



UKELA CLIMATE CHANGE WORKING PARTY RESPONSE

DEFRA Consultation on Measures to Reduce Carbon Emissions in the Large Non-energy Intensive Business and Public Sectors

31/01/2007

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FAO: Brian Rapose
National Climate Change Policy Division
Zone 3/E5
DEFRA
Ashdown House
123 Victoria Street
London SW1E 6DE

31 January 2007

epc.phase2@defra.gis.gov.uk
By Email and Post

Dear Sirs

DEFRA Consultation on Measures to Reduce Carbon Emissions in the Large Non-energy Intensive Business and Public Sectors

As co-chairperson of the UKELA Climate Change Working Party, I have pleasure in enclosing the response of the Working Party to the above Consultation paper.

If you or any of your colleagues would like to discuss any aspect of our response please do not hesitate to contact either me or my co-chair Michael Woods. My direct dial telephone number is 0870 839 1263 and e-mail address is tom.Bainbridge@hammonds.com. Michael's direct dial telephone number is 0207 809 2554 and e-mail address is Michael.woods@shlegal.com.

I would like to thank you on behalf of the UKELA Climate Change Working Party for the opportunity to respond to the Consultation paper.

Yours faithfully

A handwritten signature in black ink, appearing to be "Tom Bainbridge", written over a large, light-colored oval shape that serves as a placeholder for a stamp or seal.

Tom Bainbridge
Co-Chairperson, UKELA Climate Change Working Party

cc. Michael Woods – Stephenson Harwood, UKELA Climate Change Working Party Co-Chair



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DEFRA Consultation on Measures to Reduce Carbon Emissions in the Large Non-energy Intensive Business and Public Sectors

Introduction

This submission is made on behalf of the UK Environmental Law Association ("UKELA") Climate Change Working Party.

UKELA is the UK forum that aims to make law work for a better environment and to improve understanding and awareness of environmental law. UKELA's members are involved in the practice, study or formulation of environmental law in the UK and the European Union. It attracts both lawyers and non-lawyers and has a broad membership.

The UKELA Climate Change Working Party has a particular remit on matters relating to climate change and emissions trading. It draws on the experience of specialist lawyers and other professionals who are actively involved in this subject and who are regularly called upon to advise on its implications and effects.

We are broadly supportive of the Government proposal for an energy performance commitment. However, we would urge the Government to give further consideration to a number of issues, in particular in relation to :

- (i) the level of ambition of the proposal;
- (ii) the coverage of the EPC and how this would correlate with corporate and public sector organisational structures;
- (iii) the distortion of the market incentive created by differentiated revenue recycling.

Responses

Q2 - What is your view on the scope for large non-energy intensive organisations to improve their energy efficiency and contribute to the UK's climate change goals by 1.2 MtC by 2020? Do you agree that the sector should be defined by electricity use of more than 3,000 MWh? If not how should it be defined? What is your view on the need for any

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new instruments and are there other new instruments that could significantly improve energy efficiency in these organisations?

Response:

The need for new instruments

The organisations targeted by the EPC are generally defined by large energy consumption which is not a significant proportion of operating costs nor is the level of energy consumption generally related to production/productivity levels. Therefore, management in these target organisations can easily overlook options for managing consumption patterns or reducing overall energy consumption levels. And, although there are a number of initiatives targeting these organisations (most notably from the Carbon Trust), penetration of "awareness" of climate change as an issue is some way ahead of technical appreciation of possible actions which might reduce energy consumption. Therefore, in our view, there is a need for additional policy measures to stimulate action in this otherwise very mixed 'sector'. In light of the above, whilst emissions reductions will be the ultimate goal, success on the pathway to reductions is dependent upon any policy instrument/s used:

- bringing the wider cost of energy consumption into mainstream thinking from Boardroom to the facilities manager;
- creating a fiscal and/or regulatory stimulus to prioritise energy action;
- making accessible technical support and guidance to help organisations identify energy management opportunities appropriate to their circumstances; and
- being simple for organisations (and the regulators) to administer.

There is a risk that the EPC creates administrative burdens in sectors unfamiliar with trading any other commodity. This may mean that actual volume of trading may be limited in practice – in turn, limiting the ability of trading, as the selected policy tool, to deliver economic efficiency. Alternatively, suppliers or other intermediaries might take over management of this issue. That may allow management of energy consumption and allowance trading to be vested in experts, but it may equally fail to encourage management to factor energy consumption into strategic decision-making.

