October 10

the inside track #20

Highlighting CSR Issues of the moment

The implications of the CRC changes for your organisation.

On Wednesday 20th October, the Government delivered its much anticipated House of Commons statement of its Comprehensive Spending Review. Its aim was to announce those areas in which it planned to make cuts or changes to deliver £83 billion of savings.

One of the surprising aspects of this statement was that one major change was not even announced to the House, but was to be found in the Spending Review Report document.

This was the scrapping of recycling payments under the CRC and retained funds generated from participants' purchase of allowances to boost public finances.

This was surprising on several counts. Firstly, the announcement came 20 days after 2,800 private and public sector organisations had registered for the CRC. Secondly, the executive agency responsible for implementation, the Environment Agency, had clearly not been told in advance of the change - the statement on its website immediately after the announcement was that "it is working with the government to understand the implications of the changes and more information will be announced as it becomes available". And lastly, but not insignificantly, the amount raised by this change - which is in effect now a tax on carbon emissions - is £3.5 billion in the next four fiscal years - over 4% of the target of the Spending Review. British Retail Consortium director-general Stephen Robertson said of the announcement "a tax of this size surely merits a mention in the Chancellor's speech".

To make the change more palatable, the government announced the first purchase of allowances will be for the 2011/2012 CRC year, eliminating the need for any purchases in 2010/2011. These purchases will be made at year-end (likely to be around June 2012 for first purchase) but the revenue generated from the sale of allowances for this **and** subsequent years will now be retained by HM Treasury.

Perhaps the first point to emphasise is that currently this announcement does not appear to have changed the basic principles of the CRC scheme.

An online comment attributed to the Environment Agency points out the requirements for footprint and annual reports remain unchanged, including producing them for the scheme's first year i.e. April 2010 to April 2011. In addition this comment made it clear that the requirement remains for the evidence pack - together with the Agency's auditing of it. Hence CRC participants need to ensure they have the systems in place to ensure their evidence pack, which includes the footprint and annual reports, is fully compliant with the legislative requirements.

Furthermore, the Agency has commented the performance league table will still be published in October every year. This will include reporting on all three metrics - absolute, early metrics and growth - as well, presumably as the 4 qualitative areas - director responsibility, employee engagement, publishing performance and targets. But the table loses its role as a financial incentive, and depends more on its reputation driving potential.

To say that the immediate reaction to CRC allowance recycling was close to incandescent is not far from the truth, but it is necessary to try to establish what it will **really** mean to organisations both in the private and public sectors.

TVC comment overleaf >

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the virtuous circle comment: #20

With CRC becoming an emissions tax, are there other implications for participants?

First, CRC allowances being purchased at each year end means the scheme will change from a cap and trade scheme (from phase 2). Participants will not have to forecast their required annual allowances or purchase more during the year if requirements are underestimated.

This should make CRC accounting easier for participants. But emissions throughout the year still need to be monitored to avoid unexpected year end bills.

Second, the government's performance league table included early action incentives. However, without financial linkages, there is no CRC related benefit to achieve Carbon Trust Standard certification or introduce Smart Meters. Instead investment decisions for these measures should be based purely on business benefits -a much more commercial position to adopt.

Third, the change to a tax generation approach makes investment appraisal for energy saving initiatives simpler to justify. The recycling measures were overly complicated and difficult for senior management to understand. The change provides participants with a stronger and clearer incentive for energy efficiency investments.

The fourth implication is that clients are saying the tax impact enables far greater traction with senior management than the previous recycling approach. This should enable a stronger dialogue with the board on energy and carbon management.

However, some participants may accept CRC tax impacts rather than reduce energy consumption. Such a decision would be short lived with likely changes in carbon prices. The CSR policy assessment indicates Treasury assumptions on cost are £12 and £16 per tonne - the latter is for the 2nd phase. The Treasury anticipates a rising CRC allowance price. Secondly, DECC's Chris Huhne indicated there will be a floor under the price of carbon to provide a sound footing for companies investing in renewable and nuclear power generation.

The price of carbon will rise for CRC participants - probably more than anticipated previously.

The fifth implication relates to CRC being a tax. Originally, with CRC not being a tax, participating property landlords who provided serviced accommodation were generally unable to recharge CRC to tenants unless they had a "green lease". With CRC becoming a tax this will change - under the terms of a normal lease, landlords can usually recharge property based taxes imposed on them.

If your organisation leases any serviced premises, then your CRC exposure (and cost) may be greater than originally anticipated.

Overall, these changes are likely to make anticipation of CRC costs more uncertain - the government is likely to price carbon allowances on a yearly basis. Probably the future UK price of carbon will rise, both as an incentive for non fossil fuel power generation, and as part of the Treasury's tax raising armoury.

In this respect, with carbon emissions being taxed, how long before the Treasury aims to lower CRC thresholds, encompassing more organisations, and generating more tax revenue?

Of course, there is a caveat. Our comments reflect our interpretation of the impact of the changes. The Environment Agency has indicated that it will consult on changes to the scheme. Secondary legislation is required to affect the change from recycling to tax generation. There may be changes yet to come!

Whilst organisations may take comfort from the absence of payment during the first CRC year, the following years will be more challenging than perceived prior to Wednesday 20th October. Energy management will be of even greater importance.

If you would like an objective and impartial view on the new requirements described in the is newsletter, contact Tony Hoskins - thoskins@thevirtuouscircle.co.uk or Ian Redington - iredington@thevirtuouscircle.co.uk

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