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Carbon Reduction Commitment – Organisational Structures

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1 Executive Summary

Introduction

The Carbon Reduction Commitment (CRC) is a proposed mandatory cap and trade scheme that will apply to emissions not covered by Climate Change Agreements or EU Emissions Trading Scheme (EU ETS) from primarily large non-energy intensive organisations (those with electricity use of 6,000MWh per year through half-hourly meters in Great Britain and 70kW metering systems in Northern Ireland). The scheme focuses on both financial incentives and Corporate Social Responsibility (CSR) drivers, given that energy costs are typically less than 3% of total operating costs. To ensure energy efficiency is placed at senior management level, the CRC employs financial drivers through the auctioning of allowances and the recycling of auction revenue, linked to performance. Reputational drivers will also be employed through a league table published by government, ranking the CRC organisations' performance. A key objective of CRC is to capture organisations as a whole, so that the CRC organisation is responsible for both its direct energy use emissions and indirect energy use emissions (from electricity).

Ecofys and Burges Salmon were commissioned to provide guidance on how the CRC obligation should be placed on organisations, to establish responsibility for emissions under a number of scenarios outlined below.

The report covers three Strands:

1. Strand 1: Responsibility of emissions under CRC
2. Strand 2: Business Sector
3. Strand 3: Public Sector

This summary briefly outlines the context to certain scenarios in each strand, summarises the issues that were investigated, providing (with explanations) recommendations and a brief rationale for each issue in turn.

Strand 1: Responsibility of emissions under CRC

2.2 Assigning responsibility for emissions to an organisation

It is important to be able to identify clearly who will be responsible legally for emissions under the CRC. The legal definition used to determine which organisation takes responsibility for a given source of emissions is therefore fundamental.

Issue: There is scope for confusion and dispute without a clear, legally robust method of assigning responsibility for a given emissions source to an organisation. This is particularly true in those instances where more than one organisation could be seen to have responsibility for the same energy use. Many of the solutions relating to Business and Public Sector organisation structure flow directly from the resolution of this issue.

Recommended Solution: Responsibility for energy-use emissions should lie with the organisation that is the 'counterparty to the contract for the supply of that energy.'

Rationale: This definition would capture the organisation which would be contractually liable for the debt for the energy, should any bill remain unpaid. It is therefore simple to identify the organisation and legally robust. In most cases this definition will also assign responsibility for emissions with the organisations that are in a position to modify their energy usage and deliver emissions savings.

In certain scenarios, such as outsourcing, facilities management, third party purchase, and Private Finance Initiatives (PFI) / Public Private Partnerships (PPP), the organisation responsible for reporting emissions under the CRC will vary according to the specific contractual arrangements in place. Each of these scenarios (such as outsourcing, third party purchase, PFI/PPP) has been investigated, using the recommended definition for allocating emissions responsibility – and we consider the recommended solution to be robust to such scenarios.

2.4 Outsourcing and facilities management

"Outsourcing" is a broad term for an arrangement whereby a third party provides services to an organisation that the organisation previously carried out itself. Outsourcing and facilities management are effectively identical arrangements in terms of elements relevant to the CRC, differing only in the common perception that outsourcing generally refers to the provision of off-site services and facilities management refers to on-site services.

Issue: How should emissions responsibility be allocated in situations where a public sector or private sector organisation outsources service delivery to contractors?

Recommended Solution: Allocate emissions responsibility to the undertaking which is "counterparty to the energy supply contract". The exact contractual arrangement between the parties will determine whether this is the outsourcer or the outsourcee in each case.

Rationale: The counterparty to the energy supply contract is the organisation most likely to have a financial interest in the energy use and so the financial drivers of CRC are likely to work most effectively on that organisation. With regards to outsourcing, in many (but not all) cases, the Outsourcee will be the counterparty to the electricity supply contract and so will be the organisation best placed to respond to CRC. Use of this definition means that it is simple to determine the organisation responsible for the scheme.

2.5 Third Party Energy Purchasing

In some cases, an organisation acts on behalf of other organisations to bulk purchase energy at preferable rates.

Issue: Under Defra's consultation proposal that emissions responsibility should lie with the organisation that pays the energy bill, it is possible that an organisation may be responsible for emissions covered by CRC where its sole purpose is to purchase energy on behalf of a client. In such situations, Defra sought to find out if it would make the CRC less effective in this case and how that could be resolved.

Recommended Solution: Assign emissions responsibility to the 'counterparty to the supply contract'; as a consequence, in most cases, the consumer of the energy will be responsible for emissions in the scheme rather than the third party purchaser.

Rationale: Using the counterparty definition means that responsibility can be assigned simply and clearly in all cases. In the majority of instances responsibility will fall to the energy consumer, which is the organisation likely to be most receptive to the CRC drivers, rather than the third party purchaser. It is desirable to avoid instances where the purchaser is the counterparty, so that the CRC drivers may work most effectively. If there are some limited cases where the 3rd party purchaser is the 'counter-party to the supply contract', then the CRC may incentivise the 3rd party agent to renegotiate procurement contracts with their clients (i.e. to avoid CRC applying to the 3rd party purchaser organisation).

2.6 Public Private Partnerships (PPP) and Private Finance Initiatives (PFI)

Many public sector participants of CRC are likely to be involved with PPP/PFI arrangements. In PFI/PPP contracts the responsibility for energy-use and buildings' infrastructure can be divided up between the public body and the private investor, which may have implications for CRC.

Issue: PFI/PPP service outsourcing scenarios are a particular type of outsourcing that many public sector participants of CRC are likely to be involved with. Defra sought to understand the implications of PFI/PPP for CRC, in particular to find out how best to split responsibility for energy-use emissions between the public body and the PFI/PPP project company.

Recommended Solution: Assign emissions responsibility to the 'counterparty to the energy supply contract'; emissions responsibility will vary in each case between the public authority and the PFI/PPP project company according to contractual arrangements in place.

Rationale: This approach is simple and straightforward to apply and sets the financial drivers for emissions reductions where they will be most effective. In those cases where the PFI / PPP project company is the counter-party to the supply contract, it may be the case that some of the cost associated with the implementation of CRC would need to be met by the PFI/PPP awarding authority because the introduction of the CRC would constitute a "Change in Law" under the majority of PFI/PPP contract terms (to the extent such provisions are included). Nevertheless, the recommended approach still represents the most effective use of financial and reputational levers. Given this clear definition, it is likely to be applied effectively in new contracts, as well as to some existing contracts.

2.7 Franchises

Due to the nature of franchises, the franchisor allows the franchisee to use a name that is associated with the franchisor. The franchisee operates their business in accordance with the franchisor's concept and under the franchisor's trade name or trade mark so that to the outside world the franchisee is the franchisor. In most cases the franchisee will be independent legal persons that are not in fact part of the franchisor's corporate group - the franchisee is not a subsidiary of the franchisor as defined by the Companies Act 2006.

Issue: How should franchises be treated by CRC, given that franchises operate under the same corporate brand and therefore have an equal contribution to that brand's CSR reputation?

Recommended Solution: Create derogation from the standard 'counter-party' criterion for assigning emissions responsibility. Instead, responsibility for emissions should be transferred from the franchisee to the franchisor.

Rationale: This approach will increase emissions coverage in CRC and will encourage large corporations that operate as franchisors to offer energy efficiency services to their franchisees. Importantly the reputational driver is placed with the franchisor which has high visual brand identity and the most incentive to protect the brand image.

Whilst the policy goal is simple and straight-forward, this will be a complicated policy to draft into law. However, there are precedents to work from. Whilst energy contracts do not normally sit with the franchisor, it will have a financial incentive to encourage energy efficiency through the CRC performance bonus and penalty. The franchisees will gain the benefit of reduced energy bills allowing the franchisors and franchisees to develop mutually beneficial approaches to CRC compliance.

2.8 Landlord-tenant situations

In the case of landlord-tenant situations, the ability to reduce emissions in a leased property is split between both parties: the landlord is able to change the fabric of properties, whilst the tenant is able to change their behaviour to consume less energy.

Issue 1: In a particular sub-set of circumstances, CRC landlords will be the counterparty to the energy supply contract requiring them to account for CRC tenants' emissions for the purposes of the CRC. In such circumstances, it may be desirable to allow responsibility for emissions to pass from the CRC landlord to the CRC tenant, to best leverage reputational and financial drivers. Tenants have an important role to play and should be encouraged to engage with energy efficiency. Investigation into the transfer of emissions responsibility was carried out where landlords are the counterparty to an energy supply contract to their tenant(s) and whether this should occur by i) mutual agreement or ii) unilateral consent.

Recommended Solution: Transfer of emissions responsibility from the CRC landlord to the CRC tenant should be allowed to take place by mutual agreement of both parties where (a) the landlord has installed suitable sub-metering which gives the landlord and the tenant visibility over energy consumption levels, and (b) the relevant tenant's organisation is also a CRC organisation. We suggest that this flexibility is offered before each phase in line with organisation registration, the reporting of source lists and to minimise administrative burden.

Rationale: In the case of mutual agreement between both parties, it is clear and simple to ascertain which party is taking responsibility. It is significantly less administratively burdensome, as both parties would be aware of the transfer of responsibility. Requiring mutual agreement avoids the need for an additional process in the case of unilateral consent, whereby the Scheme Administrator would need to conduct an auditing process to determine whether criteria were met before transfer was authorised and subsequently inform tenants that responsibility for emissions has been transferred.

There is a secondary issue with regard to the landlord-tenant scenario in that there will always be situations where the option to transfer emissions responsibility cannot be taken, since the criteria for reallocation are not met. For example, a landlord would retain emissions responsibility in CRC where it is the counterparty to the energy supply contracts for a building occupied by tenants that are not CRC participants. In this case landlords would seek to reallocate costs and benefits incurred by the scheme to tenants where possible.

Issue 2: Defra asked Ecofys / Burges Salmon to examine different ways that landlords could share the costs and benefits of the CRC scheme with tenants.

Recommended Solution: To establish a separate set of voluntary guidance for landlords on how to pass on costs and benefits to tenants in various situations, i.e. with or without sub-metering in place. Costs can be passed onto tenants through a) the service charge, b) a separate direct charge, c) using the revenue recycling payments to finance energy management. Landlords may be able to pass on costs and benefits to tenants by making provision for such costs in new leases.

Rationale: The financial and CSR drivers of CRC provide wide opportunities for landlords and tenants to share the costs and benefits of CRC. As the CRC participant the landlord will benefit from visibility in the performance league table. Tenants on the other hand could benefit from the landlord's energy efficiency investments through reduced energy costs in the service charge. Whilst there is no guarantee that costs can be passed from landlords onto tenants in the case of all existing leases the scope for both parties to see benefits from CRC should drive productive dialogue between landlords and tenants so that they can develop mutually beneficial approaches to CRC compliance.

Strand 2: Business Sector

Taken at its simplest level, any organisation in the public and private sector that uses in excess of 6,000MWh of electricity per year through half-hourly meters in Great Britain (and 70kW metering systems in Northern Ireland), would qualify in their own right for inclusion in the CRC scheme. However, in the Business Sector there are a number of specific issues which need to be considered when designing the CRC scheme; these are outlined in turn below.

3.2 Business Organisations

Issue 1: How to capture individual organisations, including those organisations (i.e. some partnerships, unincorporated associations, trusts, etc.) which, while not separate legal entities in their own right, would otherwise qualify for the scheme?

Recommended Solution: Capturing such individual organisations should not be an issue; if the recommended criterion for responsibility is applied, being the 'counterparty to the supply contract' then this will, in all cases, be a 'legal person' in law (i.e. someone who could be sued for breach or default under that contract). For organisations which are not separate legal entities, the counterparty to the supply contract will be the individuals running the organisation (i.e. partners, trustees, etc.), who individually are unlikely to meet the inclusion threshold.

Rationale: If the test for responsibility to be applied is the 'counterparty to the supply contract', this criterion is robust for all types of legal entity which would include, for instance, all companies, limited liability partnerships and industrial and provident societies. It would also apply to individual persons, unless an appropriate derogation expressly excluding individuals is included in the Regulations.

Issue 2: How to ensure that the wider business organisation, which an individual organisation forms part of, is included under the scheme. Capturing wider business organisations would enable emissions to be aggregated at the highest level where the CRC drivers are expected, in general, to act most strongly. It would also ensure that one legal person could be designated as the party responsible for compliance with the scheme.

Recommended Solution: Capture wider organisation by fashioning appropriate definition of group, targeting the highest parent undertaking, making use of concept of undertaking from Companies Act 2006. This will operate to create corporate groups.

Rationale: Simplicity is maintained as the administrative burden is placed at highest level of a Group and is consistent with current business practice. By aggregating emissions at the highest level, greater emissions coverage is achieved and the responsibility for these emissions is placed at the highest level of organisation where CRC drivers will have the greatest influence. However, various additions to the Companies Act definition of "undertaking" will be required to address the fact that certain types businesses and organisations will not necessarily fall within the definition of 'undertaking' (including individuals and trusts, industrial and provident societies, Limited Partnerships, Limited Liability Partnerships and universities, for example).

3.3 Joint Ventures (JV) / Joint Ownership (JO) / 3.4 Private Equity (PE) / Venture Capital (VC)

Defra's June 2007 CRC consultation, which included targeting group structures based on Companies Act definitions did not explicitly state how various types of jointly owned undertakings (JV, JO, PE and VC) would be treated.

Issue: How should jointly owned undertakings be affected by CRC? Is an alternative approach required to maximise emissions coverage from these undertakings?

As far as PE and VC joint ownership scenarios are concerned, crafting a specific derogation from the standard 'counter-party to the supply contract' approach was investigated. Such firms may have significant control over financial input into the company, and therefore financial drivers for energy efficiency investments. However, to create such derogation (special treatment to ensure coverage of CRC extends to such firms) would present significant legal and administrative complexities, as undertakings qualified as PE and VC companies do not differ constitutionally or structurally from other companies.

Recommended Solution: In the case of majority equity stakes, emissions of the parent and subsidiaries would be aggregated to the majority stakeholder, making use of concept of undertaking from Companies Act 2006. Where an organisation only holds a minority stake (50% or less) of another company, the company's emissions should not be

aggregated with that of its minority shareholder. In such cases the jointly owned company would qualify in its own right for the scheme, if it meets the inclusion threshold.

Rationale: Under this approach, it will be clear and simple to determine which organisation will be responsible for the purposes of the scheme. It is highly unlikely that a minority shareholder would make the final decisions on investment in energy efficiency measures in the companies it invests in. In the case of the majority shareholders, they exercise control over the company and have a direct responsibility for its activities, therefore the effectiveness of the financial and reputational drivers is maximised.

There would be a loss of coverage in cases where individual companies with no majority shareholder do not meet the inclusion threshold in their own right. However, this is outweighed by the goal of administrative simplicity. In those cases where the jointly owned company does pass the CRC inclusion threshold, it will of course be targeted in its own right, and in this context the financial and reputational drivers will be leveraged appropriately.

3.5 Overseas Ownership

The suggestion set out in the Defra consultation document was that the participation and reporting obligation should be placed on the highest parent entity incorporated in the UK. The risk in adopting such an approach is that this approach would not address those groups with overseas structures which have UK subsidiaries (which could be trading or dormant), but perhaps no single 'highest' UK undertaking.

Issue: How should the CRC capture undertakings in the UK which do not individually qualify for the scheme but which are owned by the same overseas parent and which, if taken together as a group, would meet the inclusion threshold?

Recommended Solution: If the general inclusion threshold is passed (i.e. greater than 6,000 MWhr/year of half hourly metered electricity use through half-hourly meters in Great Britain and 70kW meters in Northern Ireland), as regards UK energy use emissions, overseas parent undertakings (whether as a 'counterparty to the supply contract' or an ultimate parent undertaking of a group) should participate in the CRC in respect of their UK energy use emissions (making use of the concept of parent undertaking from Companies Act 2006). This should be coupled with a requirement for such undertakings to nominate a UK-based proxy to meet compliance obligations on its behalf. This could be a UK subsidiary, if one exists.

Rationale: A foreign company carrying out activities in the UK would still fall under the jurisdiction of UK law, and therefore there is no reason why an overseas parent should not take responsibility for all its UK activities. There would be no loss of emissions coverage from small multiple undertakings which are owned by the same overseas parent, or emissions loss from the parent undertaking itself. This would be relatively simple to administer because the relevant undertaking will be named on the supply contract. There would be fair treatment between UK and non-UK business organisations and therefore equitable location of the financial driver as well as good location of reputation driver.

We recommend that a requirement for overseas incorporated undertakings to nominate a UK-based proxy forms part of the Regulations. Without such a requirement, there may be potential enforcement issues if action is taken against the overseas undertaking for failure to comply with the requirements of the regulations. This would be a particular issue where the overseas undertaking does not have a UK based subsidiary which could be made jointly and severally liable; the UK administrator of the scheme would need to pursue the overseas undertaking in a foreign court, incurring extra costs and administrative complexity. However, this risk is avoided if the regulations include a requirement for overseas incorporated undertakings to nominate a UK-based proxy.