Clearly, there are policy alternatives and these should be the subject of further consideration. We note that the Consultation paper states that CCAs *"have been very successful in delivering energy efficiency improvements where they have been used to date"*. Therefore, an alternative to the EPC might be to extend CCAs (in some form) to non-energy intensive organisations. This would seem to have the following potential advantages:

- it would build on existing learning and avoid a proliferation of different schemes;
- participation would be voluntary rather than mandatory, which should generally be preferred;
- it would encourage sector-based innovation in terms of achieving energy efficiency – which flexibility is particularly important given the variety of sectors at which any new instrument will be aimed.

However, we also recognise that there could potentially be financial and legal obstacles to such a proposal and these would require further investigation:

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- there would be a cost to the Treasury through reduced CCL revenues;
- alternatively, the CCL could be increased generally (offsetting eligibility for discounts) and, to accelerate changes in behaviour, Government should be prepared to invest any increased CCL revenues raised in emissions reduction technologies and techniques;
- there could be legal constraints on the extent of any increases/reductions to CCL under the Directive on taxation of energy products and electricity (2203/96/EC) and State Aid Rules, although they may not be insurmountable.

We also recognise that the lack of correlation between energy consumption and productivity in this mixed sector suggests that voluntary measures may be ineffective and some form of mandatory instrument essential. In this context, we are generally supportive of the EPC proposal but believe that, if the EPC route is pursued, then it and the CCAs should ultimately converge into a single policy instrument.

Defining the sector by reference to electricity consumption above 3,000 MWh per annum

Assuming the EPC route is pursued, we support the setting of an electricity threshold that strikes an appropriate balance between maximising emissions coverage whilst minimising administrative burden. The relative merits of a 3,000 MWh threshold compared to a higher or lower threshold should be given further consideration, particularly as Government thinking regarding the definition of 'organisation' and the nature of organisations to be covered develops (see Q.18 below). The consultation document and RIA suggest that a 3,000 MWh threshold will capture 1,500 organisations with emissions coverage of ~15MtC, compared to a 10,000 MWh threshold capturing 1,300 organisations with emissions coverage of ~12.5MtC. Lessons from the EU ETS in relation to the cost and administrative issues involved with regulating smaller emitters should be taken into account in setting an EPC threshold. It may be appropriate to include exclusion criteria for small energy users and/or where significant energy efficiency measures have already been put in place.

Finally, whilst it is clearly relevant to have a threshold set on electricity consumption, it is unclear how the proposals will affect organisations where there is significant use of gas or other fuels but which would fall outside the remit of the EPC because half-hourly electricity metering is not used. Failure to address this issue could affect the fairness of the scheme.

Scope of this sector to reduce emissions by 1.2 MtC by 2020

We question whether a 1.2MtC target is sufficiently ambitious.

Considered across this whole sector, the reduction is negligible, equating to an average annual saving of between 73tC saving per organisation (assuming coverage of 1,500 organisations) down to 21tC per organisation (if coverage were to extend to 5,000 organisations). This requires little more than each organisation turning off a few lights and a few PCs each evening. Given that the consequence of reducing energy consumption should, in most cases, be revenue positive, we believe that the target should, at least, genuinely reflect potential for cost-effective reductions in consumption within these sectors which must be greater than this.

Q3 - Do you have views on the following options: (a) examining the scope for improving building regulations in the long term; (b) improving information and advice and (c) industry led agreements to reduce emissions. Are there other new options that could significantly improve energy efficiency in these organisations?

Response:

- (a) Building Regulations: there still seems to be significant potential for improvement in the standards required under the Building Regulations when evidence of built-out energy performance standards are compared to those of some other EU member states. This may be a question of raising standards still further, greater simplification, better training coupled with stronger enforcement powers and more independent and effective use of enforcement powers. Further, it would appear that, in transposing the Energy Performance of Buildings Directive into amendment of the Building Regulations, the Government has chosen to take a restrictive view of the requirements of Article 4, thereby missing an opportunity to gain a greater contribution towards carbon reductions from existing building renovations.

