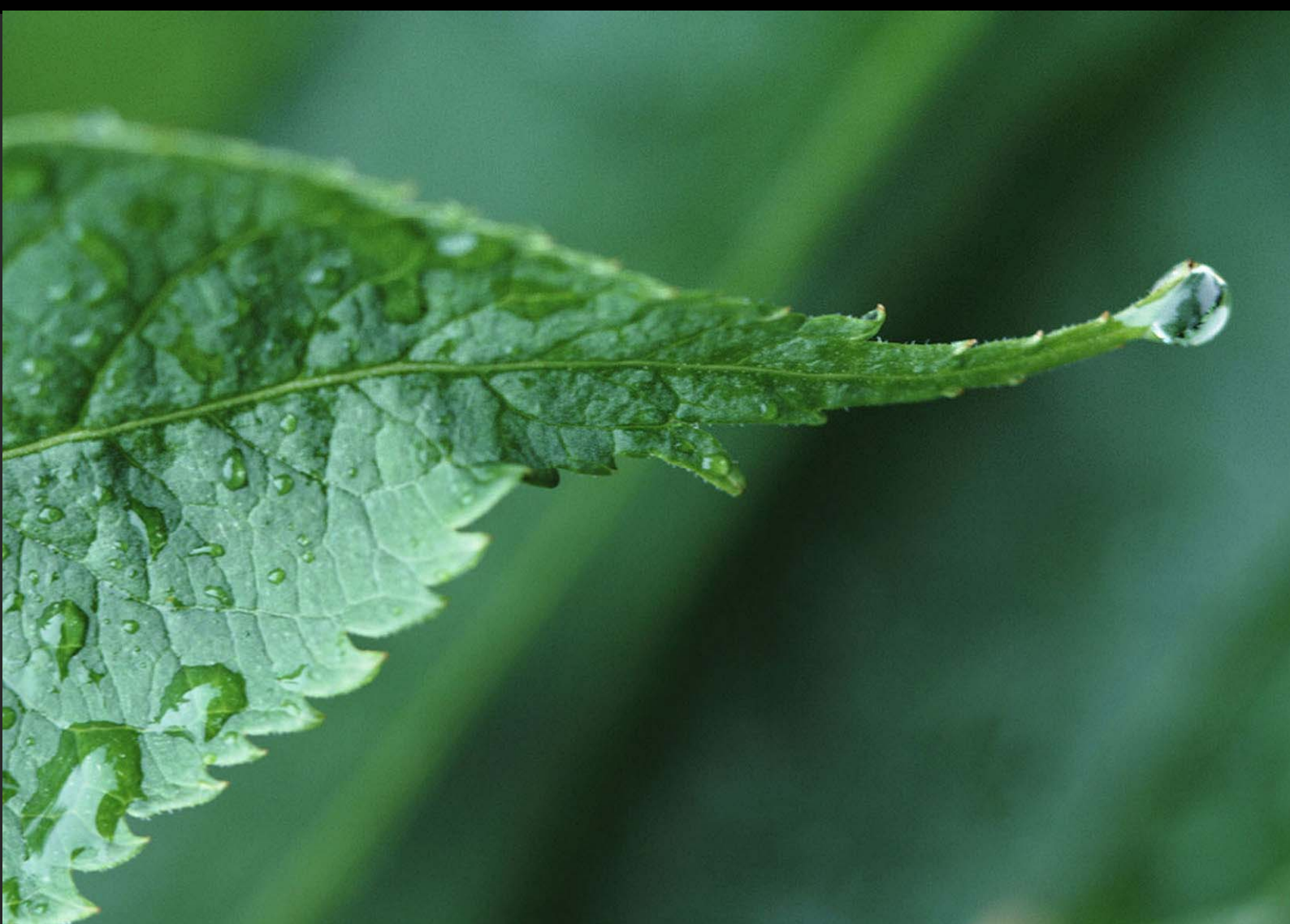


# CRC Energy Efficiency Scheme – an overview

OLSWANG



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## CRC Energy Efficiency Scheme summary

