UK Environmental Law Association (UKELA) Response to CRC Simplification

UKELA is the UK's foremost membership organisation comprising both lawyers and non-lawyers. Our aim is to improve the understanding and awareness of environmental law, and to make the law work for a better environment. UKELA has a climate change and energy working party (CCEWP) which monitors and, where appropriate, comments on the development of climate change and energy related policy and legislation.

As many of UKELA's members work in private practice, they are well informed on how various environmental policy measures work and common issues that their clients face when complying with such measures.

In responding to consultations, UKELA's aim is to ensure that the proposed policy measure or law will work including within the policy and legislative landscape within which it is framed.

In response to your request for suggestions from stakeholders on the simplification of the CRC scheme, we summarise below the issues that have crystallised at our CCEWP discussions.

The decision to drop revenue recycling now leaves businesses with a new financial burden. We are not in a position to estimate the impact of this on energy consumption behaviour, although we expect that some companies may now err on the side of a leaner group structure definition where they previously assumed they would be winners from the recycling redistribution. Overall, we are happy to see that an unpredictable pricing system has gone, driven as it was by unforeseeable rankings between non-comparable businesses, and we urge DECC to consider the resulting composite carbon price in the round with a view to maximum clarity as to its total amount (see paragraph 5).

However, the scheme's design still contains inherent complexities which we do not see a way of resolving within the current framework. These are:

1. The organisational and supply rules require too much analysis and this analysis is not a one-off. It must be kept up-to-date. Particular difficulties have arisen in relation to private equity-held ownership structures (which are constantly changing and often feature a foreign 'highest parent' that would never get involved in the detailed running of its many portfolio companies), trust structures (which often feature trustees who do not participate in the management of a variety of assets for which they perform that very narrow function) and the interface between the public and private sectors (in relation to PFI contracts, and in other areas where there is a long-term relationship between a public authority and a private service provider in

which the public authority may have an interest - because the sums involved here can be high, there is potential for unconstructive litigation). These are only examples of some of the most problematic scenarios, which have been explored in detail by the relevant industry associations.

For some, smaller organisations the organisational analysis may be straightforward, but there are too many scenarios where this task is very complex and, even after extensive analysis, a decision about organisational boundaries cannot be conclusive. On a number of issues, legal opinion is split, with conflicting (even diametrically opposed) QC opinions circulating the legal community. The time and cost associated with this work is being incurred purely for CRC purposes, yet does nothing to reduce energy consumption and has diverted time and resource away from the primary objective of the scheme (stimulating investment in energy efficiency).

2. We anticipate that the regulators will have a nightmare auditing participants where these complex problems arise. There are too many issues on which a 'definitive' position can only be realised through a test case. Whilst as lawyers in private practice, we would be delighted to be involved in CRC litigation, as members of UKELA, we are looking to improve the effectiveness of law in protecting or enhancing the environment, without unnecessarily alienating the business community. In that context, these problems, which are fundamental design flaws in the CRC, cause us real concern.

3. Because supply and organisational boundaries are determined by commercial agreements, what is within and what is outside the CRC can change as result of commercial agreement. Agreements made or changed for reasons totally unrelated to CRC define and re-define the scheme's coverage.

4. The longer term ambition of the CRC (to move to caps and auctioning) is not compatible with a scheme whose boundaries are completely flexible. Auctioning requires a cap to be set. Setting a finite cap on a scheme, the emissions capture of which can expand or contract without any change at all in actual metered consumption, means that the theoretical advantage of certainty of emissions reduction claimed by a cap and trade approach over a tax does not exist in practice. While a significant increase of regulated supply (e.g. through the consolidation of industry ownership bringing smaller entities into the CRC) could be diffused by reliance on the safety-valve, a decrease of regulated supply, for any reason other than an actual decrease in energy consumption, would lead to artificially low prices. In any case, participants face a variable carbon price and the uncertainty and extra administrative costs this entails, without the environmental benefitting from a definite and degreasing cap.

5. With fixed price sales, the CRC will act just like a fixed tax. With capping and auctioning, it would act like a variable tax. Indeed, HM Treasury, and now the

climate change minister, acknowledge that the purpose of the CRC is to raise tax revenues. In light of this, all the unnecessary complexity could be removed and the CRC merged into the CCL. However, the behavioural change sought is unlikely to come from the CCL (or CRC) unless the price is set very high indeed – these are, after all, non-energy intensive businesses, so by definition their energy use does not feature prominently on their bottom lines. If the CRC were subsumed into the CCL but with relief granted to those who volunteer to reduce emissions in a verifiable way, this could provide a real incentive to opt in, just as there has been with CCAs. The key here is that the potential savings have to be transparent. It has to be easy for an energy manager to present a business case to their finance director for opting in to a report & reduce scheme.

Whether the currently envisaged price level under the CRC is the right one to achieve the government's policy goals given the absence of revenue recycling should be reconsidered in the round, bearing in mind the cumulative regulatory cost on carbon. We are not in a position to judge this, but it seems unlikely that it has been calculated to be optimal, given that its impact is now entirely different than originally envisaged.

6. The twin regulatory approaches of pricing and reporting complement each other: the more expensive wastefulness becomes, the less companies will begrudge the resources required to understand their energy consumption better; and the better-equipped companies are to manage their emissions, the less a hike in energy prices will hit their bottom line. While we see the desirability of introducing mandatory greenhouse gas reporting requirements, forcing such disclosure inevitably leads to the issues of definition of supply and organisational structure. If companies can decide for themselves where they would prefer to report and reduce and where they would prefer to pay then, provided that payment is sufficiently high to make the choice a considered one, they will be doing the regulator's most difficult job for them.