

**EXPLANATORY MEMORANDUM TO**  
**THE CRC ENERGY EFFICIENCY SCHEME (AMENDMENT) ORDER 2014**  
**2014 No. 502**

**1.** This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament, the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly by Command of Her Majesty.

1.1 This memorandum contains information for the Joint Committee on Statutory Instruments.

**2. Purpose of the Instrument**

2.1 This Order makes amendments to the CRC Energy Efficiency Scheme Order 2013 (2013 Order) in order to finalise simplification of a non-domestic energy efficiency scheme known as the CRC Energy Efficiency Scheme (the CRC Scheme). The Government committed to simplify the CRC Scheme in 2010 and announced its conclusions in December 2012. These changes were enacted in May 2013 through the 2013 Order.

2.2 The simplification conclusions included a commitment to further consider how the CRC Scheme could incentivise participants to take up onsite self-supplied electricity. The Government is proposing that the consumption of energy from supplies that meet the definition of self-supplied renewable electricity will be reported against a zero emissions conversion factor, provided other Government support has not been received for the same supply. In effect, this means that the purchase of CRC allowances will not be required by participants for eligible energy.

2.3 In addition, the Government proposes to introduce an exclusion from the CRC Scheme for energy used for metallurgical and mineralogical processes that are deemed eligible for an exclusion from the Climate Change Levy (CCL) as announced by the Chancellor of the Exchequer in Budget 2013. Without the CRC exclusion, holders of Climate Change Agreements (CCAs) (which provide a discount from the CCL and exemption from the CRC Scheme), which are subsequently withdrawn, may become liable for CRC Scheme costs. This is not the policy intent of the Budget 2013 announcement.

2.4 The Government also believes the current drafting of the 2013 Order does not give force to the Government's policy intent on two issues as set out in its conclusion in December 2012. It is proposing to make two drafting changes to avoid double-counting of energy supplies used in third party CCA facilities or EU Emissions Trading System (EU ETS) installations and to allow participants greater flexibility to

disaggregate subsidiaries of their organisations. The Government has also taken the opportunity to make a number of technical amendments to the 2013 Order to make the wording of the regulations clearer for participants.

2.5 The Government proposes this Amendment Order comes into force at the beginning of the next phase of the CRC Scheme on 1<sup>st</sup> April 2014.

### **3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

### **4. Legislative Context**

4.1 The CRC Scheme was introduced by the CRC Energy Efficiency Scheme Order 2010 (SI 2010/768) (the 2010 Order) under powers conferred by sections 44, 46(3) and 48 of and Schedule 2 and paragraphs 9, 10, 11 of Schedule 3 to the Climate Change Act 2008. The CRC Energy Efficiency Scheme (Amendment) Order 2011 (SI 2011/234) (the 2011 Order) postponed the second phase of the CRC Scheme by extending the introductory stage to March 2014 and introduced initial simplification measures. The 2013 Order (SI 2013/1119) delivered 46 proposals to streamline and simplify the CRC scheme. This Order is made under the same powers except this Order is subject to the negative procedure (under paragraph 12 of Schedule 3) as its provisions do not contain any of the matters listed in Section 48(3), Climate Change Act 2008.

### **5. Territorial Extent and Application**

5.1 This instrument applies to all of the United Kingdom.

5.2 The definition of the extent of the United Kingdom in regard to this instrument is set out in section 89 of the Climate Change Act 2008

### **6. European Convention on Human Rights**

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

### **7. Policy background**

7.1 The CRC Scheme is a mandatory UK-wide trading and reporting scheme introduced in April 2010, but the qualification period for the scheme started in 2008. It was designed to improve energy efficiency and drive emission reductions in public and private sector organisations through the application of financial and reputational drivers. It is divided into phases. Phase 1 ran from April 2010 to March 2014 and each phase is divided into compliance years which run from 1<sup>st</sup> April to 31<sup>st</sup> March. The next phase begins on 1<sup>st</sup> April 2014. The Environment Agency, the Scottish Environment Protection Agency, the Natural Resources Body for Wales and the Northern Ireland Chief Inspector administer the scheme.

7.2 Since the introduction of the CRC Scheme in April 2010, stakeholders have argued that it is overly complex and administratively burdensome, especially in relation to emissions regulated under the EU ETS or CCAs. They have also stated that the organisational focus of the CRC Scheme is misaligned with their operational management structures and business processes. Government announced its intention to simplify the scheme in the Annual Energy Statement in August 2010.

7.3 In December 2012<sup>1</sup>, the Government announced its conclusions on the simplification of the CRC Scheme. These changes were enacted in May 2013 through the 2013 Order and delivered significant simplifications and consequent cost savings to CRC participants. Changes included:

- Reduction in fuels covered from 29 to 2 – electricity and gas (latter for heating purposes only);
- An organisation-wide 2% de minimis threshold for gas (for heating);
- A reduced reporting burden;
- Removal of the overlap with CCAs and EU ETS schemes; and
- 55% reduction in administrative costs equating to £275 million of savings for participants up to 2030. £61 million net present value of simplification proposals compared to existing scheme.

#### ***What is being done and why***

7.4 To finalise CRC simplification, the Government is making two further amendments in the treatment of renewable energy and energy used in metallurgical and mineralogical processes.

#### ***Treatment of renewables***

7.5 In the response to its consultation on simplification of the CRC Energy Efficiency Scheme (published in December 2012), Government announced it would consider how the CRC could incentivise the uptake of onsite renewable self-supplied electricity, whilst keeping the energy efficiency focus of the CRC Scheme

7.6 In its consideration Government has been conscious not to undermine the core principals of CRC simplification through unnecessarily increasing reporting burdens or duplicating support which is made available through the Renewable Obligation (RO) and Feed-in Tariff (FIT) schemes which are its principle mechanisms to support renewable generation across the economy as this would represent poor value for money for the taxpayer.

