

# CRC: DECC's Final Decision on Reform Measures Published

The UK Department of Energy & Climate Change (DECC) has published its final proposals on reforming Phase 2 of the CRC Energy Efficiency Scheme (CRC) in a response to its March 2012 consultation<sup>1</sup> (the Response). Most of the simplifications proposed in March have been adopted but with a few variations. In addition, DECC intends to apply some of the changes to the current 2012/2013 and 2013/2014 compliance years in Phase 1, most significantly a reduction in qualifying fuels from 29 to 2 and abolition of the Performance League Table. The scheme is still in doubt, however, given the Government's announcement of a further CRC review in 2016 and its intention to abolish the tax element of the scheme as soon as public finances allow. This briefing looks at the principal reforms as set out in the Response. Where proposals have been adopted as proposed in the consultation, this has been noted in the headings below.

## Qualification rules (adopted as proposed in consultation)

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 current 6000MWh threshold will be retained which DECC believes will result in around 1000 fewer Participants in Phase 2.

The qualification year runs from 1 April 2012 to 31 March 2013<sup>2</sup>. Phase 2 begins substantively on 1 April 2014.

## Key issues

- Phase 2 reforms broadly reflect March consultation:
  - Qualification based on settled half-hourly supply
  - Greater flexibility to disaggregate
  - Fuel types reduced from 29 to 2; "90% rule" abolished
  - Removal of cap on emissions; fixed prices - no auctioning
  - Abolition of Performance League Table
- Some changes applied to remainder of Phase 1 (e.g. reduction in fuels)

<sup>1</sup> [Consultation on simplifying the CRC Energy Efficiency Scheme – Government Response – December 2012](#)

<sup>2</sup> The consultation materials were inconsistent on this but DECC have since confirmed the position to us.

## Registration

The timing for registration for Phase 2 (and future phases) has recently changed. DECC confirmed the changes when we queried inconsistencies in the proposed dates for registration and disaggregation in the consultation materials. Participants will need to register at the latest two months before the start of the relevant phase. For Phase 2, therefore, registration will be required by 31 January 2014.

## Organisational grouping rules (adopted as proposed in consultation)

The current rules for initial aggregation of groups for CRC participation on the basis of group structure will remain. Participants would, however, have significant additional flexibility to disaggregate undertakings as set out below.

### Disaggregation

Individual undertakings (or sub-groups of undertakings) within the Participant could be disaggregated, even where they do not separately reach the 6000 MWh qualification criteria. Even a company in the middle of a group structure could disaggregate, leaving its subsidiaries as part of the original Participant.

There is also flexibility as to when disaggregation can occur:<sup>3</sup>

- For disaggregation to apply **in the first compliance year of Phase 2 (2014/2015)**, both of the following steps need to occur by the last working day in April 2014:
  - the Participant will need to notify the Environment Agency of the disaggregation request; and
  - the disaggregating entity/ies will then need to register separately.

This gives considerably more time than under the current timetable (disaggregated undertakings would have had to register separately by 30 September 2013).

- Participants will also be able to disaggregate undertakings **during any compliance year** as long as the notification request / separate registration (as above) occurs by the last working day of April of that compliance year (i.e. by 30 April 2015 to ensure disaggregation for the 2015 / 2016 compliance year).

All disaggregations apply for the remainder of the relevant phase.

### Organisational changes (adopted as proposed in consultation)

The current rules impose certain obligations involving transfer of Significant Group Undertakings (SGUs)<sup>4</sup>. These include obligations to notify the Environment Agency of transactions and the "buyer" taking responsibility for the whole compliance year's worth of emissions. DECC proposes to retain these obligations but only impose them on changes involving whole Participants or newly defined "Participant Equivalents" (PEs): PEs are single undertakings that would, alone, have met the qualification criteria.

