

Carbon Reduction Commitment (CRC) – CBI consultation response

1. British business is committed to playing its part in delivering the UK's carbon reduction targets. CBI believes that energy efficient practices must become mainstream in business operations in order to build a low-carbon economy, and therefore we support the overall aims and ambition of the Carbon Reduction Commitment (CRC). Encouraging cost-effective carbon savings in business will deliver widespread environmental and financial benefits.
2. We recognise that this UK-wide mandatory carbon emissions trading scheme, targeting large public and private sector organisations, will be a key lever to deliver carbon reductions. Under the scheme businesses will be required to measure and report their energy consumption, and then purchase carbon allowances to cover the energy they use. The scheme is set up to provide financial incentives for organisations to be energy efficient by offering bonuses to those that reduce their energy consumption and penalties for those that do not. An annual league table showing how companies have performed is designed to provide additional reputational incentive to take action. These regulations aim to push energy efficiency up the corporate agenda, unlocking cost-effective carbon reduction potential from commercial properties.
3. CBI supports economy-wide carbon pricing, as demonstrated in our support for the EU Emissions Trading scheme, covering energy-intensive businesses. Action is now needed in the non-ETS sector of the business community and therefore we support the CRC cap-and-trade scheme.
4. However, this is a challenging time for UK businesses, and therefore it is imperative that these regulations are as simple as possible, achieving their environmental objectives with minimal administrative costs. For these regulations to prove successful, Government must:
  - ***Assess impact on companies' cash-flow in light of economic conditions ahead of first payment***
  - ***Allow businesses flexibility in determining CRC administration most relevant to their operations, and therefore allow large subsidiaries to operate in the CRC in their own right***
  - ***Reward good carbon management irrespective of business change through exploring the use of sector specific metrics and bench-marks in the capped phase***
  - ***Incentivise companies to invest in renewable energy generation within the CRC***
  - ***Expand the Early Action metric to include other accredited carbon management schemes and standards***



- ***Recognise the burden that the CRC will place on landlords, provide sufficient guidance and permit allowance transfers between landlords and tenants***
- ***Ensure consistency between the CRC and carbon reporting requirements to make it easier for companies to administer; and***
- ***Minimise the regulatory burden of multiple climate change policies by analysing interaction and overlap.***

**Assess impact on companies' cash-flow in light of economic conditions ahead of first payment**

5. CBI members are very concerned about the detrimental effect that the CRC will have on companies' cash-flow. CRC participants are required to buy carbon allowances at a cost of £12/tonne of carbon from April 2011. Government will then recycle this revenue back to participants depending on their carbon reduction performance. The time-gap between the sale of allowances and the recycling payment has been reduced from 18 months to 6 months, which is a welcome change. However, businesses are still very anxious about the effect on cash-flow. The cost of allowances, staff costs associated with compliance, registration and annual fees, and possible civil penalties for failing to meet scheme deadlines are all extra costs for businesses, additional to any money they decide to invest in energy efficiency.
6. Integrating a cost for carbon into business decision-making is needed. However, this could be done without moving cash from businesses to Government and back to businesses again, especially when cash is in short supply. Government should assess the cash-flow impact that this method of payment and revenue recycling will have on businesses if the economic situation has not significantly improved by Q4 of 2010. CBI economic forecasts show that with minimal economic growth of 0.1% projected for 2010, we do not yet know whether businesses cash-flow capabilities will be any more secure in 2011.

**Allow businesses flexibility in determining CRC administration most relevant to their operations, and therefore allow large subsidiaries<sup>1</sup> to operate in the CRC in their own right**

7. CBI members are very concerned that the 'one-size-fits-all' approach to defining a 'group' for participation in the CRC will in some instances place responsibility on those who have limited or no operational control over those emissions. They believe that the grouping of organisations for the purposes of the CRC does not necessarily fit with corporate structures, and therefore will increase the administrative burden for companies. There is the danger that in some cases the CRC will place responsibilities on organisations that do not have direct control over the operations of other businesses deemed to be in their 'group', and therefore will not be able to drive energy efficiency but will simply incur extra costs.
8. Under the proposals the CRC will target parent organisations (or highest organisation within the UK for companies operating internationally) that have direct influence on any 'subsidiaries'. A parent subsidiary relationship is primarily determined by the 'tests' set out in section 1162 of the

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<sup>1</sup> 'subsidiaries' in terms of the scheme, which would therefore include linked businesses under separate operational control and private equity portfolio companies.

