

## Review of the CRC supply rules

### Introductory Notes

- In the light of feedback about the operation of the CRC scheme, the Government is considering simplification of the CRC. In doing so, Government will take into account feedback from stakeholders including:
  1. The effectiveness of the framework for driving energy efficiency in large private and public sector organisations, in the light of wider policy developments in other areas such as the implementation of a carbon price floor<sup>1</sup>, electricity market reform<sup>2</sup>, implementation of a Green Deal for business<sup>3</sup> and the review of Climate Change Agreements<sup>4</sup>, and company reporting of greenhouse gas emissions<sup>5</sup>.
  2. The perceived complexity of the CRC scheme and hence the need to reduce the administrative burden on:
    - those organisations which are subject to the scheme
    - the administrators of the scheme (Environment Agency, Scottish Environment Protection Agency, Northern Ireland Environment Agency).
  3. Optimising the projected emissions savings attributable to the CRC scheme<sup>6</sup> due to an increased focus on energy efficiency by the target sectors.
- This is one of a series of discussion papers which aim to stimulate an informal dialogue between Government and participants about the simplification of the CRC Energy Efficiency Scheme. As such, this paper is not a statement of Government policy.
- These papers have been developed on the basis of feedback from participants about the operation of the scheme since April 2010. Ideas for simplification arising from this dialogue process will help inform consideration for amendment to the current legislation underpinning the scheme. Any formal legislative proposals would be subject to public consultation with the intention that they would come into force through affirmative Orders in Council before registration for the second phase of the scheme begins in

<sup>1</sup> [http://www.hm-treasury.gov.uk/consult\\_carbon\\_price\\_support.htm](http://www.hm-treasury.gov.uk/consult_carbon_price_support.htm)

<sup>2</sup> <http://www.decc.gov.uk/en/content/cms/consultations/emr/emr.aspx>

<sup>3</sup> [http://www.decc.gov.uk/en/content/cms/legislation/energy\\_bill/energy\\_bill.aspx](http://www.decc.gov.uk/en/content/cms/legislation/energy_bill/energy_bill.aspx)

<sup>4</sup> [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/lc\\_uk/ccas/ccas\\_policy/ccas\\_policy.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/ccas/ccas_policy/ccas_policy.aspx)

<sup>5</sup> <http://ww2.defra.gov.uk/environment/economy/business-efficiency/reporting/>

<sup>6</sup> Projected savings attributable to the CRC are outlined in Annex G of the June 2010 DECC energy and emissions projections

April 2013.

- It is essential that all participants continue to comply with the existing scheme, in full, as set out in the current legislation. The CRC remains a mandatory scheme, and the Environment Agency and other administrators continue to provide support to participants with their CRC compliance. Organisations who fail to comply may be subject to enforcement action and civil penalties. Participants should continue to fully comply with the scheme and use the introductory phase to gain experience on reporting, complying and surrendering allowances in CRC. For advice and support on compliance with the first phase of the CRC scheme participants should refer to the CRC Energy Efficiency Scheme Order 2010<sup>7</sup> and Environment Agency guidance.<sup>8</sup>

### **Issue**

1. The definition of an energy supply in CRC is critical to the operation and success of the scheme, given the definition assigns CRC obligation and responsibility to the appropriate party.
2. Policy development work to date has focused on defining the existence of a supply relationship between two parties, referenced as 'A' and 'B' in the CRC Order, with the policy aim of aligning CRC responsibility with ability to influence energy consumption. However stakeholder feedback has indicated the current supply rules are one of the biggest contributors to the perceived complexity of the scheme. Simplification will be considered if emissions coverage and alignment with the responsible party is maintained.

### **Background**

3. It is Government's policy intent that responsibility for energy supplies rests with the party which can and should do most to improve energy efficiency in an energy supply/energy use relationship.
4. Stakeholder feedback indicates that the application of the CRC's supply rules, especially between undertakings of the same group and complex outsourcing/PFI arrangements, are contributing to the scheme's perceived complexity amongst participants. The complexity may also contribute to a reduced emissions coverage as participants struggle to accurately identify the 'supplies' that they are

<sup>7</sup> [http://www.opsi.gov.uk/si/si2010/draft/ukdsi\\_9780111491232\\_en\\_1](http://www.opsi.gov.uk/si/si2010/draft/ukdsi_9780111491232_en_1)

<sup>8</sup> <http://www.environment-agency.gov.uk/business/topics/pollution/98263.aspx>

responsible for under the CRC. Similarly, certain supply arrangements might fail to meet the definition and fall out of the scheme.

5. Over the course of CRC policy development the supply definition has evolved from an approach based around the concept of a 'counterparty'<sup>9</sup> to the supply contract' (i.e. party with legal responsibility for the contract) through to the current drafting below:

(Schedule 1, section 1).

