

BURGES SALMON INFORMATION NOTE**THE CARBON REDUCTION COMMITMENT (CRC) – WHY IS IT IMPORTANT TO THE AEROSPACE AND DEFENCE SECTOR?****April 2009**

Our Environment Unit has been advising the Department of Energy and Climate Change (DECC), along with other public and private sector clients, on the carbon reduction commitment (CRC) and we believe that this could have significant cost implications for organisations within the aerospace and defence sectors.

The Carbon Reduction Commitment (CRC) is a new UK emissions trading scheme that will impact on all organisations with half-hourly electricity meters. Furthermore, organisations that meet the scheme's inclusion threshold will have obligations to fulfil and could face significant costs arising from participation in the scheme.

For organisations that are likely to be covered by the CRC it will be important over the coming months to understand the potential implications of the scheme, budget and make preparations for it, and ensure that systems and processes have been put in place to collate the information required for compliance. Furthermore, CRC implications will need to be taken into account in transactions, and in relation to existing and new tenancy agreements and service contracts.

WHY IS THE CRC RELEVANT TO YOU?

In September 2009, the Environment Agency¹ (who will administer the CRC) will contact all UK billing addresses with half-hourly meters and provide them with Registration Packs. Most reasonable sized office buildings and shopping centres have half hourly meters, which are required for any organisation with more than 100kW peak load of electricity usage.

In 2010, with assistance from their electricity supplier, all organisations with half-hourly meters (regardless of whether the inclusion threshold is met) will need to provide the Agency with a list of their half-hourly meters. Organisations who used between 3,000 – 6,000 MWh of metered electricity in 2008 will also need to provide information on their use through half-hourly meters. Importantly, all public and private sector organisations whose metered half-hourly electricity usage for the 2008 calendar year was more than 6,000 MWh will be required to participate in the CRC.

BASIC REQUIREMENTS OF CRC

A draft Order on the CRC, consultation on the Order and a step-by-step User Guide for the CRC were released by DECC on 12 March 2009 and public consultation on the Order will be open until 4 June 2009. DECC have confirmed that the scheme will begin in April 2010, with scheme years running April to March, although information gathering and reporting will need to occur prior to this to assess 2008 electricity usage against the inclusion threshold.

Organisations which pass the threshold for metered electricity usage will have to calculate their emissions from static energy use (which includes electricity, gas and other fuels such as coal, diesel and LPG but excludes transport related emissions), fulfil reporting obligations, purchase allowances corresponding to their emissions and surrender the allowances at the end of each scheme year.

Energy use from all sources will need to be monitored from April 2010 to March 2011 in order for this to form the footprint for the company and be used as the baseline to measure reductions against. The first three years of the scheme will be the 'introductory phase' where there will be no cap on the number of allowances that can be purchased during the phase, and the price for allowances will be set at £12.

¹ Or Scottish Environmental Protection Agency or Northern Ireland Environment Agency in Scotland and Northern Ireland respectively.
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SCHEME COVERAGE

The emissions for which organisations have to purchase and surrender allowances will include all emissions from core electricity and gas sources² (no matter what percentage of total emissions this amounts to). Emissions from residual sources (such as fuel usage) will need to be included until the whole organisation's combined percentage of emissions from core sources, residual sources, and emissions covered by the EU Emissions Trading Scheme and Climate Change Agreements, is above the 90% threshold. If core sources already cover 90% or more of an organisations' emissions, residual sources will not need to be reported.

Some organisations within the aerospace and defence sector will currently have emissions covered by the EU ETS and/or a Climate Change Agreement (CCA). Only emissions outside of these existing schemes will be caught by the CRC and if 25% or more of an organisation's total emissions are covered by a CCA then they will be exempt from the CRC altogether (where there are no subsidiaries). Also, members of organisational groups (e.g. subsidiaries) that have at least 25% of their emissions covered by a CCA will be treated as exempt when working out footprint emissions.

In terms of treatment of electricity generation, DECC has confirmed that (with certain exemptions³) organisations that operate an electricity generation process which exports electricity to the grid or other users will be entitled to claim an electricity credit for electricity exported to the grid.