Companies Act 2006. However, the 'parent' is not only those business undertakings required to report under the Companies Act, but also includes private equity funds and franchisors. Legal responsibility for compliance will rest with the group as a whole, but a nominated "primary member" (not necessarily the parent company) will have to administer the scheme and take responsibility for corresponding with the Environment Agency.

9. However, complex corporate ownership structures raise questions over where responsibility for the scheme should lie. The CBI remains concerned about the practicalities and associated administrative cost of participating in the scheme for organisations with more complicated structures and operations. Therefore to make the scheme more workable, companies should have the option to function in the CRC in their own right, rather than as part of an organisational group.
10. Specifically, Government should give parent companies the flexibility to "define and explain" the approach they have taken to how their subsidiaries will participate within the scheme, rather than requiring them to administer the participation of each and every subsidiary they own. This would allow companies within the CRC to define organisational boundaries in line with established practices in emissions reporting, which follow existing practices in financial reporting (as advocated in the draft DEFRA corporate reporting guidelines). This would not reduce the overall emissions coverage of the scheme, but would make participation within the CRC more practical for many businesses.
11. In the case of franchise arrangements Government must recognise the limited ability of franchisors to influence franchisees to reduce carbon. There is no provision for franchisees to provide key data to franchisors, and equally no scope for franchisors to pass any costs or benefits to the franchisee. For franchises we believe that to determine a 'parent subsidiary relationship' for the purposes of the scheme there must be genuine influence over patterns of energy use, and visibility of the name of the trading company. Therefore we recommend that franchisees are only included in the franchisor's emissions where the franchisor specifies the energy efficiency of the franchisee.
12. We believe that to achieve this flexibility, it will be important for businesses and the Environment Agency to establish a productive dialogue, working together to understand how best the scheme can drive carbon reductions across a diverse business community.
13. As far as small businesses are concerned, Government should also ensure that special care is taken to avoid unintended consequences. In some cases, the definition of a group for participation in the scheme will place responsibilities on small businesses that would otherwise have been exempt from the scheme. For example when small businesses are owned by a private equity fund required to comply with the CRC.
14. In addition, due to business complexities Government should clarify that civil penalties resulting from registration failures should be applied at organisation level rather than at site or meter level, to ensure that companies are not disproportionately penalised in the initial stages of the scheme. Alternatively a reasonable cap could be placed on such penalties so that larger organisations are not disproportionately penalised.

**Reward good carbon management irrespective of business change through exploring the use of sector specific metrics and bench-marks in the capped phase**

15. CBI members believe the structure of incentives may unfairly penalise growing companies and those that have already made significant investments in energy efficiency. The annual performance league table is designed to provide a reputational driver for businesses to reduce emissions. Primarily a company's position in the league table will be determined according to absolute emissions reductions (i.e. relative to its average annual emissions over the preceding five years). The provision for emissions changes due to growth (change in emissions per unit turnover) is limited to 20% of the score in the introductory phase, and 25% in the capped phase. Performance in the league table will determine how much revenue will be recycled back to each participant.
16. If businesses find the league table a useful and fair measure of performance it could be an effective tool to encourage wide-spread uptake of energy efficiency. Therefore, Government should work to achieve business buy-in on the measures of performance in the league table, ensuring that the scheme rewards those businesses which actually invest in cost-effective energy efficiency measures, not simply those that reduce emissions through business decisions such as outsourcing a key department, or closing a unit due to company decline. Government should include detailed worked examples in the CRC user guide to demonstrate how the league table will be formulated, incorporating a sample of companies from different sectors over a period of time, to help businesses understand how it will work.
17. Further, CBI members believe that the current design and weighting of the growth metric will not sufficiently reward carbon efficient business growth. An organisation's baseline can only be updated if subsidiaries, which would be big enough to be in the CRC in their own right, are bought or sold. This presents difficulties for outsourcing companies, those that experience project-related peaks and troughs, and growing businesses, whose absolute emissions are likely to grow or fluctuate and therefore performance in the CRC may deteriorate, regardless of any improvements in carbon efficiency.
18. It is also the case that turnover is not a relevant measure of growth for many sectors, and it is not clear what turnover figure participants are required to use where there are no consolidated accounts relating to the grouping of businesses deemed to be a 'participant' for the purposes of the scheme. Companies that are already 'good performers' will also face difficulties, as their ability to achieve year on year carbon reductions is likely to be limited. Attaining a position in the upper half of the performance league-table will incur higher costs for early-movers than later-movers who are yet to capitalise on the low-hanging fruit.
19. Therefore CBI members believe that throughout the introductory phase Government should monitor the positioning of companies in the league table, and may need to reassess the metric weightings to apply from the capped phases onwards to ensure that the league table promotes the right behaviours, i.e. carbon efficiency. The cap on emissions within the CRC will ensure absolute reductions, regardless of the measures of performance used to determine the league table and recycling payment. Trying to maintain simplicity in the scheme should not be at the cost of delivering the overall aims, and therefore Government should re-assess the idea of moving towards

