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BEIS Consultation on Climate Change Agreements (CCAs): consultation on extension to 31 March 2027 & further proposals on any potential future scheme

FDF Response — 10th May 2023

Introduction

This submission is made by the Food and Drink Federation, the trade association for food and drink manufacturing in the UK, representing companies from ambitious sole traders and SMEs to the largest global brands. Food and drink is the largest manufacturing sector (accounting for almost 20 per cent of the total manufacturing sector) in the UK, turning over more than £113billion per annum; resulting in Gross Value Added (GVA) over £33billion and employing over 450,000 people across every region and nation.

We welcome this consultation on implementing the extension to 31 March 2027 of the current scheme, and on further proposals on any potential future scheme. Indeed the importance of CCAs continues to increase given that the IETF does not have ring fencing for the food and drink sector or matched funding from support schemes that have closed. Alongside, food and drink is a dispersed manufacturing sector located outside of the industrial clusters and where 97% are SMEs (FDF, 2021).

However, the cumulative impact on the key challenges and proposals for a two-year extension are very concerning and will lead to higher scheme administration costs and lower levels of participation. Of particular note are the following:

- Targets need to address the issue that the remaining opportunities in energy efficiency are now larger scale investments which require a longer target period. If not, targets may be missed.
- Removing the use of surplus will make investment thresholds harder to meet
- Mandatory reporting of action taken, energy efficiency and decarbonisation potential encompasses scope creep, will be costly and is inappropriate for companies to disclose given its highly confidential and competitive nature

Looking towards a future phase of the scheme and building on the comments above, FDF therefore believes it is essential to include the following, which were also missing from the BEIS commissioned consultancy review from 2020:

- The existing eligibility criteria should be retained: earlier proposals could have resulted in a fall of around 750 to circa 100 food and drink sites.
- A full impact assessment, including on level of site participation in the scheme
- The overarching policy framework in which CCAs sit
- The intention of the Climate Change Levy which is to aid decarbonisation
- CCAs are the only standardised cross industrial sector reporting tool
- The Government's Net Zero target and the need to reduce emissions by 78% on 1990 levels by 2035, from a point in 2019 of only a 44% reduction[1]

[1] https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035

Likewise, it is imperative the consultation process begins as soon as possible as the new rules would need to be in place from January 2025. FDF also urges further reflection on the following points raised in this consultation for a future phase:

- *Collection of facility level data to establish targets*
- Data would be commercially sensitive and subject to FOI requests
- Additional costs through duplication of audits and analysis – should use existing ESOS reports
- Assessment criteria for quantifying potential is absent
- Uncertainty as to what is being proposed – sector, sub-sector or site targets?

- *Facility level reporting and performance measurement*
- remaining opportunities are now larger scale investments making investment thresholds harder to reach: removing ‘bubbles’ will likely result in lower levels of investment and number of participating sites
- Removal of stringency tests and mixed base years is not sufficient advantage

- *Energy efficiency and decarbonisation*
- Need to utilise existing ESOS reports to assess potential and avoid duplication and unnecessary costs
- Further scope on energy efficiency is more limited versus decarbonisation through fuel switching.
- Under an energy efficiency target, electrification measures will not always result in energy efficiency savings but will result in CO_2 savings.

- *Removing the use of surplus*
- Enabling surplus helps support the investment case for larger projects over longer timescales
- Remaining energy efficiency opportunities are larger in scale
- Excessive stringency will discourage scheme participation and amplified further if no bubbling in place.

We are very keen to work with the BEIS team both on the two-year extension to the scheme and on a future phase of CCAs, and so welcome an opportunity to discuss our response with you.

Yours faithfully,

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FDF Response

1. Do you foresee any impacts arising from this two-year extension?

A scheme extension creating a TP6 to December 2024 is very welcome as CCAs are an important driver for investment into energy efficiency and is key to sustaining and building investor confidence especially in this post-Covid 19 economic environment.

Furthermore, the wider policy landscape has changed since CCL and CCAs were introduced: the move to Net Zero must now be encompassed in a future scheme to ensure it is aligned to the wider policy framework. The extension enables sufficient time and resource to consider the correct reform required to ensure alignment to Government's decarbonisation targets.

