

RELEASE OF FINAL ORDER FOR THE CARBON REDUCTION COMMITMENT ENERGY EFFICIENCY SCHEME (CRC)

January 2010

Following several rounds of Government consultation, the final publication of the CRC Energy Efficiency Scheme Order enables organisations to better evaluate whether their particular organisation is covered by the Scheme, to what extent, and if so, what now needs to be done.

This briefing seeks to provide organisations with an overview of the steps which they will be required to take under the Scheme, and includes key points of clarification provided by the Order.

Step One – What is my organisation?

The first question for any organisation will be to address precisely where the boundaries of that organisation lie under the CRC Scheme. This has been a key area of uncertainty for many organisations.

The Order sets out when public bodies and private organisations will be required to participate as groups, who will be responsible in group structures, how subdivision of groups can occur and how franchises and PFI structures will be treated.

Reminder - Qualification Criteria:

The qualification criteria for full participation in the CRC Scheme are that an organisation, during the 2008 calendar year (or qualification year): (1) had at least one settled half-hourly meter for their electricity supply; and (2) used at least 6,000 MWh of electricity.

Private Sector Organisations

The Order has not changed the main default position that the participation of private sector organisations takes a 'top down' approach that requires related parent and subsidiary holdings to participate together. The Scheme uses the terminology of 'undertakings' and related definitions from the Companies Act 2006 to effect this grouped participation. The effect of this is that all UK operations of any ultimate parent company (whether that parent is outside or within the UK) will be grouped as one organisation under the CRC.

Importantly, a group will be a 'participant' under the Scheme. Responsibilities for the registration of the group, reporting on the group's emissions and ensuring sufficient allowances are surrendered by the group will rest with the 'participant' not specifically any nominated primary member or ultimate parent company. This means that although each group may nominate a member of the group to act as account holder, each member of the group will be jointly and severally liable for all members of the group for all compliance matters.

Significant Group Undertakings

The default all-inclusive position set out above is qualified somewhat by the ability of group organisations to request separate participation for certain parts of the organisation. This "disaggregation" is possible where:

- an undertaking or group of undertakings would itself satisfy the qualification requirements itself (it is a 'Significant Group Undertaking');
- the administrator¹ agrees to such separate participation; and
- the Significant Group Undertaking registers to participate separately within the required timeframes.

Where disaggregation occurs, the parent group and the Significant Group Undertaking will be considered as separate groups under the Scheme and no joint and several liability will exist between those parties.

Public Bodies

As a general rule of thumb, public bodies will be those that are public authorities under the Freedom of Information Act². Public bodies will only be required to participate under the CRC where they fulfil the qualification criteria. Certain government departments

¹ The Environment Agency

² The Freedom of Information Act (2000) and the Freedom of Information (Scotland) Act 2002.

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that are defined in the order³ will be required to register regardless of their energy use.

Unlike their private sector counterparts, public bodies will only be required to participate as a group in certain defined circumstances. For example, the default position for a body corporate that is majority owned by one of the defined government departments is it will be required to participate as a group with that department. This compares with default position for bodies corporate that are owned by other public bodies (such as Local Authorities) which is that they will be deemed to be public bodies in their own right and will not be joined with their owning public body. Both of these default positions are subject to any decisions to aggregate or disaggregate public bodies made by the defined government departments. Further, maintained schools will by default be grouped with their Local Authority governing bodies for the purposes of the Scheme.

In order to demonstrate its commitment to the Scheme, Government has also included a mechanism which will allow it to mandate Government Departments and Local Authorities to participate in the Scheme.

In contrast to the joint and several liability which attaches to private sector organisations; it will broadly fall to the figurehead of any group of public bodies to shoulder responsibility for compliance with the Scheme on behalf of its group. However, it should be noted that criminal liability under the Scheme remains able to attach to any group member.

