Easing the administrative burden?

Hannah Kramer examines whether the DECC's proposals will create a simplified CRC

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'On 10 December 2012, the government published its response to the March 2012 consultation and confirmed that the CRC will not be scrapped, but will be streamlined following implementation of most of the 46 proposals set to be introduced in either June 2013 or April 2014.'

On 10 December 2012, the Department of Energy and Climate Change (DECC) published their response to the March 2012 consultation on proposed changes to the CRC Energy Efficiency Scheme (CRC) and confirmed that the CRC is here to stay, albeit with some modifications. The consultation sought to address stakeholders' various criticisms, which argue that the CRC is overly complex, creates a significant administrative burden and associated costs, and fails to reflect the organisational and operational realities of different trust and corporate structures. Notably, the landlord and tenant rule, which treats landlords who provide energy to their tenants as responsible for that energy supply, has been criticised for failing to reflect the reality of the commercial rental market.

After considering the 255 responses received to the 46 proposed simplification measures set out in the consultation, the DECC have announced that most of these proposals will take effect either this June or on 1 April 2014, creating a 'new leaner, simplified and refocused CRC' and delivering a 55% reduction in the overall administrative costs for CRC participants. Though most of the proposed changes should simplify the scheme, it remains to be seen whether they will generate any tangible savings for participants of the current introductory phase, who will need to adjust the way in which they manage the last year of this phase, and for those about to register for phase 2, who may need to reassess their reporting and allowance requirements going forward.

Irrespective of any 'streamlining' effect of the new changes, the CRC is likely to remain a complex scheme and continue to entail management costs for participants in addition to the cost of buying allowances. Moreover, it is far from clear that the new 'simplified' scheme will address all of its various criticisms.

The CRC – an overview

Since it took effect on 1 April 2010, property lawyers have been getting to grips with the key provisions and effect of the CRC, which is a mandatory emissions trading and reporting scheme introduced by the CRC Energy Efficiency Scheme Order 2010 (SI 2010/768) under the Climate Change Act 2008. It was designed to improve energy efficiency and reduce carbon dioxide emissions by the use of reputational and financial 'drivers'.

The CRC is divided into several overlapping phases and we are currently in the middle of phase 1, the 'introductory phase', which ends on 31 March 2014. Registration for phase 2 starts on 1 April 2013, and compliance will run from 1 April 2014 to 31 March 2019. During the qualification year of each phase potential participants must assess their organisational structure and the energy usage of all UK properties held by that group to determine whether they qualify. If they do, they must prepare for registration and participation.

Participants are required to submit annual reports to their CRC administrator detailing their energy supplies and carbon dioxide emissions for each year of the relevant phase. The CRC administrator for England is the Environment Agency.

In addition to the reporting requirements, participants must also purchase sufficient 'allowances' to cover their carbon dioxide emissions for the relevant year of the phase. Currently, participants are placed in a league table that reflects their energy

efficiency and provides a reputational driver by 'naming and shaming' energy inefficient participants.

Failure to comply with the CRC can lead to criminal penalties of up to 12 months' imprisonment and/or fines of up to £50,000, and civil penalties of fines up to £40,000.

The CRC applies to all non-energy intensive organisations – including trust structures and charities – within the private and public sectors in the UK that are responsible for the energy supply. Although it does not apply to domestic accommodation, it catches the common parts of residential buildings and is therefore potentially applicable to almost all types of landlord and tenant arrangements.

The qualification criteria is set out in the table on p4.

Originally, the entity required to comply with CRC was the 'counterparty to the supply contract', ie the person named on the energy supply agreement. This has since been replaced with the rule that compliance rests with the party responsible for the energy supply. Compliance will therefore rest with the organisation that contracts for the supply (ie pays for it), receives the supply and, in the case of electricity and gas, where the supply is measured by a meter. An organisation that contracts for the supply of energy for third parties and passes on such 'unconsumed supplies' to third parties, such as a facilities management company, will not usually be deemed to be 'responsible' for that supply. The exception to this is the landlord and tenant rule discussed below.

