EXPLANATORY MEMORANDUM TO

THE CLIMATE CHANGE AGREEMENTS (ADMINISTRATION AND ELIGIBLE FACILITIES) (AMENDMENT) REGULATIONS 2025

2025 No. 813

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 Sarah Jones, Minister of State for Industry at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Olivia Absalom, Deputy Director for Business & Industrial Transformation, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Rowan Green at the Department for Energy Security and Net Zero Telephone: +44 20 7215 4361 or email: rowan.green@energysecurity.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends secondary legislation dealing with the Climate Change Agreements (CCA) scheme. This is a voluntary scheme pursuant to which CCA scheme participants enter into agreements with the Government to reduce their energy use or emissions and, in exchange, are entitled to pay reduced rates of Climate Change Levy (CCL). CCL is a tax on the supply of energy to non-domestic users, introduced in 2001 to encourage energy efficiency.

4.2 The main purpose of the amendments is to provide for a new phase of the CCA scheme. There will be three new target periods (periods during which energy efficiency or carbon reduction targets must be met) running from 1 January 2026 to 31 December 2030. This will make CCA scheme participants eligible for reduced rates of CCL up to 31 March 2033. The instrument makes other amendments to the operation of the CCA scheme, explained below.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument is the United Kingdom

4.4 The territorial application of this instrument is the United Kingdom

5. Policy Context

What is being done and why?

5.1 CCL is a tax on the supply of energy to non-domestic users, introduced in 2001 to encourage energy efficiency.

5.2 The CCA scheme is a voluntary scheme pursuant to which CCA scheme participants enter into agreements with the Government to reduce their energy use or emissions and, in exchange, are entitled to pay reduced rates of CCL.

5.3 The CCA scheme supports the Government's objectives to deliver affordable and secure energy and decarbonisation while also helping productivity and the growth agenda.

5.4 The instrument extends the CCA scheme by adding three new Target Periods (TP); specific timeframes during which operators must meet agreed energy efficiency or carbon reduction targets to maintain eligibility for a discount on their CCL: TP7: 1 January 2026 to 31 December 2026, TP8: 1 January 2027 to 31 December 2028, and TP9 1 January 2029 to 31 December 2030.

5.5 The instrument makes amendments to set CCA targets at a facility level (as opposed to setting targets for a group of facilities with the same operator) with reporting and performance assessment required at this level. It will also make amendments in relation to the provision of information by introducing additional annual reporting requirements relating to actions taken towards meeting the target, the UK Emissions Trading Scheme and confirmation of eligibility for the CCA scheme, as well as new interim reporting requirements in the first year of a two-year target period. These changes address findings of a 2020 independent evaluation[1] which highlighted the need to better target the new scheme for maximum effectiveness, thereby protecting taxpayers while continuing to support UK industry. The move to facility level reporting will also simplify several rules and requirements in the scheme and provide the government with a more detailed view of energy usage across participating sectors.

5.6 The instrument makes amendments to the terms to be included in a CCA agreement relating to the buy-out fee; a fee that an operator may pay to retain certification in the CCA scheme when they have not met their targets. The instrument provides for a formula for the calculation of the buy-out fee for the new target periods, a dynamic fee starting at £37/tCO2e in 2027 (an increase from £25 in the last target period), which adjusts each Target Period to ensure continued relevance relative to the value of CCL rates, (tax rates which have effect independently of the buy-out fee), encouraging businesses to save more energy while keeping costs fair. The formula reflects the methodology used to calculate the buy-out fee for TP 6 and takes an average of the respective value of electricity and gas CCL relief (i.e. £/kwh), divided by the emissions factor to convert to a cost per carbon dioxide equivalent (£/tCO2e). Whilst updating this formula the Government has taken the opportunity to update the Primary Electricity Factor (PEF) and Carbon Emission Factors (CEF) that had not been updated since 2001 and 2012 respectively to align with latest energy metrics reflecting grid efficiency and decarbonisation. The change to the PEF is described at paragraph 5.12.

[1] https://www.gov.uk/government/publications/second-climate-change-agreements-scheme-evaluation

What was the previous policy, how is this different?

5.7 To remain compliant with the CCA scheme and retain entitlement to reduced rates of CCL, operators must either meet agreed energy efficiency or carbon reduction targets or pay the buy-out fee. The buy-out fee is currently payable on each tonne of carbon dioxide equivalent by which a Target Unit (a group of facilities operated by a single operator) falls short of meeting any target for a Target Period. There were four initial Target Periods in the CCA scheme for which Target Units were required to meet their targets, covering the four two-year periods from 2013 to 2020 inclusive, followed by Target Period 5 (during the first extension to the CCA scheme) running from 2021 to 2022 and Target Period 6 (during the second extension to the CCA scheme) running from 1 January to 31 December 2024.