The flexibility on disaggregation is useful as it will allow entities to reflect their operational framework in their CRC arrangements. Private equity and funds Participants, in particular, will be able to disaggregate operational portfolios from the fund entities. Participants will still however, need to carry out the analysis of the overall group structure at the beginning of a phase which still potentially results in significant cost. Hopefully this cost will be reduced in Phase 2 given the experience and knowledge gained in Phase 1. There could well be an incentive to spin out "bad performing undertakings",

<sup>3</sup> The consultation materials were inconsistent on the relevant dates but DECC have since confirmed the position to us.

<sup>4</sup> SGUs are those parts of a group that would have qualified on their own for CRC if they were not part of a wider organisation.

and the abolition of the Performance League Table (see below) may increase this temptation.

The administrative requirements which follow transactions will also be simplified. In particular, where non-Participants acquire a Participant, the non-Participant will no longer be obliged to register. Deadlines for registration and notification of changes will also be relaxed.

## Removal of fuel types and the 90% rule (proposals adopted but with changes)

DECC has extended its proposal to cut the number of fuels included in the CRC by removing kerosene and diesel used for heating. This will leave just electricity and gas in the scheme. In addition, only gas used for heating will be included.

The rule whereby 90% of regulated emissions need to be included in the scheme will be abolished along with the associated Footprint Reports. As a result, 100% of electricity and gas consumption will be covered by the scheme. However, DECC has now decided that where a Participant's gas consumption makes up less than 2% of its overall electricity consumption in the first reporting year of a phase, it will not need to include gas consumption in its reporting figures.

## CCA/EU ETS emissions (adopted as proposed in consultation)

There will be no CRC obligations at all in relation to the EU Emissions Trading System and Climate Change Agreements facilities. Certain other supplies will also be excluded, e.g. those made for the purpose of generating electricity. A corresponding change will see electricity generation credits abolished.

## Removal of the cap on emissions and no auctioning of allowances for Phase 2 (proposals adopted but with changes)

DECC has confirmed its previous proposal to remove the cap on allowances and rely on fixed price allowance sales. Prices would be fixed by the Government, and Participants would buy allowances at twice-yearly intervals with a lower price at the first sale than at the second. The lower price at the beginning of the year is intended to encourage Participants to forecast energy consumption, in order to avoid the higher prices when balancing accounts at the end of the compliance year.

DECC is still expecting a secondary market for emissions trading in CRC allowances to develop. This will depend on the differential in the two sale prices. We now know that from Phase 2, prices will start at £16 per tonne of carbon dioxide in 2014-15, rising in line with RPI from 2015-16 onwards. However, we still do not know what the differential will be between beginning / end of year sale prices.

DECC now proposes to extend the deadline for surrendering allowances to the end of October (30 September was previously proposed).

DECC has reconfirmed that banking of allowances will be allowed between different compliance years of the same phase, but not between phases.

## Supply rules changes

### Unconsumed supply (adopted as proposed in consultation)

In broad terms, the rules governing which entity is responsible for supply will stay the same although some changes will be introduced to deal with complex scenarios where there has been uncertainty or emissions have been lost from the scheme.

Under the current scheme, if a person receives a supply which is then used by a third party, the third party is generally responsible for the supply. The rules will change to allow this pass through only where that third party would also meet the "responsibility for supply" definition. Also, supplies made to a third party at Person A's direction are now the responsibility of

Person A. In addition, the rule requiring that payment is made for the supplies is removed.

Certain supplies will be excluded from supply calculations: annual gas supplies of less than 73,200 kWh through domestic meters and electricity supplies through certain domestic meters.

### Landlords and Tenants (adopted with changes)

DECC still refuses to change the standard supply rules as they apply to landlords and tenants. Supply responsibility for energy consumption will therefore generally remain with landlords (where they contract for the energy supply).

DECC has reconfirmed its intention to include a specific exception from the normal landlord / tenant rule in the case of long ground leases where the tenant agrees to construct a building. In such a case, under certain conditions, the tenant is responsible for the energy supply. This situation would only apply rarely as the tenant would normally arrange its own supply in such cases (and therefore be responsible under CRC for supplies anyway). DECC however proposes to decrease the length of applicable ground lease from 40 to 30 years.