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Impetus for change

Practitioners will be familiar with the criticisms made by participants and other stakeholders about the complexity of the CRC and its disproportionate administrative burden. Below is summary of the principal areas of concern:

Complex supply and qualification criteria

The two-stage qualification approach, which exclusively focuses on settled half-hourly meters (HHMs) for the first criterion, but then looks to all HHMs for the second, has caused some confusion for participants and one of the proposals set out in the 2012 consultation was to align the two strands of this qualification test.

The supply rules, which focus on the person responsible for the supply,

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Qualification criteria

An organisation qualifies as a participant in the CRC if it satisfies the following criteria:

- It is supplied with electricity by at least one settled half-hourly meter (HHM) in any of its UK properties during the qualification period of the relevant phase.
- The organisation was supplied with over 6,000 MWh of half-hourly electricity through all of its HHMs, ie including settled half-hourly meters, non-settled half-hourly meters or a dynamic supply, during that qualification period. It is estimated that this second limb, the 'qualification threshold', equates to an annual electricity bill of approximately £500,000.

As mentioned below, the second limb will change as a result of the 2012 consultation so that the supply of electricity will only be measured through settled HHMs.

have also been criticised for failing to clarify the position where supplies are made at the direction of a third party, such as in complex outsourcing/PFI arrangements.

However, the criticism most property lawyers will be familiar with is the fact that the CRC supply rules do not include most landlord and tenant relationships in the 'unconsumed supply' exemption. The CRC counts energy supplies provided by landlord for their tenant's consumption toward the landlord's energy usage for CRC registration and participation purposes.

Failure to comply with the CRC can lead to criminal penalties of up to 12 months' imprisonment and/or fines of up to £50,000, and civil penalties of fines up to £40,000.

Significant reporting burden

Currently, the CRC requires participants to report on their energy supplies from 29 fuels, and on supplies through all half-hourly meters. Participants must also submit a footprint report during the financial year preceding the start of the first year of the phase and yearly annual reports detailing all energy supplies, and their CO2 emissions, for the relevant year of the phase. In its report commissioned by the government, 'Assessing the Administrative Costs of the CRC Energy Efficiency Scheme' dated 5 December 2011, KPMG noted that the annual reporting costs, particularly the preparation of footprint reports and initial registration costs, have dominated the costs in the introductory phase. Depending on the size of the organisation, participation costs have been between £7,000 and £56,000.

Overlap with other climate change agreements or energy efficiency policies

The scheme sought to target emissions that are not regulated by Climate Change Agreements (CCA) or the EU Emissions Trading Scheme (EU ETS). However, the processes designed to avoid double regulation have led to an overly complex system.

Organisations that are party to a CCA may qualify for one of three exemptions to the CRC. However, exempt organisations must still register for the CRC though they may subsequently declare themselves exempt. An organisation that is party to a CCA, but does not qualify for an exemption, must register as a CRC participant but can deduct the CCA-element of its energy usage from the emissions detailed in its footprint report. The detailed rules relating to CCA exemptions have therefore led to some confusion and calls for simplification.

Equally, although installations covered by the EU ETS are not exempt, participants must still account for their EU ETS emissions in its Footprint Report (though they will not need to purchase allowances to cover these emissions).

Participants are also currently required to confirm in their footprint report that they meet the '90% applicable percentage rule', demonstrating that at least 90% of their emissions are covered by EU ETS, CCA and CRC schemes. Although this was originally introduced to reduce the reporting burden, by allowing participants to deduct up to 10% of their emissions from these schemes, it has been criticised for being overly complex and causing uncertainty.

Failure to deal with organisations in their natural business structures

The CRC groups together all organisations under common ownership, control or management for both qualification and participation purposes with the effect that all members of the group must register if the aggregate energy usage of all UK-properties held by the members of the group meets the qualification criteria. Unless another member is nominated, the 'highest parent undertaking' will act as the 'primary member', responsible for liaising with the scheme administrator on behalf of the group. Where the highest parent undertaking is an overseas company it must identify and nominate a willing UK-based organisation to act as their 'primary compliance account holder'.

All members of the group will be jointly and severally liable for compliance. Currently, it is only possible to disaggregate a member of the group if that member qualifies for CRC in its own right and will not cause the rest of the group to fall below the 6,000 MWh qualification threshold. As a result, a company may be caught by the CRC even though it has no involvement in the energy usage of the other members who have caused the group to qualify. These qualification rules have a particular impact on organisations with complex corporate structures, such as private equity investors that may hold a portfolio of independent businesses.