In addition, softer initiatives, such as regional energy plans, local planning guidance dealing with energy efficiency, etc, have potential to be effective in raising standards beyond 'minimum compliance' with Part L. Therefore, it would seem particularly unfortunate if the OCLG draft guidance "Planning Policy Statement: Planning and Climate Change – Supplement to Planning Policy Statement 1" (currently out to consultation) were to prevent local authorities requiring standards beyond Part L.

- (b) Information and advice: there remains a lack of understanding of Part L amongst elements of the developer community and a considerable lack of understanding of cost-effective potential to save energy amongst most consumers of energy (public sector, business and individuals). Therefore, raising awareness, encouraging and assisting are crucial. However, with a bewildering number of different Government and business schemes to choose from, we would recommend an attempt by Government to consolidate and make more widely available and more effective existing schemes.

- (c) Industry led agreements to reduce emissions: voluntary approaches should always be the preferred route, with intervention and compulsion being resorted to where voluntary approaches are not forthcoming or unlikely to deliver sufficient action. Energy efficiency have self-evident potential to deliver cost savings for any individual, business or public sector consumer. However, for most, there is so little visibility of energy costs (let alone attributable emissions) that few are motivated to taken action voluntarily. Therefore, policy instruments of some form are necessary to raise awareness and improve management of energy consumption. If specific business sectors volunteer approaches to reduce emissions from energy consumption within their sector, these should be encouraged provided the approach they volunteer is sufficiently robust, is based on an equitable share of burden being assumed and does not have the effect of derailing the policy objective of raising awareness and standards across a much broader section of the economy.

Q4 - Would the proposed coverage of the scheme bring in the right organisations, striking an appropriate balance between including as many tonnes of carbon as possible while keeping administrative burdens to a minimum? In particular, should the sector be defined by electricity use through mandatory half-hourly meters or other means? If so, what is an appropriate threshold of mandatory half-hourly metered electricity use?

Response:

Half Hourly Metering (HHM)

Using half-hourly electricity metering and an annual half-hourly metered consumption threshold seems an appropriate approach to define the sector. This approach has the potential to deliver regulatory simplicity for defining the boundaries of the mandatory sector.

The proposal is to restrict the primary eligibility criterion to those businesses with mandatory HHMs for reasons of certainty and the availability of data. For the same reason and bearing in mind the need to minimise the administrative burden in accordance with Better Regulation, we suggest that the EPC should exclude from mandatory coverage sites operated by organisations falling within the EPC, that have no mandatory HHMs.

The NeraEnviros analysis at 6.1.1.6 identifies a "not insignificant number of NHH sites with relatively high levels of electricity consumption" (but with no requirement for mandatory HHMs). Given the need for the scheme to be designed to be seen to be fair, we believe further investigation is required to ensure sites are not unfairly excluded.

HHM monitors electricity consumption and, so, this criterion assumes that the main fuel used is electricity. It is unclear how many large gas users the operation of this criterion would effectively exclude. Again, this goes to the fairness of the scheme.

There is currently no database which identifies the location and ownership of HHM's, nor is it clear how this is to be linked to the concept of "organisation". The Government needs to propose a robust and cost-effective method for doing this – see further below.

The obligation to identify sites for HHMs falls on electricity suppliers. Would any organisation which failed to register for the EPC because of failure by the electricity supplier to put in place mandatory HHMs be excused?

Threshold

The consultation paper discusses the balance between coverage and regulatory burden for thresholds of 3,000 MWh, 2,000 MWh and 10,000 MWh but does not specify what the coverage is with a threshold 2,000 MWh. Working on the basis that an ideal scenario would be to get 80% of the coverage for the least amount of administrative burden on organisations, we suggest that consideration is given to the coverage and administrative burden if the threshold is set at 2,500 MWh to see if the coverage can be increased to 80% without significant shift in the administrative burden.

Opt-in?

We suggest that voluntary entry into the scheme should also be considered:

- (a) below the annual consumption threshold; and
- (b) possibly, for non-half-hourly metered entities - provided they demonstrate that they are subject to metering with a verifiably equivalent level of accuracy.

However, we believe there may be two particular concerns of doing so:

- there may need to be some *de minimis* level set so that the administrative burden borne by the Regulator is kept to a minimum; and
- consideration may need to be given to the possibilities for regulatory arbitrage between CCA's and the EPC. We note that in the case of the overlap between the EU ETS and the CCA, organisations were allowed to opt-out of the EU ETS providing the CCA requirements that they were subject to were deemed to be of equivalent value (in terms of CO₂ savings) as the EU ETS.