5.8 Alternatively, operators who did not meet their targets may choose not to pay the buy-out fee and lose their certification to claim the discount on CCL for the next certification period (certification periods run after Target Periods and are set in underlying agreements – agreements made between the operator of a target unit and the scheme administrator). If a Target Unit overachieved 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. A surplus can be off-set against under achievements against targets in certain subsequent Target Periods.

5.9 Operators who complied with the scheme (either by meeting their targets or by paying the buy-out fee) will benefit from the reduced rate of CCL until the present CCA scheme ends, which was 31 March 2027 prior to these amendments.

5.10 The policy intent behind this instrument is to extend the CCA scheme to 31 March 2033. It does so by amending the Climate Change Agreements (Administration) Regulations 2012 (S.I. 2012/1976) to provide for three new target periods (Target Period 7, Target Period 8 and Target Period 9) from 1 January 2026 to 31 December 2030, and amending the Climate Change Agreements (Eligible Facilities) Regulations 2012 (S.I. 2012/2999) so they remain in force until 31 March 2033. Certification Periods will now run to 31 March 2033, ensuring businesses can continue claiming reduced CCL rates throughout the scheme's duration. Alongside this extension of the CCA scheme, the instrument makes amendments to the operation of the scheme following consideration of responses from the consultation that ran from 15 March 2023 to 10 May 2023 and engagement with the scheme administrator: the Environment Agency. The amendments which have not already been described in paragraphs 5.4 to 5.6 above are explained below.

5.11 This instrument makes amendments to S.I. 2012/1976 to reflect the current responsibility for the operation of the CCA register, and to remove some obsolete provisions.

5.12 It also makes amendments in relation to the multiplication factor for calculating reckonable (i.e. primary) energy, which is the amount of energy supplied to, or used by, a facility and on which CCL is payable. It amends the factor for grid electricity from 2.6 to 2.1 to account for the greening of the grid and increased efficiency of electricity generation, transmission and distribution. Electricity generated from solar, wind or water and either generated on-site or not supplied through a distribution network is not subject to this multiplication.

5.13 It also makes amendments to the provisions dealing with the calculation of reckonable energy from combined heat and power (CHP)) stations and dedicated electricity generation plant. These amendments reflect the use of renewable fuel (biomass) and non-renewable fuels in such facilities, and ensure that electricity from a CHP station is

only regarded as put into public supply where it meets the appropriate CHP quality assurance standards.

5.14 The instrument introduces a transitional provision to the effect that the amendments apply only in relation to the new Target Periods. This reflects the fact that S.I. 2012/1976 includes provisions which are specific to particular Target Periods.

6. Legislative and Legal Context

How has the law changed?

6.1 Section 30 of, and Schedule 6 to, the Finance Act 2000 make provision for CCL to be charged on certain supplies of energy. A reduced rate of CCL is charged if a facility which receives supplies of energy is certified as being covered by a CCA, as defined at paragraph 46 of Schedule 6 to that Act, for a certification period. Part IV of Schedule 6 makes provision in relation to CCAs and confers powers on the Secretary of State to make regulations in relation to the CCA scheme.

6.2 The Climate Change Agreements (Administration) Regulations 2012 (S.I. 2012/1976) appoint the Environment Agency to administer CCAs and make provision in relation to the administration of the scheme. The Climate Change Agreements (Eligible Facilities) Regulations 2012 (S.I. 2012/2999) define what is an eligible facility for the purposes of entering into a CCA and how reckonable energy is to be calculated. The instrument amends these two sets of regulations to give effect to the policy described in section 5.

Why was this approach taken to change the law?

6.3 The policy is implemented by making amendments to the existing regulations. This is because the amendments are not so extensive as to justify reproducing those existing regulations with amendments.

7. Consultation

Summary of consultation outcome and methodology

7.1 A consultation was published alongside an announcement of a new 6-year phase of the CCA scheme at Autumn Statement 2023. This followed previous announcements of short-term extensions and legislation to extend the current scheme. The 2023 consultation, which ran between 22 November 2023 and 14 February 2024, sought views on policy proposals for a new 6-year CCA scheme, including changes to eligibility requirements, reporting requirements and target setting processes.

7.2 The consultation built on earlier engagements, including a December 2021[2] consultation on the future of the CCA scheme and a March 2023[3] consultation on a two-year extension (Target Period 6) and future scheme.

7.3 The government response, published on 16 October 2024[4], re-affirmed the commitment to a new 6-year CCA scheme, with targets to the end of 2030 (with the first target period starting for existing CCA sectors on 1 January 2026) and providing for CCL reduced rates for those meeting their obligations until March 2033.

