



# **Wider Simplification of the Carbon Reduction Commitment Energy Efficiency Scheme (CRCEES)**

A response to a number of discussion papers issued in January 2011 by the  
Department of Energy and Climate Change (DECC)



## BACKGROUND

This response has been produced by the British Property Federation (BPF) in consultation with its membership.

The BPF represents companies owning, managing and investing in property. This includes a broad range of businesses comprising commercial property owners, the financial institutions and pension funds, corporate owners, residential owners, as well as all those professions that support the industry.

An assessment by the ENDS Report<sup>1</sup> recently asserted that real estate companies formed 25% of registered participants for the introductory phase of the CRCEES.

As the Government will be aware, the BPF has been part of a group of property member organisations, collaborating as the Green Property Alliance, which examined the implications of the CRCEES for the property sector and set this out in the context of a Guide for Landlords and Tenants (with a second version issued in August 2010)<sup>2</sup>. The group of organisations also issued a consultation in 2010<sup>3</sup> which sought industry views concerning the application of the CRCEES in new leases. The purpose of this exercise was to determine whether it would be possible to arrive at industry standard clauses, which would ensure that tenants understood the approaches landlords took toward managing the CRCEES, and that avoided unintended consequences on property transaction.

The BPF has also been working with AREF and DATA and other stakeholders to advise the Government concerning helpful changes to CRCEES private sector organisational rules. These changes would correct unintended consequences where CRCEES responsibility for properties held in trust is directed toward the legal owner of the property, who has very limited influence over the day-to-day management of the property, rather than its beneficial owner (the landlord). A paper containing recommendations for improvements to the treatment of Trusts has already been submitted to Government on this subject and a further copy accompanies this response.

We are therefore in a good position to comment on the issues concerning the implementation of the CRCEES in the context of commercial property.

## STRUCTURE OF THIS SUBMISSION

The BPF was one of the signatories to an industry document which set out emerging thoughts on wider simplification<sup>4</sup>. The document was submitted to Government in December 2010, and it called for: the CRCEES to be merged with the Climate Change Levy so as to form a retrospective carbon tax; the introduction of mandatory carbon reporting to assist in escalating decision-making on energy efficiency and carbon abatement to board level; and the introduction of Display Energy Certificates for commercial buildings. We continue to support these proposals in reference to wider simplification of the CRCEES for reasons which we have set out in other consultation responses and which are reiterated in the opening section of this submission.

We hope our proposals will be given serious consideration, since we share the Government's desire that the existing commercial building stock is made more sustainable. However, we believe that the current framework is flawed and will not result in the savings which Government and our industry wants to see.

In seeking to be as helpful as possible, we have also sought to respond to each of the proposals where we believe we can meaningfully contribute, as should only piecemeal reform of the CRCEES follow, we would like to ensure that it is as workable for our members as possible.

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<sup>1</sup> <http://www.endsreport.com/downloads/26694.pdf>

<sup>2</sup> [http://www.bpf.org.uk/en/files/bpf\\_documents/sustainability/CRC\\_Guide\\_2010.pdf](http://www.bpf.org.uk/en/files/bpf_documents/sustainability/CRC_Guide_2010.pdf)

<sup>3</sup> [http://www.bpf.org.uk/en/files/bpf\\_documents/CRC\\_Industry\\_Consultation\\_FINAL\\_-\\_17th\\_December\\_2009.pdf](http://www.bpf.org.uk/en/files/bpf_documents/CRC_Industry_Consultation_FINAL_-_17th_December_2009.pdf)

<sup>4</sup> [http://www.bpf.org.uk/en/files/bpf\\_documents/sustainability/Wider\\_Simplification\\_of\\_the\\_CRCEES\\_-\\_GPA\\_Emerging\\_Thinking\\_23rd\\_December\\_2010\\_FINAL.pdf](http://www.bpf.org.uk/en/files/bpf_documents/sustainability/Wider_Simplification_of_the_CRCEES_-_GPA_Emerging_Thinking_23rd_December_2010_FINAL.pdf)

## FOR FURTHER INFORMATION AND FOLLOW-UP

We would be delighted to expand upon any aspect of this response and to provide further supporting information. Please contact: Patrick Brown (Assistant Director) British Property Federation, St Albans House, 5<sup>th</sup> Floor, 57-59 Haymarket, London, SW1Y 4QX Tel: 0207 802 0100 Fax: 0207 834 3442 Email: [pbrown@bpf.org.uk](mailto:pbrown@bpf.org.uk)

Our response is not confidential. We would be delighted, on request, to organise a session for DECC officials with our membership to provide feedback on more developed Government proposals at a later date.

# Section 1: toward a simple, effective carbon tax

## OVERVIEW

The BPF believes that the CRCEES, having become a revenue raising instrument, can be radically simplified. The Government should rationalise the fiscal element of both the CRCEES and the Climate Change Levy to a simple carbon tax on the carbon associated with energy consumption that is applied equally to all sectors, save those who currently enjoy a discount via the system of Climate Change Agreements. To encourage energy efficiency, the carbon price could be set via an escalator (in a similar fashion to the way the landfill tax currently works). For ease of reference, we refer to our proposal as the 'Escalating Carbon Tax' below.

## SCOPE

Approximately 990,000 organisations accounting for 51 MtC are currently covered by the Climate Change Levy package, of which up to 5000 organisations accounting for 14 MtC were the original target group for inclusion within the CRCEES (the actual number of current CRCEES registrants is closer to 3000, which the Administrator believes to be on account of mergers and acquisitions). There are some 3m small businesses which do not pay the Climate Change Levy (approximately 3m organisations accounting for 1MtC).