*A public body or undertaking ("A") is supplied with electricity by a person ("B") where—*

- (a) A agrees with B that B will supply electricity to A and that A will pay B for that supply;*
- (b) A receives a supply further to that agreement; and*
- (c) that supply is measured by a metering device or is a dynamic supply.*

*A metering device is a device where the electricity supplied is charged for as measured by the device.*

Similar definitions exist for the supply of gas and fuels, although the presence of a metering device is not required in respect of the latter.

6. The supply rules are supported by an unconsumed provision. This accounts for third party energy procurement services by placing responsibility for supply with the customer rather than the procuring party. This provision is not available in respect of landlord/tenant relationships, given the influence of landlords over the levels of energy use in their buildings.
7. In addition organisations may be considered to self-supply electricity and gas in certain circumstances. Such supply is reportable in the same manner as supply from a third party.
8. Stakeholder engagement and questions to the CRC Helpdesk have highlighted a number of scenarios where the relationship does not fulfil the above criteria (e.g.

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<sup>9</sup> The counterparty to a contract is the party that is legally liable for fulfilling the terms of that contract. In the case of energy supply, the counterparty is the organisation financially liable for paying the bill.

where an organisation is paid, rather than pays for, the input fuel into the generation process) or where the contractual relationship is particularly complex.

9. The requirement for a clear and simple approach to defining supply relationships is therefore highly desirable.

## **Options for simplification**

### **Option 1**

10. Government considers that instead of meeting a number of tests to qualify as a CRC supply, a counterparty to an energy contract could instead be deemed to be supplied with energy provided under the provisions of a contract. The current requirements, that a payment should be made for the supply and that the supply be measured by a meter or be a dynamic supply, would no longer exist. Government welcomes comments on how the issue of double reporting could be avoided without reference to a meter.
11. An exception to this rule to deal with the scenario of an organisation procuring energy for a third party might be that:
  - All the supply will be deemed to have been made to the organisation which receives the supply from the organisation who is the counterparty to the energy supply contract where an organisation procures the energy on behalf of another organisation under a contractual arrangement save where there is a landlord/tenant relationship between the counterparty to the energy contract and the organisation receiving the supply.
12. Under this situation there would need to be documented evidence, retained locally by both parties, of the transfer of responsibility. This position would ensure supply responsibility was always assigned to a party. This would simplify the current unconsumed supply and landlord/tenant complexity, and avoid placing an obligation on those facilities management companies and third parties that buy energy for pass through purposes only.
13. The option would also remove the requirement for a meter in order to establish a CRC supply relationship (for electricity and gas) – thereby bringing more private wire arrangements into the scheme and simplifying the treatment of complex supply chains. Such an approach would also bring unmetered supplies measured

on a passive or non half-hourly basis within scope, thereby removing the disincentive for organisations to upgrade their supply profiles to dynamic basis.

14. Although this would simplify the supply rules, the option would increase emissions coverage, with resultant allowance costs to participants. It would also simplify the treatment of group structures with a central procurement function, where there may be a split between the undertaking agreeing to an energy supply and the undertaking funding this supply – resulting in potential coverage loss.

15. The broad comparison between the current treatment and the new option is shown in the table below. It is suggested that the proposed approach both simplifies the process for determining supply responsibility and maintains the current determination in respect of these scenarios.

<b>Scenario</b>	<b>Current drafting – CRC responsibility</b>	<b>Proposed drafting – CRC responsibility</b>
Tenant with counterparty (c/p) status	Tenant	Tenant as counterparty
Landlord with c/p status	Landlord - exception to unconsumed supply rule	Landlord as counterparty
Non occupying third party (eg FM company) with c/p status – contractual relationship with Landlord	Landlord - unconsumed supply rule is applied to the FM company and the exception to the unconsumed supply rule is applied to the landlord.	Landlord applying counterparty rule
Non occupying third party (eg FM company) with c/p status – contractual relationship with tenant	Tenant - the unconsumed supply rule	Tenant applying counterparty rule

## **Option 2**

16. Government is also considering applying the supply and self-supply definitions at the participant, rather than the undertaking or public body level. This would simplify the CRC's treatment of complex intra-group arrangements and enable the existing treatment of Significant Group Undertakings.

### Option 3

17. Government proposes retaining the self-supply provision for electricity and gas supply. This will help to incentivise efficiency of use by those organisations falling within this definition. No changes are proposed to the exclusions from the self-supply definition, namely electricity used for generating, transmitting or distributing electricity, or gas used for transporting, shipping or supplying gas, is excluded from the scheme. However feedback is welcomed on whether the self-supply exclusion for such licensed activities should be extended to electricity and gas supplies from third party organisations (i.e. paragraphs 1 & 2, Schedule 1 of the CRC Order). Two sub options exist for the treatment of licensed activities;

- I. Entirely exclude such usage from the scheme or
- II. Exclude only from consideration when assessing qualification.