The CRC Energy Efficiency Scheme ("CRC") is a mandatory cap and trade scheme starting in April 2010 which requires companies to purchase allowances from the government to cover their CO<sub>2</sub> emissions. All companies with half-hourly meters ("HHMs") whose electricity consumption during 2008 exceeded 6,000 MWh (a cost of around £500,000) will have to participate. Organisations with HHMs that do not exceed this threshold will be required to comply with certain reporting obligations (known as information disclosures) under CRC.

A league table will be published at the end of each compliance year showing the performance of each participant. The revenue raised from the sale of allowances will be refunded to participants, subject to a bonus or penalty dependant on the participant's ranking in the league table.

CRC is administered by the Environment Agency (the "Administrator") and will run in phases. The Introductory Phase runs from 2010 to 2013; the second phase from 2013 to 2020. Subsequent phases will also last seven years.

## Action to be taken now

- Sign up to the CRC mailing list: <http://dmtrk.co.uk/AYH-2U0/s2.aspx>
- For group organisations, seek advice on the extent of your group structure.
- Consider appointing suitable personnel within your organisation to manage your participation in the scheme.
- Consider whether you will need to appoint consultants to assist in analysing your energy consumption and emissions levels and integrating the implications of the scheme into your business strategy.
- For full participants, consider applying for Carbon Trust Standard or installing voluntary automatic meter reading in order to improve your positioning in the CRC league table that will be published from 2010 onwards.

## Full details

### Qualification

CRC applies in full to organisations that had at least one HHM settled on the half hourly market in 2008 and whose electricity consumption in 2008 was at least 6,000 MWh. At current energy price levels, this means those with an annual electricity bill of more than £500,000.

Some uses of electricity are excluded from CRC and must not be taken into account in qualification calculations. In addition, emissions covered under the Climate Change Agreement scheme and direct emissions included in the EU Emissions Trading Scheme (the "EU ETS") will not be regulated by CRC. Any energy used for transport will also be excluded and organisations with more than 25% of their emissions in Climate Change Agreements will be completely exempt from the scheme.

Organisations that had at least one HHM in 2008 but consumed less than 6,000 MWh of electricity will not need to participate by purchasing emissions allowances but will have to make certain prescribed information disclosures.

### Group organisations

Group organisations must combine to participate in CRC as one entity. This means that the electricity consumption of all group companies with HHMs must be combined when determining qualification and companies which alone do not qualify for CRC may have to participate by virtue of other group companies' emissions. Allowances must be purchased for and distributed among all group companies and reporting will have to cover the whole group. One company within the group, normally the highest parent organisation, will need to be responsible for this.

The only exception to the requirement for groups to form a single participant is in the case of a group company which would qualify in its own right to participate in CRC were it not part of a group. These companies are known as Significant Group Undertakings and may be disaggregated from the group to participate on their own.

Determination of group structure is in accordance with the Companies Act 2006 and it is therefore possible that unrelated entities will have to participate together. This is a particularly complex issue for private equity funds and the companies owned by them and specific advice should be sought.

### Buying allowances

Allowances are sold during one month only in **April** of each year. For the Introductory Phase, allowances will be sold by the Administrator without any limitation on the number available. As the first year of the scheme will be a monitoring period only, the first sale will not take place until April 2011 when participants will be required to buy allowances for emissions anticipated to be made in 2011 – 2012. During the Introductory Phase, the price of allowances will be fixed at £12/allowance (one allowance is required per tonne of CO<sub>2</sub> emissions). For the second and subsequent phases, a fixed quantity of allowances will be sold to participants annually by auction, hence they are referred to as the "capped phases".