The CRCEES is deemed to have no overlap with the EU Emissions Trading System or Climate Change Agreements by virtue of a series of exemptions which apply to organisations' partial emissions footprint under CRCEES when captured by one or more of the schemes.

CRCEES does not operate a similar exemption for those who pay the Climate Change Levy. This means that it is possible for those who pay the Climate Change Levy to also be subsumed within the CRCEES, but this will depend upon the amount of energy they procure as an organisation.

As it applies to buildings, in rented buildings, occupiers will likely pay the Climate Change Levy on their supplies which they purchase **direct** from energy suppliers **and** the Climate Change Levy will likely be passed through to tenants by landlords on the energy they procure on their tenants' behalf for common parts and common services. This will be subject to the exemptions for generators and combined heat and power and those covered by a Climate Change Agreement (who are likely to be heavy emitters subject to sector or umbrella agreements with DECC). Landlords would, of course, be required to pay the Climate Change Levy in respect of their own operations and office functions.

There are three main ways that a carbon tax could be implemented:

### Option 1 – An Escalating Carbon Tax

The cap and trade element of the CRCEES could be withdrawn and the cost of carbon could be added to the Climate Change Levy. An incentive to reduce emissions could be set via the use of a price escalator (akin to the current approach adopted by the Landfill Tax) which sets the price of carbon under the tax (perhaps under advice from the Committee on Climate Change). Participants would be able to exercise marginal cost abatement strategies and make educated choices as to whether to accept the cost of the tax or to reduce exposure to the carbon price by installing more energy efficient kit or via the better management of the use of energy in the buildings they own and/or occupy.

Such an approach would make the price of energy material to occupiers within non-domestic buildings and encourage energy efficiency on the part of tenants. Tenants in turn would demand more energy efficient buildings from their landlords, encouraging landlords to observe better management practices and undertake energy efficiency retrofit works. This approach would fall in line with the doctrine of polluter pays, and would return more of the cost of participation to the Exchequer with less administration costs falling upon participants.

We are aware of Government plans to set a minimum carbon floor price via the Climate Change Levy<sup>5</sup> in order to stabilise the price of carbon and to rectify market failures in respect of the attractiveness of investment in low carbon energy generation. A simplified carbon tax would not cut across these objectives and would help to deliver their benefits. We believe that industry would be more likely to see benefit in a carbon tax which seeks to stimulate not only energy efficiency via materiality of energy price, but also to stimulate the investment case for low carbon energy.

### Option 2 - Tax on Half Hourly Meters

If the Government wished to retain separate fiscal incentives upon landlords and tenants, an alternative might be to allocate a tax on electricity supplies through Half Hourly Meters. The tax could be automatically collected by the utility suppliers in a similar way to the Climate Change Levy. Exemptions could apply in the case of the EU ETS and Climate Change Agreements.

The advantages of this approach are that it would address some of the concerns expressed in the papers on private sector organisational rules, reducing overlap between schemes and issues concerning the supply rules. This is because the attribution mechanism would be relatively simple, and could be made even simpler by only applying the tax in the case of those with mandatory half hourly meters, automatically tackling the larger emitting premises which currently lie outside the EU Emissions Trading System and Climate Change Agreements.

In terms of disadvantages, a dual tax on energy use in buildings would seem an administratively burdensome approach for Government toward tackling incentivisation of energy efficiency compared with simply merging features of the CRCEES with the Climate Change Levy (which remains our preferred approach).

On the other hand, there would be associated benefits from this approach for industry as a great many residual supplies and fuels, which are sometimes difficult to quantify accurately, would be removed from the Scheme. The consequences of this approach being followed are that it is likely that the Government would wish to increase organisational coverage under the Scheme, in order to accommodate the loss of emissions coverage.

### Option 3 – Carbon Tax Applied to Business Entities Using Company Law Definitions

The BPF has considered whether a carbon tax could be applied to business entities, making use of the same existing company law definitions used to define organisations under the CRCEES. However, we do not think that this option is worth pursuing further as such an approach would be subject to many of the current complexities affecting the CRCEES and its participants.

We therefore favour **Option 1** as our preferred approach toward simplification of the scope of the CRCEES. We explore the proposal in greater detail in the following sections below.

## RESPONSIBILITY

The relative influence of landlords and tenants over energy use within rented buildings depends on a range of factors and to understand the factors at play, it is helpful to think of energy use in rented buildings as ‘shared consumption’ and ‘exclusive consumption’.

- Shared consumption energy is obtained by the landlord and may include energy for consumption for common areas of the building (e.g. lifts, operation and lighting of common areas). Shared consumption may also include electricity for tenant consumption under shared, unmetered arrangements (e.g. ventilation, heating or air conditioning from central plant). Local controls are sometimes a feature of the latter shared, unmetered services.

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<sup>5</sup> [http://www.hm-treasury.gov.uk/consult\\_carbon\\_price\\_support.htm](http://www.hm-treasury.gov.uk/consult_carbon_price_support.htm)

- Exclusive consumption generally falls into two categories:
  - energy procured by the tenant directly from energy companies (often for special uses, such as data centres, for which the tenant may wish to procure and meter energy separately). This energy will count toward the CRCEES responsibility of the tenant (where the tenant has sufficient energy demand within its overall organisational boundary to qualify for the CRCEES); and
  - energy procured by the landlord and provided for tenant consumption on an exclusive metered basis. The tenant will have local control over the extent of the use of this energy. Moreover, intensity of use, hours of operation and occupancy will all have a measurable effect on the use of the tenant. This energy use will count toward the CRCEES responsibility of the landlord.