3.6 Business Changes

Large organisations are often structured (and restructured) into groups, the constituent parts of which are separate legal entities (subsidiaries). If the sole policy goal was to minimise the administrative burden on participants, no changes to baselines would be made during a phase as a result of the sale/purchase of CRC subsidiaries/organisations. However, there are wider goals – to sustain coverage (if a large subsidiary is sold), to leverage CSR drivers of large subsidiaries (to secure energy efficiency improvements), and to have some fairness in the scheme league table (i.e. accounting for sale / purchase of large subsidiaries). Accordingly, Defra recognises that CRC should be sufficiently flexible to account for the purchase and sale of major subsidiaries, which could take place at any stage during a scheme phase.

Issue: How to identify the most appropriate model to capture business changes for the purposes of the scheme?

Proposed Solution: At the start of each phase of the scheme, during the qualification process, organisations would be required to declare which of their subsidiaries would qualify for the scheme in their own right. Changes to baselines should be made when entire CRC participants or “large” subsidiaries (i.e. those that would qualify for the scheme in their own right) of CRC organisations are bought or sold (including purchase by or sale to another CRC organisation). Therefore, each year, as well as reporting its total emissions, the CRC organisation would have to report to the administrator its energy use emissions from its large subsidiaries.

Rationale: The approach is more equitable to all CRC undertakings, with regards to performance within the league table and revenue recycling calculations, as baselines would be updated to reflect purchase or sale of large subsidiaries. This approach leverages CSR drivers of large subsidiaries (by requiring reporting by CRC organisations of their large subsidiaries), it sustains scheme coverage (rather than have large subsidiaries drop out of the scheme if sold to a non-CRC participant) and is administratively acceptable (since CRC organisations will in any case have to collect energy use emissions data for their subsidiaries to honour their overall CRC compliance obligations). Whilst this approach may not be as simple as keeping baselines the same throughout a phase, we consider that the advantages of updating baselines as described above outweigh this disadvantage.

Strand 3: Public Sector

As a general rule, the CRC scheme will apply to the ‘highest parent undertaking’ as defined in law. In the public sector however, many entities are established in law with defined and devolved authority that limits the direct influence of any nominal parent body. It is therefore appropriate to consider whether, in the public sector, the level of organisation in the public sector that will act as the CRC organisation should in certain cases be something other than the equivalent of the “highest parent undertaking”. The ‘parent and subsidiary’ approach taken in the private sector to define overarching groups under the CRC will, in practice, have more limited practical application to the public sector since, by and large, public sector organisations do not hold equity stakes in other public sector organisations.

4.2 Government Departments and Non-Departmental Public Bodies (NDPBs)

If Government adopts the recommended eligibility criterion, it is expected that NDPBs will only participate in the CRC together with their Government Departments, under the aegis of their Secretary of State, where those NDPBs do not have separate legal personality (i.e. where they are not independent of the Secretary of State). Where NDPBs (e.g. Executive NDPBs) do exist as individual legal entities they will take part in CRC if they themselves exceed the inclusion threshold.

Issue: Whether or not to group other public bodies within the remit of a Government Department to increase the emissions coverage of the scheme.

Recommended Solution: The recommended solution is to use the definition of responsibility for emissions as the “counterparty to the electricity supply contract.” Under this definition, the Secretary of State would be the counterparty to the electricity supply contract for each government department and for some of the department’s sponsored bodies. This approach would therefore define the relevant departmental grouping (called a “family” for the purposes of this report) as including all of the bodies for whom the Secretary of State acts as counterparty to the electricity supply contract. As a result, the departmental family, headed by the Secretary of State, will include some NDPBs, but not those that have separate legal personality and are therefore counterparty to the electricity supply contract in their own right. One possibility that may be worth exploring in the context of public sector leadership on climate change is the mandatory inclusion of all central UK Government departments within CRC (i.e. irrespective of whether they pass the 6,000 MWh/year inclusion threshold). As stated in the Energy White Paper, all UK central Government departments are publicly committed to ambitious carbon reduction goals – and in this context CRC could potentially be a valuable instrument to drive delivery.

Rationale: Using this definition, the governmental public bodies that fall outside of a departmental family are those that are most likely to have their own identity and their own financial and CSR drivers. This is a simple, straightforward approach that should include the majority of public sector emissions, and only exclude those from smaller organisations, maintaining the present CRC emphasis on the largest organisations for whom energy efficiency benefits should significantly outweigh administrative costs. This approach should put the right emphasis on the financial and CSR drivers in central government and public bodies.

It is possible that this approach may result in some loss of emissions coverage in the event of institutional change whereby government departments merge, split or amalgamate and their respective associated bodies change allegiances. However, this approach is aligned with the goal of simplicity. If Government wished to ensure no loss of emissions coverage from Government Departments and wished to fairly take account of all such 'machinery of Government' changes to Departments, then a site based 'changes of operation' process would be required, which would be substantially more burdensome and administratively complex.

4.4 Local Authorities

If the recommended eligibility criterion is adopted, individual Local Authorities, as separate legal undertakings defined in the Local Government Act, will be the CRC organisation taking responsibility for their own buildings and services, where they reach the inclusion threshold (unless emissions responsibility falls to another party due to contractual arrangements in the case of third party purchase, outsourcing arrangements, PPP/PFI contracts). However, the option of grouping local authorities together at the regional level has been explored for the purposes of the CRC to establish whether this type of grouping would be practical and beneficial.

Issue: Should any local authorities be grouped together at the regional level for participation in the CRC? In particular, does the GLA constitute a sufficiently special case for this grouping to be justified?

Recommended Solution: Local authorities will participate individually in the CRC with no grouping.

Rationale: The default solution remains the most appropriate as it makes the best use of the financial and reputational drivers, placing responsibility for emissions at the level at which energy efficiency decisions are made. There may be some emissions loss where smaller local authorities do not meet the inclusion threshold. This loss however is likely to be outweighed by the benefits of placing responsibility at the appropriate level.

With regard to the GLA and its member organisations, there are a number of interesting options for grouping that Defra might want to consider further. Out of the three options identified we would suggest either solution 1 or 2 is the most suitable. Under Solution 1 each member organisation would participate individually in the scheme where they meet the inclusion threshold – i.e. in line with the default approach. In this case, only the Metropolitan Police Authority and Transport for London are likely to qualify in their own right for the scheme. This approach would make the best use of financial drivers within the GLA family. Alternatively, under solution 2 GLA, LDA and TfL would be grouped on basis that the Mayor has legal powers to direct these three organisations regarding emissions reductions, as set out in the Greater London Authority Act 1999. This approach makes broader use of the CSR drivers, as responsibility for emissions reflects the Mayor's powers over these organisations; and this approach would achieve greater emissions coverage as four of the five organisations would fall in some way under the scheme: GLA, LDA, TfL and MPA. Note that the MPA would qualify in its own right and only the emissions of LFEPA would not fall under the CRC scheme. However it is not yet clear how costs and benefits of the scheme would be attributed to each organisation.

4.5 Schools

Defra's proposal for the treatment of schools in the consultation document was a voluntary one, with Local Authorities (LAs) taking responsibility for school emissions in those specific cases where the LA paid the energy bill for that school. The following reasons support a mandatory approach to include state schools:

- In the main LAs do not pay the energy bill for schools and as such the voluntary approach is likely to lead to a variable and patchy coverage of schools across the UK.
- CRC, as an instrument, is well suited to targeting schools as part of the LA estate since LAs exercise a significant degree of influence over the schools for which they are responsible and it would also encourage LAs to provide energy management support to schools. The scheme is designed to tackle energy use emissions of organisations with many small emissions sources by placing obligations essentially on the 'corporate centre' (which is in a position to direct or influence the conduct of those subsidiary bodies for which it is responsible) rather than on individual emitters. The principle is that the 'corporate centre' is much better placed in terms of expertise and resources to respond to the administrative requirements of a cap and trade scheme, compared with the individual emitters (who can nonetheless still benefit from the incentives provided by being covered by such a scheme). LAs as 'corporate centres' and schools as individual emitters closely follow this model.
- There are significant opportunities for cost-effective energy efficiency savings in schools.

Issue: Regardless of whether a voluntary or mandatory approach to including schools is adopted it is relevant to consider how and whether to pass on the costs and benefits of CRC from local authorities to the schools

Recommended Solution: To develop, in consultation with stakeholders, good practice guidelines for how schools and LAs could potentially agree to share CRC costs and benefits as part of working together on energy efficiency. By mutual agreement between LAs and schools, CRC costs and benefits could be usefully passed on in a number of ways from LAs to schools (e.g. placing CRC recycling payments in a separate fund for investment in energy efficiency in schools; or, potentially, awarding funds to the schools which performed well on energy efficiency or to those which have the greatest emission reduction potential. In relation to CRC auction costs, these could be passed on simply in proportion to school energy use emissions [or energy bills], in line with the polluter pays principle).

Rationale: Passing on CRC costs and benefits – potentially in the form of energy efficiency investments – will provide more resources to schools to reduce emissions, strengthening the relationship between LAs and schools. The CRC will then act both as a driver to energy efficiency gains and as an educational tool.

4.6 NHS Bodies

As with local authorities, the default position is that NHS bodies would participate individually in the CRC with no grouping. However, the option of grouping NHS bodies together at a higher level has been explored to establish whether this type of grouping would be practical.

Issue: Is there a potential structure in place that can be used to group NHS bodies to NHS bodies in order to leverage financial and reputational drivers?

Recommended Solution: NHS bodies (Strategic Health Authorities, Primary Care Trusts, National Health Service Trusts, Special Health Authorities, NHS Foundation Trusts) to participate in the CRC individually, if the organisation exceeds the inclusion threshold.

Rationale: This approach maintains the principles of simplicity and clarity for scheme participants, in line with the standard approach to definition of organisation. By not grouping bodies where no appropriate basis for grouping exists, this approach minimises the administrative burden of reporting emissions. It sets financial and reputational drivers at the correct level as the CRC responsibility would be placed on those organisations best placed to take up energy efficiency measures. Any potential loss of emissions coverage is outweighed by the benefits of clarity and better targeting of the drivers.

4.7 Police and Fire Authorities

It is also expected that Police and Fire Authorities would participate individually in the CRC with no grouping. However, the option of grouping such bodies together at a higher level has been explored to establish whether this would be practical.

Issue: Is there a potential structure in place that can be used to group Police and Fire Authorities that would more effectively leverage financial and reputational drivers?

Recommended Solution: The default position remains the most practical, where Police and Fire Authorities would participate in their own right if they meet the inclusion threshold. In the case of Fire Authorities which are part of the county council, they would fall under the local authority portfolio as the local authority itself is designated as the fire and rescue authority in law.

Rationale: This solution is legally robust, making use of existing legal structures and maintaining simplicity of the scheme. The financial and reputational drivers will be leveraged effectively. In the case of Fire Authorities which form part of the county council, if the local authority exceeds the inclusion threshold, then those fire authorities will come into the CRC scheme.

4.8 Further and Higher Education

The default approach, where all Further Education / Higher Education (FE/HE) institutions would be treated individually for the purposes of the scheme would result in a situation where in the cases of some collegiate universities, neither the university nor the colleges would meet the inclusion threshold.

Issue: Would it be beneficial to group the colleges with the university in order to maximise the use of existing drivers?

Recommended Solution: As a general rule further and higher education bodies should participate in the CRC as separate organisations. However in the case of collegiate universities we recommend that provision should be made in the regulations for the

collegiate parts of named universities (for example, Oxford, Cambridge and Durham) so that these colleges participate as a group, as part of their respective university.

Rationale: By making provision in the legislation in certain cases, this would achieve a greater leverage of reputational drivers, as the emissions and performance of each individual college would be aggregated and attributed to the University's name in the performance league table. This approach would also result in a greater amount of emissions coverage, since, in specific cases, colleges would not have reached the inclusion threshold without being grouped with the university.

4.9 Devolved Administrations

It is the intention that the CRC policy would be applied within the Devolved Administrations (DAs) in the same manner as within England, in as much as it is legally practical. In line with this principle, the DA governments should be included in the CRC in the same ways as English governmental public bodies.

The conclusions reached in this report are generally applicable only to the situation in England. There is a need to continue co-operation with the DA departments that deal directly with fire authorities, schools, higher education and health to ensure that the proposed solutions for England can be effectively transferred to – or adapted for – the DA situation (recognising the context that the great majority of CRC consultation respondents emphasised the value of a UK wide approach). Key areas for investigation, which are outside the scope of this report, include but are not limited to, the following:

- Options for police and fire authorities in the DAs.
- Treatment of NDPBs that are related to bodies in England.
- The structure of health authorities in the DAs.
- The structure of higher education establishments in the DAs.
- Any central legal issues relating to the private sector that could result in differential treatment of businesses incorporated and operating in the DAs.
- Issues of administrative ease and coherence between the UK and DAs in interpreting policy and mobilising more complex policy decisions, for example landlord/tenant emissions transfer.
- Further areas as identified by the DAs themselves.

1.1 Background

The Carbon Reduction Commitment (CRC) is a proposed mandatory cap and trade scheme that will apply primarily to large non-energy intensive organisations in the public and private sectors with electricity use of 6,000MWh/year through half hourly meters in Great Britain and 70kW metering systems in Northern Ireland. The scheme aims to cut carbon emissions by 1.1 million tonnes carbon per year by 2020. The key principle of CRC is to capture organisations as a whole, so that the scheme imposes responsibility for the direct and indirect emissions which arise through their energy use throughout the organisation.

An important element of the CRC is that the benefits accrued from energy efficiency measures should outweigh the costs of participating in the scheme, which should have a low administrative burden. The inclusion threshold has been set to capture those organisations which are large enough to be able to see the benefits. Defra's Regulatory Impact Assessment suggests that the CRC would result in an overall Net Present Value benefit to participants of £755 million (based on a 10% commercial discount rate), with the upfront and ongoing costs being more than offset by lower energy bills over time. The scheme will not target emissions covered by Climate Change Agreements (CCAs), nor direct emissions covered by the EU ETS; organisations with over 25% of their energy use emissions in CCAs will be completely exempt.

Ecofys and Burges Salmon have been commissioned by Defra to provide clear and robust evidence to support the Government in the design of the CRC relating to organisational structures. The CRC aims to use the financial and reputational drivers at the correct level to stimulate senior management awareness in organisations. The scheme focuses on financial incentives and Corporate Social Responsibility (CSR) drivers, as such organisations do not respond to energy price signals alone, since energy costs are typically, less than 3% of total operating costs. Financial drivers of the scheme include the auctioning of allowances and the recycling of auction revenue, linked to performance. Financial benefits include the recycling of revenues raised by sale of allowances, as well as the benefits realised through energy efficiency improvements. The reputational driver of the scheme is provided through a performance league table published by Government. The league table will rank participants based on their respective performance within the scheme, measured by defined metrics.

Ecofys undertook the policy analysis, interviews and developed case studies. Burges Salmon carried out an analysis of the legal robustness and implications of the various options proposed. The team conducted a series of interviews with key organisations in the public and private sectors to understand how the formulation of the CRC scheme will interact with organisational structures. The aim of this was to ensure that the scheme will:

- Capitalise on financial and corporate social responsibility (CSR) drivers: in defining the most appropriate organisational structures to capture emissions, it is important that the scheme can stimulate awareness and action in energy efficiency at senior management level.

- Ensure a good coverage of emissions from the large non-energy intensive sector in the UK. A wide coverage will help ensure that the policy delivers significant carbon and energy savings.
- Maintain simplicity, to provide clarity for participants in the scheme, as well as minimising administrative burdens as far as possible.

Information regarding organisational structures taken from interviews was applied to test the viability of legal definitions and the practicality of policy options being considered for the CRC scheme.

Defra set out the challenges which need to be addressed in formulating CRC policy; these are classified in three key strands:

Strand 1: Responsibility for emissions under the CRC

- Defining legal responsibility for the purposes of the scheme: It is important to be able to identify clearly who will be responsible legally for emissions under the CRC. The definition of this legal responsibility will have different consequences in different types of organisational structures. Three alternative definitions have been devised and tested to understand which organisations would be covered by the CRC under a number of different circumstances outlined in this Strand.
- Outsourcing of energy purchase, facilities management, Third-party purchase of energy and PFI/PPP: These arrangements can cover different models of responsibility for energy purchases and energy use. In these cases, the eligibility criteria for establishing responsibility for energy use emissions have been tested to determine whether the CRC will be effective in leveraging energy efficiency improvements.
- Franchises. Consideration of how franchises should be treated by CRC, given that franchises operate under the same corporate brand and therefore have an equal contribution to that brand's CSR reputation
- Landlord-tenant relationship: in certain circumstances the organisation that has the contract with the energy supplier is not necessarily the organisation consuming the electricity. This may often be the case in landlord-tenant relationships: where the landlord pays the bill on behalf of the communal parts and its tenants. Therefore it is important to define where responsibility under CRC lies, in the case of the landlord-tenant relationships.

Strand 2: the Business Sector

- Business changes: large businesses are often structured (and restructured) into groups, the constituent parts of which are separate legal entities (subsidiaries). The CRC needs to be flexible enough to accommodate major business changes during a scheme phase, whilst avoiding a site-based 'changes of operation' approach.
- Private Equity, Venture Capital, Joint ventures and Joint ownership: For the purposes of the CRC scheme, investigation has been carried out into how such

ownership structures would be affected by the scheme and whether it is desirable to identify other options to maximise coverage from these undertakings.

