The CRC Energy Efficiency Scheme

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The CRC (Carbon Reduction Commitment) Energy Efficiency Scheme (EES) is a mandatory carbon dioxide emission reporting and trading scheme for public and private sector organisations. They have to report their emissions to create performance league tables, and larger organisations also have to trade allowances to emit carbon.

However, the CRC EES has been criticised by businesses who say it is too complex. Also, following changes made by the 2010 Spending Review, any revenues raised through trading will not be recycled to the best-performing companies as originally planned, but instead retained by the Treasury. The scheme's full implementation was delayed by the Review, and the first performance league table was produced in November 2011. In May 2012 a draft order was laid to allow the first trading of allowances (retrospectively, for 2011/12).

However, following Budget 2012, the CRC EES is now under full review through a DECC consultation. The Chancellor has said that if the scheme cannot be simplified to produce "very significant administrative savings" for businesses, then it will be replaced by "an alternative environmental tax" on which the Government will consult in Autumn 2012.

Contents

1 Introduction

The CRC was first announced in the Labour Government's May 2007 Energy White Paper *Meeting the Energy Challenge,*[1] with a later 2009 consultation.[2] The scheme was implemented by the *CRC Energy Efficiency Scheme Order 2010* (SI 2010/768). It began in April 2010. Smaller organisations report emissions and are then placed in performance league tables, and larger ones do this too, but also have to trade allowances to emit carbon.

The Energy and Climate Change Committee held a one-off evidence session on the CRC energy efficiency scheme on 17 May 2012; evidence is not yet available. The National Audit Office provided the committee with a memorandum[3] on the scheme beforehand. This points out that the data needed to assess the first year impact of the scheme will not be available until October 2012 (when the second performance league table will be produced).

2 Main elements of the CRC EES

Reporting and league tables

In all, around 20,000 public and private sector organisations are required by the scheme to report on their electricity usage. The scheme is administered by the Environment Agencies in each country[4] who publish a performance league table at the end of each 'compliance year'. The first was published in November 2011.[5] Commentators considered that this provided a year one 'benchmark' for over 2,000 organisations that submitted reports.[6]

Trading scheme

The largest companies (around 5,000 organisations that use more than 6,000 megawatt-hours per year and have certain meters) are also covered by a trading system.

Before the 2010 Spending Review, the plan was for companies to have annual fixed price sales of allowances during a 'phase 1' of the scheme. Companies had to purchase allowances equivalent to their emissions each year either through the CRC scheme, or other 'safety-valve' mechanisms including the EU ETS[7] via the Environment Agencies. In a second phase there would be an up-front sealed bid fixed price auction and the number of allowances would have been capped, again requiring anyone who did not buy enough allowances to get these through other means.

However, feedback showed[8] that companies have so far found it hard to predict their emissions well enough under phase 1, and that the planned phase 2 trading was too complex for organisations unused to trading schemes.

Allowances sale and recycling revenues

It was also originally intended to recycle all of the revenue raised from selling allowances back to the participants six months after the sale of allowances, with league table positions determining bonuses or penalties.[9]

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1 DTI, *Meeting the Energy Challenge*, May 2007, p52
2 DECC, *Consultation on the draft order to implement the Carbon Reduction Commitment*, March 2009
3 NAO Briefing for the House of Commons Energy and Climate Change Committee March 2012 http://www.parliament.uk/documents/TSO-PDF/committee-reports/crcenergy.pdf
4 See *CRC Energy Efficiency Scheme* pages of the Environment Agency website
5 Environment Agency, *CRC Performance League Table 2010/11*, 4 November 2011
6 *BusinessGreen,* "How to stay on top of the CRC league table", 15 November 2011
7 EU emissions trading scheme
8 DECC March 2012 *Consultation on simplifying the CRC Energy Efficiency Scheme* http://www.decc.gov.uk/en/content/cms/consultations/crc_simp_cons/crc_simp_cons.aspx

But the October 2010 Spending Review announced that the revenue from the scheme would instead be used to support the public finances. It also announced that the first sale of allowances would be delayed by one year:

> The CRC Energy Efficiency scheme will be simplified to reduce the burden on businesses, with the first allowance sales for 2011-12 emissions now taking place in 2012 rather than 2011. Revenues from allowance sales totalling £1 billion a year by 2014-15 will be used to support the public finances, including spending on the environment, rather than recycled to participants. Further decisions on allowance sales are a matter for the Budget process.[10]

The *CRC 2011 Amendment Order* therefore extended the introductory phase to three years of allowance sales. The first auction of allowances under the second phase was delayed to 2014/15, to give organisations another year of reporting, complying and surrendering allowances in the introductory phase.[11] The planned 'cap' on the number of allowances available, intended to constrain emissions, was also removed.

