

Carbon Reduction Commitment Energy Efficiency Scheme

The CRC is a compulsory carbon emissions trading scheme that affects many large UK public and private sector organisations including companies, partnerships, universities, local authorities and NHS bodies. It came into force on 1 April 2010 and changes to it have already been made. Here is the current position.

The CRC forms part of the Government's wider climate change policy agenda as set out in the Climate Change Act 2008. In that Act, the Government entered into a legally binding commitment to reduce the UK's greenhouse gas emissions by 80 per cent by 2050.

This note covers the CRC as applied in England and Wales.

Those required to participate should have registered between April and September 2010, although according to the Environment Agency, which regulates the scheme, registrations were significantly lower than expected.

Part of the reason must be the sheer complexity of the scheme. The Government promised simplification "... to reduce the burden on business"¹. The CRC Energy Efficiency Scheme (Amendment) Order 2011 has made some simplifying changes (as from 1 April 2011) while a longer-term consultation about the future of the scheme is undertaken by the Department of Energy and Climate Change.

From April 2010, participants should have started to monitor and record emissions and, from April 2012, will have to pay for those emissions.

The scheme provides financial and public relations incentives to reduce emissions and to invest in energy efficiency programmes, although one of the cornerstone incentives – the "recycling" back into the scheme of payments for emissions allowances – was removed in the 2010 Comprehensive Spending Review. The cost of allowances will now go to the Treasury rather than back to participants. Once you have paid for your allowances, that money has gone for ever (unless organisations are able to find a market to whom to sell any surpluses).

Who has to participate?

Qualification criteria

Organisations that, in 2008:

- 1 had at least one half-hourly electricity meter; and
- 2 consumed at least 6,000 megawatt hours (MWH) of electricity through half hourly meters (at 2008 prices, about £500,00),

have to participate. (For the purposes of this note, those organisations are known as "participants".)

Those who have an half-hourly meter but do not satisfy the consumption threshold will not be required to participate. They used to have to disclose certain information to the Environment Agency about consumption, but this obligation has been removed by the Amendment Order as from 1 April 2011.

Half-hourly meters are usually installed in large commercial and public sector premises and measure electricity consumption at hourly intervals, enabling electricity providers to charge consumers according to demand at different times of day.

To put the electricity consumption threshold in context, Mills & Reeve LLP, which has six offices and 800 staff and partners, consumes approximately 3,000 MWH each year. The average UK household uses five MWH each year.

Central Government departments such as the Ministry of Defence and the Department for Communities and Local Government must participate irrespective of whether they meet the qualification criteria.

¹ The Comprehensive Spending Review October 2010 paragraph 2.108

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Identifying the “organisation”

Before you can establish whether or not your organisation meets the qualification criteria, you need to work out the extent of your organisation for the purposes of CRC and for what electricity consumption it is responsible.

In respect of the first issue, the following general principles apply:

- **The business sector.** This includes companies, partnerships and unincorporated associations.
- A single company with no parent and no subsidiaries will form an organisation in its own right. Companies in the same group (according to the test set out in section 1161(5) of the Companies Act 2006) will be joined together to form one organisation.² In some situations, joint venture/PFI companies and franchisees may form part of that group. Where the parent company is based overseas, all UK arms of that overseas parent company must be grouped together. (A group’s overseas operations do not need to be included.)
- Partnerships³ and unincorporated associations will form organisations in their own right, together with any companies they own. Sole traders do not come within the scheme.
- Companies that are owned by public bodies (other than central Government departments) will form organisations in their own right and will not be grouped together with their owners.
- **Higher education.** Universities will form organisations in their own right.
- For collegiate universities, the colleges and university will be grouped together to form a single organisation for the purposes of assessing whether the qualification criteria are met.⁴ If they are, “independent colleges” have to participate on their own unless they agree to join together (for the

purposes of CRC) with other independent colleges or the university itself.⁵

- “Independent colleges” are colleges which have their own governing bodies with a legal identity separate from the governing body of the university itself.⁶
- Universities should not include companies that they wholly or partly own in their group.⁷ These companies are treated separately.
- **Local government.** County councils, district councils and borough councils will form individual organisations.
- Education authorities will have to include the state funded schools in their area within their group. This includes not only the authority’s maintained schools, but also any academies, city technology colleges and city colleges in their area. PFI schools are not included.
- Local authorities should not include their wholly or partly owned companies in their group. These companies participate alone (or as their own group).
- **NHS.** Strategic health authorities, special health authorities, primary care trusts, NHS trusts and NHS foundation trusts are the main types of NHS body that will form CRC organisations.⁸ Other entities providing primary medical, dental or ophthalmic services (such as partnerships) will also form separate organisations.
- NHS bodies should not include companies that they wholly or partly own in their group. These companies participate alone (or as their own group).

For what electricity consumption is the organisation responsible?

Subject to special rules mentioned below, organisations are responsible for all electricity supplied to them under an agreement with an electricity provider which they then use. The provider could be a utility company or a facilities management company.

² The CRC does, in certain circumstances, enable a corporate group to disaggregate certain parts of its group to enable those parts to participate separately – groups may, for example, want to separate out different brands.

³ See below for further information on partnerships that are providing primary medical, dental or ophthalmic services.

⁴ Once it has been determined that a collegiate university satisfies the qualification threshold, the colleges are able to decide how they would like to participate – as one large group, as a number of groups or individually.

⁵ Articles 21 (1) (b) and 22 of the CRC Energy Efficiency Scheme Order 2010.

