

## CRC Energy Efficiency Scheme - the implications for companies

### The CRC Scheme

The CRC Energy Efficiency Scheme (CRC Scheme) came into force on 1 April 2010 and is a mandatory, emissions trading scheme affecting the whole of the United Kingdom.

The aim of the CRC Scheme is to encourage large businesses to reduce the amount of energy that they use in return for public recognition and financial reward. The catalyst for the CRC Scheme is the United Kingdom's pledge to reduce its greenhouse gas emissions by 80% by 2050.

The Environment Agency has overall responsibility for administering the CRC Scheme.

### Establishing whether your organisation is covered by the CRC Scheme

The CRC Scheme will only apply to large businesses and public sector organisations. It is often straightforward to establish if a company is covered by the CRC Scheme simply by considering the annual cost of the organisation's electricity. The rules become more complex where the company is part of a group or other business structure.

There are also new requirements for smaller organisations who use substantial amounts of electricity but that do not fall within the rules of the CRC Scheme. These requirements apply to all organisations that had at least one half hourly meter settled on the half hourly market in 2008. Their obligations are limited to making an information disclosure relating to energy use once every few years.

There are three key steps to establishing whether an organisation is covered by the CRC Scheme:

- establish the organisational structure of the business;
- calculate the electricity used by that organisation;
- establish whether the organisation meets the qualification criteria.

### Organisation structure

This is one of the most complex aspects of the CRC Scheme. It applies to groups of companies, partnerships, unincorporated associations and other types of undertakings. The structure of an organisation is calculated as at a specified date for each phase of the scheme.

In relation to groups of companies, it will be necessary to identify the parent company and its subsidiaries, using the rules set out in the Companies Act 2006. The entire group of companies will be treated as one organisation for the purpose of the CRC Scheme.

The ultimate parent will usually be treated as the Primary Member which will liaise with the CRC Scheme Administrator on behalf of the group. There is scope for larger subsidiaries to be treated separately in certain circumstances. These are known as "Significant Group Undertakings" (SGUs).

If the parent company of a group is based outside the United Kingdom, but the group uses energy within the United Kingdom, the group will be covered by the CRC Scheme. The CRC Scheme will not catch an organisation established in the United

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Kingdom that does not use energy in the United Kingdom.

The CRC Scheme also applies to joint venture arrangements, Private Finance Initiative structures, Public Private Partnership structures and franchise structures.

It is worth noting that the CRC Scheme also has ramifications for landlords and tenants, which could affect business organisations. Where a landlord is part of the CRC Scheme, they may approach the tenant to vary the lease terms to allow the landlord to recover any CRC Scheme costs.

For new tenants, landlords may include provisions in the lease terms to allow it to recover any CRC Scheme costs.

A significant issue for organisations made up of more than one company is liability. Under the CRC Scheme, each undertaking within a group of companies is jointly and severally liable for compliance failures. There are both civil and criminal sanctions for those failures.

Where companies within groups are commercially unconnected, this may prove to be a sensitive area. The Environment Agency has indicated that it will pursue the Primary Member first, but could still pursue other companies in the group.

Separating a larger group of companies into SGUs is a possibility, but this generates a raft of new issues. This will only be possible if both the separated organisation and the remaining group companies meet the criteria for participation in the CRC Scheme.

### Responsibility for energy supplies

Generally an organisation is treated as being responsible for energy supplies if energy bills are addressed to it.

Being responsible for the energy supply does not necessarily mean consuming the energy supply itself but all of the energy supplies of the entire organisation will be taken into account.

The CRC Scheme does not apply to all energy used by an organisation. Emissions relating to transport or domestic accommodation or that are already covered by another carbon efficiency scheme are not to be included in the calculation of use.

### Qualification criteria

Broadly, organisations that have at least one half hourly electricity meter and which used more than 6,000 MWh of electricity in the relevant qualifying year. The first qualifying year is 2008, with qualifying years being established for each of the full seven phases of the CRC Scheme. The net effect is that the CRC Scheme will, initially, primarily affect organisations that received electricity bills of approximately £500,000 and over.

