

## Commercial real estate - Carbon Reduction Commitment: Briefing Note

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### What is the CRC?

- The CRC Energy Efficiency Scheme (CRC) is a new UK-wide **mandatory** emissions trading scheme, which applies to large businesses and public sector organisations. It came into operation on **1 April 2010**.
- The government estimates that these organisations are responsible for around 10% of the UK's overall greenhouse gas emissions.
- The CRC used to be known as the Carbon Reduction Commitment but this was changed to the CRC Energy Efficiency Scheme.

### What is the aim of the CRC?

- To make business and the public sector more energy efficient and therefore reduce their CO2 emissions.
- To help the UK reduce its greenhouse gas emissions by 80% by 2050 (compared to 1990 levels), as required under the Climate Change Act 2008.

### What type of organisations does the CRC apply to?

- The government estimates that the CRC will apply to around 5,000 organisations, primarily those whose annual electricity bills are approximately £500,000 and over. For details of which organisations will have to participate in the scheme, see section below entitled "What are the Qualification Criteria?".
- The scheme is also likely to affect another 20,000 organisations,

which will not have to participate in the scheme but may still have to provide the Administrator with information about their energy use (known as an Information Disclosure).

- The types of companies and other organisations that will be covered by the CRC include:
  - large retailers (such as shopping centres and supermarkets);
  - hotel chains;
  - large offices (such as banks, accountants and law firms);
  - private equity funds;
  - joint ventures (JVs), private finance initiatives (PFIs) and public private partnerships (PPPs);
  - franchises;
  - utility companies (such as water companies);
  - NHS Trusts and hospitals;
  - schools and universities;
  - Central government departments and local authorities.

### When did the CRC come into force?

- The CRC came into operation on **1 April 2010** and applies across the UK.
- The relevant legislation is the CRC Energy Efficiency Scheme Order 2010 (*SI 2010/768*).
- The scheme is divided into seven Phases:
  - Phase 1 (the Introductory Phase): 1 April 2010 to 31 March 2013.
  - Phase 2: 1 April 2011 to 31 March 2018.



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- Phase 3: 1 April 2016 to 31 March 2023.
- etc.
- Each Phase is divided into Compliance Years, which run from 1 April to 31 March. There will be some overlap between the end of one Phase and the start of the next one.
- The Introductory Phase consists of just three Compliance Years. Subsequent Phases will consist of seven Compliance Years.

### How does the CRC work?

#### A cap and trade scheme, with a twist.

- During the Introductory Phase, the government will sell an unlimited number of Allowances at a fixed price of £12 per tonne of CO<sub>2</sub>.
- In subsequent Phases, the government will auction a limited number of Allowances annually, to encourage Participants to reduce their CO<sub>2</sub> emissions.
- Participants will buy Allowances based on how much they think they will emit during the relevant Compliance Year.
- Participants can also buy or sell Allowances from each other in the Secondary Market.
- At the end of each Compliance Year, Participants will need to surrender enough Allowances to the Administrator to cover the amount they emitted during the relevant Compliance Year.
- The government will recycle the revenue raised from the Fixed Price Sales and auctions of Allowances back to Participants after a six-month

period.

- In order to incentivise Participants to improve their energy efficiency year-on-year, the Revenue Recycling payments will have a bonus or penalty applied to them, so that those whose energy efficiency improves each year will receive a larger payment and those whose energy efficiency does not improve (or worsens) will receive a smaller payment.
- The size of the bonus or penalty will be based on the Participant's position in a League Table that the Administrator will publish each year.
- The bonus or penalty will vary over time: in the first Compliance Year that the League Table is published (2011–2012), this will be +10% / -10%, rising to +50% / -50% in the fifth Compliance Year.
- All Participants will be ranked together (rather than by sector), using three metrics:
  - The Absolute Metric: This measures how a Participant's emissions have changed over the last Compliance Year as compared to a rolling average of the previous five Compliance Years.
  - The Early Action Metric (the EAM): This measures whether Participants have taken voluntary steps prior to the start of the CRC to reduce their CO<sub>2</sub> emissions. This metric is determined by two equally-weighted factors: the percentage of a Participant's emissions covered by automatic metering (AMR) and the Carbon Trust Standard (CTS) (or a recognised equivalent scheme).
  - The Growth Metric: This measures a Participant's change in emissions relative to its turnover (or expenditure, in the case of public sector Participants). This metric is the percentage change in emissions intensity for the current Compliance Year as compared to a rolling average of the previous five Compliance Years.
- Each metric will have a weighting. The relative weighting of the metrics will change over the first four years of the scheme. The EAM will only apply during the Introductory Phase.



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### What do Participants have to do?

