Carbon Reduction Commitment – an overview

OLSWANG

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Action To Be Taken Now

If your organisation had at least one half hourly electricity meter settled on the half hourly market in 2008 and your electricity consumption in 2008 was at least 6,000 MWh, you will need to participate in the Carbon Reduction Commitment fully (meaning you will be required to purchase allowances annually for your carbon emissions). If your consumption was less than 6,000 MWh, you will not need to participate fully (and will not need to purchase allowances) but will need to make certain information disclosures.

Recommended action to be taken now:

- Sign up to the CRC mailing list: http://www.defra.gov.uk/environment/climatechange/uk/business/crc/register.htm ;
- Look out for qualification packs that will be posted to you in September 2009;
- If your electricity consumption in 2008 was at least 6,000 MWh, 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 Energy Efficiency Accreditation Scheme certification in order to improve your positioning in the CRC league table that will be published from 2010 onwards.
- For full participants, prepare cashflow models in anticipation of the requirement to purchase two years' worth of emissions allowances in April 2011.

Background

Following the 2006 Energy Review, the Government published a White Paper on Energy (May, 2007) (the "**White Paper**") which introduced a new framework for addressing the UK's commitment to reducing energy use in large non-energy intensive organisations, largely encapsulated under the heading *"Carbon Reduction Commitment"* ("**CRC**"). Further to the objectives set out in the White Paper, a draft Climate Change Bill was proposed which establishes governmental powers to implement schemes which would enable the CRC to progress. The Climate Change Bill received Royal Assent in 2008 to become the Climate Change Act 2008.

CRC Scheme Summary

The CRC Scheme will commence in April 2010. The first allowances will need to be purchased in April 2011 to cover emissions for 2010/2011 and 2011/2012. In subsequent years allowances will need to be purchased in April to cover emissions in the subsequent 12 months (ie for the 12 month period ending in March of the following year). Payments made for allowances are refunded to participants at the end of each year, subject to a bonus or penalty to reflect the emissions performance of each participant relative to all other participants.

Who will the scheme apply to?

The CRC applies in full to organisations that had at least one half hourly electricity meter 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.

Emissions covered under the Climate Change Agreement scheme ("**CCAs**") and direct emissions included in the EU Emissions Trading Scheme will not be regulated by the CRC. Organisations with more than 25% of their emissions in Climate Change Agreements will be completely exempt from the scheme.

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

Details of the scheme

The basis of the CRC Scheme is what has been called a "cap and trade" scheme, which encompasses the notion that all organisations party to the scheme will be required to purchase annual energy use allowances to cover their anticipated annual carbon related emissions.

The Scheme operates in phases, which are made up of a number of compliance years:

Introductory phase : 2010 – 2013

Second phase : 2013 – 2020

Subsequent phases will also comprise 7 years each.

Buying Allowances

Allowances are sold for one month only in **April** of each year. For the introductory phase, allowances will be sold by the scheme administrator without any limitation to the number available. The first sale will take place in **April 2011** when participants will be required to buy allowances for the emissions already made in 2010 - 2011 and for those anticipated to be made in 2011 – 2012. During the uncapped introductory phase, the price of allowances will be fixed at £12/allowance (one allowance is required per tonne of CO2 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 be also able to purchase allowances:

- In the secondary market – once allowances have been purchased in the initial sale / auction, participants will be able to trade on the secondary market should they wish to buy or sell surplus allowances.

- Safety valve mechanism – this is to prevent allowance prices rising undesirably high and will take the form of a "buy-only" link to the EU Emissions Trading Scheme (the "**EU ETS**") subject to a minimum of £12 / allowance.

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, may reconsider the number of organisations requiring independent audit).

In **September 2009**, organisations with at least one half hourly meter will receive a qualification pack in the post. The registration forms must be returned to the scheme administrator between **April and September 2010**.

By **29 July 2011**, each fully participating organisation must return a report of their total CO_2 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 tools available on the online CRC registry to calculate an organisation's emissions based on its energy (and not just electricity) use. 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, it will be entirely exempt from participation in the CRC.

From the total Footprint emissions, a participant then calculates the emissions regulated by the 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 either the CRC or by Climate Change Agreements or by the EU Emissions Trading Scheme.