- Overseas ownership: In the case of overseas ownership of organisations, options have been suggested regarding how to aggregate a business' emissions where the ultimate parent of the business is based overseas, or where multiple small organisations are owned by one overseas parent.

Strand 3: the Public Sector

- The CRC aims to capture at least the following public bodies: Government Departments, Non-Departmental Government Bodies (NDPBs), Local Authorities, NHS Bodies, Police and fire authorities, institutions in the Further and Higher Education (FE/HE) sector. Consideration needs to be given on how best to include such organisations, at what level of aggregation should be used, and where responsibility for reporting emissions under the CRC scheme should be placed.
- Further consideration also needs to be given to inclusion of schools within the local authority portfolio.

1.2 Aim

This report aims to identify preferred policy options to maximise the use of financial and reputational drivers within organisations, whilst aiming for extensive emissions coverage of the CRC where possible. The CRC scheme should also aim to be as simple as possible for participation purposes. Policy options need to be legally robust, whilst avoiding the inadvertent creation of loopholes and including appropriate and sensible flexibilities, where necessary.

Analysis of the proposed solutions demonstrates the extent to which they deliver:

1. simplicity and clarity for participants;
2. legally robust and sound solutions, and,
3. action to stimulate senior management commitment and increased uptake of energy-efficiency measures.

1.3 Methodology

Task 1: Mapping and prioritisation of organisations

To help focus the work in this project, organisations were mapped by the characteristics relevant for the CRC, including type and complexity of energy usage. The mapping helped to identify which issues applied to different types of organisations and guide the choice and type of questions posed to each organisation. By continuously updating this mapping exercise throughout the interview process, any gaps regarding such issues that needed further research and discussion were identified.

Desk based research

In parallel to the mapping process, the project team undertook desk-based studies for key areas such as schools, Government Departments and NDPBs, as well as brainstorming

across different Strands. This helped inform the development of specific targeted questions for the interviews.

Development of key questions for each strand

Specific questions were defined to examine the issues identified under each strand. Questions cover the practical issues such as achieving greater emissions coverage, points where twin CRC drivers of finance and reputation can act most effectively, as well as legal implications for key sectors.

A complete set of questions is attached as an annex to this report.

Interview process

Interviewers were fully briefed and familiar with the CRC policy proposals, Defra's emerging thinking on policy preferences and additional policy solutions suggested by the project team. Therefore the questions drafted did not represent a strict questionnaire or script for the interviewers; this flexible approach allowed interviewers to ask a variety of questions to the organisations to obtain the relevant information to inform interview analysis.

Interviews were conducted by telephone in most cases; in addition, some meetings were held with specific organisations to discuss key issues (such as franchises, schools, NHS). The information in the case studies is based on publicly available information and information obtained through the interview process and is, to the best of the consultants' knowledge and belief, correct at the time of writing. The information obtained for case studies is for illustrative purposes only and may not represent all possible organisational structures.

In the interview analysis, the proposed policy approach(es) and potential legal definitions were tested against known organisational structures to:

1. Identify the significance of issues and challenges analysed and identified;
2. Identify any other problems not yet considered;
3. Propose solutions which will help mitigate any problems or risks.

1.4 Scope of this report

This report focuses on organisational structures and the necessary legal and policy approaches required to include CRC organisations at the highest level. The focus is on the impact in England, but issues associated with devolution were identified for further investigation and feature at the end of this report.

This report has been prepared jointly by Ecofys UK Limited and Burges Salmon LLP acting on the instructions of Defra. The legal aspects of this report are general in nature and are not intended to constitute complete coverage of the law in this area. Further professional advice should always be taken on the precise implementation of the options considered.

Burges Salmon LLP will not be responsible to anyone other than Ecofys UK Limited and Defra for providing the protections afforded to clients of Burges Salmon LLP nor for any of the content of, nor the giving of any legal advice in relation to, this report.

2.1 Introduction

Organisations are required to participate in the CRC if they use more than 6,000MWh/year of electricity collectively from one or more half-hourly meter (or 70kWh metering system in Northern Ireland). For the purposes of the CRC, organisations will be required to aggregate their total electricity use from these meters to see if they exceed the inclusion threshold. Those organisations that qualify for the scheme are then required to monitor and report on their energy-use emissions from all types of electricity meter and all fossil fuels, subject to Defra's *de minimis* proposal which allows organisations to opt-out insignificant emissions sources.

The question that arises from this proposal is 'who is responsible for the emissions related to any given electricity meter, or energy supply?' In most circumstances it is clear and obvious which organisation is responsible for any particular source of energy-use emissions. However in some instances more than one party has an interest in the use or procurement of the same energy, for example in a landlord and tenant scenario or a private finance initiative (PFI) and so it is necessary to determine which party takes responsibility for the purposes of CRC.

In this section, Ecofys/Burges Salmon have assessed three methods of assigning responsibility for emissions, and have considered the effect of these methods in a range of scenarios where multiple organisations have an interest in the same energy including landlord/tenant situations, outsourcing arrangements, 3rd party energy purchasing scenarios and Private Finance Initiatives / Public Private Partnerships (PFI/PPP).

2.2 Assigning responsibility for emissions to an organisation

Based on findings from Hedra¹ and from discussions with stakeholders, Defra proposed a rule of thumb in the consultation document to assign responsibility for emissions from any given source to whoever *pays* the energy bill. In the example of a landlord - tenant scenario emissions responsibility would lie with the landlord where the landlord pays the bill and the tenant where the tenant pays the bill.

The project team have given further consideration to this rule, in particular to test whether it would be more legally robust to assign responsibility to the *undertaking to which the electricity is supplied* or to the *counterparty to the electricity supply contract* rather than to *the entity which pays the bill*.

The following options for allocating emissions responsibility were therefore tested:

1. "Undertaking which pays the bill" (initial Defra proposal)

¹ <http://www.defra.gov.uk/environment/climatechange/uk/business/crc/pdf/hedra-report.pdf>

2. "Undertaking to which electricity is supplied" (we have taken "supply" in this context to have the meaning given to it in the Electricity Act 1989)
3. "Undertaking which is the counterparty to the electricity supply contract"

The Electricity Act 1989 provides a useful definition of what actually constitutes the supply of electricity which the Defra draughtsman may like to make use of when drafting the CRC Regulations. Section 4(4) of the EA 1989 stipulates that:

"supply", in relation to electricity, means its supply to premises in cases where—

(a) it is conveyed to the premises wholly or partly by means of a distribution system, or

(b) (without being so conveyed) it is supplied to the premises from a substation to which it has been conveyed by means of a transmission system,

but does not include its supply to premises occupied by a licence holder for the purpose of carrying on activities which he is authorised by his licence to carry on;

The merits of using a definition with which the electricity industry will already be familiar are clear, in that it should facilitate the identification by suppliers of the recipient of the electricity supply. This will be crucial, since the first step in the participant identification process will be for suppliers to send information packs and emissions figures for the qualification year to entities using half-hourly meters in Great Britain (and 70kW metering systems in Northern Ireland).

The first point to note is that the CRC has to place responsibility for emissions at the level of legal persons.

A legal person is shorthand for a body which can enter into legal relations (for example, a contract) with another such body. A body which can enter into such relations is said to have "legal personality", and a company is therefore a legal person just as much as an individual is. Confusingly the term "legal person" is sometimes used to denote purely "artificial" bodies such as companies (which, as mere legal constructs, owe their personality to the operation of the law) as opposed to "natural persons" (i.e. individuals). In this report however, we use the term to encompass both corporate entities and natural persons.

The use of the term undertakings, organisations or groups are only useful in as much as they define a body whose emissions will be pooled within CRC. However, responsibility for emissions arising from energy use ultimately has to lie with individual legal persons. CRC participants may therefore be made up of groups of legal persons.

In certain circumstances, such as third party purchase, facilities management and PPP/PFI scenarios, the use of any of these definitions could lead to an undertaking becoming responsible for emissions in the CRC when it is not actually the undertaking to whom the electricity energy is supplied. This is explored in further sections in this Strand.

Issue: The legal definition used to determine which organisation takes responsibility for a given source of emissions is fundamental to determining which organisations would be captured by the CRC. There is scope for confusion and dispute without a clear, legally robust method of assigning responsibility for a given emissions source to an organisation, particularly in those instances where more than one organisation could be seen to have responsibility for the same energy use. Further, many of the solutions relating to Business and Public Sector organisation structure flow directly from the resolution of this issue.

Recommended Solution: Responsibility for energy-use emissions should lie with the organisation that is the 'counterparty to the contract for the supply of that energy.'

Rationale: This definition would capture the organisation which would be contractually liable for the debt for the energy, should any bill remain unpaid. It is therefore simple to identify the organisation and legally robust. In most cases this definition will also assign responsibility for emissions with the organisations that are in a position to modify their energy usage and deliver emissions savings.

In certain scenarios, such as outsourcing, facilities management, third party purchase, and Private Finance Initiatives (PFI) / Public Private Partnerships (PPP), the organisation responsible for reporting emissions under the CRC will vary according to the specific contractual arrangements in place. Each of these scenarios (such as outsourcing, third party purchase, PFI/PPP) has been investigated, using the recommended definition for allocating emissions responsibility – and we consider the recommended solution to be robust to such scenarios.

Figure 1

2.2.1 Definition 1 'Undertaking which pays the bill'

Advantages

- a) Simplicity, clarity and lowering administrative burden
It will usually be clear which organisation sees itself as having responsibility for paying the bill and which organisation does in fact pay it.

Disadvantages

1. Simplicity, clarity and lowering administrative burden
The "undertaking paying the bill" is not a concept for which a robust legal definition can be crafted easily since for the sake of legal certainty such definitions need to be written in terms of obligations to pay and entitlements to receive. The realities of what happens commercially in practice do not provide a robust definition.
2. Maximising the use of financial and reputational drivers
It would be unusual for an undertaking to pay for electricity which is not supplied to it or which it is not contractually liable to pay for, but not unknown.

2.2.2 Definition 2 'Undertaking to which electricity is supplied'

Advantages

a) Simplicity, clarity and lowering administrative burden

Provided an appropriately robust definition of "supply" is used (e.g. from s.4(4) Electricity Act 1989), this is a relatively clear means of allocating responsibility for emissions, since all electricity for commercial use will be "supplied" to an organisation.

b) Maximising the use of financial and reputational drivers

This approach would circumvent the issues regarding third-party purchase of electricity identified above and would allocate emissions correctly to the ultimate consumer of the electricity rather than an intermediary.

Disadvantages

a) Simplicity, clarity and lowering of administrative burden

This approach is unlikely to provide the same degree of simplicity or clarity as Definitions 1 or 3. In many cases it may be difficult to assess who electricity is 'supplied' to without referring to a contractual relationship (i.e. definition 3).

This is likely to entail a higher administrative burden on Defra and the potential CRC participant, due to the need to investigate and make assessments of the day to day usage of electricity by business rather than simply referring to the supply contract.

b) Maximising the use of financial and reputational drivers

If the definition of "supply" from Electricity Act 1989 is used, this becomes a site-based (rather than an organisation-based) approach, since supply for the purposes of the Electricity Act 1989 is to a premises rather than to an organisation.

In some cases, the undertaking simply receiving a supply of electricity might have:

- i. limited flexibility to reduce consumption, for example, if it was obliged to perform its contractual obligations in a certain way and the other party to the contract did not have any incentive to alter the performance requirements (as can be the case in PFI / PPP situations); and/or
- ii. limited incentive to do so if not liable to pay according to volume of consumption.

2.2.3 Definition 3 "Undertaking which is counterparty to the supply contract"

Advantages

a) Simplicity, clarity and lowering administrative burden

This definition appears to provide a high degree of simplicity and clarity.

There is a low administrative burden in identifying eligible undertaking since the counterparty will be written on the contract itself.

It is not necessarily dependent on identifying a legally robust appropriate definition of "supply".

b) Maximising the use of financial and reputational drivers

This definition would circumvent issues, where a third party purchases energy on behalf of an entity (see third-party purchase) and would allocate emissions correctly to the ultimate consumer of the electricity, rather than the intermediary.

This definition will capture the organisation which would be contractually liable for the debt for the energy, should it remain unpaid. This organisation is most likely to be able to respond to energy efficiency drivers.

Disadvantages

There are no additional disadvantages identified for this option.

However, it should be noted, that all three of the above definitions could result in an organisation being included in or excluded from the CRC, where this may not be optimal for the aims of the policy. The circumstances in which this is the case are addressed further in sections (see franchises) below. In this section, a sufficiently robust definition has been identified to ensure that, in the large majority of cases, coverage is maximised and reputational and energy efficiency drivers located appropriately.

2.2.4 Conclusion

Given the advantages of definition 3, "undertaking which is counterparty to the supply contract", we recommend that option 3 be used for CRC and have tested it throughout our analysis of business and public sector organisation structures. Where the conclusions to be drawn in respect of an issue addressed in this report would be materially different with one of the alternative definitions, the implications of this difference are highlighted.

2.3 Outsourcing, facilities management, third party purchase and PFI/PPP

Outsourcing, facilities management, third party purchase arrangements and Private Finance Initiatives (PFI) / Public Private Partnerships are four scenarios where Defra asked Burges Salmon / Ecofys to investigate the implications of different approaches to assigning responsibility for emissions, given that it may be unclear as to which party has control over the emissions, or which party will be guided most effectively by the financial and CSR drivers.

It is important that a clear policy is adopted within CRC in terms of allocating responsibility for emissions. In section 2.2, we recommend that emissions responsibility should be assigned to the counterparty to the energy supply contract and, in this section, have tested whether it delivers suitable outcomes in each of these cases.

2.4 Outsourcing and Facilities Management

"Outsourcing" is a broad term for an arrangement whereby a third party provides services to an organisation that the organisation previously carried out for itself. For example a bank could take out a contract with a call centre operator to provide customer support that the bank previously carried out itself. The concept of outsourcing is wide enough to encompass not only what is understood in common parlance as "outsourcing" - the provision of off-site services such as that of the bank's call centre already mentioned - but also services such as facilities management where a third party provides services within an organisation's buildings. While there is a conceptual difference between on-site service provision such as facilities management and off-site outsourcing of services these are effectively identical arrangements in terms of elements relevant to the CRC, and so are treated side by side in this section. PFI/PPP and third party energy purchasing are also forms of outsourcing, however these have individual distinct features that merit separate treatment for the purposes of this report.

In the cases of outsourcing, third party purchase, and PPP/PFI, we have tested whether to allocate emissions responsibility using the solution recommended in section 2.2 – allocating responsibility to the "Undertaking which is counterparty to the electricity supply contract" - or whether assigning responsibility in all cases to either the "outsourcer" or "outsourcee" might deliver a better outcome for CRC.

Issue: How should emissions responsibility be allocated in situations where a public sector or a private sector organisation outsources service delivery to contractors?

Recommended Solution: Allocate emissions responsibility to the outsourcer or the outsourcee the basis of which undertaking is the "counterparty to the energy supply contract".

Rationale: The counterparty to the supply contract is the organisation most likely to have a financial interest in the energy use and so the financial drivers of CRC are likely to work most effectively on that organisation. With regards to outsourcing, in many (but not all) cases, the outsourcee will be the counterparty to the electricity supply contract and so will be the organisation best placed to respond to CRC. However, using the above criteria means that it is simple to determine the organisation responsible for the scheme which could be either party depending on the particular contractual arrangements in each case.

There is potential for loss of emissions coverage with this approach, if the counterparty to the contract is not a CRC organisation. But this is outweighed by the simplicity and clarity of the recommended method for assigning emissions responsibility.

Figure 2

2.4.1 Recommended Solution

The recommended solution is to attribute emissions arising from energy-use to the undertaking which is named as the counterparty to the electricity or energy supply contract.

Advantages

a) **Simplicity, clarity and administrative burden**

The recommended solution is simple and straightforward to apply. The criterion is clear, can be applied across the board and it is straightforward to identify the counterparty on the electricity supply contract.

b) **Maximising the use of financial and reputational drivers**

In most cases, this solution will leverage appropriate financial drivers since the counterparty to the electricity supply contract will usually be best placed to reduce emissions. The outsourcee, or facilities manager usually has direct control over energy use, or changes in practices or investments that can influence energy use in the facilities that they manage.

This approach also results in the effective use of reputational drivers. Where an outsourcee has complete control of facilities, these are often operated in the name of the outsourcee e.g. leisure service companies. These companies therefore have both a public and professional reputation to protect through effective participation in the CRC. In the case of facilities managers that work behind the scenes, where they are counterparty to the supply contract, they are likely to provide a suite of energy management services, and therefore will have a valuable professional reputation to

protect. Others will only use their services if they have a solid reputation in energy management, which will include managing CRC obligations.

In the case where the outsourcer remains contractual counterparty, the reputational driver may still be retained. This would be the case in many public services where the government department for example, would have a public reputation that could be leveraged through the CRC. In such cases, the facilities management firm would still have a professional reputation, which would then not be linked to CRC drivers. However, where there is a split between the professional and public reputational drivers, it is not possible for the CRC to capture both. For the league tables, the public reputation is considered to be more important.