The removal of the 'recycling' of financial rewards was criticised by industry as making the CRC scheme a simple 'green tax' on industry and services, reducing the incentive to increase energy saving measures. The CBI said it was disappointed that the Government had not gone further to "repair the damage caused by its decision to remove the incentive behind the Carbon Reduction Commitment".[12]

As the NAO points out, the scheme was "designed to deliver a net financial benefit for private sector participants, but the removal of revenue recycling means that for this sector it represents a net cost". Added to this, the administrative costs have been higher than expected; a 2011 survey suggested first year costs on average of between £30,000 and £36,000 for participants, compared to the 2010 Impact Assessment estimates of £7,000 to £29,000. [13] This is pre-any simplification that may result from the current consultation.

Current draft regulations

Since the 2010 Spending Review announced that the first allowances sale under phase 1 would be put back to 2012, it will be a retrospective one, for 2011/12 emissions, at a price of £12/tCO_2.

In January 2012 the Government published an updated version of the draft *CRC Energy Efficiency Scheme Allocation Regulations*, seeking comments by 10 February. These regulations provide the legal basis for the CRC allowance process. DECC said:[14]

> The Government has published an updated version of the draft CRC Energy Efficiency Scheme (CRC) Allocation Regulations. They contain consequential changes from previous simplifications of the CRC Scheme. They also include the allowance price of £12 for 2012 as announced at Budget 2011. Future prices are a matter for the Budget process.

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9 Environment Agency, *A short introduction to the CRC Energy Efficiency Scheme*, p6
10 HM Treasury, *Spending Review 2010*, Cm 7942, 20 October 2010, para 2.108
11 DECC March 2012 *Consultation on simplifying the CRC Energy Efficiency Scheme* p.60 http://www.decc.gov.uk/en/content/cms/consultations/crc_simp_cons/crc_simp_cons.aspx
12 *Daily Telegraph*, "Government 'tinkered' with controversial green tax" 1 July 2011
13 NAO Briefing for the House of Commons Energy and Climate Change Committee March 2012 http://www.parliament.uk/documents/TSO-PDF/committee-reports/crcenergy.pdf
14 http://www.decc.gov.uk/en/content/cms/emissions/crc_efficiency/crc_efficiency.aspx as of 15 May 2012

> The Allocation Regulations, laid by HMT under the Finance Act 2008, will make provision for the sale of allowances in the first phase of the Scheme. The exact dates of the proposed allocation periods are contained in the Regulations. Broadly speaking they are in June and July each year. Two allocation periods are provided for, an annual Government sale (the primary allocation period) and an opportunity for the Environment Agency to finalise the processing of late requests (the secondary allocation period). Account holders will not be able to request allocations in the secondary period. As the cap has been removed there is no need for the safety valve mechanism. This has been removed from the Regulations.

Updated draft regulations have been laid and are due to come into force before 1 June 2012. They allow for the first, retrospective, sale of allowances. They set, for example, the dates of allocation periods and the carbon price of £12/tCO_2. There were to be debated on 21 May 2012 by the second delegated legislation committee.