### Real Estate held through Trusts (adopted with changes)

DECC has altered its proposals on dealing with Real Estate held through trusts. The scheme will apply a revised version of its proposed hierarchical approach to working out which entity is responsible. In broad terms:

1. As previously proposed, where there is a controlling beneficial owner, or an investor beneficiary with a majority share over 50%<sup>5</sup>, that entity takes responsibility for CRC purposes;

For other trusts, CRC will treat them as undertakings, as follows:

2. As previously proposed, if the trust is regulated under the Financial Services and Market Act 2000, responsibility would pass to the operator of the trust<sup>6</sup>; and
3. In other cases, the trustee would be responsible. Previously DECC had suggested that such trusts would be dealt with separately for the purposes of qualification and registration. However, following concerns over loss of emissions from the scheme, DECC now proposes that all trusts operated by a trustee would need to be aggregated. Individual trusts could then be disaggregated but the initial aggregation will mean that fewer such trusts will fall out of Phase 2 than would otherwise have been the case.

DECC has still not explained how it would manage the enforcement issues associated with looking through the trusts to the beneficiaries. The beneficiaries under category 1 above might not be easily ascertainable.

### Abolition of the Performance League Table (PLT)

Whilst abolition of the PLT will remove various reporting burdens it also removes the one tangible reputational driver from the scheme. Aggregated energy use and emissions data will be published instead.

### Data submission / storage (adopted as proposed in consultation)

Existing Participants will be able to use a facility to migrate data from the first phase to second phase registration.

<sup>5</sup> This second limb is not specifically mentioned in the response although DECC have confirmed it will apply.

<sup>6</sup> The operator will have to aggregate all trusts for which it is operator for qualification and registration purposes. The operator will, however, be able to disaggregate the different trusts subsequently.

Also, scheme data will only have to be kept for 6 years following the scheme year (rather than the current 7 years from the end of the relevant phase).

## Early changes being introduced in June 2013

One surprise is the new proposal to introduce some changes from June 2013 which means that they would apply for the current compliance year (2012/2013) and final introductory phase compliance year (2013/2014) as well as in Phase 2. These include:

- Abolition of the PLT.
- The reduction of fuels from 29 to 2 (as mentioned above)<sup>7</sup>.
- The application of the 2% consumption threshold; excluding gas not used for heating purposes and gas supplied through domestic gas meters (each as mentioned above).
- Extension of the CRC surrender deadline to the end of October (as mentioned above).

## Final Comments

We finally have some clarity on what CRC Phase 2 will look like although there will be disappointment in many quarters that the scheme is not going to be immediately scrapped. Whilst most of the simplification changes are welcome, it still remains an excessively bureaucratic scheme for what the CRC aims to achieve.

CRC seems destined to be dogged by uncertainty as DECC intends to review the effectiveness of the scheme in 2016 (beyond the next general election). The Government notes in the Response that "*The tax element of the CRC introduced at Spending Review 2010 will be a high priority for removal when public finances allow*". This seems to suggest that CRC might remain but possibly some of the more complex elements of the scheme which made the scheme broadly cost neutral would have to be re-incorporated such as recycling payments / auctioning of allowances for cap and trade / and the Performance League Table. Calls for an alternative mechanism to encourage energy efficiency will no doubt continue to be made.

## Next Steps

Further guidance is expected on the Phase 2 qualification process and updated guidance for Phases 1 and 2 and these should be published shortly. A revised version of the CRC Order will also be published when it is laid before Parliament for approval (possibly in January according to DECC); no further public consultation is expected on the Order.

Given the delay in registration and disaggregation deadlines mentioned above, existing and potential Participants will now have more time to consider whether they are likely to qualify for Phase 2 and map out their route to registration (and possible disaggregation) - registration will be needed by the end of January 2014, with disaggregation requests and separate registration needed by 30 April 2014. In any event, it can be hoped that this will be a simpler process for existing Participants than for Phase 1 given the knowledge and experience gained.

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<sup>7</sup> This is accompanied by a corresponding restriction in the use of electricity generating credits during the remainder of Phase 1.

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