In conclusion, the recommended approach is simple, straightforward, and sets the financial and reputational drivers at the most optimal level possible.

Disadvantages

a) Maximising emissions coverage

There is a possible risk that the outsourcer may seek actively to avoid participation by requiring that the outsourcee is named on the electricity supply contract, so that emissions do not count towards outsourcer's total. This deliberate avoidance of inclusion in the CRC may only be possible where the outsourcee, or outsourcees, is/are substantially below the inclusion threshold and does not risk inclusion themselves. Furthermore, the risk of this transfer is balanced by the outsourcee's ability to refuse to take on contractual obligations that would take them into the CRC.

Furthermore, the CRC is designed to capture organisations for which energy costs are less than 3% of their total operating costs. Therefore it is unlikely that organisations will undertake gaming strategies to avoid obligations affecting such a small part of their total costs, particularly since participants may receive financial benefits from the scheme, through performance bonuses and reduced energy bills as a consequence of increased energy efficiency.

b) Maximising the use of financial and reputational drivers

In theory the counterparty to the electricity supply contract would have a strong incentive to reduce consumption and should leverage the correct financial and reputational drivers. There may be cases where the existing contractual arrangements between outsourcers and outsourcees may need to be revisited to take on board the implications of the CRC policy. This is not considered a significant disadvantage, as long-term contracts ought to be flexible in the face of a changing policy context

2.4.2 Alternative solution 1

Under this alternative solution, emissions responsibility at all the sites owned or occupied by an outsourcer could be assigned to that outsourcer, irrespective of the identity of the counterparty to the electricity or other energy supply contract. This would ensure that all the energy usage in an outsourcer's own business operations, whether outsourced or not would form part of that organisation's portfolio for CRC.

Advantages

a) Maximising emissions coverage

This approach would eliminate the potential risk of gaming on the part of an outsourcer. However the risk of such gaming is thought to be low.

b) Maximising the use of financial and reputational drivers

This approach captures all the emissions relating to an outsourcer's business operations under their responsibility. This should help bring energy efficiency and carbon-related issues higher up the agenda for these businesses and use its organisation-wide levers to capture opportunities.

Disadvantages

a) Maximising emissions coverage

There would be emissions loss from the system where an outsourcer's emissions across sites are below the inclusion threshold, but should such emissions have been allocated to the outsourcee's, then it would have exceeded the inclusion threshold. It is not clear how significant this loss of emissions would be. The outsourcing organisations investigated in this report were generally quite large and therefore any transfer of responsibility to the outsourcer would be unlikely to result in significant emissions loss from the CRC system.

b) Simplicity, clarity and administrative burden

This approach has the potential to be highly complex to administer for some sites where there may be only one outsourcee but several outsourcers, for example in the case of a multi-customer call centre.

An extremely robust definition of outsourcing (in other words, what is meant by an 'outsourcee' and what is meant by an 'outsourcer') would be required for the purposes of the CRC Regulations. However it is not clear that such a definition is possible – indeed it may well be impossible to produce a robust legal definition of outsourcing for the purposes of the CRC regulations that:

- i. is broad enough to capture all activities that Defra would want to be considered as outsourcing for the purposes of the CRC; and
- ii. is precise enough to exclude any activities that Defra would not want to be considered as outsourcing.

It is possible that any definition that satisfied (i) above would also classify as outsourcing activities that Defra may prefer to have fall under the assessment procedure for normal businesses.

c) Maximising the use of financial and reputational drivers

The outsourcer may have strong reputational incentives to manage their energy use, where the outsourcee is merely performing a background function. However, the outsourcer may still not have direct control over emissions reductions, and the financial drivers may in fact lie with the outsourcee, depending on the contractual agreement. There are also arrangements in place whereby the outsourcee holds both the reputational and financial drivers e.g. in the case of leisure facility management.

A further disadvantage is that the outsourcer may not have sufficient sight of consumption data to manage emissions appropriately. This would be a particular issue in the case of existing long-term contracts, as amending these may impose costs on the outsourcer. A potential solution would be for the outsourcer to negotiate future contracts with their outsourcees appropriately, or to place reporting obligations on the outsourcee to ensure the outsourcer had timely and accurate information to comply with its CRC obligations.

From a policy perspective, this alternative solution offers no advantages in terms of improved leveraging of financial and reputational drivers as compared to the recommended solution. In fact, this solution appears to remove the CRC responsibility from the organisations with the most control of emissions.

From a legal perspective alternative proposal 1 does not appear to offer significant advantages over the recommended solution that outweigh the significant legal difficulties of drafting a robust definition of “outsourcer” and “outsourcee”.

2.4.3 Alternative solution 2

This alternative solution is that emissions responsibility for all energy consumed in the course of its business could be allocated in all cases to an outsourcee. This would include electricity supplied under a contract to which the outsourcee is not the counterparty.

Advantages

a) Maximising emissions coverage

This would avoid any loss of coverage of outsourcee's emissions, where outsourcee's emissions across all the sites at which it consumes electricity exceeds the inclusion threshold, but the emissions from individual outsourcer sites would not.

b) Maximising the use of financial and reputational drivers

The outsourcee generally has good control over emissions through energy management processes, and sometimes are responsible for delivering entire outsourced activities, increasing their control further. Also, outsourcee organisations often have high brand visibility, and certainly professional reputations that could be influenced by their performance in the CRC.

Disadvantages

a) Simplicity, clarity and lowering administrative burden

This solution would incur a significant administrative burden since an outsourcee would have to collate information on emissions arising from energy use across all of its businesses. It may be difficult to obtain such data in cases where it is not the counterparty to the supply contract.

The need for a robust definition of an “outsourcee”, “outsourcer” and “outsourcing” (and the attendant legal issues) identified above would apply equally to this alternative.

b) Maximising the use of financial and reputational drivers

As described under advantages, the outsourcee could be expected to have strong financial and reputational incentives to manage energy use, however, the contract may not in fact give it sufficient flexibility. For example, in respect of a facilities manager, the outsourcee would not be in a position to affect the outsourcer's electricity consumption. This may reduce the effectiveness of the CRC.

From a policy perspective alternative 2 does not offer significant advantages over the recommended approach in terms of leveraging financial and reputational drivers. From the legal perspective alternative proposal 2 does not appear to offer significant advantages over the recommended solution.

2.4.4 Conclusion

In the case of outsourcing, assigning emissions responsibility to the 'counterparty to the energy supply contract' would strike the best balance between making the most effective use of the financial and reputational drivers and being simple and legally robust to apply. It is true that there may be contractual outsourcing arrangements which mean that the counterparty has little influence over energy-use, however this is the case with all the options for the treatment of outsourcing in CRC. Whilst this issue should be disregarded for the purposes of deciding which treatment option to pursue, we recommend that Defra keeps this issue in mind when drafting guidance to participants, so that those involved in outsourcing can come to mutually beneficial arrangements with their outsourcing partners.

2.5 Third Party Energy Purchasing

Issue: Under Defra's consultation proposal that emissions responsibility should lie with the organisation that pays the energy bill it is possible that an organisation may be responsible for emissions covered by CRC where its sole purpose is to purchase energy on behalf of a client. In such situations, Defra sought to find out if it would make the CRC less effective in this case and how that could be resolved.

Recommended Solution: Assign emissions responsibility to the 'counterparty to the supply contract'. This will result, in all but very few cases, the consumer of the energy will be responsible for emissions in the scheme rather than the third party purchaser.

Rationale: Using the counterparty rule means that responsibility can be assigned simply and clearly in all cases. In the majority of instances responsibility will fall to the energy consumer, which is the organisation likely to be most receptive to the CRC drivers, rather than the third party purchaser. It is desirable to avoid instances where the purchaser is the counterparty, so that the CRC drivers may work most effectively. If there are some limited cases where the 3rd party purchaser is the 'counter-party to the supply contract', then the CRC may incentivise the 3rd party agent to renegotiate procurement contracts with their clients (i.e. to avoid CRC applying to the 3rd party purchaser organisation).

Emissions may be lost from the scheme with this approach. For example, in the event that a procurement agent, that qualifies for the scheme in its own right, purchases energy for clients that do not meet the inclusion threshold themselves, the emissions related to that purchased energy could be captured by crafting a derogation from the recommended eligibility criterion in order to place responsibility with the procurement agent. However, the emissions loss is outweighed by the benefits of simplicity and of ensuring that responsibility lies with those most responsive to leveraging the financial and reputational drivers.

Figure 3

Third party purchasing is a particular type of outsourcing arrangement where an organisation bulk purchases energy on behalf of other organisations. Such third party organisations will be acting either as an agent (i.e. with the authority to enter into contracts on behalf of their principal) or as an introducer or facilitator (i.e. not entering into the contract but securing the best terms for the organisations it is acting on behalf of).

Even where a third party purchaser "enters into" an electricity supply contract on behalf of a principal, it will usually do so in the name of the principal. In this case, it will still be the principal who is the counterparty to the supply contract rather than the third party purchaser. This was the case in all the interviews conducted on this subject.

In some cases, both the third party purchaser and the principal are parties to the contract with the electricity supplier, creating a "tri-partite" arrangement. In such circumstances,

however, the entity contractually liable for the debt in respect of the supply will always remain the principal.

The following case study illustrates the case of where Kent County Council owns LASER, a third party purchasing organisation that buys energy for several local authorities:

Third Party Purchase case study: LASER

Kent County Council operates the LASER Energy Buying Group, a third party organisation which buys energy for around 70 other Councils and other public bodies. LASER employs around 30 people and would not qualify for CRC in its own right – but would fall under CRC as part of Kent County Council through the “highest UK parent” organisational rule (see Strand 3).

LASER is responsible for placing supply contracts for Gas, Electricity, Heating Oil and Roads Fuels and paying energy bills worth around £200 million per annum. The majority of energy supplied is also billed through LASER i.e. the energy Suppliers bill LASER centrally, LASER validate the billing and pay correct bills, LASER then bill the end users. In this case, the contract is Tripartite – so the ‘Consumer’ is defined as ultimate liability for payment – although LASER are responsible for payment of suppliers invoices.

In the case of small electricity accounts, LASER generally put the supply contracts in place but the billing is often ‘direct’ i.e. the energy supplier bills the end user direct and LASER do not have sight of the invoices. These direct billed accounts (small primary schools, Day Centres, Landlords Lighting etc) are individually small in terms of electricity use – but are large in number (around 30,000 sites direct billed, 3,000 billed through LASER). In this case, the contract is between the supplier and the end user Authority – so LASER are not responsible for payment.

All Gas and Oil is billed through LASER and LASER is liable for payment.

Most of the Councils buying their energy through LASER will have a mix of LASER Billed and Direct Billed sites, the mix of direct or LASER billed will depend on the type and number of buildings – and the particular requirements of the Council which is the ‘end user’ of the energy.

In most cases LASER (Kent County Council) are the ‘Customer’ as far as the energy supplier is concerned – but LASER do not have any control over the end use of energy in the buildings of its own customers, being numerous councils and other public bodies.

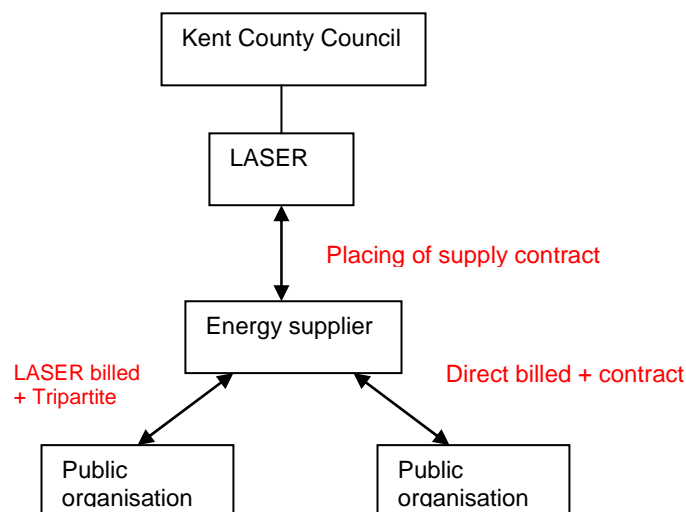


Figure 4 Case Study Third Party Purchase: Laser

Analysis of LASER Case study under proposed definitions

Organisation eligible and captured in scheme under recommended approach
'counterparty to the supply contract' (Definition 3): Public Body

Organisation eligible under the alternative criteria:

'Undertaking which pays the bill' (Definition 1): LASER in the majority of cases;
Public Body in the minority of cases where there are smaller electricity accounts.

'Undertaking to which electricity is supplied' (Definition 2): Public Body.

Figure 5 Analysis of LASER case study under proposed definitions

Under Defra's consultation proposal, LASER would be responsible for the emissions of the energy-use of its clients if the "undertaking which pays the bill" criterion were used for the purposes of allocating responsibility. It would be highly unusual for a third party purchaser to be acting in such a way that it could be considered the person to whom the electricity is supplied, since it will not actually in receipt of the energy.

2.5.1 Recommended Solution

The recommended solution is the attribution of emissions responsibility to undertaking which is named as the 'counterparty to the electricity or energy supply contract'.

In most, if not all, scenarios, this will capture the consumer of the energy rather than the third party purchaser. However, to address the "tri-partite" arrangement referred to above, it would be appropriate to refine the standard eligibility criterion to refer to the "counterparty to the electricity supply contract having ultimate liability to pay for the supply", or something similar.

Rationale:

a) Maximising emissions coverage

Coverage is likely to remain high, since many of the organisations which employ the services of an energy purchasing contractor are likely to have sufficient emissions in their own right. In the case of LASER, and similar public sector-orientated organisations, the majority of their clients are large public sector entities such as local authorities and universities, most of whom would be expected to be over the inclusion threshold. The case for private sector third party purchasers may be slightly different.

b) Simplicity, clarity and administrative burden

It will be straightforward to prove who the eligible entity is, where this solution is used since the name of the organisation will be printed on the face of the energy supply contract.

c) Maximising use of the financial and reputational drivers

This solution would capture the energy consumer in a situation where it used an agent to purchase electricity. In such an agency scenario, the principal would still be the party to the electricity supply contract (the agent contracting on behalf of and in

the name of the principal). The legal position would be identical to a scenario where the principal concluded the contract directly with the electricity supplier.

This solution is likely to provide effective use of the financial driver, since the counterparty to electricity supply contract will usually be best placed to reduce consumption and third party purchaser will have no control over energy use.

This solution is also likely to leverage the reputational driver, since the counterparty to electricity supply contract will be the most visible consumer of the electricity, for example a local council, as opposed to a third party purchaser, such as LASER.

2.5.2 Alternative proposal 1

The alternative would be to attribute emissions responsibility to the 'undertaking which pays the electricity or energy bill'.

In many scenarios, this would include the third party purchaser in the CRC rather than the consumer of the electricity.

Advantages

a) Maximising emissions coverage

There is a low likelihood of loss of coverage in certain instances: since LASER is owned by a local authority, its emissions are likely to be included through its local authority parent. Similarly, placing responsibility on other purchasing organisations operated by Local Government would not add to the coverage of emissions as they would already be part of the CRC via their respective local authority.

There is the potential for also gaining some emissions coverage if any of the undertakings on whose behalf the third party purchaser procures electricity do not meet the 6,000Mwh/year threshold themselves. Under the recommended option, these organisations' emissions would not be covered.

Disadvantages

a) Maximising use of the financial and reputational drivers

The main disadvantage of this option is the fact that the focus of economic and reputational drivers would not be set where they would be most effective. Third party purchase organisations do not have any leverage over energy management and emissions reductions within their client organisations.

b) Simplicity, clarity and administrative burden

This approach may be perceived as complicated and, in some ways, inconsistent. Under this approach, the organisation responsible for emissions under the CRC in the case of third party purchase would be determined on the type of relationship that the client has with the third party purchase organisation. This means that if two identical organisations existed, and both used third party purchasers, the organisation that uses the third party purchaser for billing services would not be responsible for their own CRC emissions. The other organisation, who paid their own bills, would be responsible for their own emissions under the CRC. This type of outcome is illogical,

as there is no reason why the two organisations should be treated differently for the purposes of the CRC.

Furthermore, situations will arise where an organisation such as Kent County Council (KCC), which owns a third party purchase organisation, LASER, will end up assuming responsibility for the emissions of a totally separate body. This is not only administratively complex, but is illogical and inequitable.

2.5.3 Alternative proposal 2

A second alternative is the attribution of responsibility for emissions to the 'undertaking to which electricity is supplied'.

It is worth noting that in nearly all scenarios, this and the recommended approach would give the same result. In general, the third party purchaser is highly unlikely to be undertaking to which electricity is supplied. Indeed, if the electricity were supplied by the supplier to the third party purchaser, the third party purchaser would then have to "on-supply" to the ultimate consumers. To do so, the third party purchaser would need to be licensed as a supplier of electricity for the purposes of the Electricity Act 1989.

As this alternative proposal does not offer a sufficiently different result from the recommended solution, it has not been considered in any more detail here.

2.5.4 Conclusion

In the case of third party purchasing, the recommended eligibility criteria outlined in definition 3, the 'counterparty to the supply contract' would be most appropriate, as in most if not all scenarios, this will capture the actual consumer of the energy rather than the third party purchaser.