[2] https://www.gov.uk/government/consultations/climate-change-agreements-ccas-proposals-for-a-future-scheme
[3] Climate Change Agreements: consultation on extension and future scheme (2023) - GOV.UK
[4] https://www.gov.uk/government/consultations/climate-change-agreements-consultation-on-a-new-scheme

7.4 62 responses to the consultation were received from the following groups: 41 were from sector/trade associations, 17 were from businesses, 3 were from consultants and 1 was from an academic.

7.5 There was broad support for the new 6-year scheme including maintaining the current financial penalty, allowing surplus energy savings to be carried forward between target periods, and updating the primary electricity factor before each target period.

7.6 Majority of respondents welcomed the proposal of gathering data at facility level, and for the data gathering exercise to be conducted prior to any target setting process. There were concerns about potential increased administrative costs and on the deliverability of the timelines, which prompted the delay of the scheme to start 1 January 2026. DESNZ will introduce standardised reporting templates that seek to ease stakeholder concerns on administrative burden (see 9.2).

7.7 The devolved administrations in Scotland, Wales, and Northern Ireland are regularly updated on changes to the scheme, recognising the UK-wide application of the CCA scheme.

8. Applicable Guidance

8.1 Guidance previously issued under paragraph 52D(6) of Schedule 6 to the Finance Act 2000 is being updated to take account of the introduction of the new CCA scheme and will be published and available on the GOV.UK Climate Change Agreements page.

8.2 Existing scheme guidance for the EA and for operators is available on the GOV.UK Climate Change Agreements page[5] and the Environment Agency's CCA operational manual, which detail compliance, reporting, and eligibility requirements.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because the CCA scheme relates to a tax measure and is therefore not a regulatory provision within scope of the Better Regulation Framework. However, a proportionate analysis has been prepared to adhere to best practice and will be published alongside the SI. This analysis focuses on the impact of the establishment of a formula to calculate buy-out across TP7-TP9. If a business misses its target, it can pay a "buy-out" fee to still qualify for the tax discount. For the new scheme's TP7 the buy-out fee will increase to £37/tCO2e.

9.2 CCAs are a voluntary scheme which provide eligible energy intensive businesses with the opportunity to receive significantly reduced rates of CCL if they meet energy efficiency or emission reduction targets. For those businesses signed up to agreements there is a potential positive impact on their CCL tax bill as well as potential security of supply benefits and reduction in energy bills from the implemented energy efficiency measures. Additional administrative requirements are being implemented to improve the value for money of the scheme (relative to the findings from the 2020 independent evaluation). There is insufficient evidence to indicate that there will be significant impact on participating business, charities or voluntary bodies. Moreover, the additional administrative requirements are due to be introduced in a proportionate

[5] https://www.gov.uk/government/publications/climate-change-agreements-statutory-guidance/climate-change-agreements-scheme-extension-2023-statutory-guidance#:~:text=This%20guidance%20has%20been%20updated,a%20period%20to%20allow%20new

way, considering additional burden on operators and looking to allow participants to continue their voluntary participation in the scheme.

9.3 The buy-out fee increase is commensurate with the increased value of the reduced rate of CCL provided since the buy-out was last reviewed for TP6, and the updated emissions factors of gas and primary electricity introduced in the new scheme. The level of buy-out required has remained relatively constant (around half of target units) in the first 6 CCA Target Periods despite increases to the buy-out price in that time (from £12/tCO2e to £25/tCO2e). Moreover, whilst the use of the buy-out mechanism has remained broadly flat amongst scheme participants, there is not as yet evidence of any notable change in the number of scheme participants across the first 6 CCA Target Periods – indicating the attractiveness of the scheme has not been significantly impacted by the previous increases in the buy-out fee.

9.4 Furthermore, the use of the buy-out mechanism will be dependent on the targets that participants are set. These are yet to be confirmed and will be finalised prior to the scheme commencing in January 2026.

9.5 There is insufficient evidence to indicate that the legislation will have a significant impact on small or micro businesses. No specific action is proposed to minimise regulatory burdens on small businesses (employing up to 50 people). The basis for the final decision on what action to take to assist small businesses is that this is an extension to an existing, voluntary scheme which small or micro businesses do not have to participate in. If they do, then they will receive the reduced rate of CCL which should outweigh any of the voluntary participatory costs as a result of the additional reporting requirements that are due to take effect.

9.6 There is no significant impact on the public sector as participants of the scheme because the scheme is focussed on business in eligible energy intensive sectors.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 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

10.2 No further monitoring or review is planned. The regulations extend the reduced rates of CCL through to 31 March 2033, and its application is, therefore, time-limited.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

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

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023.