⁶ Article 21 (1) (a) of the CRC Order.

⁷ Article 22 and Schedule 3 paragraphs 3 and 6-9 of the CRC Order.

⁸ Other types of NHS body might also be eligible.

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Special rules apply to attribute responsibility between organisations for energy supplied to tenanted properties.

The following broad principles apply:

- If the landlord contracts with the provider for the supply of electricity to a tenanted property but that electricity is used by the tenant or in the common parts, with the cost being recovered via a service charge, the landlord will have to include that electricity consumption in its own calculation. This could be the case in a multi-let building.
- If the tenant contracts with the provider for the supply of electricity to a tenanted property, the tenant will have to include that electricity consumption in its calculation. This is most likely to be the case where the tenant leases the whole of a building.

How does the CRC work?

The CRC operates in phases. The first phase (April 2010 – March 2014) is an introductory phase, where many key features will be softened to allow participants to get used to the CRC in a controlled environment. The original scheme envisaged a 3-year introductory phase but the Amendment Order has extended it to 4 years.

The following two sections explain what the key features of the CRC are and how they are modified for the introductory phase.

Key features

The Government will set a scheme-wide cap on the amount of CO₂ that all full participants, as a group,⁹ can emit in each scheme year.¹⁰

Originally the scheme envisaged that at the start of the scheme year the Government would sell off allowances which would allow participants to emit CO₂. Each allowance will enable one tonne of CO₂ to be emitted. The cost of an allowance will be driven by market forces. The number of allowances for sale will equal the emissions cap that the Government sets, so there will be a finite number of allowances available.

Under a change introduced in the recent CSR, allowances are now to be offered for sale at the end of the scheme year instead of the start. This should mean that participants can buy exactly the number of allowances actually needed rather than having to

forecast, buy in advance and then adjust at the end of the scheme year. This should take the guesswork out of budgeting.

Participants will however still need include emissions from nearly all types of energy used, not just electricity. This includes, for example, emissions from gas, electricity, heating oil and LPG. Emissions from licensed road-going vehicles, trains, planes and boats do not need to be included.¹¹

Modifications – Introductory phase

In the introductory phase (April 2010 to March 2014), the following modifications apply:

- Participants do not need to buy allowances for the first year of the phase (ie, April 2010 – March 2011). The first sale will be in 2012 for the April 2011 – March 2012 year. (This heralds a change to payments for emissions in arrears; as outlined above, the scheme originally envisaged the purchase of allowances at the beginning of the scheme year “upfront”.)
- The cost of one CO₂ allowance is fixed at £12/tonne.
- There is no cap on the number of allowances available for sale.

What are the incentives?

Not as generous as they were! The CRC still provides a financial and a public relations incentive to encourage emissions reductions and investment in energy saving technology.

- **Putting a price on emitting CO₂.** This provides a financial incentive for participants to reduce their emissions – the less they emit, the lower the cost of compliance will be.
- **Stick rather than carrot – the loss of the recycling payment.** The CRC was originally designed to be revenue neutral for the Government. Money received from the sale of carbon allowances was to be recycled back to scheme members and those who performed better in terms of reducing their emissions were in line to receive a larger payment than poor performers. Everyone was due to receive at least part of their contributions back (starting at 90% and gradually reducing to 50% as the scheme matured).

⁹ An individual participant's emissions will not be capped.

¹⁰ A scheme year will run from 1 April to 31 March.

¹¹ There are other exclusions. For example, emissions which already fall within the EU Emissions Trading Scheme are excluded from the scope of CRC. Emissions covered by a Climate Change Agreement are also excluded.

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As outlined above, this recycling element has now been eliminated and the money paid for allowances bought from the Environment Agency will go to the Treasury rather than back to participants.

There is still an incentive in reducing emissions because participants will want to have to pay for as few allocations as possible.

- **Performance league table.** At the end of each scheme year, the Government will publish a league table showing the relative performance of all full participants. The main criteria for determining positions in the league table will be the amount by which an organisation has decreased its emissions. The original rationale for the table was to rank participants so that recycling payments could be assessed. Poor performance reflected in the table will still though be available for all to see and could have damaging public relations implications.

How will the CRC be enforced?

The majority of the CRC obligations will be enforced by way of civil penalties rather than criminal penalties.

For example, a financial penalty will be imposed if an organisation fails to register as a participant¹² and if it fails to surrender sufficient allowances at the end of a scheme year.¹³ The Environment Agency will have the

¹² This currently stands at £5,000, subject to increase at a daily rate of £500 until the participant registers.

¹³ At the time of writing this stands at £40/tonne CO₂ for which the participant was unable to surrender an allowance.

power to serve an enforcement notice in respect of breaches of CRC obligations.

It will be a criminal offence to breach an enforcement notice. Criminal sanctions will also apply in cases of falsification of information and deception.

What should organisations be doing now?

- Establishing whether they need to participate in the scheme – the Environment Agency believes that many obligated organisations have still not registered.
- Considering any necessary procedures to enable emissions to be monitored and reported.
- Assessing the impact that the requirement to buy allowances (especially now that the money will not be recycled to participants) will have on budgets.
- Considering the impact on landlord & tenant and licensor & licensee (including under PFI contracts) relationships. Does there need to be a conversation about contributions by tenants and licensees when they are supplied electricity or other qualifying fuels by the landowner?
- Coming up ways to reduce their CO₂ emissions.
- Considering the possible impact of the CRC performance league table on your their chain.

Get in touch



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