Similarly, trustees currently qualify for participation if the total energy usage of all the properties held in their various trusts meets the qualification criteria. This is particularly relevant

Rule	Current position	Proposal	Timing
Qualification criteria	The qualification amount is based on the supply through all HHMs.	Restrict the qualification to supplies through settled half-hourly meters.	1 April 2014
Landlord and tenant rule	Landlord responsible for energy supplies to tenants except where tenants procure and pay for their own energy supplies.	Disapply the landlord and tenant rule in respect of ground leases where the minimum construction lease term is 30 years.	1 April 2014
Academies and state-funded schools	CRC currently applies to both state-funded schools and academies.	CRC will no longer apply to state-funded schools (including academies) in England. The devolved administrations will decide separately how CRC should apply to academies and schools in their jurisdictions.	1 April2014
Fuels covered by the CRC	The CRC currently covers 29 types of fuel.	Reduce this to two: electricity and, where used for heating purposes, gas. There will be a rebuttable presumption that all gas supplies are for heating purposes.	1 June 2013
Supply rules	CRC does not clarify who is responsible where supplies are made at the direction of a third party.	Clarify the supply rules to give CRC responsibility to the organisation with direct control for fuel it receives, or supplies made at its direction.	1 April 2014
Footprint reports	Participants must submit footprint reports in the financial year preceding the first year of the phase.	Remove the requirement from phase 2 onwards.	1 April 2014
Removal of 'residual percentage rule'	Participants must demonstrate that at least 90% of their emissions are covered by EU ETS, CCAs or the CRC.	Remove this rule so that participants must report on 100% of their (non-CCA) supplies of electricity and, where used for heating, gas. It will be replaced with a 2% *de minimis* consumption threshold in relation to gas supplies for heating.	1 April 2014
Removal of Climate Change Agreement exemptions	Organisations may qualify for one of three exemptions in respect of supplies falling under CCAs.	Remove all CA exemptions so that participants will be required to report on 100% of their non-CCA supplies of electricity and, where used for heating, gas.	1 April 2014
Application of CRC to EU ETS	Installations covered by EU ETS are not exempt and emissions from these installations must be reported on.	Electricity supplies to EU ETS will not be accounted for when deciding whether an organisation qualifies under CRC.	1 April 2014
Disaggregation of undertakings	Disaggregation only permitted where the undertaking, and the remainder of the group, meet the minimum qualification threshold following disaggregation.	Any undertaking will be permitted to disaggregate for separate participation irrespective of the qualification threshold. Disaggregation may be requested at any point within the first year of the phase, and thereafter on an annual basis.	1 April 2014
Treatment of trusts	Trustees must participate where the total energy usage of all properties held by their trusts meets the qualification criteria.	Amend so that trusts with a majority beneficial owner will group their energy emissions with that beneficial owner for CRC qualification and participation. All other trusts will group their emissions with the trustee, or operator where one is engaged to conduct regulated activity, for qualification purposes. Disaggregation permitted for participation purposes.	1 April 2014
Sale of allowances	Allowance sales in phase 2 will be auctioned with a limited cap on allowances available.	Auctioning replaced by two fixed price sales per year (a cheaper forecast sale and a more expensive buy-to-comply sale after the end of the reporting year). Banking of allowances between years within a phase, but not between phases. The government has also announced that the price of CRC allowances will be £12 per tonne of carbon dioxide in 2013/14, £16 per tonne in 2014/15, and will increase in line with the retail price index thereafter.	1 April 2014
Allowance surrender	Deadline for surrender of allowances is currently the end of July.	Extend this to end of September.	1 June 2013 (ie apply to the last years of the introductory phase)
Performance league table	Participants energy performance is catalogued in a league table that 'names and shames' the energy inefficient.	Abolition of the performance league table, though the Environment Agency will publish the aggregated participants' energy use and emissions data.	1 June 2013

to professional trustees, who often hold properties for wholly unrelated trusts and beneficiaries but which are grouped together for CRC purposes.

