

THE CARBON REDUCTION COMMITMENT ENERGY EFFICIENCY SCHEME (CRC) – NOW IN FORCE

April 2010

The CRC Energy Efficiency Scheme Order 2010 has now been published and is in force.

The final publication of the Order follows several rounds of Government consultation, and now provides organisations with the certainty required to evaluate whether their particular organisation is covered by the Scheme, to what extent, and if so, what now needs to be done.

This briefing summarises the key steps which organisations must carry out to ensure CRC compliance. In doing so, important considerations common to many CRC participants will be highlighted.

Step One – What is my organisation?

The first question for any organisation is 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 are required to participate as groups, who is responsible in group structures, how subdivision of groups can occur and how franchises and PFI structures are 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 through half-hourly meters.

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) are grouped as one organisation under the CRC.

Importantly, a group is 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 rests with the 'participant', and not any specifically 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 is 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 are those that are public authorities under the Freedom of Information Act². Public bodies are only required to participate under the CRC where they fulfil the qualification criteria. Certain government departments that are defined in the

¹ The Environment Agency

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

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order³ are required to register regardless of their energy use.

Unlike their private sector counterparts, public bodies are only required to participate as a group in certain defined circumstances. For example, a body corporate that is majority owned by one of the defined government departments will be required to participate as a group with that department. A body corporate owned by any other public body (such as a Local Authority), is deemed to be a public body in its own right and will not be joined with its public body owner. 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 are 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 allowing 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, responsibility for compliance with the Scheme on behalf of a public body group will broadly fall to the figurehead of any such 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 PPP/PFI project) which is majority owned or controlled by a public body, is itself deemed a public body under the Scheme. However, such bodies are only required to participate under the Scheme if they meet the qualification criteria.

Any body corporate (including those that are joint ventures or special purpose vehicles used to deliver services/assets in the context of a PPP/PFI project) with a private sector majority shareholder is grouped with that owner under the Scheme.

Where there is no majority shareholder, either public or private, the joint venture or PFI company is 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 an organisation, the next step is to assess the energy which that organisation is responsible for under the Scheme. It is important to determine where responsibility for energy use lies both when assessing whether an organisation qualifies for participation, and subsequently for reporting requirements under the Scheme. A body is 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 metering device⁴.

Self Supply

An important exclusion from the definition of supply relates to self-supply, which affects 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.

Landlords and Tenants

Landlords need to be aware of how the Scheme treats their tenants' consumption of energy. Where a landlord has the supply contract for a tenant's energy use they are responsible for that supply under the Scheme. Organisations should also be aware that, due to the drafting of the Order, these provisions are applicable 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).

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

⁴ Measurement by a metering device is a requirement which only attaches to electricity and gas supply.

Franchises

Additional responsibilities are imposed on those organisations which the Scheme classes as having a franchise agreement. The Scheme treats 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, that supply is deemed to have been made to the franchisor for the purposes of the Scheme.

Step Three - Registration

Registration applications are made to the Environment Agency's online Registry, and are required by 30 September 2010.

Where disaggregation is being considered by an organisation there is a further, earlier, deadline. To disaggregate a group must first have applied to be registered by the end of June 2010. Once the group is registered, a further application will be required to register the Significant Group Undertaking that is being disaggregated. This second registration must be completed by the overall registration deadline of 30 September 2010.

At registration the participant is 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. Participants will also be required to submit information concerning their organisation and the intended compliance account holder.

Step Four – Footprinting & Reporting

The process of footprinting requires participants to submit, prior to the final working day of July in 2011, 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 European Union Greenhouse Gas Emissions Trading System (EU ETS) or Climate Change Agreement (CCA) regimes;
- any other amounts of energy supplied to the participant during the footprint year (i.e. other than electricity, gas or any 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; and
- the level of emissions captured under the EU ETS or a CCA.

Participants will be required to submit a footprint report for each successive phase of the CRC.

CCA Exemptions

As the Scheme is not intended to overlap with other existing carbon emission regulations there are exclusions with respect to emissions already covered under the EU ETS regime or CCAs. Further, where an undertaking's emissions are made up of at least a quarter of emissions captured under a CCA, that undertaking is 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).

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

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 applies. 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 is important to consider these implications in both existing arrangements and those that may be entered into in the future. Examples of these could include:

- the acquisition of part of a CRC organisation by another organisation. How should the transfer of information and any allowances held in relation to the emissions from that part of the organisation be dealt with?;
- 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 property agreements;
- where services are provided that affect energy use, including efficiency requirements in contracts; and
- intra-group allocation of costs and liabilities.

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 in-depth explanation of the Scheme in its final form;
- assistance in liaison with the administrator;
- consideration of Scheme coverage, how this applies 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 transactions relating to any CRC organisations;
- review of service contracts to ensure these appropriately apportion CRC costs and include energy efficiency targets where necessary; and
- intra-group agreements on CRC costs and liabilities.

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, Associate, 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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