Energy efficiency will always be a key priority for businesses, and now more than ever given the volatile energy market. In the time period the extension affords, the BEIS CCA team must also consider what the goals of focusing on energy efficiency are: we believe these are about promoting grid stability and reducing carbon emissions as the grid system decarbonises. Maintaining current eligibility and incorporating a carbon element into the CCA targets is therefore essential.

2. Do you agree with the proposed dates for Target Period 6 and Certification Period 6?

Yes.

3. Do you see any issues with maintaining the current scheme eligibility criteria?

FDF supports the continuation of the existing eligibility criteria, both for the extension and in a future phase of the scheme.

Whilst making the scheme more effective is essential for a future scheme, this should focus on how to better support Government objectives around improving energy efficiency and carbon reduction targets – and not about reducing eligibility or making it harder for installations to participate. This is particularly important for sectors where there are many SMEs and where CCAs are the main vehicle for supporting energy efficiency and decarbonisation efforts – only a few sites are able to access funding under the Industrial Energy Transformation Fund.

More widely, eligibility, and the need to shield from the full rates of CCL must also encompass implications of cost pass through to customers and the impacts on business competitiveness in the supply chain: the Food and Drink sector for example is the largest manufacturing sector in the UK accounting for almost 20 per cent of the total manufacturing sector employing over 450,000 people across every region and nation. If sites lose their eligibility to participate in the scheme, the unintended impacts on business competitiveness would undermine the value food and drink brings to the levelling up agenda as a dispersed manufacturing sector, and to the costs of living challenges consumers are facing as the country decarbonises towards Net Zero.

4. Do you agree with the dates proposed for new entrant applications?

FDF believes that new entrants should be allowed to join during the Target Period of 2024 – a precedence has previously been set as it was possible in the old scheme. Given the scheme is to help installations improve energy efficiency and reduce emissions, enabling sites to join part way through a Target Period, would still align with the scheme objectives.

5. Do you agree with the proposal to maintain 2018 as the baseline year?

Yes.

6. Do you agree with process as set out for agreeing sectoral targets?

Yes, the idea of using TP5 performance looks sensible. There is however insufficient detail provided to comment fully and with it only covering one year, there are concerns about using a straight line extrapolation given the reasons highlighted in question 7 below. This is on top of the challenges in reduced margins and cash reserves that companies are now operating under.

7. Do you agree with the proposal that surplus from previous Target Periods should not be brought forward for use in TP6?

No. It is inappropriate to penalise companies that overachieve given the investment timescales for large environmental projects can be many years longer: excessive stringency and competitive disadvantage on early movers must be avoided – indeed the reverse, in order to maintain investor confidence and see larger investment decisions continue. Alongside incremental improvements to energy efficiency which you may see in one-year TPs, these opportunities are now much less. Instead, remaining opportunities may be much larger, but with correspondingly greater capital and investment threshold requirements to meet, thus making the use of surplus mechanisms even more critical to the investment decision.

8. Do you agree with the proposed amendment to Rule 6.4 to account for operators with absolute targets?

Yes.

9. Do you agree with the proposal to introduce mandatory reporting to the Environment Agency of action taken in Target Period 6 by 1 May 2025?

No. Whilst it is helpful for businesses to be clear on the financial benefit being gained, it doesn't have to be sent to a 3rd party to make this happen.

Given that reporting to the scheme administrator would be subject to a Freedom of Information Request, this could only be undertaken and assessed if collected in some standard template: such information could not be shared on an individual basis as it would be highly confidential and a source of competitive advantage. It is not appropriate for companies to disclose this information if there is a risk this information can go into the public domain.

Alongside there would also be complexities around how to present information, which would add significantly to the costs of administering the scheme.

10. What are your views on extending this reporting to include provision of further evidence of energy efficiency and decarbonisation potential?

Overall, the Government should consider the proportionality of the extra information provision versus the benefit that companies will receive.

Extending disclosure to include potential encompasses scope creep and would engender extra cost to obtain the extra information required if the site has not had a detailed ESOS or other type of audit.

