

Review

BEG Property



The CRC Energy Efficiency Scheme - The key questions for the Property Industry

WHAT IS THE CRC ENERGY EFFICIENCY SCHEME?

The CRC Energy Efficiency Scheme ("CRC") (which was until recently simply known as the Carbon Reduction Commitment) is a mandatory emissions trading scheme that aims to improve energy efficiency and reduce the amount of carbon dioxide (CO₂) emitted in the UK. It is designed to tackle CO₂ emissions not already covered by Government regulation (such as those covered by the EU Emissions Trading Scheme or Climate Change Agreements) and is a key component of the Government's strategy to achieve an 80% reduction in net CO₂ emissions (against the 1990 baseline) by 2050 as enshrined in the Climate Change Act 2008 ("CCA"). The CCA contains the enabling powers for the introduction of trading schemes relating to greenhouse gases and the CRC will be the first such scheme introduced under these new powers.

WHO WILL IT AFFECT?

The scheme applies to large commercial organisations and public sector bodies whose total annual half hourly metered electricity consumption in 2008 was a minimum of 6,000 MWh. This is broadly equivalent to an electricity bill of approximately £750,000. Subsidiary organisations and their parents will be grouped together for the purposes of the scheme and the highest parent organisation will be responsible for the compliance of the group. Franchisors will be responsible for their franchisees and local authorities will be responsible for the schools they fund.

It is estimated that between 4,000 and 5,000 organisations will qualify for the scheme and these are likely to be the large retailers, hotel chains, banks, local authorities, universities etc. Some of the larger property companies will also be caught as will a number of institutional landlords. Organisations who had one half hourly meter during the qualification period but whose energy consumption was less than 6,000 MWhs will not have to participate fully in the scheme but will still have to make an information disclosure about their electricity consumption. In the case of Central Government departments they will be included in the scheme regardless of whether or not they meet the qualification criteria.

HOW WILL IT WORK?

The CRC will work as follows:

- Organisations that qualify for the CRC will be required to report their annual CO₂ emissions from all energy sources (except where this is consumed in the transportation of people or goods in certain forms of transport or in domestic residential accommodation) and purchase allowances to cover their emissions from such sources during each year of the scheme (which will run from April to March).
- The Government will sell allowances to participants during the Introductory Phase of the scheme (April 2010 – March 2013) at a fixed price of £12 per tonne of CO₂ and there will be no limit on the number of allowances available for purchase. However, in later phases of the scheme – the Capped Phases – the number of allowances will be limited and their sale will take place by closed auction where the price will be fixed by reference to sealed bids and limits will be placed on the percentage of allowances that any one organisation can buy.

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- If participants fail to buy sufficient allowances in the initial sale or auction at the start of each scheme year they will be able to buy additional allowances in the secondary market (which will be open to non CRC participants) or via a safety valve mechanism (but such allowances will always be more expensive than those sold at the initial auction).
- The revenue generated by the initial sale or auction of the allowances (but not that generated by sales in the secondary market or via the safety valve) will be held in a central fund, administered by the Environment Agency and will be 'recycled' to scheme participants based on their performance in an annual league table. Each phase of the scheme will have a "footprint year" which will form the basis of the recycling payment calculation for each participant in that phase. The recycling payment will then be adjusted upwards or downwards by a percentage based on that participant's performance in the league table (which will start at 10% and then increase over the first five years of the scheme to 50%). It is estimated that with the bonus payment/penalty set at 10% this would be equivalent to 1.5% of a participant's energy bill and at 50% this could be as much as 8%. There will accordingly be both a financial and reputational incentive to do well in the league table. In the Introductory Phase of the scheme the league table will be based on three metrics: the Early Action Metric, the Absolute Metric and the Growth Metric. The Early Action Metric is based upon two early actions: achieving the Carbon Trust Standard (or equivalent) and installing automatic meters. This metric will form 100% of the score in the first year of the scheme reducing to 40% in Year 2 and 20% in Year 3.

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WHAT ARE THE KEY DATES FOR COMPLIANCE?

The Government has signalled its intent to ensure the CRC is implemented this year. The final regulations are expected to be published shortly. Assuming implementation proceeds as planned, the key compliance dates in the Introductory Phase (i.e. April 2010 – March 2013) of the scheme will be as set out in Box 1.

BOX 1

DATES	REQUIRED ACTION
April 2010 – September 2010	Registration for the Introductory Phase but as a concession no allowances have to be bought in respect of the first compliance year.
April 2011	1st sale of allowances will take place to cover the projected emissions for the year 2011/2012.
July 2011	Emissions for the year 2010/2011 must be reported.
October 2011	Recycling payments made out of revenue from 1st sale of allowances.
April 2012	2nd sale of allowances to cover projected emissions for the year 2012/2013.
July 2012	Emissions for the year 2011/2012 must be reported and corresponding allowances surrendered.
October 2012	Recycling payments made out of revenue from 2nd sale of allowances.