Either sub option could be achieved through reference to the supply definition under section 28(1) of the Utilities Act 2000.

*“supply”, in relation to electricity, means supply of electricity conveyed by a distribution system to premises other than premises occupied by a licence holder for the purpose of carrying on the activities which he is authorised by his licence to carry on;”.*

### Option 4

18. Another option is to exclude fuels, as currently defined under Schedule 1 of the CRC Order, from the definition of supply. This would have the impact of reducing emissions coverage by focusing the scheme on electricity and gas only, but significantly simplifying the administrative burden as participants could obtain all their data under the suppliers’ annual energy statement obligation. Currently there is no equivalent obligation on the suppliers of fuels. If this option is to be progressed the 90% applicable percentage would need to be adjusted – perhaps to 100% of electricity and gas supplies, to avoid significant emissions loss from the scheme (see option 8). Government is also mindful that such an approach may incentivise organisations to switch from electricity and gas to other fuels outside of the scheme, either to avoid qualification or to reduce their reported emissions. Government welcomes views on the desirability and impact of such an amendment.

### **Option 5**

19. Government is also aware of the need to simplify the treatment of transport related activities and proposes an additional option to tie in the supply definition with that of supply to a site. This would therefore exclude supplies made for the purpose of transport. Government welcomes views on how such a building-related supply could be defined.

### **Option 6**

20. Alternative options have been considered with respect to allowing organisations to decide CRC responsibility between them, on the proviso that supplies which would have been included within the scheme when assigned to the counterparty, are not eligible for transfer outside of the scheme to an organisation which subsequently fails to qualify for participation. If it qualifies for participation, the counterparty would need to complete some form of registration process prior to transferring emissions responsibility to ensure the transfer was captured within the scheme. Whilst this is not necessarily a simplification, on account of the additional checks required to ensure compliance with the previous transfer point, it would provide an often requested degree of flexibility to the scheme.

### **Option 7**

21. Another option under consideration would be to assign emissions responsibility on the basis of *consumption* rather than *supply* (effectively the 'polluter pays' principle). This would primarily reverse the treatment of landlord/tenant relationships, effectively moving the CRC obligation from the landlord to the consuming tenant or end party in a supply chain. Whilst such an approach would reflect the party actually consuming the energy, it arguably does not reflect their respective influences to reduce consumption and therefore emissions over time. In addition such a 'downstream' approach would require the engagement of all elements of a supply chain to avoid double reporting of emissions by parties. Government welcomes ideas on how such an approach could work across the CRC sectors, especially reference the data requirements on landlords to facilitate this option (where a tenant is unsighted as to their exact consumption through a fixed monthly charge).

### **Option 8**

22. Government is also considering whether to remove or amend the applicable percentage, where participants have to ensure that at least 90% of their EU ETS, CCA and CRC emissions are covered by the CRC. Removal of this percentage

would facilitate the removal of the core and residual source distinction and meter definitions - a source of significant stakeholder confusion. It would also remove the requirement for a footprint report to be submitted once per phase, further reducing the administrative requirements on participants. Government welcomes stakeholder views on the following three sub-options:

- I. Remove the 90% applicable percentage and introduce a requirement for organisations to annually report on their **total** electricity and gas supplies (where outside of the EU ETS and a CCA). This could be enabled through the removal of fuels from the scheme (option 4), thereby keeping the scheme coverage at a broadly consistent level. Government considers that such an approach would significantly simplify the requirements of participants.
- II. Retain the 90% approach but remove the requirement for a footprint report to be submitted once per phase. Participants would still be required to keep evidence locally of their compliance with the applicable percentage, and make such evidence available for audit, but they would not need to submit a footprint report as per current requirements. The core/residual distinction could also be removed so that participants would have an additional flexibility of choosing which sources to include in order to reach the 90%.
- III. Remove the organisation-wide applicable percentage and in its place adopt a site based de-minimis approach, whereby participants would be required to include any energy or fuel source which constituted more than a minimum percentage (e.g. 10%) of that site's total emissions in their annual report. Participants would be required to retain evidence locally of compliance with this requirement, and make available for audit when requested, but the requirement for a footprint report would be removed.

### **Contributing to the dialogue**

23. If you would like to submit written views on simplifying this aspect of the CRC scheme, or if you would like to make wider comments and suggestions about the scheme as a whole, please send your comments to [crc@decc.gsi.gov.uk](mailto:crc@decc.gsi.gov.uk) or CRC Team, National Carbon Markets, Department of Energy and Climate Change, 3 Whitehall Place, London, SW1A 2AW) **by 11th March 2011**.