Where energy for exclusive tenant use is provided by the landlord, it is largely within the control of the tenant how much energy is used, and the landlord's influence over that energy use is constrained by the terms of the lease, under which the tenants can exclude all others from their premises, including the landlord, save for reasonable access for maintenance and other specific purposes. Some landlords have been experimenting with 'green clauses' in leases<sup>6</sup> under which both parties agree (for example) to carry out their activities in an environmentally-friendly and energy-efficient manner. As yet, few tenants are prepared to fetter the manner in which they operate in this way. Even where they are prepared to enter into such a commitment, they will not wish this to be legally binding because this might make the lease more difficult for them to sell on in the future. So the best that can be achieved is a personal 'memorandum of understanding' between the landlord and tenant about 'green' issues (such as agreement to exchange data on energy uses each procures, agreement to participate in a building management committee), which is not legally binding and which may be time limited.

Having said that, in the vast majority of leases, and certainly in all leases entered into before 2008, there will be no mention of energy use at all. Until the burgeoning of interest in sustainability in the past few years, neither a landlord nor a tenant would expect a lease to stipulate how a tenant was able to use premises for the purpose of its business in this much detail. Landlords therefore have no control, over their tenants' energy use. If the tenant wishes to leave their lights on all night in the building, though a responsible landlord may seek to influence the tenant's behaviour, they will be unable to compel the tenant to comply with their wishes.

To further add to the complexity of these arrangements, though patterns of energy procurement may vary, the tenant will pay for all energy use associated with the building (save the landlord's own operations on-site). This means that if an energy efficiency improvement is made to a building, the direct beneficiary of the improvement will be the tenant. Unless specified in the lease, it is unlikely that the landlord will be able to recover the cost of the energy efficiency investment from the tenant. A corollary of this is that if landlords are unable to pass some or all of the cost of participation in the CRCEES to the tenant, then the tenant has no incentive to assist the landlord in managing his CRCEES participation. The withdrawal of recycling payments, although it has removed a number of complexities within the CRCEES which were an issue in a landlord and tenant context<sup>7</sup>, has raised the stakes insofar as the pass-through of costs is concerned.

It is therefore misleading to say that landlords have the most influence over the energy consumption within buildings (as was asserted in the Government's consultation on Simplification of the CRCEES, issued in November 2010 and implied within the discussion paper on Changes to Supply Rules) and belies the complexity of patterns of energy use, control and procurement within those buildings. The success or failure of the CRCEES in terms of rented buildings will depend upon finding incentive structures (both fiscal and reputational) which reach across the landlord and tenant divide to influence both parties to co-operate and act appropriately in their use of energy.

In our work on producing the Carbon Reduction Commitment Guide for Landlords and Tenants, it became clear that in cases where the landlord was the participant, under existing leases it was unlikely that the landlord would be able to pass the cost of allowances to their tenants. Though the latest revisions to the

<sup>6</sup> <http://www.betterbuildingspartnership.co.uk/download/bbp-green-lease-toolkit.pdf>

<sup>7</sup> See section 3 of the CRC Guide for Landlords and Tenants for further details

CRCEES may potentially permit the pass through of costs to tenants, on the basis that the CRCEES is now akin to a 'tax'. However, the view from the legal community has been that the variety of lease wording employed across the industry means that every lease will still have to be examined in detail to determine whether or not reasonable costs of participation in the CRCEES may be passed through from landlord to tenant. Many of our members have expressed their frustration concerning the level of administrative burden that this brings to the Scheme. An additional fear is that in a number of cases, the landlord's ability to pass through costs may be subject to challenge by tenants unwilling to sustain the cost of the landlord's participation, and may pursue a legal challenge in the courts. We believe that this outcome is counterproductive.

## REVENUE RAISING

It is important to remember that the cost savings which arise from energy efficiency will principally accrue to the tenant in rented buildings, and as such we believe that as a compliance position, the tenant should be responsible for paying the Escalating Carbon Tax. As tenants currently pay the Climate Change Levy in any case, and many tenants are already caught by the CRCEES, our proposals would reduce the overall administrative burden on both landlords and tenants. However, we believe that raising the Escalating Carbon Tax to levels which makes the price of energy material to occupiers in rented buildings will be instrumental in encouraging tenants to demand efficient management of buildings from their landlords and may result in greater co-operation/cost sharing on energy efficiency retrofit projects. We anticipate that an approach which attaches a charge to the energy bill will justify an equivalent or greater level of revenue to the Exchequer that would have been enjoyed under the Post-Comprehensive Spending Review CRCEES.

## TIMING

A significant advantage of the approach set out in Option 1, where the cost of carbon is added to energy bills, is that organisational change can be accommodated (including sales and acquisitions of assets in the case of property owners, changes of use or increased intensity of use of space). A forecast emissions sale in conjunction with unpredictable organisational change can lead to unintended consequences in a cap and trade scheme, where participants seek to overbuy allowances (particularly in capped sales) in order to guard against a need for additional allowances later in the compliance year. This outcome runs counter to the intention of a cap and trade scheme, where participants judge between the cost effectiveness of abating emissions versus the cost of purchasing allowances.

## LEGAL ISSUES

We do not believe that primary legislation would be required to enact our proposals, since a tax on energy use is required of the UK in any case under the Energy Products Directive, and the Climate Change Levy infrastructure is already in place. From a legal perspective, some members have suggested that the powers to enact a carbon trading scheme under the Climate Change Act are permissive rather than powers which need to be exercised on a mandatory basis.