2.6 Public Private Partnerships and Private Finance Initiatives

2.6.1 Introduction

The term Public Private Partnership/Private Finance Initiative (PPP/PFI) is used to cover numerous different arrangements many of which will have the same or similar characteristics to outsourcing. A PPP or PFI project will involve a public body (local authority, government department, NHS Trust, etc., commonly referred to as the 'Authority') and a private partner, which can be a single private company or can be a consortium. The corporate structure of the private partner (usually called the "project company" or "special purpose vehicle (SPV)") will differ on a case by case basis and can involve a number of other companies as illustrated in the diagram below:

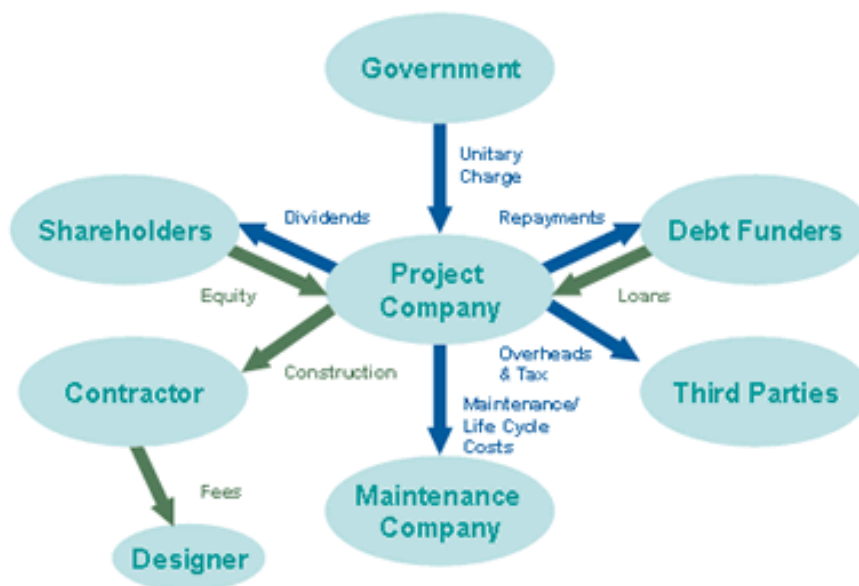


Figure 6 The structure of a PFI/PPP project²

In this example, the Contractor and Maintenance Company provide services to the Project Company, which then delivers the contracted services to Government.

Energy efficiency measures can be undertaken both by the public body and the PFI project company. Some PFI/PPP contracts include a specific clause which states that the monetary gains due to efficiency improvement are shared between the parties. There are opportunities to integrate energy efficiency within PFI contracts for example through the Competitive Dialogue process. The Competitive Dialogue stage represents successive rounds of bidding against, and/or responses to, successively revised output requirements. In that sense, individual discussions with bidders are not so much parallel negotiations, but rather they facilitate the general revision of the public body's requirements.

Two general observations are worth making regarding PFI/PPP:

² Source: Burges Salmon

1. The general public has little understanding of PFI structures and may continue to regard the public authority as responsible for issues such as emissions reduction, whereas in reality the responsible organisation for the purposes of the CRC may be the project company.
2. Project companies are almost exclusively set up as joint ventures and the conclusions reached regarding aggregation of emissions in joint ownership scenarios in Strand 2 would apply equally to PFI/PPP.

2.6.2 Common PFI structures

There are two general forms which the majority of PPP and PFI projects tend to adopt. These are known colloquially as either a "thin" project company or a "thick" project company:

Scenario 1 – the "thin" SPV/Project Company

The SPV is sometimes a mere contracting entity. Whilst the SPV will in all circumstances remain contractually liable to the Authority for the provision of the services, in practice responsibility for provision of such services will frequently be sub-contracted to other entities. In the example above, the Contractor and the Maintenance Company are acting as sub-contractors to the SPV and it is frequently the case that they will be the ones which contract with third parties for the provision of goods and services such as electricity, rather than the SPV itself. In this scenario, the SPV is known as "thin" since it is effectively just a pass-through entity, with the Contractor and the Maintenance Company being the ones actually supplying the services to the public sector.

Scenario 2 - the "thick" SPV/Project Company

In other cases, the SPV may contract directly for the supply of goods and services to it and will then actually itself be responsible for some or all of the direct supply of services to the public sector. In this scenario, the SPV is known as "thick" because it is more than just a pass-through entity – it is actually a company of substance.

Issue: PFI/PPP service outsourcing scenarios are a particular type of outsourcing that many public sector participants of CRC are likely to be involved with. Defra sought to understand the implication of PFI/PPP for CRC, in particular to find out how best to split responsibility for energy-use emissions between the public body and the PFI/PPP project company.

Recommended Solution: Assign emissions responsibility to the 'counterparty to the energy supply contract'; emissions responsibility will vary in each case between the public authority and the PFI/PPP project company according to contractual arrangements in place.

Rationale: This approach is simple and straightforward to apply and in the majority of cases will set the financial drivers for emissions reductions where they will be most effective. The effect of reputational drivers may be more limited, because of the confusion in the public mind about PPP/PFI arrangements, but there will still be some leverage.

However, under this approach, there may be some loss of emissions coverage, the extent of this loss depends on the prevalence of some specific PFI/PPP structures and is not a strong enough reason to choose a different option. In those cases where the PFI / PPP project company is the counter-party to the supply contract, it may be the case that some of the cost associated with the implementation of CRC would need to be picked up by the awarding authority because the introduction of the CRC would constitute a "Change in Law" under the majority of PFI/PPP contract terms (to the extent such provisions are included). Nevertheless, the recommended approach still represents the most effective use of financial and reputational levers. Given this clear definition, it is likely to be applied effectively in new contracts, as well as to some existing contracts.

Figure 7

2.6.3 Recommended Solution

We recommend that Defra uses the preferred criterion for allocating emissions responsibility in PFI/PPP projects. This would mean that the counterparty to the electricity or other energy supply contract would take on the obligations of CRC. This could be either the public body or one of the businesses involved in the project depending on the particular circumstances. The implications for allocating emissions in this manner vary depending on the structure of the particular project, and are considered below.

The principal advantage of this approach is simplicity and clarity. It will be straightforward and clear for the organisations involved in a PFI/PPP to determine who has CRC responsibility for which emissions sources. For example, where the Contractor or Maintenance Company is counterparty to electricity supply contract, it will participate in the scheme if emissions across its organisation exceed the inclusion threshold.

This approach also has the advantage of setting the CRC's financial drivers at the level of the entity that has the most control over investments related to emissions reductions. To

a certain extent, this approach would also set the reputational drivers at the correct level, although this would depend on the degree to which the PFI/PPP's reputation is aligned with those responsible for energy and with those, usually the public entity, more readily associated with the project itself for example school or hospital.

It is possible that the financial drivers may not be as accurately aligned for existing contracts as the allocation of responsibility would suggest. Although the organisation with the greatest financial control over emissions-related capital expenditure is likely to become the responsible organisation under the CRC, these organisations may be able to avoid this financial responsibility initially through modifications to the PFI/PPP contract terms.

Changes in contracts would be possible because the implementation of CRC applying at SPV, Company A or Company B level (see Figure 8, below) would probably constitute a "Change in Law" under the majority of PFI/PPP contract terms (to the extent such provisions are included). The awarding public authority may be forced to pick up any CRC-related capital expenditure or operational expenditure on contracts currently in place, although they would not be the responsible CRC organisation.

For new contracts extra provisions for the CRC would just be included in the contract at the outset, which would allow for the appropriate leverage of financial drivers. Provisions for the CRC may include costs provisions, or provisions for additional personnel and systems to record and report for purposes of CRC compliance. Interviews were not able to indicate clearly how costly the CRC would be to implement PFI/PPP projects already in place. It may be that the costs of renegotiating the contract terms would outweigh the perceived costs of the CRC.

However, despite the risks in relation to existing contracts, the recommended approach still represents the best attempt to place financial and reputational levers correctly, and is able to be effectively applied to new contracts. It is important to note that even where contracts are renegotiated in a way that incurs costs for the public body, these negotiations themselves could still act as a forum to plan for, and bring into effect emissions reductions for the PFI/PPP project.

Thin SPVs

The majority of project companies are thin SPVs and have a limited role in terms of direct delivery of the services. It is likely that in many of these cases, the counterparty to the principal electricity supply contract for the project will be either the Contractor or the Maintenance Company (alternatively, Company A or Company B in Figure 8, below). In such circumstances, the emissions of the Contractor or Maintenance Company would be aggregated with that of the rest of its corporate group for the purposes of the CRC. If such aggregate emissions exceeded the inclusion threshold, the group would be captured by the CRC.

The recommended approach would ensure good emissions coverage where the Contractor or Maintenance Company is part of large organisation with aggregate emissions in excess of the inclusion threshold. There will be some emissions losses where smaller sub-contractors are used, who fall below the threshold for the CRC. Furthermore, the recommended approach sets the financial drivers at the correct level in

the case of thin SPVs. The Contractor and/or the Maintenance Company are well placed to be able to influence energy use in a large majority of PFI/PPP projects.

In the case of reputational drivers, the levers should be set at the correct level where the contractor or maintenance company have a strong reputation and recognition. It should be noted, however, that the public might feel that it is the responsibility of the public authority most closely related to the PFI/PPP project itself to carry out reductions, whereas as the ability to do so will lie with private sector contractor, therefore the public authority's reputation may suffer inappropriately. The public authority could then put pressure on the SPV to take appropriate reduction measures. In terms of the goals of the CRC, the professional, and not just public, reputation of the contracting firms should also be important drivers towards a low-carbon economy. As there are several reputations at stake, and one solution will not be able to lever them all, the recommended solution seems to be the best fit in terms of the combination of financial and reputational drivers.

Thick SPVs

If the project is delivered by a "thick" SPV which contracts directly for the supply of electricity to it, then the SPV's emissions will be aggregated with that of its parent company, assuming it is majority-owned by one of the shareholders in the SPV (i.e. Company A in Figure 8, below). If there is no majority shareholding in the SPV, the SPV would be considered for inclusion in CRC as an independent legal person. If the SPV's emissions through half-hourly meters (or 70kW metering systems in Northern Ireland) exceed the inclusion threshold, the SPV would be obliged to participate in its own right.

This approach has good emissions coverage where the SPV is majority-owned by a substantial organisation, with which the SPV's emissions will be aggregated. However, if the SPV is not majority-owned (or its majority owner is not a substantial company) and its emissions are below the inclusion threshold for the CRC, emissions from the project would not be covered. It is not clear the degree to which this approach represents an overall emissions loss or gain.

This approach has the major advantage of being simple and straightforward to administer. Where the SPV Company is counterparty to the electricity supply contract, it will participate in the scheme if emissions across its organisation exceed the inclusion threshold.

The SPV will be well placed to be able to influence energy use, therefore the financial drivers would be set at the correct level. Similarly, the reputation of the SPV may be more directly associated with a particular PFI/PPP project than those of sub-contractors, aligning reputational drivers correctly. In some cases the SPV may not be well known to the public but may have an important professional reputation to protect.

Public Authority

An Alternative Approach: In circumstances where the public sector authority remains the counterparty to the electricity supply contract, the responsibility for emissions will be attributed to the authority and will be aggregated with the rest of the authority's emissions for the purposes of the CRC.

Where the public authority is responsible, emissions coverage will generally be good. The majority of public entities responsible for PFI/PPP projects are likely to be included in the scheme by having aggregate emissions in excess of the inclusion threshold

This option is simple and straightforward to administer.

Where the public authority is the contracting party, the reputational drivers would be appropriately placed, since public perception is likely to be that the authority should be the one making emissions reductions in large public projects such as hospitals or schools. However, the public authority will have limited scope for making reductions in electricity consumption since much of the electricity supplied to it will in fact be used by the Contractor or Maintenance Company.

Arguably participation by the public sector in the CRC where PFI/PPP projects are in place runs counter to the contracting out of services, risks, responsibilities etc related to the public estate. However, the public authority's decision to be counterparty to the electricity supply contract took place outside the context of the CRC and the risks would have been assessed at that stage.

2.6.4 Responsibility with public authority

An alternative approach is to make the awarding authority responsible for emissions from all of its PPP/PFI projects. This approach benefits from placing the emissions responsibility on the party which in most cases will be the most recognisable party to the public. In the case of an NHS hospital built and managed under a PFI contract, the CSR drivers are likely to act most strongly on the NHS Trust, since the public will identify activities carried out at the hospital with the Trust rather than the PFI provider.

Furthermore, for qualifying public authorities, this approach would ensure that CRC captures the emissions of all PPP/PFI projects awarded by that authority. Counting the emissions of all of an authority's PFI/PPP projects towards the inclusion threshold may also cause more public authorities to qualify for the scheme.

However, there are significant disadvantages with this approach. Significant derogations from the eligibility criteria would be needed to capture the public authority in every instance, which compromises the simplicity of the scheme. This approach would also place the administrative burden of the CRC on the public authority in every case, who may have to revisit documentation on well established projects.

Under this approach, there is a real risk that the CRC would not focus on those who are ultimately in the best position to manage energy use and therefore the deliver the objectives of the CRC. Examples of potential problems include the fact that the public authority may not have right of access to meters or access to information on emissions profiles relating to PFI/PPP projects. They may then need to seek to add contractual provisions regarding reporting requirements into the PFI/PPP agreement, which may have financial implications.

2.6.5 Alternative Approach 2: Responsibility with SPV

A further alternative could be to allocate responsibility under the CRC to the SPV itself in all cases. However this would require a derogation from the recommended eligibility criterion, which would be highly complex to draft. Ultimately, there are no identified advantages which would merit such a derogation, as the financial and reputational driver would not be correctly leveraged and it would be difficult to implement.

2.6.6 Standard energy supply arrangements in a PFI scenario

The following diagram illustrates the standard energy supply arrangements in a PPP/PFI project:

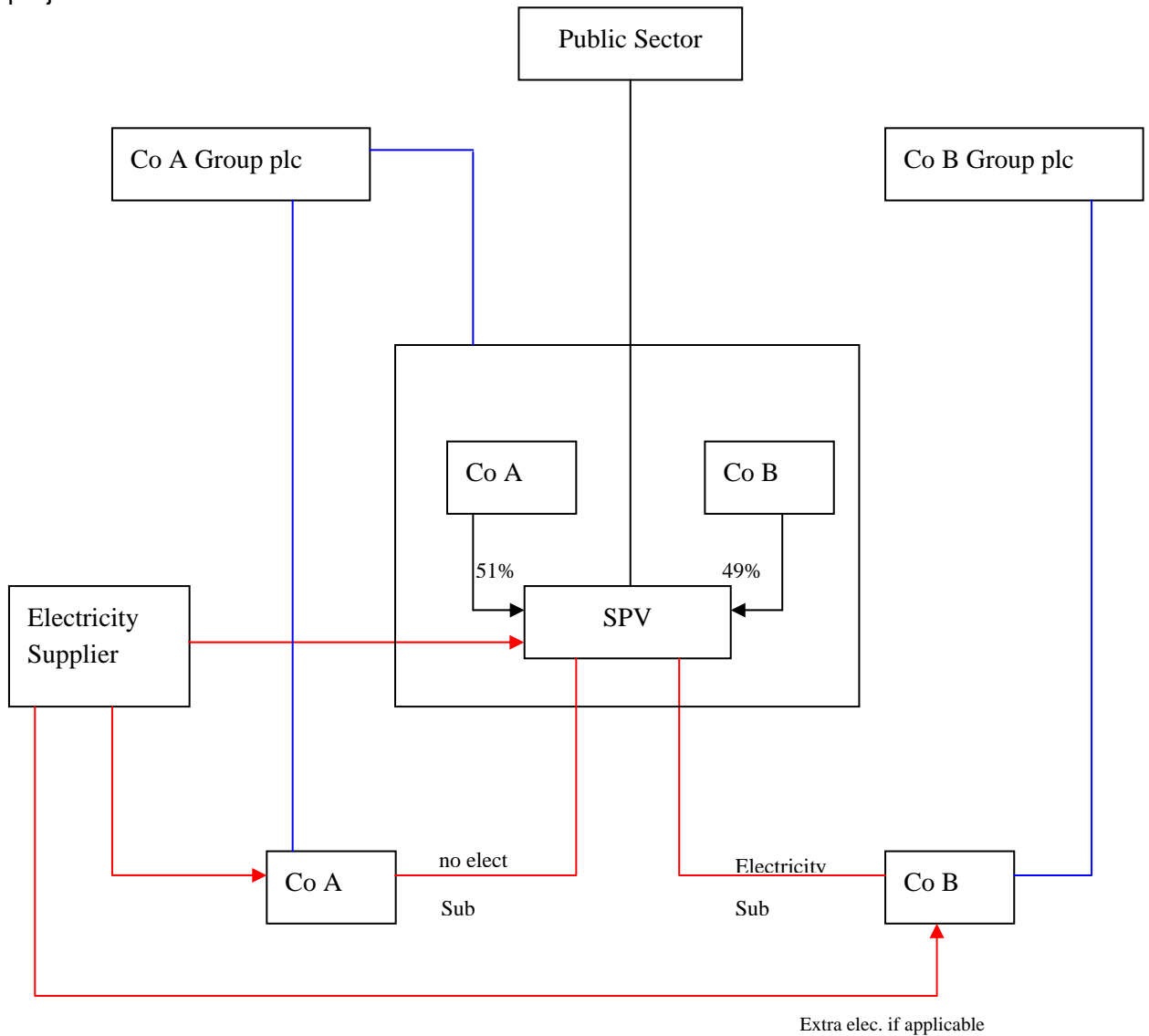


Figure 8 Standard energy arrangements in a PPP/PFI company

In Figure 8, above, the SPV is owned by two shareholders, Company A and Company B, who also provide services to the SPV to assist it in providing the contracted services to the public sector. In this example, electricity is supplied direct to Company A and to the SPV, but not to Company B, which effectively uses electricity it needs via a sub-contract

with the SPV. The red lines in the diagram represent contracts either for the supply of, or enabling the use of, electricity. The blue lines represent ownership of Company A by Company A Group plc and ownership of Company B by Company B Group plc.