As with Q9, given that reporting to the scheme administrator would be subject to a Freedom of Information Request, this could only be undertaken and assessed if collected in some standard template: such information could not be shared on an individual basis as it would be highly confidential and a source of competitive advantage. It is not appropriate for companies to disclose this information if there is a risk this information can go into the public domain.

An alternative to the mandatory reporting proposal would be to require the company to hold the information and increase the random auditing to ensure they are in place. Likewise, there could be a threshold for such a requirement where the CCL discount is low e.g., where a site has a CHP and only has a CCA for low usage.

Additional reporting requirements may also increase duplication and become too burdensome, as many companies already report under ESOS, SECR, UK ETS, and other Government schemes.

11. Do you agree with the proposal to increase the buy-out price to £25/tCO2e?

No – if taken into account with all the other proposals for the extension, the cumulative effect of these will limit the incentive to be part of the CCA scheme given that alongside Q7, since it is only a one-year TP, opportunities for incremental energy efficiency improvements are now much less, yet the business case for making larger scale investment now becomes more challenging.

12. Do you agree with the proposal to increase the minimum financial penalty from £250 to £500?

Please see response to question 11.

13. Do you agree with the proposal to increase the financial penalty price for providing inaccurate Target Period data in line with the buy-out cost per tCO2e for TP6?

Please see response to question 11.

14. Do you agree with giving the scheme administrator discretion to waive or reduce penalty amount when considered appropriate?

Yes.

15. In which situations do you believe it would be appropriate for a penalty to be waived or reduced?

The details of each case should be assessed and some allowance for materiality being employed – there have been instances in the scheme where penalties have been significantly out of proportion to what has happened.

16. Do you agree with the proposal to maintain scheme rules for the purpose of this extension?

Yes.

17. Beyond the proposals listed above, are there any other reforms / changes you would recommend for this extension?

We do not agree with the proposals made, as when the cumulative effect is taken into account, these will limit the incentive to be part of the CCA scheme given that alongside Q7, since it is only a one-year TP, opportunities for incremental energy efficiency improvements are now much less, yet the business case for making larger scale investment now becomes more challenging.

We would like to see a widening of the new entrants window into 2024 and also the introduction of a de minimus for penalties; incurring high penalty and administrative costs for immaterial changes is an inefficient process for all. Likewise there is a need to ensure SME's are not adversely impacted by any scheme changes; some changes will be disproportionately bigger for an SME versus a larger company.

18. Do you agree with the proposed timeline for the target setting and agreement variation process?

Yes, although we are concerned about its short length, and only having a month to pull together a viable counter proposal is too short a time frame.

19. How would the proposed timeline affect you and/or businesses within your sector?

The short timeline may impact the ability to consult and obtain information in relation to target setting.

20. Do you agree with the proposed approach of collecting facility level data to establish targets for a future scheme?

No: FDF has a number of concerns with the proposals as described.

Firstly, confidentiality is crucial, and no companies will want to share information that they consider to be commercially sensitive. Given such information could be subject to a Freedom of Information Request, such information could not be disclosed if there is a risk this information can go into the public domain leading to competitors gaining an advantage (i.e. production volumes, energy use and hence cost per product, unique processes). Government therefore needs to propose how such information will be prevented from being made public by either them, the third parties or the Administrator, and how any information used will only be used for the purpose stated and not the other reasons without seeking permission.

Secondly, recent target negotiations have used site level data using existing ESOS reports. These should continue to be used and hence avoid duplicating audits and analysis.

Thirdly, the assessment criteria for quantifying potential such was what an IRR threshold should be is absent, alongside criteria such as debt profile, ownership structure and capital investment threshold, all of which will impact the viability of projects for investment.

Fourthly, it is unclear if the Government is proposing a sector target or whether sub-sector or site targets are inferred.