## AUDIT AND ADMINISTRATION

As forecasting of emissions would no longer be required under an Escalating Carbon Tax, and payments would be made via the energy bill pathway, much of the administrative structure of the CRCEES would not be required. Participants would be required to continue to self-certify but only in the case of exemptions from the Scheme, with the presumption that businesses and public sector are included unless exemptions are applied for. Should the League Table not be revised as per our recommendations below, we think that some form of information disclosure once per year may be required at the end of the Compliance Year pursuant to the League Table. However, this would mean that the submission of footprint reports and annual reports would not be required.

The Administrator would be able to use information gleaned from energy companies concerning half hourly data to conduct a risk-based approach toward regulation and audit.

## REPUTATIONAL INCENTIVES

### Overview

As recycling payments have been abandoned, and the League Table no longer supports their reallocation to participants, there is a clear opportunity to revise the League Table in such a way as to motivate performance improvement in the marketplace.

The BPF believes that an Escalating Carbon Tax will have to be accompanied by some form of reputational measure, since it has the potential to perpetuate the status quo in that energy bills will either be simply passed for payment (in the case of owner-occupiers and those on fully-repairing and insuring leases) or passed through via the service charge or the fuel charge (in the case of the majority of leased non-domestic buildings). A key objective of the CRCEES has been to focus high level decision makers on the importance of energy efficiency, and price alone may not be sufficient to do this.

Reputational incentives would be required to support an Escalating Carbon Tax, and likely both at organisational level and at building level (to ensure joint energy efficiency programmes in rented buildings).

The current League Table ranks participants across various sectors covered by the CRCEES according to a limited number of metrics. At present, the League Table seeks to incentivise:

- Absolute reductions in emissions compared to the participant's baseline determined at the beginning of the Phase (adjusted via a growth metric which plots the change in emissions per unit of turnover (private sector) or revenue expenditure (public sector) as compared to an average of its emissions per unit of turnover (of revenue expenditure as relevant) over the phase.
- The roll-out of voluntary AMR sub-metering and the Carbon Trust Standard and equivalent schemes.
- Via public disclosure of the League Table, reputational drivers which link brand identity to corporate social responsibility and escalate the importance of energy efficiency to Board level within organisations.

We agree with the overall objectives of the League Table, but believe its approach to be flawed, since:

- in ranking many sectors into one League Table, the incentives for some participants to improve are constrained since the more energy intensive sectors, and those who have less of a direct relationship between energy use and energy procurement, will have a limited ability to improve their performance;
- by placing reputational responsibility solely on the CRCEES participant, there will be no concomitant reputational driver upon tenants in buildings which belong to CRCEES participating landlords which will encourage them to work with the landlord to improve their energy use (unless the tenant is in the CRCEES in their own right);
- the League Table's approach toward organisational growth assumes that turnover is an applicable proxy for organisational growth and contraction over time. However, it is a poor proxy for the organisational growth of property companies, since it takes inadequate account of the growth and contraction of property portfolios. Whole portfolios may be traded overnight and so those who have sold assets may seemingly perform better than those who have a static portfolio or acquired assets over the reporting period;
- the definition of 'turnover' can vary from sector to sector. Many of our members have said that the flexibility of the definition of turnover under the CRCEES permits sectors to choose the indicator which best suits their performance. This means that the comparison of performance in the League Table of organisations across various sectors is further distorted; and
- the Early Action Metric, in spite of the Government's efforts to permit credit to participants for their adoption a wider array of existing Schemes within its criteria, continues to overlook well-intentioned efforts by participants that may have been undertaken prior to the start of the Scheme.

There is a need for profound improvement in the incentive structures provided by the League Table in respect of rented property. We make some recommendations below which we think will achieve the existing objectives of the League Table, but which are designed to better incentivise both tenants and landlords, where the landlord is the CRCEES participant, to behave in an energy efficient manner.

## Better Sustainability Reporting to Escalate Energy Efficiency Decision Making to Board Level

We agree with the removal of the requirement to perform an information disclosure for those energy users with 3000-6000 MWh on half hourly meters. Though the Government has yet to declare whether it intends to make carbon reporting mandatory, there is a wide expectation that mandatory reporting will be introduced, and there is also a Coalition Programme commitment to examine the scope for reintroducing the Operating and Financial Review (OFR)<sup>8</sup>. We think that these represent more holistic approaches toward reporting carbon emissions and, in the case of the OFR, wider environmental and social risk/performance.

The Defra Voluntary Carbon Reporting Guidance<sup>9</sup> places an emphasis upon absolute emissions reductions, while allowing offsets to receive some recognition. There is the potential for the purchase of emissions allowances to be counted as an accredited offset for the purposes of carbon reporting. This would have the benefit of invoking transparency concerning the number of allowances which have been purchased by the reporting organisation. However, we advise that the use of finance and operating lease approaches in Defra's Carbon Reporting Guidance to assign emissions responsibility is unhelpful in understanding energy use and control in rented buildings. There are numerous efforts under way within the industry to determine how best to allocate responsibility for carbon intensity within rented buildings, such as the those of the Green Property Alliance Common Metrics Paper 'Setting the Ground Rules for Property'<sup>10</sup>, the Global Reporting Initiative's Construction and Real Estate Sector Supplement<sup>11</sup> and the Greenprint Foundation<sup>12</sup>. The Government, in implementing Carbon Reporting, should be sensitive to existing industry initiatives and should build on the work which has already been conducted.

