Second response to CRC Simplification

June 2012

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.

1. Our expertise

We believe that the policy of reducing carbon emissions by encouraging energy efficiency is important, and that it is right for government to pursue it through regulation.

The UKELA CCEWP members contributing to this consultation response are lawyers. Our expertise is therefore in commenting on regulatory design, and in addition in providing some practical insight from our experience of advising clients. We recognise that the effectiveness of any market-based regulatory regime in achieving environmental goals will depend to a large extent on how strong those incentives are in pounds and pence. As lawyers, we are neither qualified to provide technical comment on the level of behavioural change that policy should aim for, nor are we expert on the relationship between the monetary weight of an incentive and the behavioural change it can be expected to produce in its target audience.

Much of this consultation appears to be aimed at the latter and on collecting information about participants. However, we would like to take this opportunity to comment on other factors that dilute or obscure the incentives Government intends should change organisations' behaviour. At heart these factors are all to do with certainty, transparency and the relationship between incentive and administrative cost.

2. The importance of certainty

The CRC has seen too much tinkering – it was overly complex to begin with, but it is the continued uncertainty over its rules and lifespan that makes it impossible for participants to decide how much they should invest in compliance. Many participants hired external advisers to explain the rules and rule changes to them (at considerable cost), but the future cost of carbon and related compliance is so uncertain that we have seen them frustrated by an inability to make the case for strategic decisions based on anticipated cost savings. Nonetheless, we are aware of clients who have spent much time and effort for example analysing leases to consider the ability to pass down CRC costs, reviewing group structures, property holdings and energy supply arrangements to analyse compliance requirements and so on. Further uncertainty and change – even if it ultimately achieves simplification – undermines this work.

In order for an economic incentive to have maximum behavioural impact, its magnitude needs to be both significant and absolutely clear and certain far enough in advance for those tasked with responding to do so effectively. This means that the rules by which it is calculated have to lead to unambiguous projections. The CRC has never met these tests.

A number of us therefore consider that the CRC as a regulatory instrument is not worth saving, and that everyone would be better off if it were replaced by a transparent environmental tax coupled with some form of coherent reporting obligation (see point 3. below). That said, if the CRC survives this latest round of scrutiny over the summer, we agree in principle that certain of the proposals do simplify the scheme and lighten the administrative burden, in particular the proposals on qualification, fuels and overlap between phases and other schemes (EU ETS and CCL). But to avoid further disproportionate administrative costs, participants will need to be authoritatively assured that this is the final round of changes.

3. Carbon accounting makes sense, but CRC concept of reputational driver is flawed

We agree in principle that a disclosure requirement is a useful regulatory tool - in particular if Government is not prepared, in the current economic circumstances, to make the cost of emitting carbon so high as to be sufficient on its own to drive widespread energy efficiency investments in non-energy intensive businesses. There is potential for transparency to be an incentive for carbon reduction, in particular where strong brands mean that there is an on-going communication about values with consumers.

A “reputational driver” can however only work where performance benchmarks are robust. At present, the performance league table is not recognised by many as being a meaningful measure of relative carbon-reduction performance (being currently so much influenced by early action and, for example, giving no recognition to onsite renewable generation).

It is understandable that Government wants to move the detailed rules on the league table and performance metrics out of legislation and into guidance in order to refine the rules as more evidence on their perception and effectiveness is gathered (proposal 43). However, this again introduces more uncertainty into the scheme. Allowing for future open-ended rule changes makes it impossible for participants to ascertain what measures would effectively improve their rating even in absolute terms (it is already impossible to plan relative league table improvements because that depends on the unknown actions of all other participants). It is difficult to see how this element of the scheme could act as any kind of 'driver' of behavioural change.

The monitoring and managing of carbon emissions necessitated by a disclosure requirement can itself have a positive impact on energy efficiency: as the resources and structures are put in place to understand energy consumption, efficiency opportunities are more likely to be spotted and taken up. We have witnessed many organisations engage with this issue very seriously over the life the CRC, and the consultants we work with tell us anecdotally that many organisations have discovered significant monetary savings in the process.

While “mere disclosure” may not be the reputational driver Government wants, it might be the only one it can realistically achieve. We are not sure that a meaningful league table can be created without a much more detailed breakdown of industries, goods and services to identify comparable categories (which would entail big challenges, and again would in any event be vulnerable to attack based on different rationales for categorisation). The proposed more flexible disaggregation of group undertakings will in some cases help to identify participants that are in fact under common management (note however that if many group companies disaggregate, this could entail a significant additional burden on the regulator), and will in those cases make disclosure more meaningful. Any carbon disclosure requirement based on the energy consumption of a corporate entity, rather than on supply to a site or the carbon footprint of a product or brand, will have to grapple with the issue of defining organisational boundaries (see our previous response points 1 – 3).