sector specific metrics and benchmarks in the capped phase, to allow performance to be based on more meaningful measurements. This would reward good performers, and give credit to carbon efficiency wherever it occurs across the economy. The CBI's emissions reporting guidelines<sup>2</sup> recommend that businesses normalise their emissions by a financial metric and an activity-based metric relevant to their sector, as this provides more meaningful comparisons. We would like Government to provide further guidance on what the relevant sectoral metrics should be, as many sectors lack a consistent approach. This should then be reflected in the CRC.

20. The basis for determining a company's position in the league table must be clearly communicated, and subject to review. If the league table is to be made public, it must be fair, transparent, and easily understandable. Also sector-specific tables could provide more meaningful comparisons between companies and Government should actively consider this.
21. Although there is an appeals process, through which companies can dispute their positioning in the league table, we are concerned that the first version of the table will remain public and recycling payments will not be adjusted. Government will then publish a revised league table 6 months later, taking account of any changes following the appeals process. CBI members believe Government should consider only making this revised league table public, whilst limiting circulation of the first version to participants, to avoid potential damage to corporate reputations. This should especially be considered in the introductory phase of the scheme (first 3 years) which will very much be a learning phase.

#### **Incentivise companies to invest in renewable energy generation within the CRC**

22. CBI members believe the treatment of on-site renewable energy within the scheme discourages investment. If companies invest in on-site renewable energy generation, and claim the Renewable Obligation Certificate (ROC), the energy must be counted at the grid average emission factor within the CRC. While a company can count this energy as 'zero-carbon' within the CRC if they do not claim the ROC, without this incentive these investments would not be financially viable for many companies.
23. We believe that companies wanting to invest in on-site renewables should be incentivised to do so. CBI members understand why companies are required to buy carbon allowances for the renewable energy they use (where a ROC has been claimed) within the CRC, but believe that it is still important to encourage this additional investment, given the UK's challenging renewable energy target. This is a key issue for companies that want to demonstrate significant carbon reductions, but need the financial subsidy to make the investment economic.
24. Therefore we would like to see government working with business to develop a solution to this issue. One option would be to provide a separate incentive (other than ROCs) for non energy businesses to invest in renewable electricity installations of significant size on their sites, that could

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<sup>2</sup> 'All together now: a common business approach for greenhouse gas emissions reporting', <http://climatechange.cbi.org.uk/uploaded/All%20together%20now%20-%20a%20common%20business%20approach%20for%20greenhouse%20gas%20emissions%20reporting.pdf>

be recognised within the CRC. Alternatively companies could be rewarded for investment in renewables in the calculation of points to determine their position in the league table in the CRC, even though the ROC has been claimed (a compromise between claiming it as 'zero-carbon' and not getting any credit for it). These companies would still have to buy carbon allowances for their total energy use, but their investment would be recognised in the league table and corresponding recycling payment.

**Expand the Early Action metric to include other accredited carbon management schemes and standards**

25. CBI members are concerned that the 'Early Action metric' does not fairly recognise the action companies have taken before the start of the scheme. The first league table and recycling payment are based solely on the Early Action metric, and therefore will be very important in determining the initial success of the scheme. This metric only takes account of two ways of demonstrating early action:
  - Carbon Trust standard (or Energy Efficiency Accreditation scheme)
  - Automatic metering (AMR) above and beyond the legal minimum
26. Businesses that have invested in energy efficiency but do not score highly on the Early Action metric may be disadvantaged, as it will be more difficult for them to make further cost-effective improvements than those who have previously taken little action and still have many cost-effective opportunities to save energy.
27. CBI members believe that the early action metric is too limited, and does not fully take into account the action to reduce emissions that businesses have taken before the start of the scheme. Credit for the demonstration of carbon management should not be limited solely to the Carbon Trust standard: other accreditation should also be recognised on a relative basis where a company can demonstrate carbon management. Only a small proportion of participating organisations (including public sector) have achieved the Carbon Trust standard to date, and therefore this first league table may provide more meaningful comparisons between companies if credit were given for other carbon management standards. Examples of other standards include ISO 14064 or the upcoming European EN 16001 standard, due to be established in summer 2009. These standards demonstrate a desire to measure and manage emissions in the same way as installing voluntary AMR.
28. In addition some members are concerned that although the installation of voluntary meters is recognised in the Early Action metric, their inclusion in 'core sources' (those you are obliged to report about in the CRC) provides a disincentive for companies to install them, where they are otherwise not required to do so, as it will increase their overall liability under the scheme. Therefore the installation of AMR by itself should not make that energy a 'core source'.