JV/PFI

As noted above, any body corporate (including those that are joint ventures or special purpose vehicles used to deliver services/assets in the context of a PPI/PFI project) which is majority owned or controlled by a public body, will itself be deemed a public body under the Scheme. However, they will only be required to participate under the Scheme if they meet the qualification criteria. Such bodies will be subject to the same grouping rules as any other public body, and will therefore only be grouped in the prescribed circumstances indicated above.

Joint ventures or PFI companies that have a private organisation as the majority shareholder will be grouped with that owner under the Scheme. Where there is no

majority shareholder, either public or private, the joint ventures or PFI company will be required to participate in their own right, if the qualification threshold is met.

Step Two – Who has responsibility for supply?

Having defined the boundaries of its organisation, the next step will be to assess the energy which that organisation is responsible for under the Scheme. It will be important to determine where responsibility for energy use will lie both when assessing whether an organisation will qualify for participation and subsequently for reporting requirements for the Scheme. A body will be accountable for energy use under the Scheme where the following definition of supply is met:

- it has an agreement with a supplier to purchase either electricity, gas, or another fuel source;
- it does in fact receive such a supply; and
- that supply is measured using a fiscal meter⁴.

Indirect Supply

The Government's consultation response of October 2009 had indicated that where a CHP operator provided electricity exclusively to a participant, that participant would be responsible for any supplies received by the CHP operator under the concept of "indirect supply". This concept has been dropped from the final Order. The addendum to the Government's response indicates that the Government felt that such a scenario is sufficiently covered by other provisions.

Self Supply

An important exclusion from the definition of supply relates to self-supply, which will affect all those organisations with electricity generation, transmission or distribution capacities on any of their sites. Where electricity is supplied to an organisation, it is not deemed to be a supply for the purposes of the Scheme if it is used directly for the generation, transmission or distribution of electricity. A similar exclusion affects supplies of gas for the transport, supply or shipping of gas.

³ These include all Ministerial Departments of Westminster, the Welsh Assembly Government, the Scottish Parliament and the Northern Ireland Assembly.

⁴ Measurement by fiscal meter is a requirement which only attaches to electricity and gas supply.

Landlords and Tenants

Landlords will need to be aware of how the Scheme treats their tenant's consumption of energy. Where a landlord has the supply contract for a tenant's energy use they will be responsible for that supply under the Scheme. Organisations should also be aware that, due to the drafting of the Order these provisions are capable of application to any property arrangements that involve occupation of premises with the owner's permission and may extend beyond the traditional landlord/tenant scenario (for example, licences to occupy).

Franchises

The Scheme will also impose additional responsibilities on those organisations which the Scheme classes as having a franchise agreement. The Scheme will treat a relationship between organisations as a franchise where:

- one organisation (the deemed franchisee) carries out a business which is the sale or distribution of goods or the provision of services;
- that business is carried out under a name provided by another organisation (the deemed franchisor);
- the premises from which the franchisee's business operates are used exclusively for that purpose; and
- the internal and external appearance of those premises is agreed with the franchisor and is of a form similar to other premises in respect of which the franchisor has entered into a franchise agreement.

Where a franchise agreement is deemed to exist under the Scheme and the franchisee receives a supply of energy, the Scheme deems that supply as having been made to the franchisor for the purposes of the Scheme.

Step Three - Registration

The order requires that registration under the Scheme is made by 30 September 2010. However, the Environment Agency is required to consider the application and will only register an applicant once it is satisfied that the application has been "duly made". The Environment Agency has advised that, due to the identification checks they will need to undertake, such consideration could take up to two months. It will therefore be advisable for applications to be submitted no later than the end of July 2010.

It would be wise to submit registration information earlier where disaggregation is being considered. This is because a parent group must be registered at least three months before the end of the registration period and a second registration application for the disaggregated undertaking must then be made, with both of these registrations taking up to two months for the Environment Agency to consider and certify.

At registration the participant will be required to supply a list of all half-hourly electricity meters through which the organisation received a supply of energy during the qualification year. With assistance from energy suppliers, the amount of electricity used through the listed half-hourly meters for the 2008 calendar year can be calculated and then supplied on-line to the Environment Agency.

