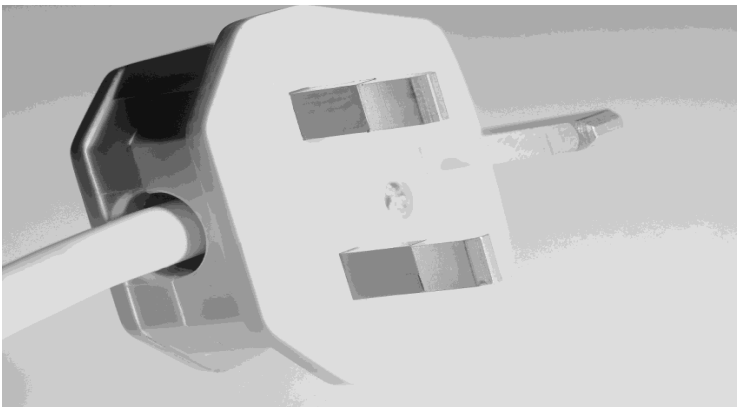


CRC - A Step along the Road to Simplification



The Government's initial proposals on reforming the CRC go some way to creating the flexibility desired by participants and to stopping the overlap with other regimes. However, the continuing complexity of the regime, and ongoing refusal to re-instate revenue recycling are likely to ensure many stakeholders remain unhappy with the Government's simplification efforts. The lengthy timetable for the review is also likely to lead to a last minute rush to register, similar to that experienced by many participants in Phase 1 of the scheme.

This briefing analyses the main proposed changes to the scheme.

The Department of Energy and Climate Change (DECC), has published its initial conclusions on reforming the CRC Energy Efficiency Scheme. As part of its ongoing work on the reforms, DECC has informally asked for comments on these by 2 September 2011 with formal consultation on the finalised proposals to follow early in 2012¹.

We comment on the major proposals below.

Simplification of qualification assessment

Qualification for Phase 2 of the scheme will only be based on consumption of electricity through **settled** half-hourly meters (replacing the previous two part test). The Government was concerned that companies were failing to install smart meters because electricity would count towards the qualification threshold as "half-hourly" supplies. It seems inevitable that the threshold for qualification will need to be lowered as a result. Whilst DECC has confirmed that it will not use this opportunity to widen the scope of the scheme, this would result in some participants who are currently just over or under the threshold being taken out of, or brought into, the scheme.

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¹ A further consultation on administrative changes to the scheme is to be announced shortly.

Removal of fuel types, the 90% rule and CCA/EU ETS emissions

The number of fuels covered by CRC will be reduced from 29 to 4: Electricity; gas; and kerosene and diesel used for heating.

In addition, DECC proposes removing the rule whereby 90% of regulated emissions need to be included in the scheme. As a result, 100% of emissions from these four energy sources will be covered by the scheme.

A further change will see emissions covered by Climate Change Agreements or the EU Emissions Trading System being completely excluded from the CRC.

These are welcome simplifications as they will reduce the reporting burden associated with small energy sources, and otherwise prevent duplication of controls on emissions regulated by other schemes. In particular, footprint reports will no longer be required as their purpose was simply to measure total energy consumption to identify whether the required 90% of regulated emissions were being brought into the scheme.

Organisational grouping rules

DECC proposes that the current rules for aggregation of groups for CRC participation on the basis of group structure would remain. However, the rules on disaggregation would be made more flexible, allowing groups to disaggregate much more freely. Whilst more detail is needed on this proposal, this could, for example, allow individual portfolios under a private equity or other fund to disaggregate from the fund level entities irrespective of how insignificant the emissions were within those portfolios. Whether fund level entities would then still have to participate if they had no emissions remains to be seen.

Whilst this additional flexibility is a benefit to business, this will potentially leave the scheme with a large number of entities with small emissions coverage which will create its own administrative headache. In addition, complex organisations will still have to carry out detailed work to assess their structures before disaggregating and this will have to be done before each phase. In addition, the organisational change rules seem destined to retain (and potentially) increase the current administrative burden. This continuing complexity seems excessive given the removal of revenue recycling, considered widely to be the main driver of improving energy efficiency, making the scheme feel like a carbon tax.

Removal of the cap on emissions and no auctioning of allowances for Phase 2

Allowance prices will be fixed by the Government and made at twice-yearly intervals with a lower price at the first sale than at the second. While there will be no fixed cap on allowances and therefore no auctioning, this will still encourage participants to forecast energy consumption before the lower price first sale, in order to avoid the higher prices when balancing accounts at the end of the compliance year.

DECC intends that this pricing strategy will allow a secondary market for emissions trading in CRC allowances to develop. This market will only function if the differential in the two sale prices is meaningful. If not, many participants may simply decide to purchase all of their allowances at the end of the year.

For the first introductory phase, DECC has now confirmed that fixed price sales will take place at the end of each compliance year. Stakeholders' concerns about a double allowance payment at the point of switchover from the Phase 1 "end of year sale" model to a Phase 2 "upfront purchases" model is mitigated to a degree by the proposed twice yearly sale in Phase 2.

Supply rules changes

Landlords and Tenants

Despite recognising some of the complexities of the current operation of CRC for landlords and tenants, DECC has avoided grappling with the issues. Supply responsibility for energy consumption will therefore still remain with landlords (where they contract for the energy supply). DECC's principal concern appears to be loss of emissions from the scheme if it adopted a consumption-based responsibility for supply (which had been sought by many stakeholders).

Whether DECC's attitude is viewed as shying away from a difficult question or a clever ploy to change industry practice, the challenges of deciding on cost attribution and improving energy efficiency will still need to be addressed and documented if landlords and tenants wish to minimise disputes.

Real Estate held through Trusts

DECC has sought to deal with two major complaints about how CRC responsibility works for real property held through trust structures: principally that trustees often have no control over energy efficiency; and a perceived unfairness that trustees of completely separate trusts have to aggregate all relevant supplies potentially bringing them into the CRC scheme for artificial reasons.

DECC's solution is to treat trusts as undertakings, thereby keeping the responsibility for CRC relating to one trust separate from any others with the same trustee. The scheme will apply a hierarchical approach to working out which entity is responsible. In broad terms:

1. Where there is a controlling beneficial owner, that entity takes responsibility for CRC purposes;
2. If there is no controlling beneficial owner and the trust is regulated by the Financial Services Authority, responsibility would pass to the operator of the trust;
3. In other cases, the trustee would be responsible but each trust would be treated separately.

DECC's position on trusts is a work in progress and we await further elaboration of the proposals. However, the separation of trusts concept seems likely to be attractive to professional trustees which will not now have to aggregate energy supplies from across different trust portfolios for the purposes of qualification into, and operation of, the CRC. DECC will also need to explain how it intends to manage the enforcement issues associated with looking through the trusts to the beneficiaries, whose identity may not be easily ascertainable (i.e. category 1 above).

Final Comment - the timetable for simplification

It is encouraging that the Government has been working with stakeholders to simplify the CRC scheme. However, this extended informal consultation process is taking longer than envisaged; the Government previously intended to consult fully towards the end of this year but this has been delayed until at least February 2012 with final scheme details only likely to be available around September 2012. Given that registration for the Phase 2 of the scheme will be taking place from April 2013, a "rush to registration", as occurred for many participants in Phase 1, seems almost inevitable for Phase 2 as well.

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