## Incentivising Building Level Performance Initiatives and Tools

The current dearth of reliable building performance benchmarks, based on actual energy usage, renders it difficult to make recommendations for immediate improvements to the League Table benchmarks at this point in time. However, we believe that in future, the League Table could take account of more sectorally-focused benchmarks once a repository of data has been collected. For this reason, we urge the Government to consider a roll-out of Display Energy Certificates to the commercially occupied non-domestic building stock (delivering on commitments set out in the Carbon Plan<sup>13</sup>).

The benefits of a roll-out of Display Energy Certificates would be:

- DECs encourage building level engagement between landlords and tenants on energy via the reputational incentive of publicly displayed ratings and by revealing where simple management efficiencies can be made;
- The DEC methodology, with adaptation, would allow for multi-tenanted situations;
- DECs allow aggregation of existing DEC scores across portfolios;
- Makes use of existing DEC assessment, lodgement and auditing infrastructure;
- Offers incentives via the DEC methodology for a roll-out of advanced metering, and in particular sub-metering of special uses (with the incentive being that sub-metered special uses can be discounted granting a better overall rating);
- Offers incentives for the adoption of on-site and directly connected renewable energy;
- Would assemble a robust set of benchmarks for buildings-in-use which can be used to help to address the gap between design and operational performance in the wider built environment<sup>14</sup>;
- Regardless of whether or not the CRCEES or any successor scheme or tax continues to base its assignment of emissions responsibility on the energy purchaser, there are elements of the management of energy which will lie outside of the control of one of either the landlord or the tenant. If neither landlords nor tenants have assurance via the lease or via legislation that they will have the cooperation of the other party then it is likely that joint energy efficiency programmes will not be incentivised.

<sup>8</sup> <http://www.bis.gov.uk/assets/biscore/business-law/docs/n10-1057-future-narrative-reporting-consultation>

<sup>9</sup> <http://www.defra.gov.uk/environment/business/reporting/pdf/ghg-guidance.pdf>

<sup>10</sup> [http://www.bpf.org.uk/en/files/bpf\\_documents/sustainability/Common\\_Metrics\\_Paper\\_FINAL.pdf](http://www.bpf.org.uk/en/files/bpf_documents/sustainability/Common_Metrics_Paper_FINAL.pdf)

<sup>11</sup> <http://www.globalreporting.org/ReportingFramework/SectorSupplements/ConstructionandRealEstate/>

<sup>12</sup> [http://www.greenprintfoundation.org/Libraries/Greenprint\\_Carbon\\_Index/Volume\\_1\\_October\\_2010.sflb.ashx](http://www.greenprintfoundation.org/Libraries/Greenprint_Carbon_Index/Volume_1_October_2010.sflb.ashx)

<sup>13</sup> [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/lc\\_uk/carbon\\_plan/carbon\\_plan.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/carbon_plan/carbon_plan.aspx)

<sup>14</sup> Recommendations 6.20 and 6.22 of the IGT Report

The value of Display Energy Certificates in this context is that they would provide a building level reputational incentive, encouraging action on energy efficiency. They would also act as an evidence base for building management committees<sup>15</sup> and green memoranda of understanding to enable discussion on joint action which is acceptable to both landlords and tenants.

One caveat is that, in applying DEC's to the commercial sector, it would be important to ensure that the methodology underpinning the DEC was sufficiently sound and that greater consistency of approach was maintained among assessors in conducting DEC assessments.

It would also be vital to explore the introduction of intensity of occupation into DEC ratings in order to ensure that otherwise sustainable behaviours are not disincentivised by the way the rating is currently calculated. As is currently enacted, the DEC would give a lower rating to a more intensively occupied building.

## Section 2: Review of Issues Raised in the Discussion papers

**In Section 1 of this paper we have set out our proposals for substantial reform of the CRCEES and its reputational incentives. Our favoured Option in Section 1 of this paper would solve the majority of the issues which are explored in the discussion papers. However, in order to be as helpful as possible to Government, we have taken each of the proposals put forward in each of the discussion papers and we have set out below the rationale for why we do or do not support each proposal.**

### DISCUSSION PAPER: CRCEES QUALIFICATION CRITERIA

Our headline view is that the CRCEES should be merged with the Climate Change Levy to create an Escalating Carbon Tax (see Section 1). Such an approach would negate the need for organisations to self-assess their qualification for the CRCEES, but instead would simply be liable for a charge which was attached to their bill by the generator.

We agree with the Government's reasoning under the first alternative option in paragraph 14 on page 5 of the discussion paper in that distinguishing between mandatory and voluntarily installed settled half hourly meters is difficult, particularly following a transaction.

In respect of the alternative proposal in paragraph 15 of the discussion paper, we believe that this approach would run counter to the overarching impetus of the simplification exercise since it would render the self-assessment process for organisations which believe they may be caught by the Scheme more complex, and we agree that there would be concomitant burdens upon the Administrator.

Therefore, if the Government is unwilling to consider rationalisation of the CRCEES into a carbon tax upon the energy bill, whereupon many of the qualification issues would be de facto simplified by virtue of the liability of the CRCEES becoming a simple charge on the energy bill, then we would support Government's favoured option (set out in paragraph 12).