Participants will also be able to purchase allowances:

- in the secondary market. Once allowances have been purchased in the initial sale (or auction during the capped phases), participants will be able to trade with each other on the secondary market should they wish to buy or sell surplus allowances; and/or
- through the safety valve mechanism. The Administrator purchases allowances through the EU ETS on the participant's behalf and converts these to CRC allowances. Safety valve allowances will be sold at the ETS market price plus broker and handling fees.

## Reporting

In order to minimise administrative burdens, the reporting and auditing requirements have been designed to demonstrate a regulatory "light touch". For example, participants will be required to self certify their energy use (although the government proposes that this will be backed up by an independent risk-based audit of around 20% of organisations per year and, depending on these results, it may reconsider the number of organisations requiring independent audit).

By the end of **July 2011**, each fully participating organisation must return a report of its total CO<sup>2</sup> emissions for the year April 2010 – March 2011. This is known as the Footprint Report and is done once only in each phase of the scheme. There are important exemptions available in terms of what must be reported, and specific advice should be sought. In particular, if at least 25% of an organisation's emissions are covered by a Climate Change Agreement, that organisation will be entirely exempt from participation in CRC.

From the total Footprint emissions, a participant then calculates the emissions regulated by CRC and for which it must purchase allowances. Again, specific advice should be sought on this calculation. At least 90% of total Footprint emissions must be regulated by CRC, Climate Change Agreements or the EU ETS.

Each year participants are required to monitor and report on their emissions levels. Annual reports must be submitted each **July** at which time allowances must also be surrendered for the compliance year ended in March.

An evidence pack must be maintained on an ongoing basis by participants which must contain information and supporting evidence on the Footprint data and the data submitted each year on its energy use and emissions levels.

## The league table

At the end of each annual reporting period, the Administrator will publish a performance league table that will rank participants based on their performance within the scheme relative to all other participants. As well as being an important reputational tool, the league table will also influence the amount of the revenue recycling payment, as detailed below. Positioning in the league table and refund payments are based on three criteria:

- the **absolute metric**: this is a calculation of the percentage reduction in a participant's CRC emissions relative to its average emissions for the previous five years (or since the start of the scheme for the first five years);
- the **early action metric**: the extent to which organisations have undertaken either or both of the early action steps to demonstrate commitment to reducing emissions levels. Organisations can act now by

(i) obtaining Carbon Trust Standard (or equivalent accreditation) or Energy Efficiency Accreditation certification; and (ii) installing voluntarily installed automatic metering by **31 March 2011**; and

- the **growth metric**: the percentage change in emissions per unit turnover relative to its average emissions per unit turnover for the previous five years (or since the start of the scheme for the first five years).

These metrics are weighted as follows:

	<b>Year one</b>	<b>Year two</b>	<b>Year three</b>
<b>Absolute metric</b>	0%	45%	60%
<b>Early action metric</b>	100%	40%	20%
<b>Growth metric</b>	0%	15%	20%

### **Revenue recycling payment**

The revenue recycling payment is made each October from the total funds collected in the sale of allowances during the previous compliance year. A participant's refund entitlement is determined according to the percentage of emissions attributable to that participant during the first year of the Introductory Phase. This percentage is fixed for the duration of CRC and applied to the total revenue raised each year. A bonus or penalty is then applied to this initial amount dependent on the participant's league table ranking to give its final refund entitlement. In the first year the bonus/penalty rate will be +/- 10%, increasing to +/- 50% for the fifth year of the scheme.