Under the recommended approach, responsibility would lie with the counterparty to the supply contract, regardless of whether or not the SPV as an organisation would form part of the organisation of Company A or Company B for the purposes of aggregating emissions under the CRC (see Section 3.3 on Joint Ventures). Ignoring the shareholdings in the SPV shown in the above diagram for the time being, if either Company A or Company B is counterparty to the electricity supply contract for the electricity that they use in the provision of services to the SPV, and is part of a larger group whose aggregate emissions are in excess of the inclusion threshold, the SPV's emissions would be accounted for the purposes of the scheme. If the Company that is counterparty to the electricity supply contract is not large enough to be eligible in its own right, then the SPV's emissions would not be included in the CRC. Large PFI/PPP players such as Serco would probably be included in the CRC owing to aggregated electricity emissions across all of its PFI/PPP projects.

Alternatively, the SPV may contract for electricity itself and allow Company A and/or Company B simply to use that electricity (perhaps sub-metering such usage) for the services they provide to the SPV at the site of the PFI/PPP project. In this case, the SPV would be the responsible entity in the CRC (unless either Company A or Company B own a majority stake in the SPV, in which case the responsible entity would be the SPV's highest parent undertaking). If there is no majority ownership, the SPV would be treated as any other company and the rules set out in Section 3.3 of this report on joint ownership would come into play.

Maximisation of coverage would depend upon which of the PFI project entities are counterparties to electricity contracts. In most PFI/PPPs the risks relating to loss of electricity supply and other similar dependencies are passed to the project company. As a result, the public sector entity would not, normally, be counterparty to the electricity supply contract in relation to the project. In an example studied, one organisation (which is involved in both facilities management and PFI), takes on contractual responsibility in 75% of PFI-related projects.

The specifics of the project do also need to be considered. There have been some PFI/PPPs, particularly for MoD we believe, where the authority or public sector entity is the contracting entity for electricity in the project and simply sub-meter to the contractor (primarily due to military base issues and the difficulty of procuring separate electricity supplies to individual buildings within a base). We are also aware of certain instances in the health sector where NHS Trusts remain counterparties to the electricity contract, despite having entered into PPP/PFI outsourcing arrangements.

PFI and Responsibility for Schools

Depending on how the derogation is crafted regarding schools (see Section 4.5 on schools) in situations where the school is not the counterparty to the supply contract, responsibility will continue to lie with that counterparty; the derogation will only operate to transfer consumption to the local authority where a school falling under the local authority's portfolio is itself the counterparty to an electricity supply contract.

Figure 9 Schools and PFI: Responsibility for Emissions under the CRC

Some schools' emissions may fall under the Local Authority's portfolio for the purposes of the scheme (see section 4.5 on schools), however, this will not override the counterparty to the electricity supply contract rule. As illustrated in the case study above, regarding the case of PFI and schools, an appropriate derogation from the eligibility criteria will have to be crafted for schools to ensure that the appropriate party is made responsible under the CRC.

We recommend that a derogation for schools be crafted along the lines of "where a school falling under Local Authority control is counterparty to a contract for the supply of electricity, the Local Authority shall be responsible for such emissions for the purposes of the CRC." As a result, where a school's energy supplies are PFI and facilities management arrangements, responsibility for emissions would not pass to the Local Authority.

It is worth noting however, that if the derogation read something along the lines of "irrespective of the identity of the counterparty to the supply contract, where a contract is for the supply of electricity to a school under Local Authority control, the Local Authority shall be responsible for such emissions for the purposes of the CRC", then the Local Authority would be responsible, even if a PFI/PPP sub-contractor were the counterparty to the supply contract. We understand that this would be inconsistent with Defra's policy intentions.

PPP/PFI: Government Departments

The Home Office (HO) has one active PFI in place which covers approximately 10-15% of emissions of their buildings. The other estates are in facilities management contracts. In a small number of estates, the HO is charged a service charge and does not know the actual energy consumption.

The Department for Work and Pensions (DWP) has 95-97% of their estate under one PFI contract with Land Securities Trillium (LST) that includes approximately 1200 buildings all over the UK. LST buys energy from the utility and is counterparty to the supply contract DWP pays monthly bills to them based on an estimated consumption. The actual consumption is calculated retroactively at the time of the annual reconciliation.

Her Majesty's Revenue and Customs (HMRC) have 80% of their estate under PFI contract and the PFI project company is Mapeley with a STEPS (The Strategic Transfer of Estate to the Private Sector) contract. In a similar way to the DWP, HMRC pay monthly bills but these are based on actual energy consumption. Mapeley is the counterparty to the supply contract.

Figure 10 PPP/PFI in Government Departments

In the case study above, for PFI arrangements in Government departments, the participant organisation appears to be the PFI contractor. It would appear that, in the Home Office example, it is the facilities contractors who are the counterparties to the contacts and not the Home Office itself. This is in direct contrast to another example explored in a government department (see section 2.3 on Outsourcing) and we should highlight that no hard-and-fast conclusion can be reached as to who is the counterparty in facilities management scenarios.

2.6.7 Conclusion

The term PPP/PFI is used to cover numerous different arrangements with varied contractual arrangements. The recommended criterion for assigning emissions responsibility of 'counterparty to the supply contract' would mean that the organisation responsible for a given emissions source in CRC would vary between the Contractor/Maintenance Company, the Special Purpose Vehicle and the Public Authority. Whilst there are different advantages and disadvantages in each case, such an approach is simple and clear to implement. The financial drivers of CRC are correctly leveraged, since CRC liability lies with the organisation that has financial liability, and reputational drivers act strongly in most, but not all, cases. It is important to note that the implementation of CRC would probably constitute a "Change in Law" under the majority of PFI/PPP contract terms and so could lead to businesses and authorities renegotiating PFI/PPP contracts to take account of CRC.

2.7 Franchises

2.7.1 Introduction

Franchise is a general term that covers a wide range of contractual arrangements between a principal party, the franchisor, and a third party, the franchisee. In general the franchisor allows the franchisee to carry out specific activities, on their behalf and/or in their name, under license. Further details on the different types of franchises are discussed in the text box below:

Franchise models:

When considering franchises it is important to bear in mind that all franchises have similar characteristics, namely:

- The franchisor allows the franchisee to use a name that is associated with the franchisor. The franchisee operates his business in accordance with the franchisor's concept and under the franchisor's trade name or trade mark so that to the outside world the franchisee is the franchisor.
- The franchisor exercises continuing control over the franchisee.
- The franchisor provides assistance to the franchisee.
- The franchisee periodically has to make payments to the franchisor.

The specifics of the arrangement and any additional elements will obviously differ from franchise to franchise. To separate these out into different "models" would be impossible. There are however, at a high level, generally two types of franchise models:

1. **Product/Trade Name Franchising:** A type of franchising where the franchisor owns the right to the business name or trademark and licenses that right to a franchisee.
2. **Business Format Franchising:** A type of franchising where the franchisor often provides an "out of the box business" with a full range of services, including site selection, training, product supply, marketing plans and even assistance in obtaining financing.

The second model is probably the most common model but one which would vary significantly between different franchises as to the levels of services provided by the franchisor. With McDonalds' operations it would operate something more akin to the Business Format Franchising, in some instances providing a fitted out restaurant, which the franchisee would simply rent from McDonalds.

Figure 11 Franchise models

Franchises are important to the CRC because franchising is a model where a franchisee operates under the name and branding of the franchisor. The franchisee operates their business in accordance with the franchisor's concept and under the franchisor's trade

name or trade mark, so that to the outside world the franchisee is the franchisor. However in most cases the franchisee will be an independent legal person that is not in fact part of the franchisor's corporate group - the franchisee is rarely a subsidiary undertaking of the franchisor as defined by the Companies Act 2006. Therefore, under Defra's current proposals, the emissions from franchises operating in the franchisor's name will not be captured within the franchisor's portfolio for CRC.

This raises the question of whether franchisors should take responsibility for the environmental standards of their franchisees for the purposes of CRC. The CSR driver of CRC is potentially a very powerful tool to incentivise franchisors to engage with franchisees to ensure that the franchisees' behaviour is in keeping with the franchisor's environmental image.

Issue: How should franchises be treated by CRC, given that franchises operate under the same corporate brand and therefore have an equal contribution to that brand's CSR reputation? What affect might this have on SMEs?

Recommended Solution: Create a derogation from the standard 'counter-party' criterion for assigning emissions responsibility. Instead, responsibility for emissions should be transferred from the franchisee to the franchisor.

Rationale: This approach will increase emissions coverage in CRC and will encourage large corporations that operate as franchisors to offer energy efficiency services to their franchisees. Importantly the reputational driver is placed with the franchisor which has high visual brand identity and the most incentive to protect the brand image.

Whilst the policy goal is simple and straight-forward, this will be a complicated policy to draft into law. However there are precedents to work from. Furthermore energy contracts do not normally sit with the franchisor so the franchisor may not respond to the financial driver of reduced energy bills, but will have a financial incentive through the CRC performance bonus and penalty. The franchisees will gain the benefit of reduced energy bills allowing the franchisors and franchisees to develop mutually beneficial approaches to CRC compliance.

Figure 12

2.7.2 Proposed solution: transfer emissions responsibility from franchisee to franchisor

The proposed solution suggests the transfer of emissions responsibilities in the CRC from the franchisee to the franchisor. One of the premises of the CRC policy is that medium to large organisations have a potential above and beyond that of smaller organisations and enterprises to achieve emissions reductions. In the case of franchise structures, there is some delegation of traditional responsibilities that a larger organisation may hold over its smaller outlets, however there is still an organisational structure in place.

As illustrated in figure 11 above, all franchise structures have a common relationship between franchisee and franchisor that involves payments from franchisee to franchisor, some control exercised by the franchisor over the franchisee and some provision of assistance by the franchisor.

An organisation with these characteristics, although the details vary, is likely to have a favourable response to the CRC policy. The structure of franchises should enable economies of scale in implementing low-carbon strategies, as well as replication, as franchise operations tend to be comparable e.g. many identical coffee shops or restaurants.

Furthermore, some franchised operations compete in the same market as comparable, non-franchised operations. For example, there are a range of coffee retail and restaurant chains operating in the UK – some are franchises and some are not. It would be slightly perverse for the CRC to only include those chains above the inclusion threshold that are all centrally owned and operated.

By making the franchisor responsible for the emissions, rather than the franchisee, the emissions from all of the individual franchisee operations would be aggregated, and if they exceed the inclusion threshold, would be made eligible for the CRC. The result would be a broader coverage of the CRC within the relevant target groups.

The transfer of emissions responsibility to the franchisor should, in turn, result in incentives being given for the franchisees to take action. However, with ultimate legal responsibility placed on the franchisor, the resultant incentives for the franchisee will vary on a case by case basis and are therefore difficult to estimate. Certainly franchisees may have to pay some costs to contribute to the franchisor's compliance with the CRC.

Considering both the potential strengths of the franchise structure in the context of the CRC, as well as some potential competitiveness effects, the recommended solution has been devised to transfer CRC responsibility to the franchisor.

A suitable derogation from the recommended criterion for assigning responsibility for emissions could be crafted in the regulations to provide for the transfer of responsibility of franchisees' energy-use emissions to the franchisor. This would apply only where the franchisee is the counterparty to an energy supply contract, so if a franchisee operates a franchise in leased premises where the landlord is the counterparty to the contract the landlord would retain responsibility for the emissions.

Responsibility under the scheme would be placed with the franchisor to:

1. Maximise the use of the reputational driver, given that individual franchisees use the brand name of the franchisor,
2. Address the potential emissions coverage loss likely to result from individual franchisees not exceeding the inclusion threshold.

Advantages

- a) Focusing financial and reputational drivers at the correct level

The principal advantage of this approach is that the reputational drivers of the CRC policy would be appropriately leveraged. Individual franchisees use the brand name

of the franchisor and it is the relationship of the individual franchises with the customer that builds up the consumer confidence in the brand name as a whole. Franchised brands have strong reputations, and these can include environmental credentials. It is therefore logical to set reputational drivers at the level of the franchisor – the ultimate beneficiary of this reputation.

Similarly, there is a financial relationship between the franchisor and the franchisee, although these vary depending on the franchise structure. By setting the CRC responsibility at the level of the franchisor, this may encourage the franchisor to exercise more control over this element of the relationship. The franchisor would be liable for any penalties or bonuses which may also act as encouragement for them to make changes across the franchises. Also, as there is a link between CRC impact on reputation and financial success, the franchisor may choose to set up appropriate levers.

Disadvantages

a) Simplicity, clarity and administrative burden

A derogation from standard eligibility criterion would need to be crafted, therefore the approach would not be entirely consistent with policy objective of keeping CRC as simple and as clear as possible.

There would be an administrative burden placed on the franchisees. All relevant information on emissions arising from energy use would need to be collated from franchisees and could involve a change to the franchise terms (in turn requiring a legal variation agreement to be entered into between the franchisor and each of the franchisees to ensure the necessary information is passed to the franchisor and also that the franchisor could take the necessary steps to achieve compliance with its requirements in this respect). The extent of the administrative burden and costs of these requirements may vary depending on the existing relationships between franchisee and franchisor in terms of contractual obligations, information sharing etc. However, this burden on large non-energy intensive franchisor based organisations would be acceptable within CRC, especially when considered in context of energy efficiency benefits being likely to exceed the administrative burden given the 6,000 MWhr/year inclusion threshold.

Different franchisors are likely to approach their CRC responsibility in different ways. This variation in burden is acceptable under the CRC and is part of the purpose of the policy – challenging organisations to treat carbon-related issues most efficiently in terms of finances and reputation.

This approach would be legally complex, but not impossible. Some solutions have been outlined below.

b) Maximising use of financial and reputational drivers

Financial drivers in relation to energy bills, behavioural changes on site and, possibly, investments may not always be appropriately leveraged since the participation obligation would fall on franchisor in circumstances where franchisees may be best placed to put in place energy efficiency measures. However, the franchisor has the

opportunity, through the CRC, to exercise influence on these areas through common programmes of investment, information dissemination, or other approaches

Legal constraints

- a) The exact nature of and legal terms governing franchise relationships can differ significantly from franchise to franchise. Consequently it will be difficult to structure a legally-robust policy approach based on a general term such as "franchisor" ", "franchisee", etc.
- b) Capturing the franchisor would require an extremely robust definition of "franchise" which would need to ensure that all activities that Defra would want to be considered as franchising for the purposes of the CRC are captured.

Note: Some suggestions as to potential avenues for the draughtsman of the CRC Regulations to pursue are set out in the box in section 2.7.4.

2.7.3 Case studie

In the case of McDonalds below, if the standard eligibility criteria were applied, it is unlikely that most of these franchises would fall under the scheme which would be contrary to the policy objective of the CRC scheme of capturing emissions from the entire group of franchises under the franchisor:

Franchise Case study – McDonald's

McDonald's has approximately 1200 restaurants in the UK; about 50% of these are company owned and 50% franchised, owned by franchisees. In most cases, McDonald's own the freehold or leasehold of its restaurants, whether company owned or franchised.

Half-hourly meters are in place in the majority of restaurants and the metering data for these restaurants is connected to a website from which individual stores can monitor their energy usage. Most of the sites are required to have mandatory half hourly meters, but some have them on a voluntary basis.

McDonald's has a central energy contract, which the franchisees are invited to join. The franchisees are billed directly by the supplier.

McDonald's exercises no direct control over the energy consumption of franchised restaurants. However, McDonald's encourages franchisees to voluntarily improve energy efficiency and provides information, education and training on this issue.

2.7.4 Franchising – Drafting the CRC Regulations

This section sets out three possible avenues for the draughtsman of the CRC Regulations to explore:

1. The Producer Responsibility Obligations (Packaging Waste) Regulations 2007
2. The Restrictive Trade Practices (Non-notifiable Agreements)(Sale and Purchase, Share Subscription and Franchise Agreements) Order 1997 [NB: Repealed] definition
3. US Federal Trade Commission Title 16, Chapter I, Subchapter D, Part 436 definition

The Producer Responsibility Obligations (Packaging Waste) Regulations 2007 definition

Summary

This applies to licensors. A "licensor" is a person who grants a licence to use a trade mark under a licence agreement. A "licence agreement" is an agreement that:

1. allows use of a trade mark to sell goods associated with that trade mark from a premises; and
2. includes an obligation relating to the presentation of those premises.