21. What else should be considered in setting targets for any potential future scheme?

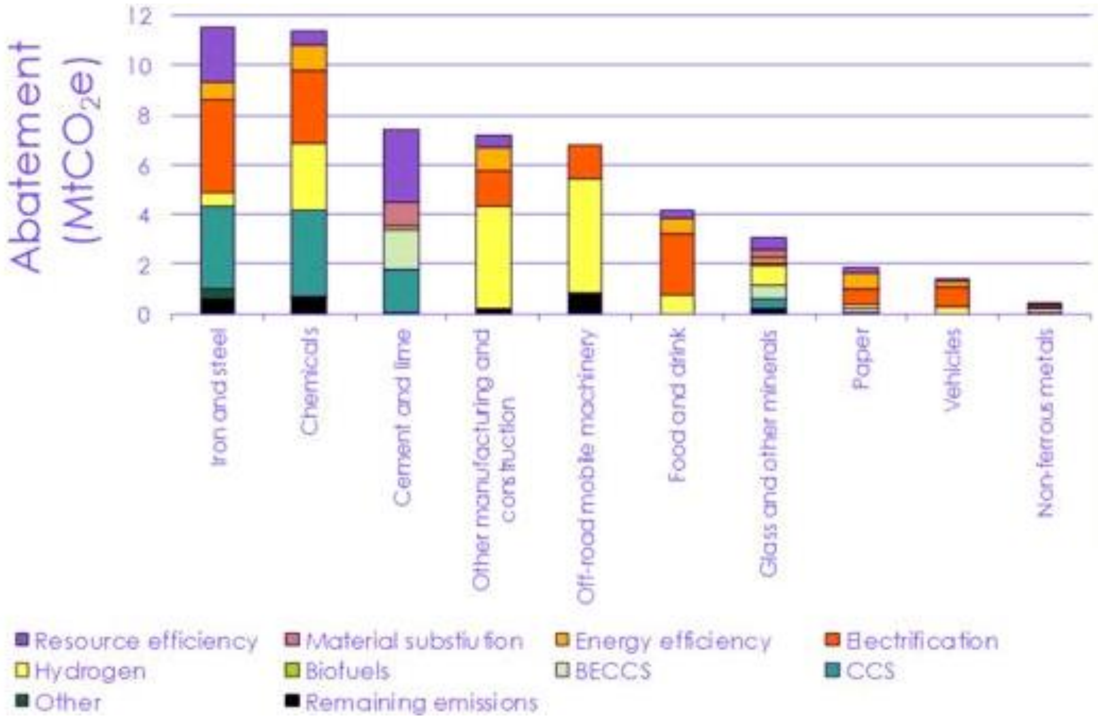
FDF agrees that decarbonisation potential needs to be incorporated, but the assessment criteria (see question 20) are currently absent.

Overall, a new scheme should have targets that can tie in to an 8-year period to link in with the Government's 2035 78% carbon reduction target.

Whilst the current focus on energy efficiency has been successful, further scope is more limited. Moreover, focusing on energy efficiency actively discourages fuel switching which is contrary to Government's overriding decarbonisation objectives. For example, firms can be penalised where lower energy efficiency conversions may be incurred e.g., with biomass boilers, and also in the use of nitrogen for cooling (despite nitrogen being a more expensive alternative to the use of electricity, an equivalent value of electricity and CO2 value is applied). A more holistic approach on carbon savings, would also mean that there is an incentive to either import or have onsite renewable generation.

Furthermore, a future scheme must encompass the duality of energy efficiency and decarbonisation going hand-in-hand. This is essential for the food and drink sector given that the decarbonisation of heat will lead to increased energy use through fuel switching to electrification – a main pathway as highlighted in FDF's heat decarbonisation report[2] and the CCC's sixth carbon budget as shown below.

[2] https://www.fdf.org.uk/fdf/resources/publications/decarbonisation-of-heat-across-the-food-and-drink-manufacturing-sector/



Abatement and remaining emissions for manufacturing and construction subsectors in 2050 (Climate Change Committee, Sixth Carbon Budget)

Indeed, as highlighted in the study we published in June 2020 on decarbonising heat in food and drink manufacturing[3], we found the focus between now and 2035 will be on renewables and electrification.

A focus on carbon targets can also provide an opportunity to consolidate with other schemes for example with UKETS to enable a more streamlined approach to achieving carbon targets, and a greater ability to be able to measure progress and cost-effectiveness of the scheme.

Overall, a holistic approach to reducing carbon emissions and saving energy will help prioritise the use of investment funds. In line with government aspirations, companies are setting carbon reduction targets and using energy efficiency as one way of achieving that.

How could these targets be set?