7.7. To this end, the Government (from April 2014 the start of the next phase of the CRC) is proposing to apply a zero emissions conversion factor (through changes to the supply rules) to onsite self-supplied renewable electricity that is eligible for but has not been surrendered to claim Renewables Obligation Certificate (ROC) or FIT scheme payments.

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<sup>1</sup> <http://www.gov.uk/crc-energy-efficiency-scheme>

7.8 This will allow CRC participants to select one of the following options (but not both) for the treatment of onsite renewable self-supplied electricity. Option (a), receive revenue from the RO or FIT schemes or option (b), consume the supply (foregoing eligible RO and FIT payments) and receive a reduction in CRC financial liability, as the supply will be rated at a zero-rate emissions conversion factor and not count towards CRC allowance costs. Option (b) will apply to renewable technologies commissioned from 1<sup>st</sup> January 2008 (the start of qualification to the CRC Scheme) and specified in section 41(5) of the Energy Act 2008, which qualify for RO and FIT payments. Only renewable electricity supplies generated after 1<sup>st</sup> April 2014 will be eligible for zero-rating under option (b), ROCs or FITs can never have been claimed for generation from the installation, and no grant from public funds can have been received for the installation.

### ***Energy used in metallurgical and mineralogical processes***

7.9 The Chancellor of the Exchequer announced in Budget 2013 that the Government would introduce exemptions from the CCL for energy used in metallurgical and mineralogical processes from April 2014. This aims to provide a tax relief to the most energy-intensive businesses as permitted under the Energy Tax Directive, for whom energy makes up a significant proportion of total costs, and helps ensure that UK manufacturers in these sectors remain competitive with producers in other EU member states. Draft legislation has been published by HMRC and has been consulted upon separately, but in its preparation it has come to light that former CCA holders who will no longer need to benefit from the CCL discount that the CCA provides, may become liable for CRC costs for the energy used in eligible metallurgical and mineralogical processes. Allowing this to happen would contradict the original intention of the policy to provide a relief on energy costs for these sectors.

7.10 The Government is therefore proposing to introduce a CRC exclusion for energy used in metallurgical and mineralogical processes through changes to the supply rules (i.e. adding a new 'supply deduction' to Schedule 1 of the 2013 Order), whereby the energy used for specified metallurgical and mineralogical processes will not be considered a CRC supply for the purposes of both qualification and reporting requirements.

### ***Other issues***

7.11 The Government is proposing to amend the current drafting of the 2013 Order because it does not give force to the Government's policy intent. These are:

- Where a landlord and tenant relationship exists and the tenant has a CCA facility or EU ETS installation the landlord who is a CRC participant will be able to exclude the supplies covered under a CCA certificate or EU ETS permit to avoid double counting of supplies regulated by more than one scheme; and
- To allow participants greater flexibility to disaggregate subsidiaries of their organisations at any point within a phase of the scheme and by mutual consent i.e.

agreement between the highest parent of the subsidiary group and the disaggregated participants for the disaggregation.

7.12 The opportunity has also been taken to make a number of technical amendments to the 2013 Order to make the wording of the regulations clearer for participants.

## **8. Consultation outcome**

8.1 In November 2013, the UK Government and Devolved Administrations consulted on the two proposals to finalise simplification of the CRC Scheme.

8.2 The Government received a total of 31 consultation responses, the majority of which agreed with the measures proposed. Whilst several respondents queried why the incentives offered under the RO and FIT payment schemes would be a barrier to zero-rating all onsite self-supplied renewables electricity, or using actual emissions for the technology in use, the majority of respondents accepted the position that allowances not required to be purchased would be an additional (double) benefit that would not provide additional renewables deployment or provide value for money. The overwhelming majority of respondents supported the proposal to implement the new supply deduction for energy used in metallurgical and mineralogical processes from the start of the next CRC phase in April 2014.

8.3 As a result of the broadly positive feedback on the proposed amendments, Government has decided to implement the proposals as set out in the consultation document. The proposed drafting amendments that were omitted from the 2013 Order have also been well received.

## **9. Guidance**

9.1 The Environment Agency has published detailed guidance on their website describing the obligations that organisations need to undertake to register and fulfil their obligations for the CRC. They also operate a helpdesk for participants. Current guidance is available at <http://www.environment-agency.gov.uk/business/topics/pollution/146886.aspx>

## **10. Impact**

10.1 The overall net benefit of implementing these proposals is estimated at -£52 million (present value, based on 3.5% social discount rate) over the next 20 years. This is a relatively small loss in carbon savings that should compare to a significant reduction on direct cost to businesses that is represented by the CCL exclusion for mineralogical and metallurgical sectors that fits in to achieving the wider Government objective of reducing regulatory costs.

10.2 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the UK Government website at [www.gov.uk](http://www.gov.uk) and on [www.legislation.gov.uk](http://www.legislation.gov.uk).

## **11. Regulating small business**

11.1 The legislation does not apply to small businesses.

## **12. Monitoring & review**

12.1 The changes will be in force from 1st April 2014, the beginning of the next phase of the CRC Scheme. The scheme will be fully reviewed in 2016

## **13. Contact**

13.1 Donald Sproson at the Department of Energy and Climate Change Tel: 0300 068 6301 or email: [Donald.sproson@decc.gsi.gov.uk](mailto:Donald.sproson@decc.gsi.gov.uk) can answer any queries regarding the instrument.