Q6 - Do you consider the design elements of the proposed EPC scheme (including an introductory phase, the auction, revenue recycling, safety valve, and other features) to be consistent with the delivery of emissions reductions at least cost and what are your reasons? Are they practically achievable without imposing significant administrative burden?

Response:

Auction and revenue recycling

While the idea of a cap and trade scheme is designed to deliver the lowest cost emissions reductions, the revenue recycling proposed cuts across this aim. Revenue recycling is extremely valuable to avoid putting UK businesses at a competitive disadvantage compared to businesses outside the UK although revenue recycling adds an additional layer of complexity to the scheme while potentially damaging its aims. Indeed, we are concerned that the approach proposed to re-distribution of revenues provides perverse incentives to organisations. With the concept of revenue redistribution based on position in a league table which compares each organisation's improvement relative to its average previous performance, the effect is to:

- (a) penalise action already taken and disincentivise action being taken between now and introduction of the EPC; and
- (b) penalise unfairly those businesses and sectors who have the least potential to introduce cost-effective energy saving measures.

Effective early action perversely would be rewarded with a low position in a league table and an additional cost-burden from a shortfall in revenue recycling. And, whilst those organisations that take effective action in response to the scheme are rewarded with a high ranking and financial reward from a surplus in revenue recycling, so too would those that stall action until the scheme starts and/or that 'drip feed' improvements year on year. A better way of recognising early action needs to be found.

The proposed approach to revenue recycling cuts against the very basis on which a policy objective can be cost-effectively delivered through a created market. Trading should work to deliver the most cost-effective reductions in energy consumption if the market is left to find those through liquidity and price. Instead, differentiated redistribution of auction revenues actually prevents the market from working effectively. Certainly, those for whom the only energy savings to be found are expensive could buy surplus allowances from those for whom energy savings can be found more cheaply. However, if they were to do so, they would be penalised through a shortfall in recycled auction revenues. Trading to compliance, under the proposal, is penalised as "bad" performance under the league table.

A league table should be an indicator of an organisation's performance when compared against other organisations in the same class – in other words, against a relevant sector benchmark. However, unless suitable benchmarks are available for covered sectors, adding the historic data requirements of benchmarking to the scheme would appear to add undesirable complexity.

Buy-out

We agree that a safety valve should be provided by way of a simple unmodified "buy-only" link to the EU ETS.

We agree that "banking" should be allowed in the post-introductory phase so as to allow participants the flexibility to distribute their energy-saving efforts over time.

Some of the key requirements of the EPC scheme, which are new to many of the industries are perhaps the smart metering as well as accurate measurement of consumed energy levels. The

issue of least cost can only be accurately examined in two aspects; business as usual and what can be practically achieved in such industry. Many industries are made up of large number of small operating units as opposed to a small number of large operating units. This will result in a significant increase to operators and regulators. Least cost is the key point and is specific to each participating organisation. Some organisations are already making significant inroads in reducing our carbon footprint and in many ways their actions will have pre-empted what the EPC is trying to create. It may be the case that we may have exhausted all cost-effective energy reductions measures before the scheme starts. In which case, previous achievements should be recognised creating a measure of confidence.

Q12 - What is your overall view of the relative merits of the proposals [EPC, Benchmarking etc] discussed above in meeting the requirements of Better Regulation, whilst also delivering the desired emissions reductions?

Response:

Overall, it is clear that a significant focus of the EPC design is simplicity and avoiding the imposition of disproportionate cost and administrative burden. This is to be applauded.

Q13 - What is your overall view on the best way to maximise emissions coverage whilst minimising regulatory burden?

Response:

We believe that by keeping the scheme simple so that energy and environment managers at organisations affected by the EPC can focus on achieving emissions saving measures and are not distracted into spending large amounts of time complying with the scheme's requirements. Similarly, setting a threshold for inclusion in the scheme that ensures only organisations with a certain size energy consumption and hence emissions are covered will also help to achieve this aim.

Q15 - What is your view on the EPC covering emissions outside CCAs and the EU ETS, and exempting completely organisations (as defined by the EPC) with more than 25% of their emissions in CCAs?