FINANCIAL IMPLICATIONS

Although the CRC will be revenue neutral for the Exchequer, a performance table will rank organisations and allocate bonus or penalty percentages that are then applied to determine the amount of the revenue that is recycled to a particular organisation. This means that organisations that perform well and rank in the top half of the table could receive more in the revenue recycling process than they had paid for their allowances, while poor performers could receive less. Some companies are concerned about potential reputational impacts of this performance table as it will be publicly available.

In terms of other financial implications, we anticipate that these could arise from administration costs (such as identification of energy sources that will be covered by the scheme, introduction of systems for reporting of data and self certification) and the introduction of energy efficiency measures.

COMPLIANCE BY ORGANISATIONS

The proposal is that responsibility for emissions will be assigned to the organisation that is the customer of the energy supplier – this is usually the organisation who pays the electricity bill. Government will aggregate organisations together using group structures based on the tests in Companies Law to constitute an organisation who pays the energy bill.

The definition of organisation in the draft Order follows the proposed 'top down' approach and attempts to capture whole company groups through use of the Companies Act 2006 definitions of "subsidiaries" and "undertakings". This means the highest UK parent organisation will have to assume compliance on behalf of the whole group, along with the associated costs and potential civil and criminal liabilities. Organisations that are part of a larger organisational group, even if they have completely unrelated activities, must act together as one entity and there will be joint and several liability. For organisations with overseas parent companies, a UK based member of that organisation must be nominated to fulfil obligations on behalf of the group.

LANDLORDS AND TENANTS

In relation to tenanted properties, the organisation that pays the half-hourly metered electricity bill will have that amount of electricity count towards the eligibility threshold to see whether that organisation qualifies under the CRC. If both the tenant and the landlord are CRC organisations, it was proposed that the legal obligation for CRC could be handed over from the highest UK parent of the landlord to the highest UK parent of the tenant, if appropriate sub-metering is in place and both tenant and landlord agree at the start of each phase – however, this suggestion is now under review and landlords may retain all CRC liabilities in any event.

² Core sources include all electricity consumed through half hourly meters (HHM), AMR meters or profile class 5-8 meters, all gas consumed through daily-read gas meters and AMR meters and all non-daily metered gas consumption of more than 73,200 kWh per annum.

³ Such as hydroelectric pumped storage facilities, large hydroelectric plants exempt from the Renewables Obligation, nuclear plants and facilities covered by EU ETS.

ENFORCEMENT AND PENALTIES

The CRC will be run on a self-certification basis, with no third party verification required, with 20% of participants audited each year. The CRC Order sets out a range of criminal offences and associated penalties for non-compliance, falsification of documentation and obstruction of regulators. Furthermore, if an offence is committed with the consent, connivance or neglect of an officer of that body corporate, both the officer and the organisation are guilty of an offence and can be prosecuted.

DECC has announced that the fine per tonne of carbon dioxide for which allowances are not surrendered at the end of a scheme year will be £40. In addition to this amount, the other penalties under the scheme could amount to significant sums because although the initial amounts of the penalties for different offences are often in the region of £5000, there are ongoing daily penalties that will be added to this amount and which in some circumstances involve a calculation of a fine per tonne of carbon dioxide for the relevant period.



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 and any further changes to the proposals resulting from the current consultation;
- assistance in preparing a response to the consultation on the draft regulations or other liaison with the regulator;
- consideration of scheme coverage, how this will apply to an organisation with your structure and the possibility of any relevant exemptions or exclusions;
- advice on preparation for the CRC, including questionnaires for parent companies to send to their subsidiaries to collate information;
- advice on the likely direct and indirect impacts of the CRC and how you could manage costs within your organisational structure;
- analysis and feedback on papers for parent companies and management boards, briefing them on the CRC;
- advice on 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 landlord and tenant provisions for your properties to look at pass through of 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 include energy efficiency targets.

FURTHER INFORMATION

If you would like to receive information on how Burges Salmon could assist you with preparations for the CRC, a more detailed article, updates on the CRC, or details of our team's capabilities on the full range of environmental issues, please contact :-

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