3 Budget 2012 changes and proposed changes or abandonment

In Budget 2012 the Chancellor said that the CRC was "cumbersome, bureaucratic and imposes unnecessary cost on businesses". If the CRC could not be simplified, he would amend it.[15]

On 27 March 2012 DECC published a consultation on simplifying the CRC EES along with a KPMG assessment of costs to business.[16] The deadline for comments is 18 June 2012. Any proposed changes will take place from the start of phase 2. The main proposals are to:

- provide greater business certainty by introducing two fixed price sales of allowances a year (one forecast and one retrospective), rather than auctions of allowances in a capped system;
- allow for greater flexibility for organisations to participate in 'natural business units';
- reduce the reporting burden in particular by reducing the number of the fuels reported from 29 to 4; using only electricity measured by settled half hourly meters (HHMs) for qualification purposes; ending the requirement for footprint reports; and other practical measures such as reduced requirements on maintaining records;
- reduce scheme complexity by removing the residual percentage rule ('90% rule') and CCA exemption rules, but aiming to achieve broadly the same outcomes;
- reducing overlap with other schemes so that organisations covered entirely by CCAs do not need to register; no longer requiring EU ETS installations to purchase allowances for electricity supplies.

The new proposals for the second phase of the CRC are therefore for two fixed-price sales of allowances. At the 'forecast sale', at the start of the year, prices will be relatively low. At the 'buy-to-comply sale', after the end of the reporting year, prices will be higher. This will incentivise people to forecast their emissions and buy at the forecast sale. They will still be able to buy-to-comply later, or hedge risks by trading allowances.

Since there is no longer a cap, the proposal is to remove the 'safety-valve' mechanism. But there will still be the chance to trade on the 'secondary market' between organisations that have insufficient or surplus allowances.

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15 http://cdn.hm-treasury.gov.uk/budget2012_executive_summary.pdf

16 http://www.decc.gov.uk/en/content/cms/consultations/crc_simp_cons/crc_simp_cons.aspx

The consultation also proposes reducing reporting requirements. For example, the scheme currently requires reporting on 29 energy and fuel types (but with a 90% rule by which 10% of miscellaneous emissions can be discounted). The fuels covered will be reduced to electricity, gas, gas oil (diesel) and kerosene (the latter two only when used for heating purposes, and to avoid unequal treatment for heating supplies in Northern Ireland and rural communities). At the same time it is proposed that the 90% rule be increased to 100%, so in summary the scheme will require '100% reporting on four fuels'.

On the recycling of revenues, the consultation says:[17]

> Furthermore the 2010 UK Government Spending Review decision not to proceed with revenue recycling has been criticised by stakeholders. This difficult decision was taken to help tackle the deficit against a background of unprecedented pressure on the public finances. The resulting revenue streams were factored into HM Treasury's spending projections.

The consultation deals with simplifying the scheme only, and does not suggest returning to the recycling of revenues. However, it seems that if the scheme is to be changed, revenue will continue to flow to the Treasury as a 'tax'.

This is because the Government has said that if the CRC energy efficiency cannot be simplified, to produce "very significant administrative savings" for businesses, then it will be replaced by "an alternative environmental tax" on which the Government will consult in Autumn 2012.[18]

The DECC consultation has been called a 'last-ditch' attempt to simplify the CRC. DECC has reportedly also hinted that it might abandon the league performance tables, which businesses say take no account of their situation and improvements before the first table started. Some commentators have argued that mandatory greenhouse gas reporting and reform of the carbon price, perhaps through the climate change levy, could achieve similar aims. [19]

The consultation says only that a 'reputational driver', such as a performance league table, is needed, but it is too early to say whether the tables in their current form should be retained. By making these non-statutory a decision can be taken later on the measures to be used for phase 2 after the effects of 'the first couple' of performance tables can be assessed.[20]

A recent survey of 100 executives has shown frustration especially with the "high administrative burden", with four out of five saying said the league table ranking had no impact on their plans. The evidence on whether energy efficiency measures would have taken place without the CRC EES being in place was mixed.[21]

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[17] Op. cit., p.11

[18] http://cdn.hm-treasury.gov.uk/budget2012_executive_summary.pdf

[19] *Business Green* 27 March 2012 "DECC makes last ditch attempt to simplify the [CRC]" http://www.businessgreen.com/bg/news/2163941/decc-makes-ditch-attempt-simplify-carbon-reduction-commitment

[20] DECC March 2012 *Consultation on simplifying the CRC Energy Efficiency Scheme* p. 66

[21] *Business Green* 17 May 2012 "Green execs divided on ideal future for Carbon Reduction Commitment"