Response:

There appears to be a sufficient number of organisations covered by CCAs and/or EU ETS yet with substantial energy consumption attributable emissions outside their CCAs and/or the EU ETS. This suggests that merely having a CCA or being within the EU ETS should not automatically exempt an organisation from the EPC. For organisations with the greater part of their energy-attributable emissions covered by CCAs, presumably there is little additional benefit that can be obtained by imposing an additional and different obligation in respect of these remaining emissions (to do so, would seem to risk taking management attention away from the greater savings that might be delivered under the CCAs). We do not feel competent to comment on the level of any threshold. However, as different legal definitions are used between the EPC, CCAs and EU ETS, we question how a 25% CCA threshold would be applied. In particular, in practice, the organisational boundary in the case of the CCAs may well differ from the "organisation" boundary of the EPC (depending on how this is, ultimately, defined).

Q18 - What is your view on the proposed EPC definition of the "organisation"? [An organisation that (i) has one or more sites with mandatory half hourly electricity meters and (ii) its total mandatory half hourly electricity meters exceeded a certain threshold – currently proposed at 3,000 MWh.]

Response:

In many organisations, currently energy use may well be managed (if at all) at site level. However, the site level manager may well need specific authorisation to introduce any additional measures to control and reduce energy consumption – even though to do so may reduce overheads. However, in non-energy intensive organisations, energy costs are unlikely to be directly related to or impact visibly on profitability. Therefore, the EPC will work best if it does two things effectively. That is, if it:

- (a) raises awareness and concern about energy use at all appropriate levels; and
- (b) provides sufficient incentive for a sufficiently high level of an organisation's management to authorise appropriate action to be taken.

This suggests that the EPC 'obligation', and penalties for non-compliance, should apply at a sufficiently high level within an organisation and the possible gains, losses and penalties should be sufficiently significant to grab management attention at an appropriate level. For group companies, this may well be the highest level operational parent company within the UK. However, also imposing some burden directly at a lower level within the organisation (at the level of the subsidiary actually having day-to-day control of the particular site/s) may well assist the parent company achieve compliance and avoid the potential gains, losses or penalties having to be too great to motivate group-wide engagement.

In other organisations, energy purchasing will be managed at a group purchasing level. Climate and social responsibility policy is also likely to be set at this level. This also indicates that the EPC should operate at Group level in order to be effective.

The definition of the EPC "*organisation*" as "*the entity to which half hourly meters are registered*" may not be appropriate, since this may be an arbitrary operating company or subsidiary, or out of date. There should therefore be some mechanism for grouping together entities operating within the same group as a single organisation for the purpose of the EPC.

Difficulties may arise where a single "*group*" under company law operates more than one distinct business groups in the UK, each of which is separately responsible for its own energy purchasing. In these circumstances, it should ideally be possible for individual businesses within the corporate group to be treated as separate organisations for the purpose of the EPC.

We would therefore suggest following an approach similar to that in respect of packaging waste, for which obligations are determined by reference to the corporate group as a whole, but the obligations of a company within a corporate group may be discharged either through individual participation by each corporate entity, or through a single group participation (see Schedule 8 of the Producer Responsibility (Packaging Waste) Regulations 2005).

The Consultation paper states that the Government does not intend the EPC Scheme rules to take account of new entrants or other rationalisations: "*To do so would be very complex and potentially unmanageable*". Whilst we appreciate the need for simplicity, we believe that as with comparable schemes (including the EUETS, UKETS and Producer Responsibility (Packaging Waste) Regulations), provision should be made for rationalisation in the interests of fairness. If this is not done, the issue will in any event need to be addressed in business acquisitions and disposals through contractual negotiations, and businesses, which experience organic growth, will be unfairly penalised.

The Consultation paper assumes that once an organisation is eligible for participation it remains in the scheme for each designated phase regardless of whether qualifies in each year of the scheme, "*because of the administrative burdens on the organisations themselves*". In our view, organisations should be free to withdraw from the scheme on an annual basis if they do not meet eligibility requirements.

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For public bodies, each entity such as a Local Authority or Government Department would need to be considered as an entity in its own right.

Regarding public sector bodies while some may be difficult to define, ordinarily we suggest that organisations with a separate budget should be regarded as single entities - that way the EPC will be directed as entities who have a control over specific spending including spending on electricity consumption.