### DISCUSSION PAPER: TIMING AND FREQUENCY OF ALLOWANCE SALES

#### CRCEES allowances in the Introductory Phase: issues and potential options

##### *Double Allowance Sales*

The financial stakes of the CRCEES have increased following the transition of the CRCEES from a Scheme which is revenue neutral to HM Treasury to a Scheme which is revenue raising. In the case of large property owners who are caught by the Scheme, millions of pounds will have to be surrendered and a double allowance sale would be untenable, particularly in view of current market conditions.

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<sup>15</sup> <http://www.betterbuildingspartnership.co.uk/download/bbp-green-building-managment-toolkit-1.pdf>

We agree that double allowance sales should be avoided. The BPF held concerns when at the inception of the Scheme a double allowance sale (for a prospective Compliance Year and retrospectively for the previous year) was proposed.

### *Multiple Allowance Sales*

Please see our response under 'Double Allowance Sales' above.

### *Link to the EU Emissions Trading System*

It is suggested in the discussion paper that, where there is an opportunity to purchase CRCEES allowances once a participant's emissions are known, there is no longer a need for the safety valve link to the EU ETS in the introductory phase.

We believe that the EU ETS link should be retained as:

- It provides a link to the burgeoning European market for carbon which ensures that distortions within the UK market can be corrected.
- It ensures that the price of carbon in the UK market cannot outstrip that of the price across Europe.
- It provides a repository of last resort which ensures that those participants who require additional allowances may obtain them and avoid civil or criminal penalties (although a fixed price, uncapped allowance sale might achieve the same outcome without a link to the EU ETS).

### **Allowance sales in the second and subsequent phases**

The BPF has held extensive dialogue with its membership to determine the most appropriate ways in which the CRCEES can be further simplified. A key issue for our members lay in the complexities surrounding participation in the CRCEES itself.

One of the most challenging features of the CRCEES for landlords is the requirement to purchase allowances in advance for emissions over the following compliance year. To do this, landlords will have to have a very detailed understanding of:

- The likely impact of any energy efficiency schemes and activities underway on their portfolio.
- Any changes to the tenant's business which are likely to have a measurable effect on their energy demand from services provided by the landlord (e.g. moving data centres on or off-site, increasing the number of employees on the premises).
- Whether tenants are likely to trade out of landlord supplies to their demise, exercising their right under the Citiworks vs Leipzig Airport European Court of Justice Preliminary Ruling.<sup>16</sup>
- Largely unpredictable weather patterns which may affect seasonable demand in cooling and heating from landlord services.
- The impact of tenant demises falling void or undergoing new tenancies. For example, if previously vacant floors of a multi-let office are let to a tenant, the energy use of the building may increase significantly.
- The likelihood of assets being traded over the course of the forthcoming Scheme year. The acquisition or disposal of properties is likely to have a considerable effect on the performance of an organisation's portfolio.

The first sale of allowances (2012) is for 2011/12, with no firm view having been taken by the Government as to whether this will be accompanied by a prospective allowance sale for 2012/13. We believe that in the absence of suitable and reliable building performance benchmarks, forecast emissions sales are likely to be an inexact science in rented buildings and would place the built environment at a significant disadvantage compared to other sectors. For this reason, we believe that the Government should make sales of allowances retrospective, if it is not minded to follow the approach set out in Section 1 of this response and wishes only to amend certain aspects of the existing CRCEES.

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<sup>16</sup> [http://www.decc.gov.uk/en/content/cms/consultations/imp\\_eu\\_third/imp\\_eu\\_third.aspx](http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx)

We understand from conversations with officials that the Government does not consider that it has *vires* to operate anything other than a trading scheme from the end of the introductory phase of the CRCEES and that this places concomitant constraints upon the timing of allowance sales (since a forecast sale provides a fertile environment for trading of excess allowances). However, the Energy Products Directive mandates member states to operate a tax upon energy use, which should provide ample enabling powers for our proposals.

## DISCUSSION PAPER: REDUCING OVERLAP BETWEEN SCHEMES

### Blanket Exclusion and Exclusion at Qualification

We do not favour the ‘Blanket Exclusion’ and ‘Exclusion at Qualification’ approaches which have been suggested in the discussion paper ‘Reducing the Overlap Between Schemes’. Our reservations with each of these approaches stems from the fact that the EU ETS and Climate Change Agreement frameworks both provide a relatively cost-effective way for an organisation to participate in an emissions reduction Scheme, compared with the post-Comprehensive Spending Review incarnation of the CRCEES. This is because:

- the price of carbon under the EU ETS has historically been unstable due to over supply of emissions allowances, leading to a relatively consistently low price for carbon; and
- under a Climate Change Agreement, those who have negotiated a company level agreement, or who have joined an umbrella level agreement with Government, are able to claim up to a 65% exemption from the Climate Change Levy.

By comparison, following the Comprehensive Spending Review in October 2010, the CRCEES has become a revenue raising instrument for HM Treasury, meaning that those caught by the Scheme have to buy allowances which cover at least 90% of their emissions.

What the Government proposes under the Blanket Exclusion and Exclusions at Qualification is to remove a significant number of organisations from the CRCEES entirely, while still permitting them to operate their exemption from the Climate Change Levy. By contrast, we would expect a significant number of real estate owners, corporate occupiers and retailers to remain covered by the CRCEES and to be unable to enjoy the advantages of a Climate Change Agreement.

It is unclear to us why heavy emitters should receive such preferential treatment, and can only assume that what appears to be a dirigiste policy is an oversight. If a Blanket Exclusion approach was followed, then the resulting emissions loss under the CRCEES would likely result in reduction in the threshold for inclusion within the Scheme. It would seem perverse to us that a range of smaller less intense energy users should be drawn into the CRCEES in order to permit a range of larger, more intense emitters to be able to emit at a lower compliance cost.