Step Four – Footprinting & Reporting

The process of footprinting will require participants to submit, prior to the final working day of July in 2011 and thereafter, a footprint report containing the following information:

- the amount of electricity, gas and fuel supplied to the participant for the footprint year;
- the amount of "core supplies" that participant has received during the footprint year⁵, excluding supplies which generate emissions covered by the EU ETS or CCA regimes;
- energy supplied to the participant during the footprint year other than electricity, gas or those other fuels listed under the Order;
- a list of further residual supplies of energy where the 90% minimum is not met;
- the amount of any electricity generating credits received and renewables generation during the footprint year;
- the level of emissions captured under the EU ETS Scheme or a CCA.

⁵ Core Supplies being gas, electricity or fuel supplied to a participant and measured by half hourly meters, non-domestic meters or dynamic supply.

CCA Exemptions

As the Scheme is not intended to overlap with other existing carbon emission Schemes there are exclusions with respect to emissions already covered under the EU ETS regime and Climate Change Agreements (CCA). Further, where an undertaking's emissions are made up of at least a quarter of emissions captured under a CCA, that undertaking will be exempt from important aspects of the CRC Scheme, be it as a sole participant or as a member of a group (note that different rules apply in order to grant an entire group exemption).

The Government position prior to the issue of the Order had been to require CCA exemption applications on registration and also, during the introductory phase only, to allow applications for exemption during the footprint year. The final position is that this will apply to *all* phases. CCA exemptions can therefore be applied for on registration *or* in the footprint year of each and every phase.

Transport

An important exemption which the Scheme has incorporated is for energy consumed for the purposes of transport. In contrast to the wide definition in the previous draft Order, the final Order sets out the specific types of transport to which this exemption will apply. Where an organisation receives a supply of electricity, gas or fuel which is consumed for the purposes of transport, that organisation is deemed not to receive such a supply for the purposes of the Scheme.

Step Five – Ongoing Considerations

The CRC will impact on many commercial arrangements and it will be important to consider these implications in both existing arrangements and those that may be entered into in the future. Examples of these could include:

- where part of a CRC organisation is purchased by another organisation, how should you deal with the transfer of information and possibly allowances held in relation to the emissions from that part of the organisation;
- estimating and including CRC related costs in prices provided in project pitches;
- including specific provision for the pass-on of CRC costs, and dealing with recycling payments in new lease agreements; and
- where services are provided that affect energy use, including efficiency requirements in contracts.

Legal Implications of the CRC

We expect that organisations that are well prepared for the CRC will be able to reduce costs, increase their potential revenue recycling arising in connection with the CRC and avoid penalties under this Scheme. The legal assistance we can offer to help you prepare for the CRC includes:

- an explanation of the Scheme in the form currently encapsulated in the final Order as laid before Parliament;
- assistance in liaison with the administrator;
- consideration of Scheme coverage, how this will apply to an organisation with your structure (including private and public sector, PFI and franchise arrangements) and the possibility of any relevant exemptions or exclusions;
- analysis and advice on your supply relationships and the supplies for which your organisation may be liable;
- advice on further detailed aspects of the Scheme including the treatment of fuels, renewable energy, third party use of energy, the 10% uplift for estimates, conversion factors and reporting requirements;
- review of provisions for your properties to consider passing on CRC related costs ;
- advice on the performance league table and metrics, including the early action metric;
- advice on transactions relating to any CRC organisations; and
- review of service contracts to ensure these appropriately apportion CRC costs and include energy efficiency targets where necessary.

Further Information

If you would like to receive information on how Burges Salmon could assist you with the CRC, or details of our team's capabilities on the full range of environmental issues, please contact: Lucie Drummond, Solicitor, on +44 (0) 117 307 6906 or lucie.drummond@burges-salmon.com, or any other member of the Burges Salmon Energy and Environment team.

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