Each year participants are required to monitor and report on their emissions levels. Annual reports must be submitted annually in **July** at which time allowances must also be surrendered for the 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 scheme administrator will publish a performance league table that will rank participants based on their performance within the scheme relative to all other participants. Their performance and ranking will also influence the amount that is refunded to them in respect of their allowance purchases. Refunds are made annually in October. The league table will also have the obvious reputational effect. 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 carbon 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: (i) obtaining Carbon Trust Standard or Energy Efficiency Accreditation certification; and (ii) installing voluntarily installed automatic metering by **31 March 2011**.
- The "Growth Metric": the percentage reduction in carbon emissions per unit turnover relative to its average emissions for the previous five years (or since the start of the scheme for the first five years).

These metrics are weighted as follows:

2010-2011: Early Action Metric – 100%

2011-2013: Absolute Metric – 60%; Early Action Metric – 20%; Growth Metric – 20%

Subsequent years: Absolute Metric – 75%; Growth Metric – 25%

The participants will be ranked, using these metrics, according to their performance for the relevant year. A league table will be published showing each participant's ranking.

A participant's refund entitlement is determined by the percentage of emissions under the CRC scheme in 2010-2011 attributable to that participant. This is then fixed for the duration of the scheme. That percentage is then applied to the total revenue generated under the scheme to give an amount to which the participant is entitled. A bonus or penalty is applied to that amount, dependent on the participant's league table ranking to give the total refund amount. In the first year the bonus / penalty rate will be + / - 10%, increasing to + / - 50% for the fifth year. Subsequent rates will be reviewed later in the scheme.

It is therefore important to note that if the total revenue raised by the Scheme decreases (because participants reduce their emissions or purchase fewer allowances), a participant will remain entitled to a fixed percentage of the reduced total revenue pool. Accordingly if that participant continues to purchase the same value of allowances each year, it will receive a reducing refund unless it also improves its league table ranking or reduces its allowance requirements.

Penalties for non-compliance with the scheme

Strong penalties will be imposed to deter abuse and ensure compliance. They arise in three areas: non-participation in the scheme, incorrect participation in the scheme and incorrect reporting. Penalties include fixed fines and fines per tonne of CO_2 (£40 per tonne of CO_2).

Important Dates for the CRC Scheme

2008

Qualification year: participation in the CRC Scheme will be determined based on organisations' electricity consumption in 2008. NB that emissions are based on total annual energy use whereas qualification is based only on electricity consumption in 2008.

2009

September 2009 – qualification packs sent out.

2010

3 year introductory phase begins. 2010 is the first compliance year.

April - September 2009 – registration.

2011

2011 is the second compliance year.

April 2011 – first sale of allowances to cover 2010/2011 and 2011/2012 emissions.

July 2011 – footprint and annual report due.

First league table published.

October 2011 – refund payments made.

2012

2012 is the third compliance year.

April 2012 – second sale of allowances to cover 2012/2013 emissions.

July 2011 – annual report due.

Second league table published.

October 2012 – refund payments made.

2013

2013 is the first year of the second phase. A limited number of allowances will be sold by auction annually in April during this and subsequent phases. Allowances from the first phase cannot be used in this or any subsequent phases.

If you have any questions concerning any information in this document or would like to contact the Olswang Climate Change Group, please email Adam Fenner at adam.fenner@olswang.com. This document has been prepared to provide a general and non exhaustive overview of the Carbon

Reduction Commitment 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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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.

OLSWANG

London
Olswang LLP
90 High Holborn
London WC1V 6XX
T +44 (0) 20 7067 3000
F +44 (0) 20 7067 3999

Thames Valley
Olswang LLP
Apex Plaza, Forbury Road
Reading RG1 1AX
T +44 (0) 20 7067 3000
F +44 (0) 20 7071 7499

Berlin
Olswang LLP
Potsdamer Platz 1
D-10785 Berlin
T +49 (0) 30 700171-100
F +49 (0) 30 700171-900

Brussels
Olswang LLP
Avenue Louise 326 bte 26
Louizalaan 326 bus 26
B-1050 Bruxelles/Brussel
T +32 2 647 4772
F +32 2 644 2165

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