A Participant's main obligations under the scheme are as follows:

- Register as a Participant by the relevant deadline. The registration deadline in the Introductory Phase is **30 September 2010**. The deadline for Phase 2 is 30 September 2011.
- Submit a Footprint Report at the beginning of each Phase, showing which of the organisation's overall emissions are covered by the CRC.
- Submit an Annual Report in July after the end of each Compliance Year, showing what the organisation's CRC Emissions were during that Compliance Year.
- Produce an Evidence Pack providing supporting information on the Footprint and Annual Reports.
- Buy and surrender enough Allowances to cover the amount of CO2 emitted by the Participant during each Compliance Year.

### Who regulates the CRC?

- The Environment Agency (EA) has overall responsibility for administering the CRC across the UK.
- The CRC is then enforced by the following Administrators:
  - The EA, in England and Wales.
  - The Scottish Environment Protection Agency (SEPA), in Scotland.
  - The Department of the Environment (DoENI), in Northern Ireland.

### Three main steps to deciding whether an organisation is covered by the CRC.

- Step 1: Establish what your

organisational structure is.

Step 2: Decide what electricity supplies your organisation is responsible for.

Step 3: Decide whether your organisation meets the Qualification Criteria.

### How does the CRC apply to different types of organisational structures?

#### In the **private sector**:

- The CRC applies to groups of companies, so you need to identify the parent company and its subsidiaries by applying the definitions of "parent undertaking" and "subsidiary undertaking" in the Companies Act 2006. The Group will participate together as a single Participant, unless it is able to "disaggregate" any of its large subsidiaries (known as Significant Group Undertakings (SGUs)). Disaggregated SGUs will participate in the CRC as separate Participants. There will be a Primary Member who will liaise with the Administrator on behalf of the Group. This will be the Highest Parent Undertaking by default.
- The CRC also applies to JVs, PFIs, PPPs and franchises.
- If the Highest Parent Undertaking of a Group is based outside the UK, but any of the members of that Group are responsible for energy supplies in the UK (for example, through a UK-based subsidiary or office), the Group may be covered by the CRC and will have to nominate one its UK members as a Primary Member.

#### In the **public sector**:

- Some public sector organisations have to participate in the CRC regardless of whether they meet the Qualification Criteria (such as central government departments). These are called Mandated Participants.
- Other public sector organisations (such as local authorities) will have to participate in the CRC only if they meet the Qualification Criteria.

### Landlords and tenants

- Landlords will be liable for their tenants' emissions if they are responsible for supplying energy directly to



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- their tenants.
- The terms of a lease may, or may not, enable landlords to recoup these costs from their tenants.

### The Qualification Criteria: how do you decide if you need to register as a Participant?

- An organisation must participate in the CRC if it:
  - is supplied with electricity by at least one Settled Half Hourly Meter (HHM) during the Qualification Year for the relevant Phase; and
  - was supplied with over 6,000 MWh of half hourly electricity through all of its HHMs during the Qualification Year for the relevant Phase (sometimes referred to as the Qualifying Amount or qualification threshold).
- Depending on the price you pay for your electricity, the Qualifying Amount equates roughly to an electricity bill of around £500,000 or more per year.
- Smaller organisations with lower electricity consumption, which do not meet the second criterion, may still need to make an Information Disclosure to the Administrator.

### The Qualification Year: when do you decide if you need to register as a Participant

- Before the start of each Phase, there is a Qualification Year to enable organisations to decide whether they need to participate in that Phase of the CRC.
- For each Phase, an organisation will need to assess whether, by the end of that Qualification Year, it met the Qualification Criteria.
- The Qualification Year for the Introductory Phase is the 2008 calendar year. The Qualification Year for Phase 2 is 1 April 2010 to 31 March 2011.

### Who is responsible for an energy supply?

- The government originally said that organisations would only be liable for energy supplies if they were the party named on the energy bill (the "counterparty to the energy agreement" rule).
- This was changed and organisations now need to decide who is "responsible for the energy supply", based on whether the supply is from a third party or whether it qualifies as Self-supply.
- However, landlords will be liable for their tenants' energy consumption if they are responsible for supplying the energy to the tenants. The terms of a lease may, or may not, enable landlords to recoup these costs from their tenants.

### Which emissions are covered by the CRC?

- You first need to assess the overall energy supplies to your organisation and then decide which emissions from those supplies are covered by the CRC. For example, the CRC does not cover emissions relating to transport or domestic accommodation.
- You then need to set this out in a Footprint Report, which must be submitted once per Phase.
- If parts of an organisation are already covered by a Climate Change Agreement (CCA) or the EU Emissions Trading Scheme (EU ETS), it may still be required to participate in the CRC, although the emissions covered by these other schemes will not be included in the CRC.

### Penalties

- Certain breaches amount to a **criminal** offence (for example, making false or misleading statements).
- However, the majority of breaches are subject to a **civil** penalty, such



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If you would like to discuss how the CRC Energy Efficiency Scheme will affect your business or organisation, please contact one a member of our commercial property team.

### Contacts

For further information, please contact your usual Leeds Day contact or

Christopher Dodd  
Partner  
01480 454301  
Christopher.dodd@leedsday.co.uk

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