Our preferred approach, therefore would be for more fundamental reform of the Scheme (option G). Please see our response under Section 1 of this response for our precise proposals in this regard.

## DISCUSSION PAPER: PRIVATE (BUSINESS) SECTOR ORGANISATIONAL RULES OF THE CRC ENERGY EFFICIENCY SCHEME

Revision of the CRCEES to an escalating carbon tax would negate a number of the issues which the Government and participants are experiencing, and which are covered in its discussion papers, in respect of:

- determining group structures and the highest parent;
- nominating UK entities as the compliance account holder where the organisation concerned is transnational;
- allocating responsibility to an organisation which has the authority to make energy management decisions (particularly in the case where trust structures are employed or private equity is involved); and

- allowing for designated changes.

An attribution mechanism which uses existing energy bill pathways to allocate a carbon surcharge to the energy bill (in a similar manner to the Climate Change Levy at present) presents a much simpler approach toward the introduction of a carbon incentive mechanism than the current approach favoured by the CRCEES.

This is because an attribution mechanism which follows the pathway of the bill payer, and adds a surcharge to the energy bill, rather than following energy procurement responsibilities and then onward to interrogating company structures, provides a much simpler allocation mechanism which does not rely on interpretations of company law to attribute responsibility. This approach would have the additional advantage of attributing responsibility to the individual who is most in control of energy use, embodying the ability to reduce energy use and to benefit from reduced costs (both in energy bill savings and any reductions in liabilities under carbon incentive mechanisms) in the same organisation.

One rationale in the original CRCEES for participation to be allocated following company law methodologies was that it was designed to ensure that energy efficiency decision making was directed to the highest decision making bodies within the corporate structure. In the opening section of our response, we have made recommendations to improve the League Table and to set corporate reputational incentives. We believe that corporate carbon reporting is a more suitable way to elevate energy efficiency decision making to Board level.

### **Consideration of the Options set out in the Discussion Paper**

*Option 1 – retain current rules to determine groups for qualification purposes – with option to disaggregate any undertaking in the Group for participation*

Subject to the points we have made in the opening section of this document concerning our preference for a carbon tax over a cap and trade scheme, we would be supportive of rescinding the thresholds for separate participation of significant group undertakings. Many of our members have been keen to see options under the CRCEES for disaggregation of their portfolios of properties so as to avoid distortive effects of the nature of their business. Via disaggregation to individual property level, tenants could be insulated from the effects of the landlord participant's purchase or sale of assets, as the landlord's baseline would not necessarily apply across their portfolios. Similarly, the effect on tenants of other tenants' decisions as to how to use their space and its concomitant demands on common services/common parts (e.g. greater intensity of occupation, introduction of special uses) whilst not negated entirely, would be at least mitigated. Option 1 would likely to be a popular feature for landlords negotiating new leases with tenants with a view to securing a contribution from them, or where they are in the rare position of being able to pass through to tenants reasonable costs of CRCEES participation via an existing lease.

*Option 2 – Bottom-up approach for qualification, with optional grouping for participation*

There is merit in the approach from the perspective that it permits flexibility in how CRCEES groups are built, even if it does potentially involve more administration arising from multiple reporting requirements across multiple participants. However, we believe that this approach would widen the scope of the CRCEES or at least radically change it such that the list of participants would change markedly and the names in the League Table would likely be unrecognisable to its intended audience.

*Option 3 – Group structure determined following accounting rules*

Given that accounting rules are based on definitions of control, similar to that of 1162 of the Companies Act, we do not think that adopting this option would result in substantial improvements to the Scheme.

#### *Option 4 – Provisions for assets held in a fiduciary capacity*

The BPF has also been working with AREF and DATA and other stakeholders to advise the Government concerning helpful changes to CRCEES private sector organisational rules which would correct unintended consequences where CRCEES responsibility for properties held in trust is directed toward the legal owner of the property, who has very limited influence over the day-to-day management of the property, rather than its beneficial owner (the landlord). Although a paper containing recommendations for improvements to the treatment of Trusts has already been submitted to Government on this subject, a further copy of the submitted paper is attached to our response.

#### *Option 5 – replace overseas top parent rule with a UK top parent rule*

Clarity is urgently needed concerning the responsibilities which the compliance account holder is taking on. At the moment, they are assuming all of the responsibilities for compliance of an overseas parent. In which case they are responsible for purchasing allowances, any fines and administrative costs. This is a significant risk which is as yet improperly priced. If UK account holders go bankrupt, the Environment Agency would have no means to get the money for CRCEES allowances and/or potential penalties from the overseas parent.

The Scheme Administrator should provide more clarity around the responsibilities concerning the UK account holder and the relationship of this organisation to the overseas parent. Particularly as the UK compliance account holder does not need to be part of the corporate group of the overseas parent.

As such, the overseas top parent rule could be replaced by a UK top parent rule, but this would not necessarily solve the problem as in many cases this would do nothing to help the UK top parent company to honour its obligations in the face of intransigence from its overseas parent. Instead, the Scheme Administrator should clarify responsibilities.

#### *Option 6 – review of designated changes*

As we favour Option 1, we believe that Option 6 could be complementary. If we read 6b correctly, it would appear that the proposal under consideration would be for baselines to be recalculated following acquisitions or disposals falling under the definition of a designated change and which fall over a certain percentage threshold of the organisation's energy use. Such an approach could help to ensure avoidance of the distortive effects of acquisition and disposal of property portfolios and individual assets, which has been a significant concern of organisations who have sought to develop enlightened approaches toward the treatment of the CRCEES in the context of rented properties, seeking to shield tenants from the effects of the landlord's trading of portfolios. However, we believe that Option 1 within the discussion paper would be a preferred approach to this problem.

