Government proposes major changes to the Carbon Reduction Commitment

Today the Government published its response to the latest consultation on the Carbon Reduction Commitment (**"CRC"**). The response includes some significant changes to the CRC including some obvious crowd-pleasers (such as the decision to drop the requirement on participants to buy allowances in the first year of the scheme). There will, though, be some who are disappointed by the Government's response: not least the renewables industry which continues to receive no significant incentivisation under the CRC.

We will shortly be sending out a full briefing note on the latest changes to the CRC, which will now be known as the "CRC Energy Efficiency Scheme". In the meantime, we set out below some of the headline issues which could impact on your business. We begin with a reminder of the basics of the CRC.

The CRC: the basics

The CRC is a mandatory carbon trading scheme under which organisations broadly with electricity bills of over £500,000 in 2008 will have to buy carbon credits (or allowances) equivalent to their energy use. Money raised by the sale of the allowances is recycled back to participants by way of a cash sum (the "recycling payment") based on a number of metrics at the end of each emissions year, including action taken before the scheme comes into force in April 2010 and absolute emissions reductions.

From a compliance perspective, the scheme is complex, with hefty penalties for breaches, "naming and shaming" and even potential director liability.

Proposed Changes to the CRC

The following is a summary of the headline changes to the CRC proposed by the Government today.

1. Cash flow

There will now be no requirement to buy allowances for the first year of the CRC (April 2010 to March 2011). Previously, the Government had proposed that, at the first sale in 2011, participants would have to buy allowances for 2010/2011 and forward for 2011/2012.

2. Principal Subsidiaries

Subsidiaries which would have qualified for the CRC in their own right will now be able to participate in their own right. Previously, these subsidiaries would have participated as part of their holding company's Group.

This could have significant implications for growing businesses where, previously, the impact of growth would have been multiplied across the entire Group and so reflected in the recycling payment payable at the end of the year. Now (subject to reviewing the detail) the impact of growth on the recycling payment can (to some extent) be isolated.

This will be of interest to a number of sectors, including data centre operators, franchise businesses and the private equity and fund management sector.

3. Renewables

The renewables sector has been calling for the carbon intensity of renewable energy to be recognised in the CRC. Where renewable sources of electricity give rise to Renewables Obligation Certificates (**"ROCs"**) and the electricity is exported onto the grid, it is treated as having the average carbon intensity of grid electricity. That will remain the case.

4. Onward transmission

The Government is proposing to re-define "onward transmission". The principle is that where A receives a supply of energy which B uses, then B is taken to consume that energy and has to account for it. That does not apply where the energy is supplied by a landlord to a tenant. However, the precise drafting of that exemption (not yet available) can have radically varying impacts for landlords and tenants.

5. Landlords/Tenants

The Government has decided not to permit landlords and tenants to opt to transfer responsibility for emissions to the tenant.

Nor will the Government legislate as to how to apportion the costs and benefits of the CRC between landlords and tenants. This is a matter for commercial negotiation between the parties – something a number of our clients are already heavily engaged in.

6. Climate Change Agreements ("CCAs")/EU Emissions Trading Scheme ("EUETS")

The Government has responded positively to the representations made by those sectors covered by CCAs and the EUETS. The exemptions available to these businesses will now be based on emissions under CCAs/EUETS from the most recent reporting year under those schemes rather than for the CRC compliance year. They will also be exempt from providing a "footprint report". This should ease the administrative burden for heavily regulated sectors such as the chemical sector.

7. Early action

The Government has accepted that the Carbon Trust Standard should not be the only energy efficiency scheme which should count towards the "early action" metric (and so feed into the recycling payment). Accreditation to equivalent schemes will also count. Also, "early action" will now receive greater weighting in assessing the recycling payment in the second year of the scheme.

8. Other matters

Other changes include amendments to the concept of "franchises" and the "transport exemption".

As important as what is changing in the CRC is what is not: most importantly, the Government is sticking to its approach that the "organisation" for the purposes of the CRC should be determined (largely) according to parent-subsidiary relationships as defined in the Companies Act 2006. This will be a disappointment to the private equity and fund management industries which were hoping that "organisations" would be aligned to operational or accounting arrangements, although they will be able to benefit from the new rules on large subsidiaries (see above).

9. Next steps

The Government will be publishing new guidance on the CRC in October. A final draft CRC Order will be published towards the end of the year and will be in force in early 2010. Registration for the CRC will be required from April 2010.

If you would like to talk to us about the Government's latest proposals or about the CRC more generally, please contact:

Michael Hutchinson – Partner
Telephone number: +44 20 3130 3164
Email: mhutchinson@mayerbrown.com

or speak to your regular contact at Mayer Brown.

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