Other organisations which used less than 6,000 MWh in 2008 will not have to participate in the scheme but may still have to provide information about themselves and their energy use.

The CRC Scheme makes provision for organisations that do not fall within the basic criteria but use sufficient electricity

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that they will have to provide information about their energy use.

#### The mechanics of the CRC Scheme

The scheme is divided into seven phases:

- Phase 1 (the Introductory Phase) between 1 April 2010 to 31 March 2013;
- Phase 2 between 1 April 2011 to 31 March 2018;
- Phase 3 between 1 April 2016 to 31 March 2023.

The remaining Phases follow the same pattern.

During the Introductory Phase the Government will sell an unlimited number of allowances at a fixed price of £12 per tonne of CO<sup>2</sup>.

In subsequent phases the Government will auction a limited number of allowances annually. The number of allowances will be reduced in each phase.

At the start of each year participants in the scheme must purchase allowances for the carbon emissions associated with their expected energy consumption. Participants can also buy allowances from each other in the open market.

At the end of each year participants must surrender allowances equal to their actual carbon emissions.

The Government will recycle the revenue raised from the fixed price sale and auction of allowances back to participants after a six month period.

The recycling payments will have a bonus or penalty applied to them. The size of the bonus or penalty will depend upon the participant's position in a league table that will be published each year. A participant's position in the league table will depend on whether they have been able to improve their energy efficiency in the year.

#### Main obligations of participants

The CRC Scheme imposes a range of obligations on its participants. They must:

- submit a footprint report at the beginning of each phase, showing which of the organisation's overall emissions are covered by the CRC Scheme;
- submit an annual report in July of each compliance year, showing what the organisation's 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 CO<sup>2</sup> emitted.

#### Important dates

**1 April 2010 to 30 September 2010** - organisations that meet the criteria must register.

**1 April 2011** - the second compliance year begins.

Participants must purchase allowances to cover their forecast carbon dioxide emissions **for the period April 2011 to March 2012.**

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**July 2011** - each participant must submit a footprint report for the Introductory Phase by the last working day of July.

**October 2011** - the first recycling payment will be made.

#### Costs of the CRC Scheme

The main costs for a participant will be:

- Registration fee: £950;
- Annual subsistence fee: £1,290;
- Costs of buying allowances;
- Administrative costs.

#### Implications for acquisitions and disposals

There are implications for both buyers and sellers in this area. The CRC Scheme will result in significant changes to the due diligence process where a company is being bought or sold.

Buyers will want to establish whether the company it is buying falls within the CRC Scheme and, if so, whether it has been part of a compliant organisation. It will then be necessary for the buyer to establish whether it will have increased obligations under the CRC Scheme as a result of the purchase or whether it might fall within the CRC Scheme for the first time.

Sellers will want to ensure that their obligations under the CRC Scheme are modified, if necessary, as a result of the disposal. They may fall outside of the CRC Scheme completely as a result.

Changes in an organisation that will affect the CRC Scheme must be notified to the

administrator of the CRC Scheme within three months. Special rules apply in these circumstances, depending on where, in the course of a phase, the changes happen.

#### Implications for directors and other officers

Under company law, directors must have regard to, amongst other things, the impact of the company's operations on the community and the environment. Shareholders have the opportunity to assess how directors are performing through the company's business review and the company's performance in relation to the CRC Scheme league tables is likely to be very relevant.

In addition, criminal penalties will apply to all officers of companies where an offence under the CRC Scheme is committed with the consent of the officer or is attributable to an officer's neglect. This is in addition to the penalties that directors can already be subject to for breach of duty.

#### Further information

This information sheet has been prepared to highlight some of the key issues relating to the CRC Scheme. It is intended to be for general guidance only and is not a substitute for specific advice. It is based on our understanding of the CRC Scheme as at June 2010 and may be affected by subsequent changes to the CRC Scheme.

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