# UK STEEL – SUBMISSION TO CLIMATE CHANGE AGREEMENTS: CONSULTATION ON A NEW SCHEME

**Date: 14 February 2024**
**To: cca@energysecurity.gov.uk**

## About UK Steel

UK Steel, a division of Make UK, is the trade association for the UK steel industry. It represents all the country's steelmakers and a large number of downstream steel processors.

## Submission to the consultation on a new Climate Change Agreements scheme

**General comments:**
UK Steel welcomes the opportunity to respond to the consultation on the new Climate Change Agreement Scheme. It is worth restating some facts about the steel sector and its current interaction with the current Climate Change Agreement (CCA) scheme, which is relevant to the consultation at large:

- The steel sector has been a member of the CCA scheme since its introduction in 2001, exemplifying the type of industry the scheme was designed to support. Namely a highly energy, carbon, and trade-intensive sector at high risk of competitive disadvantage and carbon leakage due to increased energy costs.
- As of 2014, the vast majority of the energy consumed by the steel sector is eligible for a 100% exemption from the CCL due to the Government's introduction of the Mineralogical and Metallurgical (min & met) exemption. As a result, most steel production sites have withdrawn from the CCA scheme as the financial incentive to participate is now effectively available through another more cost-effective and less administratively burdensome option.
- Even amongst sites remaining in the scheme, a large amount of energy (in some cases, the vast majority) is also covered by the min & met exemption. The CCL reduction provided by CCA participation is, therefore, only often related to a small amount of 'residual' energy on sites not with the scope of min & met exemption. This reduction in the financial benefit directly provided by the CCA to steel sites correspondingly results in a significant weakening of the incentivising effect the CCA scheme can have on energy efficiency investments. Furthermore, in cases of failure to meet targets, there will be a much finer balance between the costs of the buy-out fee and the financial benefits of remaining in the CCA scheme.
- For example, if 95% of a site's energy consumption (split equally between electricity and gas consumption) is within the scope of the min & met exemption, then membership of the CCA provides just a 0.3% reduction in energy prices for the site[1]. The overall energy cost clearly remains a strong driver for energy efficiency investments, but the CCL discount available through CCA participation will make a negligible difference in business cases for investment at such sites.
- Large investments in decarbonisation have happened as a result of bilateral negotiations between steel companies and Government, where Government provides CAPEX support. This also mirrors the development abroad, where investment to reduce emissions happens due to Government co-financing. Similarly, investments in energy efficiency have been announced after the successful application for funding from the Industrial Energy Transformation Fund, again illustrating that government co-financing is the primary driver of investment.
- However, the overall price of electricity does impact the ability of steel companies to attract investment into the UK. While significant investments have been announced in combination with government co-financing, differences in electricity prices will still impact the ability to attract long-term investment in

[1] Benefit of CCA calculated at 0.3% reduction in energy prices based on equal consumption of delivered natural gas and electricity, energy prices of extra-large energy user in 2020 from BEIS/ONS "Prices of fuels purchased by non-domestic consumers in the UK".

energy efficiency. Most of the major steel producers in the UK are part of multi-national companies with facilities in the EU, and four operate outside the EU. From this perspective, the cost competitiveness of each particular market is crucial to attracting investment. Persistent cost disadvantages in the UK lead to underinvestment, which in turn leads to further erosion of competitiveness. The CCA scheme is, therefore, helpful in reducing the CCL and lowering the overall price of electricity for steelmakers.

- As of 2023, there are 6 TUs left in the steel sector CCA comprising 12 facilities. The production and energy consumption of the industry are dominated by the primary steel producer remaining in the scheme, which accounts for over half of the facilities and the overwhelming majority of the energy – approximately 95% of the target facility energy and 99.99% of the eligible energy.
- As with most energy-intensive industrial sites, the vast majority of eligible energy consumption on site is the direct combustion of fossil fuels, which sits within the scope of the UK ETS. The target energy is, therefore, primarily electricity. As the UK's primary steel production decarbonises over the next decade, its electricity consumption will significantly increase as the switch to electric arc furnaces is incredibly electro-intensive. A switch from primary steelmaking to EAF would mean the ability to self-generate electricity onsite using waste gases will also be removed, further increasing the use of grid electricity. UK Steel estimates that the switch to EAF production will double the steel industry's electricity consumption, and the sites switching will increase their use by five times[2].
- In these circumstances, a straightforward energy efficiency target predominately requiring regular reductions in electricity consumption may cease to work for the steel sector. A mechanism will need to be found to ensure the steel sector continues to remain in the scheme and/or receive the reductions in energy costs it provides. The UK has Europe's highest industrial electricity costs, undermining industry competitiveness. Even after the implementation of the British Industrial Supercharger package, UK Steel estimates that UK steelmakers will face electricity prices 40% higher than those in Germany and France[3].
- The Government must take these considerations into account in the design of the new scheme, including taking additional necessary steps outside the scope of this consultation to safeguard the competitiveness of the steel sector and its ability to invest in decarbonisation. This should include consideration with HMT of amending the operation of the min & met exemption if it were determined that the new CCA scheme couldn't cater for the likely trajectory of the sector's target facility energy consumption as it decarbonises.

**1. Do you agree with the proposal to allow new entrants to the scheme at any time?**
We agree and support the proposals to get new entrants into the scheme at any time.

**2. Do you agree that new entrants should complete a Target Period before receiving certification for reduced rates of CCL?**
If a company joins one year into a target period, it should be able to receive certification for the reduced CCL rates at the end of that target period if it has met the necessary targets or paid the relevant buy-out fees. It would not be reasonable for them to wait until the end of the subsequent target period to be eligible for reduced CCL fees, especially if they had to pay buy-out fees for not meeting the target of the first TP.

