

## CRC ENERGY EFFICIENCY SCHEME – ARE YOU TAKING THE RIGHT ACTION?

**As part of the Government's Carbon Reduction Commitment, the CRC Energy Efficiency Scheme is now in force. It is intended to encourage large users of energy to become more energy efficient.**

### How does the Scheme work?

It works rather like some supermarket trolley schemes. You pay a deposit to use the trolley and you get back your deposit if you put the trolley back in the right place. If you do not, you lose your deposit. Supermarkets charge deposits not to raise money but to get their customers to behave properly when using trolleys. It is separate from the cost of the goods that you put into the trolley.

The Scheme works in a similar but more sophisticated way, in that the better behaved consumers get a larger refund and the poorer performers get back less. In addition to paying utility companies for energy in the usual way, organisations which are caught must purchase "allowances" from the Government to cover their carbon emissions based on a forecast they must make of their energy consumption. At the end of each CRC year, the actual energy consumption must be reported and sufficient allowances must be surrendered to cover the carbon emissions. The sums collected from the sale of allowances will be returned to participants as "recycling payments" proportional to their actual emissions based on a league table, so organisations that improve their energy efficiency receive a greater repayment than those who do not.

### Who is caught?

The Scheme applies to large businesses and public sector organisations. It can catch large consumers of energy such as multiple retailers, hotel chains, large offices, local authorities, schools and universities, joint ventures, private equity funds, PFIs, PPPs and franchises. Property owners can be caught where they obtain energy from utility companies either for their own use or for reselling to their tenants.

Single businesses may qualify in their own right, but where a business is a subsidiary of an organisation or part of a group, the group must register as a single participant under the highest parent organisation in the group which will administer CRC. Groups will be permitted to disaggregate before 30 June 2010 to facilitate administration of CRC provided that each resulting disaggregated group or business still qualifies. Overseas organisations may also be required to register in relation to energy consumption in the UK.

### What steps have to be taken?

The Scheme operates in phases, the first being a phase of three years starting 1 April 2010 and subsequent phases are of seven years each. The phases overlap by two years,

registration of participants taking place in the first six months of the first year of each phase and reporting energy consumption starting in the second year of each phase.

Organisations with annual electricity bills of over £500,000 in the “qualification year” must register. The qualification years are the 2008 calendar year for the First Phase (2010-2013), the year from 1 April 2010 for the Second Phase and then every fifth year. This means that participants should be monitoring energy consumption now and preparing a report to be submitted by end July 2011. Participants need to register by September 2010 and to purchase their first allowances from April 2011. Initially they will be purchased from the government at a fixed price but from 2013 the total pool of allowances will be capped and sold at auction. The Environment Agency which is responsible for administering the scheme is already asking organisations for details of their electricity consumption in 2008 to determine whether they qualify for CRC.

### What are the penalties for non-compliance?

Individual directors and officers may be held personally liable. There are potential criminal and civil penalties for non-compliance including fines, bad publicity, the participant being blocked from trading allowances, and imprisonment.

### Implications for landlords and tenants

The party with responsibility for providing energy to the building as counterparty to the electricity bill will be the CRC participant if they meet the qualification criteria. In multi-let properties this is likely to be the landlord, but in buildings wholly let to one tenant it is more likely to be the tenant. A tenant’s energy consumption will affect the landlord’s forecast and consumption, so participating landlords need to consider how to deal with CRC and incentivise their occupiers to be more energy efficient.

There are a number of considerations for the property profession relating to CRC costs and administration, and how landlords should deal with them in leases. The main issue is that CRC operates on an organisation-by-organisation basis, and each building will have different characteristics. Therefore landlords and tenants will interpret their responsibilities for CRC in different ways, and an industry consensus has not been reached so far. There is already evidence that some large retailers are attempting to negotiate Heads of Terms which provide that the tenant will not pay any sums towards CRC for purchasing allowances or administration costs.

Some CRC participating landlords may decide to absorb the cost themselves rather than incurring further costs dealing with the complexity of administering the scheme. However, all landlords ought to consider whether new leases incorporate CRC recovery clauses irrespective of whether they enforce them, and irrespective of whether they are participants or not. This is because they may be brought into the CRC regime in the future due to the landlord acquiring more properties, or merging, or the landlord may sell to an organisation that is a participant who wishes to recover.

For existing leases, landlords becoming CRC participants may seek to recover CRC costs from tenants via the service charge, which will depend on the exact wording of the service charge provisions, or they may seek a variation of the lease by negotiation. Alternatively they may choose to wait until tenants apply for consent to assign, sub-let, or alter their premises, at which stage the landlord may consider a variation of the lease, or conditions for the consent. However, imposing conditions on licences to assign or sublet could be seen as unreasonable, so this method should be employed with caution.

Tenants who are obliged to contribute towards the costs of CRC will expect any revenue recycling payments received by the landlord to be refunded to the tenants. As allowances are not bought for specific buildings but for the organisation, crediting them back to the tenants will require careful drafting as there are a number of issues to consider such as:

- Whether to credit tenants who have assigned their leases
- How to measure the energy consumption of each tenant
- How to allocate the revenue recycling repayments
- How to deal with timing issues when the service charge year does not match the CRC year.

### Implications for investment sales

Not all landlords will be CRC participants, so a buyer of a building will need to make specific pre-contract enquiries relating to the CRC status of the seller and the mechanisms employed at the building for dealing with CRC.

Contracts will need to be drafted carefully to ensure that CRC payments are reconciled in a way that tenants are not charged twice for payments relating to the same period.

### How we can help

It is important to ascertain whether you need to register for CRC, and how it will affect you. We can assist in the interpretation of, and compliance with CRC. We also have the expertise to draft, negotiate and review CRC clauses in property documentation.

For further information, please contact



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**IMPORTANT:** This briefing note is only intended as a general statement of the law and no action should be taken in reliance on it without specific legal advice. Release Date: 24 June 2010