While we would very much welcome the invention and publication of an easy comparator showing companies' relative carbon performance across the board, we do not think that an ambiguous, widely criticised league table is better than none. Lessons from environmental/carbon labelling of consumer goods show that information schemes that are not robust lead to the public becoming disinterested or cynical about the information provided.

It therefore would seem more workable in the circumstances to require the disclosure simply of specified key parameters that are unambiguous (e.g. emissions, annual % change of emissions, or emissions per £turnover/profit). It would then be open to anyone, including where appropriate Government, to present a convincing argument on comparative performance in relevant cases. Participants who believe they perform well compared to competitors could make that case, industry associations could use the information to construct rankings that are appropriate for their industires, financial/corporate analysts could scrutinize any claims, and environmental and transparency pressure groups could analyse specific sectors or draw other useful comparisons (for example between different products or services that might be regarded as substitutes).

4. Call a tax a tax – and make it work for the environment

Several of us therefore welcome the Chancellor's Budget statement that, should significant savings not be deliverable through simplification, an alternative environmental tax will be considered to replace the CRC – if the tax is rational (i.e., rewards low-carbon behaviour of all kinds) and provided it is coupled with appropriate reporting requirements. Whilst this may not achieve all of the CRC's original ambitions, we think it would be a good way of making sure some of them at least are achieved.

CRC without auctioning is already a "tax +" (as discussed in our previous consultation response, point 5). Rolling CRC into CCL would be one very simple way of ensuring compliance by default that should save both regulators and regulated a considerable amount of compliance-related costs.

If Government feels that a significantly higher carbon tax would pose too great a burden on participants, it could amplify the monetary incentive by providing a CCA-like relief from CCL or, say, a relief from business rates where significant demonstrable energy savings had been made. While the old "revenue recycling" mechanism tried to act as such an amplifier, it was far too complex and unpredictable (and we agree that it is sensible that this was scrapped). Instead, a simple relief could be introduced e.g. for the use of DECs or an accredited energy management system, such as CTS.

If Government decides to go down the environmental tax route, it should let participants know this as early as possible, including an anticipated timetable for introducing the relevant legislation. This is especially important as there is considerable uncertainty in the market as to what a policy change would mean in terms of timing – the Climate Change Act specifies a trading scheme, and there is some speculation as to how quickly an equivalent tax could be introduced as a separate measure and how seamless the transition would be.

The sooner a policy decision is made and communicated unequivocally, the sooner the regulated organisations can stop wasting limited resources adapting to regulatory change and start thinking about implementing rational energy efficiency and other low-carbon measures.

5. Regulatory consistency

Finally, any change to the CRC should consider policy and legislation in the pipeline – including the Energy Efficiency Directive (and its energy efficiency obligation scheme and energy audits / management systems requirements). Consistency also requires that organisations need measure and report their emissions in only one way. We agree with proposal 13 to align the CRC emission factors published by DECC with those published by Defra in each compliance year, and we hope that any broader carbon reporting requirement under the Climate Change Act will be in line with those emission factors.

6. Summary

The main issues which we believe need to be tackled if CRC is to work for the environment within current economic constraints are

1. Certainty – above all, stakeholders need confidence regarding the shape of the scheme going forward. The more certain the rules and costs of compliance, the easier it is for energy managers to make a case for investment in efficiency measures. The current level of uncertainty makes this very difficult.

2. League table – the league table in its current form suffers from the fact that it is not authoritative, for all the reasons that participants from different industries have highlighted. A radical way of changing this could be for the regulator to simply publish a few, more robust facts about participants' carbon savings, and let other actors do the analysis.

3. The "Tax + solution"- as the CRC has already ceased to be a true cap-and-trade scheme, it should not be presented as one. Coupled with appropriate reporting requirements, a CRC tax could be a more straightforward solution than the current scheme. While this (coupled with 2. above) might not fulfil all of Government's original ambitions for CRC, combining those ambitions seems unrealistic in light of the practical difficulties of regulatory design – better to set clear incentives, minimise the administrative burden and (if appropriate) add the saved administrative/compliance costs to the price of emitting carbon dioxide.

4. Consistency – any changes to the CRC should be implemented in a way that is consistent with other existing and emerging carbon reduction/reporting policy and legislation.