The CRC as an additional tax

Originally the CRC was supposed to be 'revenue neutral' and the income generated from the sale of allowances would be recycled back to participants depending on various factors, including their position in the performance league table and their energy usage. However, the 2010 Comprehensive Spending Review announced that recycling payments would not be returned to participants but would be used to support public finances. The resultant tax-like quality of the CRC has, understandably, been another 'bugbear' for participants.

The government has therefore set about addressing these criticisms by engaging with CRC participants and stakeholders. In January 2011, it published five discussion papers seeking feedback on the scheme, and published the responses in June of the same year. In March 2012 it announced that it would be engaging in a three-month consultation on 46 proposals to simplify the scheme and, as part of the 2012 consultation, hosted events in London and Manchester, which were attended by over 300 delegates.

Most revealing, the 2012 consultation followed the government's statement in its March 2012 Budget that, if it is not possible to reduce the complexity and administrative burden of the scheme, it would replace the CRC with an alternative environmental tax, thereby suggesting that the government is committed to addressing stakeholder concerns in readiness for the start of phase 2 in 2014.

DECC's response

On 10 December 2012, the government published its response to the March 2012 consultation and confirmed that the CRC will not be scrapped, but will be streamlined following implementation of most of the 46 proposals set to be introduced in either June 2013 or April 2014. Although a detailed analysis of the effect of all of the changes to be made is beyond the scope of this article, the 'headliners' are set out in the table on p5.

The government will now make and lay an order before Parliament, the Scottish Parliament, National Assembly for Wales and the Northern Ireland Assembly, with the order coming into force on 1 June 2013, subject to parliamentary approval. The government has also confirmed that it will review the effectiveness of the CRC in 2016.

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Will the CRC be improved as a result of the proposed changes?

Although the government is yet to publish the draft of a revised CRC (Amendment) Order 2013, the DECC's proposed changes appear to be geared toward streamlining the CRC and cutting down the administrative burden, and its associated costs, on participants. In particular, removing the requirement for footprint reports, reducing the number of fuels covered, and reducing the overlap with other similar schemes, should help to reduce the complexity for participants or potential participants about to register for phase 2 (registration for phase 2 commences on 1 April 2013). Replacing the auctioning of a capped number of allowances with two fixed-price sales should also address the concerns that some new phase 2 participants, who do not have experience in forecasting their emissions and allowances requirements, may have.

However, how will these changes affect existing participants who will continue to be covered by CRC for phase 2? Will they require an overhaul of the structures they have established to deal with the CRC compliance during the introductory phase, which in turn will lead to further costs? The government's commitment to review the scheme again in 2016, which may lead to a further set of comprehensive 'simplifications', may set further alarm bells ringing. Given the scale of the proposed changes, and the possibility for further change in the future, participants may consider that the future of the CRC is uncertain and question whether the cost of compliance (reduced though it may be as a result of the proposed changes) is justified.

Landlord/tenant rule

The DECC's small concession to the treatment of landlord and tenant arrangements does not address the overwhelming criticism that the scheme does not currently reflect the reality of the commercial rental market. The government maintains that, as landlords are the party most likely to be able to influence energy consumption rather than the party using the energy, the landlord and tenant rule should remain unchanged. As such, the requirement for an industry-wide practice in apportioning and recovering the cost of compliance with CRC from tenants via commercial leases remains.

At present, many practitioners rely on lease clauses which require tenants to pay all 'rates, assessments, levies, impositions, duties, charges or outgoings' in respect of the property or owner/occupier of the property (as the CRC is a charge on participants it is important that such clauses are not restricted to charges on the property). However, it is likely that a more comprehensive and accepted CRC clause will be developed over time.

Clearly, this will not address the concerns of landlords of existing leases which do not include tenant covenants to pay all such rates and charges, or could otherwise be construed as catching CRC costs. It is not clear how, if at all, such landlords may recover their CRC compliance costs.

Moreover, the Chancellor's comment in his December 2012 autumn statement that the tax element of the CRC 'will be a high priority for removal when the public finances allow' suggests that a concept such as recycling payments may be reintroduced in the future. Tenants negotiating new leases will therefore want to ensure that any CRC clause included in their lease requires landlords to apportion any reimbursement back to tenants. Practitioners may therefore find that it is difficult to generate an industry-wide acceptable CRC clause when the future of CRC is uncertain. ■