Advantages

- a) This is an extremely broad definition. If applied then it would almost certainly catch all commercial arrangements that would commonly be considered franchises; and
- b) It is derived from existing legislation and may therefore be more straightforward for Parliamentary draughtsmen to rely on.

Disadvantages

- a) Because it is extremely broad, it has the potential to catch commercial arrangements that would not commonly be considered franchises and which Defra might not want to be treated as franchises. The definition has the potential to catch any arrangement under which a trademark is licensed for display in a business with some stipulation as to how that trademark is displayed e.g. a newsagent displaying the name of a newspaper on its awning, etc.
- b) It has the potential to include arrangements (whether commonly considered to be franchises or not) where there is not operational control of the franchisee by the franchisor.

Figure 13 The Producer Responsibility Obligations approach to CRC drafting

The Restrictive Trade Practices (Non-notifiable Agreements)(Sale and Purchase, Share Subscription and Franchise Agreements) Order 1997 [NB: Repealed] definition

Summary

This definition has two parts. A "franchise" is a package of IP rights relating to trade marks, knowhow, etc. with revenue generated by the sale of sub-franchises or good / services. A "franchise agreement" is an agreement granting the right to exploit a franchise and including obligations relating to:

- use of a common trademark, trading name, etc.;
- trading premises / vehicle of uniform standard / specification;
- communication by franchisor of know-how; and
- continuing commercial or technical assistance.

Advantages

- a) This definition appears to catch those and only those commercial arrangements that would commonly be considered franchises.

Disadvantages

- a) This definition does not contain any requirement for the franchisor to have actual control as to how the franchised business is operated i.e. it does not on the face of it require the franchisee to run its business entirely in line with the franchisor's procedures or to allow the franchisor to insist on changes / additions to those procedures.
- b) The Order has been repealed and consequently may not be considered as straightforward for Parliamentary draughtsmen to rely on.

Figure 14 The Restrictive Trade Practises Approach to CRC drafting

US Federal Trade Commission Title 16, Chapter I, Subchapter D, Part 436 definition [LINK <http://www.ftc.gov/bcp/franchise/16cfr436.shtm>]

This approach has not been considered in detail. It is however a very detailed definition and expressly requires that the deemed franchisor be able to exert a 'significant degree' of control over how the franchisee conducts its business. This appears to be a key criterion for an acceptable definition of "franchise" for CRC purposes as in order for incentives to be effective the franchisor must have the ability to affect the franchisees energy consumption. This raises the question of what constitutes 'sufficient control' to incentivise the franchisor.

Figure 15 US Federal Trade Commission Approach to CRC Drafting

2.7.5 Conclusion

In the case of franchises, it appears that a suitable derogation from the eligibility criteria can be crafted to maximise the reputational drivers and ensure emissions coverage of all franchises operating under the franchisor's name. Whilst this is complex, it is not impossible and would deliver the policy objectives for the scheme.

2.8 Landlords and Tenants

2.8.1 Introduction

Defra recognised in its first consultation on instruments to reduce emissions from large non-energy intensive organisations in November 2006 that landlord-tenant arrangements could cause difficulties for CRC, since the ability to reduce emissions in a leased property is split between the landlord and the tenant. A landlord is, in general, able to change the fabric of his properties to make them more energy efficient, for example by improving insulation or changing light fittings. However a tenant is able to change its behaviour to consume less energy in the course of its business activities. In a previous consultancy project, Hedra explored the difficulties arising from this in more detail. As a result of this work and discussions with stakeholders, Defra proposed to assign emissions responsibility between the landlord and tenant on the basis of who pays the bill. This would work as follows:

- Where the tenant is paying the electricity bill, this electricity counts towards the total electricity use of the tenant (or the highest UK parent organisation of the tenant in the case of group undertakings) or;
- Where the landlord is paying the bill on behalf of a tenant or tenants, this electricity counts towards the total electricity use of the landlord (or the highest UK parent organisation of the landlord in the case of group undertakings).

This concept was the starting point of this project and has been considered in further similar scenarios such as outsourcing. On the basis of our research and analysis we recommend that Defra changes this “who pays the bill” proposal of allocating emissions responsibility to the “counterparty to the supply contract” rule. Our recommendation achieves the same result in most landlord / tenant scenarios, but benefits from increased legal clarity.

However, in a particular sub-set of circumstances, CRC landlords will be the counterparty to the energy supply contract thereby requiring them to account for CRC tenants' emissions for the purposes of the CRC. In such circumstances (where both landlord and tenant are CRC organisations), it may be desirable to allow responsibility for emissions to pass from the CRC landlord to the CRC tenant, to best leverage reputational and financial drivers. Tenants have an important role to play and should be encouraged to engage with energy efficiency. The CRC creates an opportunity for a constructive dialogue between landlord and tenant on energy use. One proposal made in Defra's June 2007 consultation to encourage this dialogue was to offer landlords the opportunity (on a once per phase basis) to transfer emissions responsibility to those tenants which also participate in CRC and which agree to take on that responsibility.

Defra asked Ecofys / Burges Salmon to carry out two pieces of work regarding landlord / tenant scenarios. The first was to develop further the proposal to transfer emissions responsibility between landlords and tenants, while the second was to investigate how landlords and tenants could best share the costs and benefits of CRC.

Transfer of Emissions Responsibility between Landlords and Tenants

The purpose of this part of the Landlord / Tenant project was to test the feasibility of transferring emissions responsibility from the landlord, where they are the counterparty to an energy supply contract, to their tenant(s). We considered two options:

1. Defra's original proposal that emissions responsibility could be transferred from the landlord to a tenant so long as:
 - i. both parties mutually agree; and
 - ii. both parties are CRC participants.

2. The alternative arrangement considered is that responsibility could be transferred *either* by mutual agreement, *or* at the choice of either the landlord or tenant so long as:
 - i. there is adequate sub-metering in place; and
 - ii. both the landlord and tenant are CRC organisations.

Issue: In a particular sub-set of circumstances, CRC landlords will be the counterparty to the energy supply contract requiring them to account for CRC tenants' emissions for the purposes of the CRC. In such circumstances, it may be desirable to allow responsibility for emissions to pass from the CRC landlord to the CRC tenant, to best leverage reputational and financial drivers. Tenants have an important role to play and should be encouraged to engage with energy efficiency. Investigation into the transfer of emissions responsibility was carried out where landlords are the counterparty to an energy supply contract to their tenant(s) and whether this should occur by i) mutual agreement or ii) unilateral consent.

Recommended Solution: Transfer of emissions responsibility from the CRC landlord to the CRC tenant should be allowed take place by mutual agreement of both parties where (a) the landlord has installed suitable sub-metering which gives the landlord and the tenant visibility over energy consumption levels, and (b) the relevant tenant's organisation is also a CRC organisation. We suggest that this flexibility is offered before each phase in line with organisation registration, the reporting of source lists and to minimise administrative burden.

Rationale: In the case of mutual agreement between both parties, it is clear and simple to ascertain which party is taking responsibility. It is significantly less administratively burdensome, as both parties would be aware of the transfer of responsibility. Requiring mutual agreement avoids the need for an additional process in the case of unilateral consent, whereby the Scheme Administrator would need to conduct an auditing process to determine whether criteria were met before transfer was authorised and subsequently inform tenants that responsibility for emissions has been transferred.

Figure 16

Many tenants in both single and multi-occupancy buildings have direct energy arrangements with suppliers. Where such direct relationships exist, the recommended position that the counterparty to the contract takes emissions responsibility would apply. Therefore the tenant's organisation will be the entity responsible for those energy-use emissions. As such the tenant organisation's aggregate emissions will be tested against

the inclusion threshold, if that organisation qualifies for the scheme the energy-use emissions from the leased property will also qualify. However, where that organisation's electricity use falls below the inclusion threshold the tenant organisation will be exempt from the scheme. While this may result in emissions loss from some leased property this loss is consistent with Defra's aim of targeting CRC at large organisations that are best able to respond to CRC.

The options under consideration, for transferring emissions responsibility from landlords to tenants are, therefore, only relevant where tenants do not have direct energy arrangements with suppliers meaning that the landlord is the counterparty to the electricity and other energy supply contracts.

To carry out either of the proposed approaches in practice, it is important to consider the questions set out in the table below, along with initial recommendations on how these challenges could be approached:

Table 1 Key issues in the Landlord/tenant transfer of responsibility

Key issue	Why important	Key concerns	Recommendation
What is adequate sub-metering?	<p>Criteria for transferring responsibility need to be set down clearly.</p> <p>Data need to be reliable.</p> <p>With a sufficient level of resolution this data could also be used by the tenant to monitor and manage their emissions.</p>	<p>If sub-metering is inadequate there will be insufficient information to justify the tenant taking responsibility for the emissions.</p> <p>Meters vary in quality: permanent versus clip-on, smart meters etc.</p>	<p>Adequate sub-metering should be a requirement if Defra adopts a mutual agreement approach or a one party elective approach.</p> <p>Defra should recommend the type of sub-metering required in general terms in relation to type of meter, permanence of meter and level of metering e.g. per floor, per tenanted space etc.</p> <p>Resolution must at least be sufficient to separate out individual tenants.</p>
Should participation in the CRC be determined before or after transfer of emissions responsibility from	To assess correctly inclusion in the scheme. For tenants this will be a criterion to allow them to receive emissions	Some landlords may fall out of the scheme if large tenants take on emissions responsibility. It is important to ensure	Without knowing where transfers had occurred, tenant participation in CRC needs to be assessed before the transfer but AS

<p>landlord to tenant?</p>	<p>responsibility. For landlords this determines which emissions could, potentially, be transferred. If this were to be carried out before CRC participants are identified, it could determine whether or not a landlord was in the scheme after transfer.</p>	<p>that inclusion is calculated correctly.</p>	<p>IF they had received responsibility for transferred emissions.</p> <p>Landlord participation needs to be assessed after any transfers have occurred.</p> <p>To simplify the process landlords and tenants could be asked to agree transfer before the deadline for submitting baseline-related information to Defra. This would enable the participants list to be set, and information submitted to Defra all at one point in time, enabling accurate assessment of those who meet the inclusion threshold.</p> <p>This approach would put a timing pressure on landlord and tenants to make decisions about transfer between themselves, which may in itself require data. Defra must consider this pressure when setting deadlines for information in the landlord/tenant</p>
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			sector.
When should the transfer of responsibility occur?	Needs to be a clear system in place: Set window of opportunity, annually, or whenever participants choose?	If transfer is only allowed at one point in time there will be limited flexibility - no transfer is possible to new tenants and upon relocation but this would benefit from lower administrative costs.	Pre-phase window of opportunity: This is in line with other business change approaches, and will be more straightforward to monitor and enforce.
Mutual agreement necessary or not?	Mutual agreement may be necessary to ensure that the tenant buys-into, and therefore properly takes on board its participation in the CRC.	Mutual agreement could be used as a way for tenants to refuse to take on this responsibility. Without mutual agreement it appears that landlords have increased control over how tenants' emissions are allocated. It may also require more administrative effort from Government to ensure that both parties were aware of the transfer of responsibility It may be hard to achieve mutual agreement.	Landlords are likely to prefer unilateral decisions whilst tenants may prefer a mutual agreement approach, although not in all cases. Either approach has advantages and disadvantages.
How to ensure rigorous transfer?	Rigorous information about which party is responsible for included emissions is necessary for effective operation and enforcement of the scheme.	Tenant could be unaware that they are responsible (particularly if there is not mutual agreement).	Defra will keep a list of participants in the CRC including those who will participate as tenants vs. landlords. There would also need to be a system of notification for

			tenants in the absence of mutual agreement.
Who will administer transfers?	There needs to be a practical process in place in order to ensure that transfer of emissions responsibility takes place as intended.	A central non-interested party should help administer transfers to ensure that they are carried out fairly. This would most likely be the Scheme Administrator.	The Scheme Administrator or a third-party contractor/verifier, should administer transfer decisions to ensure metering and CRC threshold criteria are met. This type of verification can be very time consuming and burdensome. Emissions data may be required.
What practical processes are needed?	Some administrative processes are needed.	Without appropriate administrative processes in place, transfers will be confusing and could result in the loss of qualifying emissions.	Defra should have a form for transferring responsibility and a web-based process for administering transfers.

As shown in the table above, at the basic level, Defra will need to develop a well-administered and clear cut process for transferring emissions responsibility from landlords to tenants. This process should take place over a restricted and defined time period and should take place before each phase begins, in keeping with the approach taken to business change. Sub-metering could be considered adequate if it meets guidelines that Defra should set in broad terms on the basis of resolution of meters and type or quality of meters. Transfer of responsibility could be by mutual or unilateral consent.

A step-by-step process could be described for the cases of both mutual and unilateral consent and these steps are set out below.

Mutual consent

1. Step 1: Set guidelines. Defra set out clear guidelines for the transfer of responsibility, including an explanation of the criteria for transferring responsibility, information required to prove that these criteria have been met, and deadlines for submitting this information to the competent authority.

Rationale is to make the process clear and transparent for participants, and straightforward to administer for government.

2. Step 2: Participants consider transfer. Landlords (primarily, as these are those initially obliged) but also informed tenants, to consider their position in relation to transfer and to discuss mutual agreement of transfer with each other.

Dialogue is necessary for both parties to consider transfer, in order for it to be effective.

3. Step 3: Where the parties wish to attempt transfer of responsibility for emissions, the landlord and tenants parties will need to gather information to ensure that they meet the necessary criteria, such as sub-metering requirements. Where required by Defra's guidelines, independently verified information will be provided, noting that this could be burdensome.

To ensure that transfers are valid, and therefore that transfers will result in effective functioning of the CRC.

4. Step 4: The parties need to notify system administrator of their desire to transfer emissions responsibility, their resultant emissions baseline information and any other information relevant to the criteria set out by Defra initially.

To allow for transfers to be assessed in good time and independently.

5. Step 5: The competent authority must use this information to assess whether or not transfer of emissions responsibility is possible in this case. The relevant CRC participant(s) can then be added to the register of participants, and any baseline information noted.

To ensure that rigorous records of transfer are kept and that baselines are assessed accurately in the light of any transfers.

6. Step 6: The competent authority sends confirmation to landlord and tenant of the successful or unsuccessful nature of their emissions responsibility transfer.

To ensure that participants in the scheme are fully aware of their responsibilities under the CRC.

7. Step 7: For subsequent phases of the scheme the transfers of emissions responsibility may need to be reassessed. Defra should set out advice accordingly in advance of future phases of the scheme, and in good time for participants to prepare for any changes.

To ensure that in future phases transfers are assessed appropriately.

Unilateral consent

If unilateral consent only is required then the steps required will still be the same, with the exception that in Step 2 and 3, only landlords need to be engaged, although they would preferably discuss the issue with their tenants, this can not be guaranteed.

It is even more necessary, under this scenario, for the competent authority to send information to both parties in Step 6, because tenants may not be aware of the fact that they are going to take on emissions responsibility under the CRC. The notification may result in a further stage of communication with the newly-responsible tenant to inform them of their obligations.

Freehold and leasehold

The counterparty to the supply contract clarifies the case of freeholds and leaseholds. For example, if the local authority is the freeholder for a shopping centre, but a landlord

(Company A) has a long term (for example 999 years) leasehold interest in the property, runs the shopping centre and is the counterparty to the supply contract, the highest UK parent organisation of Company A would be the CRC organisation. The leaseholder in this case clearly has the authority to implement energy efficiency in the shopping centre (potentially in co-operation with tenants). Using the standard eligibility criterion of the "counterparty to supply contract" ensures that the shopping centre does not fall into the Local Authority CRC portfolio, where there is no control over the energy use.

Updating baselines

For reasons of administrative simplicity, it would not be practicable to carry out updates to CRC baselines in respect of any transfers between landlords and tenants – whether unilateral or mutual. Updating baselines in respect of site based changes of operation would be very challenging, as the CRC is expected to cover around 5000 organisations. The decision not to update updating baselines in this case would minimise the administrative burdens on landlords, tenants and scheme regulators arising from site based changes of operation.

The following case studies on two large-scale landlords, Prupim and Land Securities illustrate how the inclusion criteria would take effect:

Landlord-Tenant case study: Prupim

PRUPIM forms part of the M&G Group of Companies which is the asset management arm of Prudential PLC, an international retail financial Group. PRUPIM currently manages around 1,000 properties with over 6,000 individual tenancy agreements.

PRUPIM does not manage the properties itself. The company uses the services of two Facility Managers (FM): DTZ for all offices and retail, MacLellan for its 10 shopping centres. The remaining properties are not managed by the contracted facilities managers, as they are occupied by sole tenants. Even where facilities management companies are used, PRUPIM remains the counterparty to the contract.

PRUPIM has centralised records of mandatory half-hourly meters for the facilities that it manages through DTZ and MacLellan. This uses software and a data base provided by TEAM EA, a utility bureau. PRUPIM does not hold the data for the properties that it does not manage. This information is held by the tenants. Prupim does not currently have sub-metering throughout all of its properties.

Analysis: PRUPIM would be responsible for electricity consumption where it is the counterparty to the electricity supply contract (Definition 3).