The first Capped Phase will then run from April 2011 to March 2018 with the footprint year being April 2011 – March 2012. The first two years will be preparatory only and the first auction will be held in April 2013.

WHAT ARE THE PENALTIES FOR NON-COMPLIANCE?

CRC is intended to be as "light touch" a scheme as possible and relies on participants' self-certification of their energy use. Participants will however be required to keep sufficient records to support their emission statements and should they be selected for audit they will have to provide a full evidence pack to the scheme administrators. The Government has decided that around 20%

of participants will be audited every year. In cases of non-compliance civil penalties will generally apply. Deliberate falsification of evidence will, however, be a criminal offence, as will failure to comply with the civil penalties. The main civil penalties are set out in Box 2.

BOX 2

OFFENCE	PENALTY
Failure to register.	Immediate £5000 and further £500 per working day (up to a maximum of 80 working days).
Failure to disclose information	£500 per settled HHM not disclosed.
Failure to provide Footprint Report/Annual Report.	£5000 fine and additional fine of £500 per working day for each day of delay up to maximum of 40 days when the daily rate fine will be doubled. In the case of failure to provide the Annual Report this will also result in bottom ranking in the league table and recycling payments blocked pending compliance.
Incorrect reporting/Failure to buy sufficient allowances.	Fine of £40 for each tonne of CO ₂ of emissions incorrectly reported or in respect of which allowances should have been acquired/surrendered and recycling payments blocked pending compliance.
Failure to keep adequate records.	£40 per tonne of CO ₂ of total emissions reported in most recent compliance year.


CRC relies on participants' self-certification of their energy use.

HOW WILL CRC WORK AS BETWEEN LANDLORDS AND TENANTS?

Under the CRC scheme the consumer of the electricity supply is the party who is the customer under an electricity supply contract and receives a supply under that contract. If the supply is then passed on to another person for his or her consumption the ultimate consumer will be taken to have consumed the electricity that has been supplied. However, where the ultimate consumer is the tenant of the counterparty to the electricity supply contract, then the tenant is not to be taken to be the consumer of the electricity for the purposes of the scheme. The effect of this exception is that large landlord organisations will be responsible for the emissions of their tenants in cases where the landlord pays the energy bills. Landlords may therefore find that they become CRC participants by virtue of being responsible for the emissions of their tenants, even where the energy supplies to their tenants are sub-metered. A landlord which is a CRC participant organisation ("CRC Landlord") will therefore have to buy allowances to cover the emissions of their tenants, whose energy they supply, as well as the emissions from the energy consumed in the common parts of their buildings and estates.

HOW SHOULD CRC COSTS BE APPORTIONED AS BETWEEN LANDLORDS AND TENANTS?

A CRC Landlord will have to decide to what extent it wants to pass on its costs of complying with the CRC to its tenants and then work out whether it is entitled to do so. Existing leases will not make any express provision for the CRC and it is uncertain whether existing leases will enable CRC Landlords to recover any of their CRC costs (However, we understand that some CRC Landlords believe their leases do entitle them to recover CRC costs). In the case of new leases, this will of course be a matter for negotiation between the landlord and tenant. In June of last year a paper was published by the CRC Working Party established by the Green Property Alliance (an umbrella group of various property industry bodies including the British Property Federation, the Investment Property Forum and the British Retail Consortium) which examined the various different methods of apportionment of CRC costs that might be adopted by the property industry. The CRC Working Party has now published a consultation document the purpose of which is to explore whether a cross-industry consensus can be reached on how CRC costs should be apportioned between landlords and tenants in new leases. The benefit of this would be that



standard lease wording could be formulated and there would be a consistency of approach between CRC Landlords. This would be of considerable benefit not only to landlords but also to tenants, such as multiple retailers, who would be able to adopt one system of calculating their CRC liabilities across their estate. Whilst the consultation focuses on new leases, there is no reason why standard CRC provisions could not be incorporated in existing leases by means of supplemental deeds of variation if the principle of this is acceptable to the parties. The outcome of the consultation will be of considerable importance. If a common approach to CRC is not established this could well have adverse implications for a wide variety of property transactions and for the property industry in general.

The consultation paper was launched on 17th December 2009 and responses are to be sent to Patrick Brown, Secretary to the CRC Working Party at crc@bpf.org.uk by close of play on 5th February 2010.

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