## DISCUSSION PAPER: REVIEW OF SUPPLY RULES

### Consideration of Options Set Out in the Discussion Paper

#### *Option 1 – deemed supply*

We have set out in Section 1 of this submission our reservations with the current determination of the responsibility for CRCEES participation in respect of rented properties where landlords procure energy on behalf of tenants.

While the approach set out in Option 1 of the discussion paper would potentially simplify the process for determining emissions responsibility in rented properties, it does not address our underlying concerns in relation to the barriers to joint energy efficiency programmes in rented properties. We therefore do not feel able to support Option 1.

From a technical standpoint, we are concerned that the justification for the removal of a requirement for a meter in order to establish a CRCEES supply relationship for electricity and gas could potentially have implications for the pending implementation of the Citiworks vs Leipzig Airport European Court of Justice Preliminary Ruling under the EU Third Package<sup>17</sup>. It is likely that in future, landlords will be required to

<sup>17</sup> [http://www.decc.gov.uk/en/content/cms/consultations/imp\\_eu\\_third/imp\\_eu\\_third.aspx](http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx)

permit, on request, tenants to procure their exclusive use electricity in rented buildings from third party suppliers (common heating and ventilation and energy in common parts will remain within the purview of the landlord to choose the head energy supplier). Some of the proposed approaches toward permitting third party access to tenant customers on private wire networks operated by landlords are dependent upon meters being in place and the landlord acting as an 'energy broker', purchasing supplies for the tenant. DECC is shortly to produce guidance on the precise requirements for implementation of the Citiworks ruling, and we urge officials to take this guidance into account when taking forward responses to the discussion papers.

*Option 2 – supply and self-supply rules applied at the participant level (rather than at the level of the undertaking)*

We have no strong views on this proposal.

*Option 3 – extension of self-supply exclusions to third party organisations*

We have no strong views on this proposal.

*Option 4 – exclusion of fuels from the definition of supply*

We do not agree that fuels should be excluded from the scope of the definition of supply. Though this would reduce administrative burden in respect of the Scheme, in that participants would be able to obtain all their data under the supplier obligation, perverse outcomes could arise as some participants could be incentivised to change from a gas supply to less carbon efficient fuels, in a bid to reduce their overall liability under the CRCEES. However, such actions arguably run counter to the intention of the Scheme - to reduce overall UK carbon emissions.

A compromise approach might be to require corporate carbon reporting as an alternative to the League Table, so that disclosure of a wider array of Scope 1 fuels within the corporate carbon report would exist to counter incentives to switch to more carbon intensive fuels under a CRCEES with a reduced emissions scope.

*Option 5 – treatment of transport related activities*

We have alluded elsewhere to the possibility of utilising the the Display Energy Certificate as a means to collect all the relevant data concerning building energy use for CRCEES purposes. The BPF has developed a tool - the Landlord Energy Statement and Tenant Energy Review (LES-TER) which provides a ready made methodology for collecting building-related energy data. We would be delighted to discuss with Government the potential to use LES-TER as a valid methodology for collecting building energy data.

We would prefer a CRCEES which excluded transport-related emissions and instead focused on capturing the energy used within buildings.

*Option 6 – transfer of responsibility for CRCEES participation*

The British Retail Consortium and British Property Federation held discussions with the Department of Energy and Climate Change in 2009 concerning the ability to transfer CRCEES responsibility between landlords and tenants where both were within the Scheme. At the time it was deemed to be too complex a proposition to be specified in the context of the CRCEES Order 2010, however, we believe that it should be possible to draft provisions in respect of rented non-domestic buildings, based upon the premise that if there is a fiscal meter at the boundary with the tenant demise, then responsibility could be transferred for the tenant's usage from landlord supplies. The proportion of landlord supplies could then be added to the tenant's CRCEES liability from their own supplies. We would be delighted to explore this proposition with officials in greater detail.

*Option 7 – assignment of emissions responsibility based on 'consumption' rather than 'supply'*

We would be supportive of this approach. Please see Page 4 of our response, under 'Responsibility' which sets out the rationale for our support for this Option.

In terms of the data issues referenced by the Government, where tenants do not have access to their actual consumption through a fixed monthly charge, the BPF has already determined a tool to permit landlords to

report to their tenants on their energy use from common services – the Landlord Energy Statement – which provides all the requisite data for the completion of a Display Energy Certificate when teamed with a tenant’s own energy data from supplies they procure directly. It would therefore be possible for landlords to honour a data collection requirement in respect of rented buildings, if responsibility for the CRCEES were to be resteed based on consumption. We would be pleased to demonstrate the LES and TER to officials, and to provide testimonials as to its usefulness, if that would be helpful.

*Option 8 – removal or amendment of the applicable percentage*

We believe that Option 8iii would best complement the roll-out of Display Energy Certificates which we have called for elsewhere in our submission (see Section 1). In this sense, a Display Energy Certificate could satisfy the data collection requirements, audit (as it would be completed by an independent assessor) and negate the need for a footprint report. We believe a site-based *de minimis* approach is more reflective of the way that the CRCEES will be implemented in rented non-domestic buildings, since property owners and tenants will likely have to monitor on a site-by-site basis and aggregate data to participant level.

**End of Submission**