**Recognise the burden that the CRC will place on landlords, provide sufficient guidance and permit allowance transfers between landlords and tenants**

29. CBI members are concerned about the difficulties in determining how costs and benefits can be shared between landlords and tenants. Responsibility for emissions will fall to the counterparty to the energy supply contract. In most cases, the company that pays the energy bill. In multi-let commercial properties it may be the case that the CRC targets landlords rather than the tenants who are the main energy users. However, there may also be instances where the tenant falls under the CRC but their leasing arrangement provides limited options for them to improve the energy efficiency of the building they operate in. Therefore the CRC will require landlords and tenants to agree energy performance requirements for their buildings.
30. The British Property Federation and the British Retail Consortium have developed 'good practice' voluntary guidance on this matter which will soon be available. While there is scope to incorporate provisions for the CRC into new leases, questions remain over how much scope there is in existing leases for landlords to recover costs through service charges, and similarly how to reward tenants when they perform well. Individual negotiations between landlords and tenants will be required, but it is likely that rather than driving energy efficiency, the limitations of existing leases may simply result in extra costs for both landlords and tenants.
31. To allow businesses flexibility, we believe that the transfer of allowances between landlords and tenants should be permitted where there is mutual agreement to do so. Tenants may prefer this option in order to ensure they reap the benefits from any improvements in energy efficiency.

**Ensure consistency between the CRC and carbon reporting requirements to make it easier for companies to administer**

32. CBI members are concerned that the requirements for reporting under DEFRA guidelines for corporate carbon reporting are likely to be different to those required under the CRC. Corporate carbon reporting is likely to be mandatory for many businesses from April 2012, as detailed in the Climate Change Act. If and when this happens, a company's disclosure is likely to include CRC emissions as well as some transport and other greenhouse gas emissions.
33. Any differences between the carbon disclosure for corporate reporting and the CRC are likely to cause some confusion, and therefore the figures would require explanation. Also reporting under two frameworks will incur additional costs for businesses. Therefore, Government should reduce the burden on businesses by only requiring them to report and verify the same information once.
34. In addition, to reduce the administrative burden in proving qualification for the CRC, we believe that organisations with 2008 half-hourly electricity consumption over 6,000MWh (and which therefore tick the box on registration acknowledging that they will be full participants in the scheme) should not have to disclose the total consumption figure. This figure itself is not used by the Regulator for any other purpose, and so requiring its disclosure would create significant additional burden for large companies for no apparent benefit.

**Minimise the regulatory burden of multiple climate change policies by analysing interaction and overlap**

35. CBI members are concerned that many companies will be required to comply with multiple climate change policies: EU Emissions Trading Scheme (ETS), Climate Change Agreements (CCAs), Integrated Pollution Prevention and Control regulations (IPPC) and now the CRC. For example among others, companies in the cement, steel and car manufacturing sectors are managing large-scale emissions in the ETS, participating in a CCA, required to gain permits under the IPPC, and will now be required to buy allowances in the CRC to cover residual emissions (mainly from energy use in buildings).
36. The issues that climate policy overlap creates for business include:
  - additional time and resources spent understanding and managing several different schemes,
  - potential inability to efficiently prioritise emission reduction investment across a company, due to; potential distortions within a particular sector or sub-sector caused by larger installations being subject to one scheme (ie EU ETS) and remaining installations in the sector subject to other schemes (ie CCA and CRC).
37. To minimise the burden for these companies in the CRC, Government should recognise existing industry data submissions (ETS and CCA data) for companies' footprint reports.
38. Government should also assess the treatment of fuel used for research, development and engine testing in the CRC, and consider applying principles consistent with Environmental Permitting Regulations.
39. Government should conduct analysis (particularly at a detailed sector level) of the interaction of different thresholds for the EU ETS Phase 2 and Phase 3, current and future Climate Change Agreements, IPPC regulations and the Carbon Reduction Commitment. CBI calls for much greater focus and effort to minimise climate policy overlap.