Carbon targets can be developed as part of the target negotiations as has been done previously. Indeed, the current CCA allows for targets to be set based on just energy efficiency measures or a broader range of projects that result in carbon savings (i.e., fuel switching). Both are then measured in a similar way: energy targets are based on total energy use and production; carbon targets use the same except the energy data is converted into carbon. Both have a buy-out in CO2.

It should be noted that whilst the uptake of carbon targets has been low, this is because the measures that targets have been based on so far have focused on energy savings – it is not because they are not wanted. Indeed, the future looks very different

[3] https://www.fdf.org.uk/fdf/resources/publications/decarbonisation-of-heat-across-the-food-and-drink-manufacturing-sector/

as there will be more fuel switching and the electricity grid is decarbonising rapidly at the same time.

For Food & Drink, a carbon target could be derived from establishing the measures the sector could implement and calculate the carbon reductions we should see. The challenge is the treatment of emissions from electricity; in a future scheme these will need to reflect the actual decarbonisation of the grid - so far in the CCA they have been fixed.

Overall, electrification will be a key tool in the food and drink sector's decarbonisation strategy and will have a greater impact that energy efficiency measures, hence companies will be prioritising many of these actions. Under an energy efficiency target calculated in primary energy, electrification measures will not always result in energy efficiency savings but will result in CO_2 savings as the grid decarbonises and if companies are on renewable supplies which can be reported as zero emissions under GHG reporting guidelines.

22. Do you agree that targets should remain primarily focused on the implementation of cost-effective energy efficiency improvements, and that the target setting exercise is the best way to determine where carbon targets would be more appropriate?

Please see responses to questions 20 and 21. Given the focus companies give to decarbonisation and the use of on-site electricity generation the possibility of a carbon target would seem a sensible option.

23. Do you agree with moving to Facility level reporting and performance measurement?

No. Whilst the justification for the proposal is on streamlining the process is noble in cause, the negative implications on removing 'bubbles' more than outweigh the benefits of removing stringency tests and mixed base years.

Since the start of the CCAs, legal entities have been able to have one target which includes all their sites, enabling companies to choose where energy savings can be made to best effect. The impacts of such a change would likely result in lower levels of investment and number of participating sites as covered under Q24.

However, a way to mitigate this could be to ensure that the CO_2 result against the target (i.e. generated from over or under performance) from the different sites belonging to a legal entity should be tradable without further action necessary. The net CO_2 position should then be recorded at the legal entity level and if the net position is a buy-out, then one buy-out invoice should be raised to prevent administrative complexities.

24. What do you think the impact of this change would be for your sector?

As referred to in Q7, even without any change to eligibility rules, when combined with the proposed changes for the extension of the current scheme, the net cumulative impacts will result in it becoming more challenging to finance larger scale investments. This may lead to less installations participating in the scheme as opportunities for incremental improvements to energy efficiency are now much less, and those remaining being much larger in scale with corresponding increases in the capital and investment threshold requirements in the investment decision making process.

25. Do you agree with the proposal to reform reporting as described above?

No. This proposal is completely disproportionate, and even more so for smaller sites, outweighing the perceived benefits of scheme simplification. Furthermore, sites through their existing ESOS reports, already can identify opportunities for improving efficiency.

The proposal over complicates the approach by mandating the analysis of data to establish the baseline and the variable energy use, then using these to predict what energy use should be at different production volumes:

- Analysing energy use and developing a robust statistical link to production is challenging and can take many months of work to agree with the Environment Agency
- It will only work for sites with lots of energy and production data
- It will not work for sites with little data and sites that produce many different products
- The proposal will be costly and complicated
- The analysis will need repeating when significant changes are made (e.g. new products or major equipment is introduced).

26. What would the impact of this change of reporting be for you and/or your sector (e.g. estimated operational/logistical costs or overarching impacts)?

As referred to in Q7, even without any change to eligibility rules, when combined with the proposed changes for the extension of the current scheme, the net cumulative impacts will result in it becoming more challenging to finance larger scale investments. This may lead to less installations participating in the scheme (particularly for smaller sites where the proposals are completely disproportionate) as well as fewer large-scale investments which have more challenging investment threshold requirements to pass.

