

DATA CENTRES AND THE CARBON REDUCTION COMMITMENT: WHAT YOU NEED TO KNOW

By Michael Hutchinson

What is the Carbon Reduction Commitment (“CRC”)?

On 7 October the Government published its response to the last consultation exercise on the Carbon Reduction Commitment, a new carbon trading scheme that will have a major impact on the data centre market. The CRC - now called the CRC Energy Efficiency Scheme - is due to come into force in April next year, so having a clear understanding of the scheme and what it requires is likely to be a business critical issue for data centre operators and occupiers alike.

In this article, we look at some of the key issues arising from the CRC relevant to data centres. First, we summarise how the scheme works.

The CRC is a mandatory carbon trading scheme under which affected organisations will have to buy carbon credits (or allowances) equivalent to their energy use. At the start of each year (except the first year) there will be a sale (or in due course, auction) of allowances. Initially these will be at a fixed rate of £12 per tonne of CO₂. From 2013 the price will be determined according to a clearing price established from the bids made by the participants. There will, also from 2013, be a cap on the number of allowances available which is intended to push up the price of carbon and so incentivise participants to undertake energy efficiency measures.

Money raised by the sale of the allowances is recycled back to participants by way of a cash sum, based on a number of metrics, at the end of each emissions year, including action taken before the scheme comes into force and absolute emissions reductions. In other words, the amount of money you receive back depends on good performance: it does not necessarily reflect what you paid upfront.

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

The main questions for data centre operators and end-users are as follows.

What do you need to do know?

1 Do you qualify? Qualification is “organisation”-based rather than site-based. So the first key issue is: what did your “organisation” comprise on 31 December 2008 for the purposes of the CRC? The general rule is that parents and subsidiaries are aggregated together for the purpose of CRC qualification (and subsequent compliance). However, the picture becomes much more complex where foreign parents are involved.

In addition, the normal consolidation rules for parents and subsidiaries are modified for the purposes of the CRC in a number of ways: there are special rules for joint



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ventures and even the normal definition of “parent” and “subsidiary” are amended. Care needs to be taken when working out how far up the family tree the concept of “organisation” goes e.g. does it include the ultimate investors? If so, do you aggregate their other business interests?

Once you have worked out what your “organisation” is, then you need to work out whether it consumed electricity above the qualification threshold in 2008.

The test for “consumption”, in most cases, will be whether any part of your organisation receives a direct supply of electricity from half-hourly meters. This is usually evidenced by being a party to a supply contract.

The model for electricity supply varies in the context of data centres: at one end of the spectrum end-users might receive direct supplies from licensed suppliers; alternatively the supply might come via the landlord or a service company. The precise legal arrangements need to be borne in mind when attributing responsibility under the CRC for energy use.

- 2 Are there any ways to transfer risk/liability?** Once you have worked out whether your organisation qualifies for the CRC, you have to account for (or buy allowances in respect of) 90% of total energy use. The “organisation” may well have changed between 2008 and the scheme start date of April 2010 and there are special rules dealing with this. On 7 October, the Government announced that participants will not have to buy allowances in respect of the year 2010-2011. Allowances will need to be bought in April 2011. That said, the next critical question will be: are there opportunities to transfer risk under the CRC? A careful review of the exemptions available in the draft CRC legislation is an

important first step in understanding what your carbon footprint is for the purposes of the CRC. Alternative structures may be another option for excluding energy use from your obligations under the CRC. Where you cannot divest liabilities, we have developed models for sharing risk with others, e.g. landlords or tenants.

3 Are there ways to maximise the money which the Government recycles at year end?

If you want to get rewarded under the CRC, “early action” needs to be planned now. Understanding the options and their impacts is likely to be a major task for some businesses. Critical for businesses growing over the next few years will be finding ways of minimising the impact of that growth on your recycling payment. Growth can result in a penalty across your organisation. The Government has recently announced changes to the CRC which will enable participants to disaggregate subsidiaries which would have qualified for the CRC in their own right from the rest of the Group. Understanding the circumstances in which disaggregation is permitted and optimising alternative structures will be key to maximising the recycling payment.

4. How should you be covering the CRC risks in acquisition documents or leases/outourcing arrangements?

Analysing the potential impacts of the CRC on target assets is already important. The data centre market is beginning to develop a number of options for sharing risk and cost where wholesale risk transfer is not possible.

These are some of the critical questions which data centre operators and end-users are facing now. The task of gathering relevant data, analysing it and developing a strategy to lower costs and maximise reputational benefits as well as financial return is no small task. April 2010 may seem a long way off, but planning now for the CRC could well yield benefits for the future.