

The CRC Energy Efficiency Scheme – a new challenge for UK business

A Guest Article by David Leedham of Speechly Bircham LLP
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CRC targets mean there's no time to lose

UK legislation and policy have set a trajectory for transition to a low carbon economy – one operating off substantially less fossil fuel – to reduce greenhouse gas (GHG) emissions and minimise energy poverty and insecurity in the UK.

The Climate Change Act 2008 (CCA) set national targets for emissions reductions (80% by 2050 compared with 1990 levels) and, along with the Energy Act 2008, laid foundations for establishing mechanisms to reduce the UK's fossil fuel consumption. Such mechanisms will fit in among a matrix of other factors – for example, in the short to medium term, the UK's energy security profile and potentially higher energy costs – that will influence behaviour and infrastructure change in the private and public sectors to achieve such reductions.

Financial and reputational drivers

The mechanisms in question include the CRC Energy Efficiency Scheme (CRC), formerly known as the Carbon Reduction Commitment. The scheme, which started in April 2010, will squeeze the public and private sectors, through financial and reputational drivers, to make energy reductions year on year.

Financial incentives to encourage the uptake of small scale renewable energy systems are being introduced – Feed In Tariffs in 2010 and Renewable Heat Incentive Tariffs in 2011 – and the CCA has started the move towards mandatory carbon reporting for companies by 2012.

A business's energy performance and strategies may become necessary indicators for future value. That will be particularly so if the cost/risk profile of fossil fuels increases and CRC and other mechanisms reveal the extent of a business's dependency on fossil fuel.

An overview of CRC

CRC is a mandatory, UK-wide, cap and trade scheme for emissions allowances as of 1 April 2010. Around 5,000 of the large but non-energy-intensive private and public sector organisations are expected to have to participate.

Likely participants include banks, retailers, landlords, data centre owners, private equity funds, Public/Private Partnerships (PPPs), including large Joint Venture Companies (JVCs) and Private Finance Initiatives (PFIs), franchises, government departments and local authorities.

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Private sector participation is based on groupings determined by share ownership or control; foreign entities with an operation in the UK can be caught. Another 20,000 that do not qualify for CRC participation will have to make certain information disclosures.

Phased introduction

CRC will operate in phases. The first and introductory phase is 2010/2013. Subsequent phases, each of 7 years, run to 2043.

An organisation must participate in a phase if, in the phase's qualifying year, the organisation:

- had half-hourly metered, UK electricity consumption of 6,000 megawatt hours (MWh) or more, and
- was supplied with electricity through a settled half-hourly meter.

The qualifying year for the first phase is 2008; for the second phase it is the year commencing April 2010.

How CRC will drive down energy consumption

CRC will seek to drive down energy consumption in three ways:

1. **Annual measuring and reporting obligations** for participants' energy consumption (excluding energy for domestic or transport use).
2. **Financial drivers** – participants will have to buy and surrender, for each year, allowances sufficient to cover their emissions. Money collected on annual allowances sales by the Government will be recycled to participants, after each year, adjusted according to performance. Poor performers will be funding the better performers.
3. **Reputational drivers** – public annual league tables showing participants' comparative performances in reducing emissions.

This will all be backed by stiff civil (and criminal) penalties for non-compliance. Members of a CRC organisation will have joint and several liability for CRC compliance.

Investments (e.g. equities, assets, joint ventures) may bring investors within CRC's first or subsequent phases with all attendant obligations, risks and opportunities. Or, while investments may not be caught within an investor's own

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CRC organisation, the investment may be in another CRC organisation. As mechanisms develop to evaluate the impact of carbon reduction and sustainability, it seems that value will be affected.

CRC's impact on landlord-tenant relationships

Where a tenant has the energy contracts for the building, it will be responsible for the building's emissions. But in multi-let buildings the landlord often has the energy contracts and so will have the emissions responsibility. It will want to look to its tenants to contribute towards any costs. But mechanisms may not exist to allow recovery.

CRC (and other mechanisms focusing on energy and sustainability) will create not only new tensions in landlord-tenant relationships, but also additional reasons to collaborate – and not just on a voluntary short-term basis (particularly as there are innumerable existing leases with years to run).

Creating symbiosis

Green leasing (clauses to introduce sustainability considerations into the lease) in new lettings is only a small part of what will need to be addressed. While a lease ties a tenant to a building, CRC will create a symbiosis between the landlord and tenant businesses on a wider scale.

CRC contains no direction on how to handle CRC between landlords and tenants. We have developed structures to address CRC and other key elements of the sustainability agenda within the landlord and tenant relationship.

Those involved with developments may find that the energy consumed during construction affects their own or the landowner's CRC qualification and/or performance. This may need consideration in the building and/or development contracts. The owner/investor and user will have their own concerns as to energy sources and consumption of the final product.

Carbon dependency – a developing determinant of value?

David Leedham

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If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.