While regulatory arbitrage between the CCA and the EPC may be acceptable, if it is decided that non HH sites or organisations covered by the EPC should be included on a voluntary basis, the regulations that introduce the EPC need to be drafted so that organisations that are large collections of autonomous sites do not escape the EPC's coverage because individual sites fall outside the threshold and entities must not be allowed to exclude sites so that they fall outside the threshold.

Q19 - Is a suitably designed auction the right approach to allowance allocation?

Response:

An auction has the benefit of being administratively simple to operate from a regulator's perspective. It also has the added benefit of aligning the EPC with the approach that the Government is seeking to move towards in respect of the EU ETS allowances.

In principle we agree that, if the EPC proceeds, a suitably designed auction is a more practical approach than granting free allowances. Nevertheless, there will be a significant burden on many businesses, organisations which are not used to participation in allowance trading.

Q21 - What is your view on the proposed approach to setting the cap? [Using data collected during introductory phase to set a baseline, the first year's cap is proposed to be set near the level of emissions during the fixed price phase. The cap would then decline year on year on a trajectory to achieve 1.2MtC on a BAU basis by 2020.]

Response:

The cap should be known to at least 11 years ahead, so it needs to be a rolling cap or follow a clear path. Government must seek stakeholder views before setting the overall cap and/or reduction pathway – otherwise there is a risk that 1.2MtC cannot be achieved without unacceptably high auction prices or may be insufficiently demanding.

Q23 - Should the scheme include banking provisions in the post-introductory (capped) phases?

Response: See our response to Q8.

We think that allowing banking across different post-introductory phases of the scheme should encourage early action as well as having the benefit of mirroring the provisions of the EU ETS. The key driver being to reward and stimulate companies to engage in early action to reduce emissions. Further modelling would be needed, the key requirement is not to penalise participants whose production declines.

Q24 - Should the scheme include a "buy-only" link to the EU ETS or an alternative form of safety valve?

Response: See our response to Q6.

We think the idea of a 'buy-only' link to the EU ETS is sensible as it allows the price of carbon reductions in the EPC to be linked to that of the EU ETS; it would be unsatisfactory to have

different costs of carbon for organisations in different sectors. A 'buy-only' link would, however, be easier to put in place than full allowance fungibility between the two schemes as this would require EU legislation.

The buy-only link to the EU ETS should ensure that the scheme has access to allowances from the EU ETS which will already have had four years of operation by 2009. This four year period should ensure that any initial teething problems and allowance price volatility have been smoothed out. Two further considerations that need to be addressed, however: – how do growing or new businesses buy the allowances or additional allowances they need? – will EPC get onto Board agendas if there is the little risk? It may be appropriate to include a buy-out in first period, to allow confidence to develop, but then review the priorities for the second and subsequent parties.

Q25 - Do you agree that auction revenue should be recycled to participants?

Response:

Not necessarily, although without revenue recycling in some form, the scheme imposes an additional burden on businesses within the scheme compared to those outside it.

Revenue recycling must seek to avoid creating market distortions or perverse signals. See response to question 6.

Simplicity in any form of revenue recycling is key.

Q26 - How do you think that revenues should be recycled to participants?

Response: Please see our points raised in relation to question 6.

The role of revenue recycling is highly unsatisfactory. It is the wrong signal to just reward those who reduce by most - they may have more opportunity (due to their sector, previous inertia or accident of timing of previous premise and process decisions). It also penalises successful business expansion.

Sophisticated metering is merely one means to this end. In any case smart metering is likely to be increasingly widespread for larger electricity NHH and gas NDM sites in the next decade so that the difference between 40th and 4000th might actually be a very small proportion of energy consumption.

Q30 - Do you think the EPC should include a voluntary or mandatory benchmarking scheme?

Response:

We think that a voluntary benchmarking scheme has very little chance of success - while we note the comments in the Consultation paper about the success of some voluntary schemes, benchmarking schemes have been set up before now and have rarely resulted in meaningful data being made available. If a benchmarking scheme is to be introduced it should be mandatory.

UKELA CCWP

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Contact details:

Tom Bainbridge
Hammonds
7 Devonshire Square
Cutlers Gardens
London
EC2M 4YH
Tel: 0870 839 1263
Fax: 0870 460 2721
Email: tom.Bainbridge@hammonds.com

Michael Woods
Stephenson Harwood
One St Paul's Churchyard
London
EC4M 8SH
Tel: 020 7809 2554
Fax: 020 7003 8610
Email: Michael.woods@shlegal.com