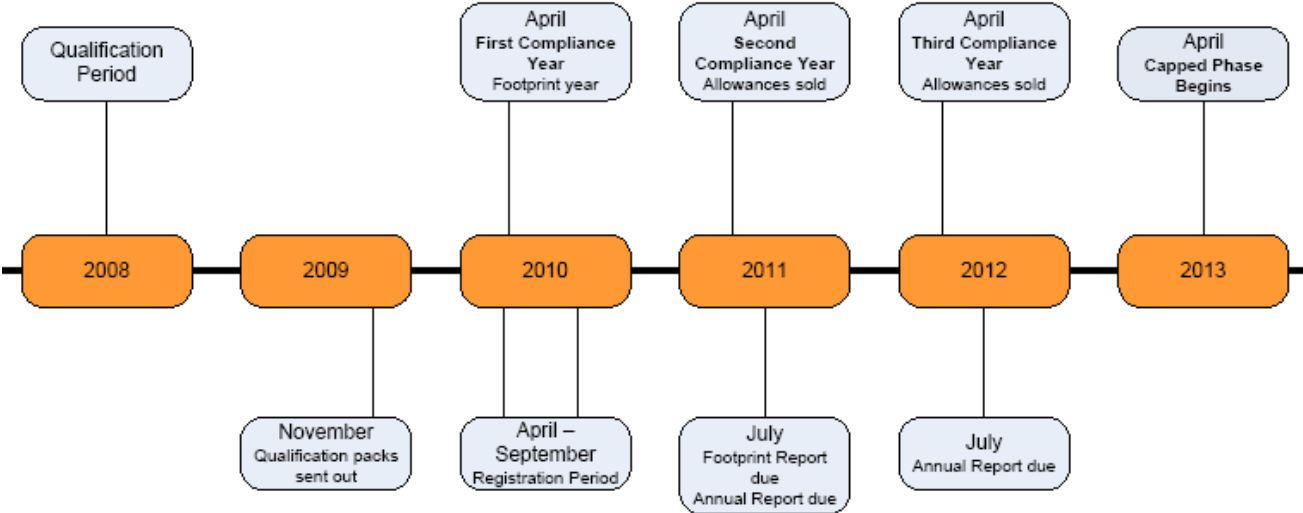
### **Penalties for non-compliance with the scheme**

Strong penalties will be imposed to deter abuse and ensure compliance. They arise in three main areas: non-participation in the scheme, incorrect participation in the scheme and incorrect reporting. For example:

- failure to register for CRC by the deadline will result in an immediate fine of £5,000 followed by fines of £500 per day until the participant registers (subject to a maximum of 80 working days);
- failure to surrender the correct number of allowances will result in a fine of £40 per tonne of CO<sup>2</sup> in respect of each allowance that should have been obtained and surrendered. If a participant fails to purchase the outstanding allowances by the end of the compliance year, it will not receive its recycling payment and the allowances will be added to the number required to be surrendered the following year; and
- failure to provide an annual report will result in the same fines as for failure to register and the participant's emissions will be doubled for the purposes of surrendering allowances for that year.

There are several other penalties applying to other aspects of CRC and participants – including those only required to make information disclosures – should be fully aware of their obligations.

# Important Dates



If you have any questions concerning any information in this document or would like to contact the Olswang Climate Change Group, please email Stephen Rosen at [stephen.rosen@olswang.com](mailto:stephen.rosen@olswang.com) or Lauren DeMarco at [lauren.demarco@olswang.com](mailto:lauren.demarco@olswang.com). This document has been prepared to provide a general and non exhaustive overview of the CRC Energy Efficiency Scheme only. The legislation implementing the scheme has not yet been finalised and therefore the summary information is subject to change. You should not take or refrain from taking any action based on the information in this document and specific advice should be sought.

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Our Firm continues to be acknowledged as a leading practice in many of our core areas: Olswang was voted TMT Team of the Year 2009 for the second year running at the annual Legal Business Awards; Olswang's Corporate Group won M&A Law Firm of the Year at the M&A Awards 2008 in conjunction with M&A Magazine, and was named Corporate Team of the Year – Mid markets at The Lawyer Awards 2008.

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We recruit personalities with a genuine fascination and notable reputation in the sectors they focus on, which is reflected in the quality of our advice. We also understand the importance of achieving our clients' goals and ensure that our advice is, above all else, practical.

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At Olswang the passion of our lawyers, the confidence of our approach and the commercial edge to our advice provide a unique and compelling service.

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