**3. What are the potential impacts of the proposal that operators should make an annual confirmation to the scheme reporting that their facilities remain compliant with the threshold?**
This would create additional administrative burdens to add further reporting requirements.

**4. Do you agree with the proposal to gather data at a facility level to inform target setting?**
We do not support moving to facility-level reporting and measurement as it would have several negative impacts on the steel industry:

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[2] UK Steel (2022), Net Zero Steel - A Vision for the Future of UK Steel Production, July 2022, https://www.uksteel.org/versions/2/wizard/modules/fileManager/downloadDigitalFile.php?url=https%3A%2F%2Fstatic.s123-cdn-static-d.com%2Fuploads%2F8346772%2Fnormal_65002b831e054.pdf

[3] UK Steel (2023), UK Steel Industrial Competitiveness - Electricity Prices Faced By UK Steelmakers, November 2023, https://www.uksteel.org/electricity2023

- This will increase administration for TUs and companies if they must report separately for each facility without any apparent benefit. The administration of filling out several spreadsheets rather than just one will require additional resources and also increase the administrative burden for the trade associations. The Government must take a balanced approach that minimises administrative burden and data requests on industry where possible.
- The energy efficiency investment at one facility would not benefit the overall TU, where one facility's improvement can balance the underperformance of another. Instead, as each facility would have its own target, it would only benefit from energy efficiency at that site. This would dissuade companies from making large investments in energy efficiency, as the benefits of this would not be shared across the whole company. Instead, the rational investments would be in minor measures at each site with small improvements.
- Therefore, any surplus built up would only benefit the one facility rather than the overall company. This again reduces the attractiveness of the CCA scheme, as it will likely increase the overall buy-out fees paid, forcing many companies to leave the scheme.

**5. Do you agree with the proposal that the proposed data gathering exercise be conducted prior to any target setting process?**
Yes.

**6. Can you provide suggestions on how to reduce potential administrative costs of this approach?**
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**7. Do you agree that 2022 should be used as the baseline year for the new scheme?**
**8. If you believe the baseline year should be revisited, which year should be used and why?**
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**9. Do you agree that the primary electricity factor should be updated before each Target Period?**
Yes.

**10. What would be the impact of updating the primary electricity factor before each Target Period?**
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**11. Do you agree with the proposal to extend reporting to include providing further evidence of energy efficiency and decarbonisation potential?**
We do not believe there is any major benefit from requiring companies to report annually. Annual energy efficiency gains are likely to be minor, and therefore reporting on a bi-annual basis retains a good balance between administrative burden and providing progress reports. The Government must take a balanced approach that aims to minimise administrative burden and data requests on industry where possible. It should also be noted that data provided through CCAs in many sectors is also of limited value to both the Government and industry. Because such a large proportion of energy sits under the UK ETS – data sets represent just a partial picture of consumption and improvements made onsite. We, therefore, do not believe that it is an efficient use of the time and resources of the participating companies to report more frequently. Annual reporting will only increase the burden of participating in the scheme, with little extra value to companies or the Government.

**12. If so, do you agree that the energy efficiency and decarbonisation reporting should capture potential within the next 6 years on an annual, rolling basis?**
No, it would be an unnecessary burden to have to report on the energy efficiency potential continuously. Reporting on this alone will not increase the investment in energy efficiency, but co-financing and a more supportive business environment would achieve this.

**13. Do you agree with the proposed methodology for calculating the buy-out price, including a weighted average between the respective electricity and gas CCL discount per tCO2e?**
Yes.

**14. Do you agree that the buy-out price should be reviewed ahead of each new target period to account for the potential continued equalisation of the CCL?**

Yes.

**15. Do you agree with the proposal to allow surplus to be carried forward between Target Periods?**
Yes.

**16. Do you agree with the proposal to keep the current financial penalties for a new CCA scheme?**
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**17. Beyond the proposals listed above, are there any other reforms / changes you would recommend for this new scheme?**
We disagree with the proposal to move to mandatory Novem targets, as this would substantially increase the administrative burden of the scheme and force participants out of the CCA scheme. There are over 3,500 grades of steel, and even though a steelmaker does not produce all, it will be horrendously complicated to have reporting broken down by each product type. The necessary and most economically rational decision would be to leave the CCA scheme, which would reduce their competitiveness and reduce the Government's ability to meet its energy efficiency target. We would strongly urge the Government to reconsider enforcing mandatory Novem targets for all CCA participants, as the number of products would increase the reporting requirements substantially without any significant benefits to the Government or CCA participants.

Separately, we would also urge the Government to reconsider moving to facility-level targets and reporting:

- This will increase administration for TUs and companies if they must report separately for each facility without any apparent benefit. The administration of filling out several spreadsheets rather than just one will require additional resources and also increase the administrative burden for the trade associations. The Government must take a balanced approach that minimises administrative burden and data requests on industry where possible.
- The energy efficiency investment at one facility would not benefit the overall TU, where one facility's improvement can balance the underperformance of another. Instead, as each facility would have its own target, it would only benefit from energy efficiency at that site. This would dissuade companies from making large investments in energy efficiency, as the benefits of this would not be shared across the whole company. Instead, the rational investments would be in minor measures at each site with small improvements.
- Therefore, any surplus built up would only benefit the one facility rather than the overall company. This again reduces the attractiveness of the CCA scheme, as it will likely increase the overall buy-out fees paid, forcing many companies to leave the scheme.

**18. Please provide any comments on the timeline set out above.**
The Government is too optimistic about what can be achieved in a limited time period. We could encourage the CCA team to give industry more time to collect data.

**For further information, contact:**
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