27. Do you agree that carbon emissions factors should be updated to the currently available factors for each TP?

Yes.

28. Do you agree that the primary electricity factor for electricity should be updated for a new scheme?

Yes.

29. Do you agree that self-generated electricity should be accounted for as set out above?

Yes.

30. Do you agree with the proposal to bring UK ETS energy into the target energy for any new scheme?

No – FDF does not agree with the current proposals for incorporating UK ETS energy into target setting. Whilst this would result in some administrative simplification for a number of sites when they enter or exit the UK ETS during a target period, the major challenge is that the proposals could result in a site paying for emissions above its free allocation in the UK ETS and paying a buy-out fee related to some or all of the same energy if the site doesn't meet its CCA target. As a consequence, this proposal will result in increased costs for sites thus taking cash away for investment in reduction projects.

Alternatively, a buy-out mechanism could be introduced to enable the trading of CO2 for over and under performance, giving an opportunity to rationalise overlapping policies namely between CCAs and UKETS.

Another perspective to consider is that UKETS was never designed for smaller industry, or with food sites in mind. As a result, there should be consideration of how all the energy use, across all fuels, could be covered with the CCAs, rather than having different fuels covered in different schemes, which increases the overall administration burden whilst diluting the overall effectiveness.

Furthermore, between these schemes there should also be consistency on measurement – namely that of carbon reduction.

31. Do you have any further views on adding annual reporting beyond those provided in the last consultation?

No.

32. Do you agree with maintaining the calculation for buy-out in carbon rather than energy?

Yes.

33. What are your views on how buy-out could be calculated for any potential future scheme?

No comment – only that the price needs to be known well in advance to help with budgeting.

34. Would you agree or disagree with this utilising a formula rather than a fixed value set out in legislation?

No comment.

35. With consideration for the reforms outlined elsewhere in this consultation, do you have any comments on how surplus should operate for a future scheme?

FDF believes it is essential the ability to use over performance and hence surplus generated to offset future underperformance, and support the investment case for larger projects. In essence, it is inappropriate to penalise companies that overachieve given the investment timescales for large environmental projects can be many years longer: excessive stringency and competitive disadvantage on early movers must be avoided. As covered in Q7, alongside, opportunities for incremental improvements to energy efficiency are now much less. Instead, remaining opportunities may be much larger, but with correspondingly greater capital and investment threshold requirements to meet, thus making the use of surplus mechanisms even more critical to the investment decision.

This is especially important if each site were to have its own target and multi-site companies can use the surplus for internal trading.

36. Please provide any comments on the timing of any potential future scheme.

It is imperative that given the 18 months left before targets for a future phase of the scheme need to be in place (i.e. January 2025), that we use this time to properly consult and analyse options for reform to make a future phase of CCAs better aligned to Government's decarbonisation targets. Indeed, as highlighted in the study we published in June 2020 on decarbonising heat in food and drink manufacturing[4] and in the CCC's sixth carbon budget, the focus between now and 2035 will be on renewables and electrification. Under an energy efficiency target calculated in primary energy, electrification measures will not always result in energy efficiency savings but will result in CO2 savings as the grid decarbonises and if companies are on renewable supplies which can be reported as zero emissions under GHG reporting guidelines.

To ensure the scheme is aligned to the wider policy framework, options for reform must also consider a wider impact assessment. For example, if increasingly stringent eligibility criteria were to be proposed, then the impact on sites dropping out of the scheme must be considered in the overall impact of the scheme in context of wider Government targets. Indeed, with this example, FDF believes the existing eligibility rules should continue (or even expanded), to avoid industries falling into a policy vacuum. Eligibility is one the most important issues and a consultation is needed on this as soon as possible. It is also essential that any future scheme should not be closed to sectors re-joining if they initially fail any revised eligibility criteria.

In terms of scheme duration, FDF proposes an 8-year period to tie in with the Government's 2035 78% carbon reduction target, and will fit well, as – in addition to electrification – alternative low carbon fuel supplies will be in much greater supply by then. This will help encourage the significant capex expend required for much these much larger projects.

[4] https://www.fdf.org.uk/fdf/resources/publications/decarbonisation-of-heat-across-the-food-and-drink-manufacturing-sector/