levy. However, a proposal has been put forward to amend the Directive to include a minimum carbon taxation on fuels and energy. The proposal is equivalent to €20/tCO_2. Clearly this is greater than the £12/tCO_2 that will be charged in the CRC so an amendment to the directive could increase costs to MPA members. However, it should be recognized that the proposed change is not well supported by Member States (the UK opposes it). Furthermore, taxation legislation requires unanimous voting. As currently drafted fuels subject to the EU ETS would be excluded.

The Directive already applies on energy taxation but could also include carbon taxation. The amendment directive is expected to be consulted on later in 2011.

6. Energy Efficiency Directive

Background: On 22nd June 2011 the European Commission put forward a proposal for a new Energy Efficiency Directive which contains a set of measures designed to "*step up Member*

[7] http://www.hm-treasury.gov.uk/consult_carbon_price_support.htm
[8] http://ec.europa.eu/taxation_customs/taxation/excise_duties/energy_products/legislation/index_en.htm

States efforts to use energy more efficiently at all stages of the energy chain – from the transformation of energy and its distribution to its final consumption"[9].

The Commission proposes simple but ambitious measures:

- Legal obligation to establish energy saving schemes in all Member States
- Public sector to lead by example
- Major energy savings for consumers

Details[10]: The Directive aims to create a common framework for the promotion of energy efficiency in the EU to reach the target of 20% primary energy savings by 2020. It will repeal the Cogeneration Directive and the Energy Services Directive, and extends their scope to all sectors with energy savings potential.

The proposed measures are minimum requirements. Member States can adapt them according to their own national circumstances and decide whether or not to include binding targets in their national energy efficiency plans. However, the European Commission will monitor the implementation of the national energy efficiency targets, and check by 30 June 2014 whether they will deliver the European 20% objective. If the review shows that the overall EU target is unlikely to be achieved, then as a second stage the Commission will consider whether to propose legally binding national targets for 2020, taking into account the individual starting points of Member States.

The proposal sets several energy efficiency requirements for the end-users sectors (i.e. the cement industry) and the energy supply sector. Among them:

- High efficiency standards would have to be applied by the public sector for the renovation of owned buildings, and for the purchase of buildings, products and services.
- Member States would have to design energy saving obligation schemes.
- Large companies would have to comply with regular mandatory energy audits at the latest by 30 June 2014 and then every three years. (Art 7)
- Energy companies would have requirements on metering and billings.
- Member States would have to adopt cogeneration plans and authorization criteria.
- Obstacles to energy efficiency in buildings, such as the split of incentives between the owner and tenant of a building or among building owners, would have to be removed. (Art 14)

There is a contentious provision in the directive to set aside EU ETS allowances if energy efficiency savings are achieved. The aim of this is to prevent the CO_2 price from being affected by a reduction in CO_2 emissions as a result of energy savings.

Next Steps: DECC is currently working with other Government departments, the devolved administrations, and stakeholders to consider the implications of the Directive's proposals. An informal consultation has been opened by DECC[11] that welcomes any informal views, comments, or observations on the content of the proposed Directive and its annexes. In

[9] http://ec.europa.eu/energy/efficiency/eed/eed_en.htm

[10] Taken from a briefing produced by CEMBUREAU Working Group 2: Energy & Materials Resources.

[11] http://www.decc.gov.uk/en/content/cms/consultations/eceed/eceed.aspx

particular any views with regards to the costs and benefits associated with the proposals are being sought. The deadline for comments is 30th September.

7. Renewable Heat Incentive (RHI)[12]

On 10th March 2011 DECC issued its proposal to introduce a Renewable Heat Incentive (RHI). This follows from a consultation in April 2010.

In the first phase the RHI provides financial support to non-domestic renewable heat generators and producers of biomethane. It provides a continuous, guaranteed income stream over twenty years to any organisation based in Great Britain that installs an eligible renewable heating system. The Government will support technology if it was installed after 15th July 2009. Tariff payments for biomass use range from 1.9-7.6 p/KWh thermal.

The RHI will be administered by Ofgem E-Serve[13] and, subject to State Aids clearance, Phase 1 will be open for applications from 30 September 2011.

The second phase of the RHI scheme will see it expanded to include more technologies as well as support for households. This transition will be timed to align with the Green Deal (see below), which is intended to be introduced in October 2012[12].

8. Green Deal[14]

The Green Deal aims to create a new financing framework to enable the provision of fixed improvements to the energy efficiency of households and non-domestic properties, funded by a charge on energy bills that avoids the need for consumers to pay upfront costs.

The Green Deal enables energy saving measures to be paid for in installments via the energy bills of the customer. The 'loan' is transferred to subsequent bill-payers for the property if the property is sold. The Government intends the core principle to be that the cost of the energy saving measures should not exceed the estimated cost savings on an average bill for the duration of the Green Deal finance arrangement – the 'Golden Rule'. This Green Deal scheme will be supported by an accreditation scheme of installers, assessors and approved measures. The development of 'Green Deal' for business is very unclear at the moment but Government hope to implement both domestic and non-domestic Green Deals on the same timeline.

A formal consultation is expected in Autumn 2011. Government hopes to have the first Green Deals in place for Autumn 2012. The Government will include powers in the forthcoming Energy Security and Green Economy Bill to introduce a new obligation on energy companies from 2012.

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[12] http://www.decc.gov.uk/en/content/cms/meeting_energy/Renewable_ener/incentive/incentive.aspx
[13] http://www.ofgem.gov.uk/e-serve/RHI/Pages/RHI.aspx
[14] http://www.decc.gov.uk/en/content/cms/tackling/green_deal/green_deal.aspx