PRUPIM is also likely to be the organisation responsible under the alternative criteria:

"Undertaking which pays the bill"(Definition 1): either PRUPIM or Tenants

"Undertaking to which electricity is supplied" (Definition 2): PRUPIM for common parts of managed portfolio or Tenant

Whilst the CRC organisation under all three criteria remains the same, definitions 1 and 2 are less robust from a legal perspective.

As shown in the diagram below, some of PRUPIM contracts are under facilities management contracts with DTZ and McLellan. The energy contracts and bills are arranged and paid directly by PRUPIM. Where the buildings are not managed by organisations contracted by PRUPIM, the contracts and bills are with the Tenants:

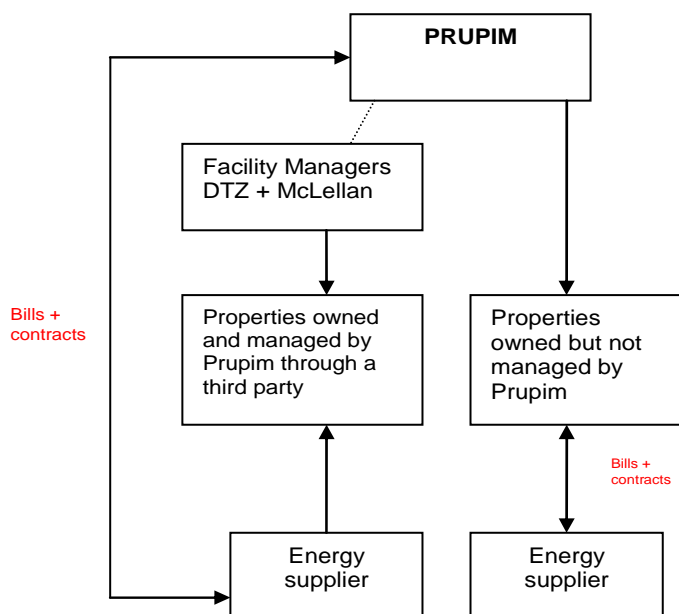


Figure 17 Case Study Landlord/Tenant issues: PRUPIM

Landlord-Tenant case study: Land Securities

Land Securities is the UK's largest Real Estate Investment Trust with a commercial property portfolio worth over £14 billion with headquarters in central London. It provides property services to more than 2,500 private and public sector clients.

The Group currently manages two-thirds of its properties portfolio. For the remainder that it does not manage directly, the Group does not pay the bills or hold the supply contract. Its current electricity bill is estimated at £12m for half-hourly meters and £800,000 for non half hourly meters.

Land Securities own and manage 22 shopping centres, of which only 3 currently provide tenants electricity via sub-meters. Around 20% of Land Securities' London office portfolios have sub-meters for tenants electricity.

In the new larger office developments, Land Securities tend to be responsible for paying the energy bills and buildings can have hundreds of sub meters. It is generally impractical to have separate low voltage supplies from the electricity company direct to the tenants.

An example of a building within Land Securities' portfolio is 80-100 Victoria Street, London. This is a large complex with up to 200 sub-meters for electricity directly used by the tenants. Land Securities is responsible for the energy use in communal parts which includes: lifts, lighting, heating and air conditioning for office space. Costs are passed onto the tenants through service charges for the communal areas. Energy directly used by the tenant will be recovered from the tenant by a separate charge.

Analysis: The organisation responsible for emissions under the recommended criterion "Undertaking which is counterparty to the electricity supply contract" (Definition 3) is Land Securities though some responsibility could be transferred to those Tenants which qualify for the scheme in their own right, if Defra takes forward the emissions transfer proposal.

Land Securities (or Tenants if they qualify in their own right and are nominated for the purposes of the scheme) are also likely to be the organisation responsible under the alternative criteria:

"Undertaking which pays the bill" (Definition 1): either Land Securities or Tenants.

"Undertaking to which electricity is supplied" (Definition 2): Land Securities for common parts of managed portfolio or Tenant.

Whilst the CRC organisation under all three criteria remains the same, definitions 1 and 2 are less robust from a legal perspective.

Figure 18 Case study Landlord tenant issues: Land Securities

A variety of arrangements for the tenant's energy supply exist and this variety is explored below. Because of the extensive range of models, it is not possible to judge the extent to which the current proposal maximises emissions coverage, or the degree to which the potential emissions losses will have an impact. The three-year initial phase of the CRC will provide more data on this issue.

A range of models: Land Securities

Interviews indicated that the extent of direct relationships between tenants and energy suppliers is not straightforward. The types of different models that could exist are set out below for the case of Land Securities, including the likely CRC implication under the current proposal.

Whole building let to sole Tenant

- Tenant has responsibility for buying energy
- CRC responsibility assigned to Tenant

Multi-tenancy properties scenario 1

- Landlord pays for common parts only which will include lighting, lifts, heating for tenants and may include air conditioning for the whole building
- Tenant has own electricity supplies for lighting and power
 - The tenant's direct energy consumption is aggregated with tenant's organisation which will be tested against the inclusion threshold in its own right.
 - Landlord retains CRC responsibility for common parts only.

Multi-tenancy properties scenario 2

- Landlord pays for all power
- No sub-metering installed - tenants recharged by net lettable floor area.
- CRC responsibility assigned to Landlord who could seek to pass on the costs of allowances and financial benefits of energy savings/performance bonuses by floor area apportionment.

Multi-tenancy properties scenario 3

- Landlord pays for all power
- Sub-metering installed for tenants power
- Tenant is billed on actual usage by landlord separate to Service Charge
- CRC responsibility assigned to Landlord as regards common parts and tenants which are not CRC participants.
- Where a tenant's organisation is a CRC participant and either the landlord or tenant elects or they mutually agree (depending on which option Defra implements), emissions responsibility is transferred to the tenant's organisation.

Multi-tenancy properties scenario 4

- Landlord pays for all power for major complex
- Tenant mix includes office and retail
- Retail units have own electricity supply
- Landlord provides gas supply to Retail units
- Sub-metering installed for tenants power
- Tenant is billed on actual usage by landlord separate to Service Charge
- Offices heating and air conditioning provided by landlord and recovered via service charge
- All tenants have service charge element for their share of building's communal areas plus service charge for estate covering basement car parks and external lighting
- CRC responsibility assigned to Landlord as regards common parts and tenants which are not CRC participants
- Where a tenant's organisation is a CRC participant and either the landlord or tenant elects or they mutually agree (depending on which option Defra implements), emissions responsibility is transferred to the tenant's organisation.

There is no practical difference between this scenario 3 and scenario 4 for the purposes of the CRC scheme, however the obligations for the latter are more complex.

Figure 20 A range of relationships between tenants and landlords: Land Securities

2.8.2 Apportioning costs and benefits of the CRC between landlords and tenants

Issue: Defra asked Ecofys / Burges Salmon to examine different ways that landlords could share the costs and benefits of the CRC scheme with tenants.

Recommended Solution: To establish a separate set of voluntary guidance for landlords on how to pass on costs and benefits to tenants in various situations, i.e. with or without sub-metering in place. Costs can be passed onto tenants through a) the service charge, b) a separate direct charge, c) using the revenue recycling payments to finance energy management. Landlords may be able to pass on costs and benefits to tenants by making provision for such costs in new leases.

Rationale: The financial and CSR drivers of CRC provide wide opportunities for landlords and tenants to share the costs and benefits of CRC. As the CRC participant the landlord will benefit from visibility in the performance league table. Tenants on the other hand could benefit from the landlord's energy efficiency investments through reduced energy costs in the service charge. Whilst there is no guarantee that costs can be passed from landlords onto tenants in the case of all existing leases, the scope for both parties to see benefits from CRC should drive productive dialogue between landlords and tenants so that they can develop mutually beneficial approaches to CRC compliance.

Potential Options for Landlords: Costs can be passed onto tenants through a) the service charge, b) a separate direct charge, c) using the revenue recycling payments to finance energy management. Where sub-metering is not in place, benefits could be used over several years to cover the costs of the installation of sub-meters. Where sub-metering is in place, benefits could be allocated to tenants according to their energy use. The use of benchmarking prior to the implementation of the CRC scheme could provide landlords with an assessment tool which can help assess tenants' energy performance by sector.

Figure 19

It is likely that some landlords will always remain responsible for some tenants' emissions, regardless of which solution to the initial issue is chosen. This is because there will always be situations where the option to transfer emissions responsibility cannot be taken since the criteria for reallocation are not met. For example a landlord would retain emissions responsibility in the CRC where it is the counterparty to the energy supply contracts for a building occupied by tenants that are not CRC participants. In these situations the landlord would be responsible in the CRC for emissions that are partly under the control of their tenants. In reality, responsibility for emissions from a leased building is shared between both the tenant and the landlord and both have a part to play in reducing energy-use emissions. However it is impractical to apportion accountability between landlords and tenants on the basis of say a percentage responsibility formula system for reasons of administrative burden and simplicity. This is, again, one of the reasons why Ecofys / Burges Salmon recommend that Defra uses the clear cut rule of assigning responsibility for emissions on the basis of the counterparty to the energy supply contract. Defra recognises that tenants have an important role to play

and should be encouraged to engage with energy efficiency. CRC creates an opportunity for a constructive dialogue between landlord and tenant on energy use. As such Defra asked us to investigate how the costs and benefits of CRC can best be shared between landlords and tenants. It is important to note that in the case where landlords are responsible for tenants' emissions, interviews with landlords emphasised the need to permit the landlord to recover the costs either via the service charge or via a direct charge to the individual occupier. Otherwise the costs of participating in the CRC scheme will fall to the landlord who is taking responsibility for the tenants' emissions.

Costs

Two sorts of costs have been identified:

1. Direct costs: these costs are associated with purchasing allowances in the auction, administrative and IT expenses and any penalties incurred. There are two options below describing how direct costs could be recovered.
 - i. Where CRC Landlords have properties that do not have any, or inadequate, sub-metering installed, Landlords could simply pass direct costs by floor area apportionment.
 - ii. Where CRC Landlords have properties that have proper sub-metering, the amount of energy consumed is clear and Landlords could pass direct costs down on the basis of actual usage.

2. Up-front expenditure on energy efficiency measures: sub-metering

Defra has clearly stated that no legal requirement would be adopted under CRC to enforce the installation of sub-meters. In most cases, the installation of sub-metering will result from a Landlord initiative or concerted approach with Tenants. Landlords could recover the costs of installing metering through:

- i. The service charge.
- ii. A separate direct charge.
- iii. Using the revenue recycling payments to finance energy management, rather than passing through a recycling payment to each tenant (unless either the particular lease in question requires the landlord to pass the payments on).

In the cases of Land Securities and PRUPIM outlined in the case studies, the landlords would seek to pass on costs to tenants using the options outlined above. Interviews with members of the British Property Federation also indicate a need for separate-stand alone voluntary guidance on how landlords can pass on the costs of the CRC scheme to tenants.

Legal elements of cost-pass through

Service charge provisions in commercial leases are intended to pass to the tenants a share of all (or most) costs of property ownership and management, producing a "clear" rent in the landlord's hands.

A lease is merely a special form of contract and, barring statutory intervention, the parties are free to settle such terms as they wish; however, in most cases, amending the terms of existing leases would require the consent of both parties.

Whilst there has been a move towards standardisation in recent years, there is no universal form of service charge clause and hence *no certainty that landlords could pass on the costs and benefits of the CRC scheme to tenants in the case of existing leases*. The only case where landlords may be able to pass on costs and benefits to tenants in the case of existing leases is if there is a generic category in the terms of the contract which makes provision for introduction of new costs, such as those which will be incurred under the CRC scheme.

For example, many recent leases will contain a provision requiring a tenant to pay all "Outgoings" where "Outgoings" are defined to include costs such as "all existing and future rates charges duties and outgoings of any sort (whether assessed or imposed on owners or occupiers)". A provision along these lines would be likely to catch the direct costs of participation in the CRC and *may* (depending on the exact wording used), enable a landlord to pass on the indirect costs of installing sub-metering.

The Service Charge Code³ is a set of recommended definitions and recovery procedures. It does not override existing lease provisions, but is intended to promote good practice. A change to the Code to cover the CRC may be an effective way to try and stimulate best practice in the field, but it will not ensure the passing on of costs in the case of existing leases, whose terms will commonly be for 5, 10, 15 years, etc. Interviews suggest that separate stand alone non-binding guidance could be helpful to outline the ways to apportion costs and benefits.

Ultimately, the only way to ensure that landlords are able to pass through costs and benefits would be to legislate by incorporating in the Regulations a provision entitling or obliging landlords to pass any costs and benefits to its tenants. In the absence of any such legislation, allocation of costs between landlord and tenant would be a matter for negotiation between landlord and tenant. Legislating to require a pass through of costs and benefits would mandate a change in existing lease conditions, which has little precedent in legislation. In terms of equity, it is not clear that that the landlord/tenant situation is sufficiently different to all other types of contractual arrangement to warrant special treatment. Our case studies have concentrated on larger landlords rather than tenants, as the most able to provide the range of information required in the timescales of this study. As such, there was not sufficient balanced evidence to provide a recommendation on whether or not legislation in this area would be desirable by both landlords and tenants.

³ www.servicechargecode.co.uk

Landlord-Tenant Case study: Workspace

Workspace currently provides flexible business space for approximately 4,500 micro-business/ small enterprises. The organisation has over 100 multi-tenanted business centres – a total of 6 million sq ft of business space.

Over 90% of its consumers are on a two year lease with a three month rolling break clause where either party can terminate at any time by giving three months' notice.

Length of tenants stay with Workspace:

- 30% of tenants leave within a year
- 20% leave within 1-2 years
- 23% stays over 5 years

Customer turnover is around 20% per annum – this covers those leaving the WSG portfolio or moving to other WSG properties.

Due to its metering arrangement, Workspace will be captured by the scheme but it envisages that none of its customers would be captured by the CRC.

1. Where sub-meters are in place, Workspace could pass down costs as total building by floor area apportionment.
2. Where sub-meters are not in place, Workspace could pass down cost down as a percentage on energy costs.

Analysis: Workspace would be responsible for electricity consumption where it is the counterparty to the supply contract (Definition 3).

Organisation eligible under the alternative criteria:

1. "Undertaking which pays the bill" (Definition 1): Workspace
2. "Undertaking to which electricity is supplied" (Definition 2): Workspace for common parts or Tenants

Whilst the CRC organisation under all three criteria remain the same, definitions 1 and 2 are less robust from a legal perspective.

Figure 20 Case study Landlord Tenant: Workspace

Benefits

There are several ways in which the benefits i.e. bonuses of the scheme could be recycled back to participants:

- Where sub-metering is not in place, benefits could be used over several years to cover the costs of the installation of sub-meters (see above).
- Where sub-metering is in place, benefits could be allocated to tenants according to their energy use over the previous five years. This approach would however be impracticable for landlords such as Workspace which provides space to tenants on a relatively short term basis. (see Figure 20 above)

- A league table could be used by landlords to rank their tenants, and then allocate the benefits accordingly. A league table approach could be an effective means of driving behaviour for those tenant organisations which are mindful of their public reputation. However, for some landlords, the administrative costs involved in operating such a league table would need to be balanced against the relatively small revenue recycling payments to individual tenants.

In addition, consideration would need to be given in putting organisations from diverse sectors in the same league table given the differences between their energy consumption patterns. However, a tool based on benchmarking which assesses an organisation's energy performance by sector would help engage with the tenants.

- Assessment tools such as LES-TER (Landlord's energy statement and tenant's energy review⁴) could be used in combination with operational energy performance ratings to help apportion benefits. These include :
 - The requirement for Display Energy Certificates: This comes into force from 6 April 2008. These Certificates require an operational rating (based on energy consumed over the previous 12 month period), which is verified by an approved Energy Assessor. It is mandatory for public sector buildings. Similar tools could be implemented on a voluntary basis across the Property Management industry
 - The Energy Efficiency Accreditation Scheme (EEAS) managed by the National Energy Foundation on behalf of the Carbon Trust provides an accreditation based on the scoring of 3 years of energy management. Three years evidences of good practice are needed to be accredited. The organisation must score a minimum of 60%.

Example of good practice: LES-TER Project⁵

The British Property Federation Project – Landlord Energy Statement (LES)/ Tenant Energy Review (TER) – has been developed with funding from the Carbon Trust, and with the support of the British Council for offices (BCO), the Chartered Institution of Building Services Engineers (CIBSE) and the Usable Building Trust (UBT).

The Landlord's Energy Statement (LES) is a tool for landlords and managing agents to understand the energy use and carbon dioxide emissions associated with providing communal services (such as heating, lifts and lobby lighting) in their buildings. The LES tool compares the performance against similar buildings with similar use, identifies any areas for improvements and illustrates where year on year improvements have been made.

⁴ www.les-ter.org

⁵ Source : *British Property Federation*

The BPF, BCO and CIBSE have formed a research partnership to develop the Tenants' Energy Review (TER) which is the parallel supporting project to LES. This project covers the energy consumed by the buildings' users, so that a complete and more detailed picture can be drawn up of the total energy use. The TER project is being developed with technical assistance from the Usable Buildings Trust. It will provide a framework for tenants to adequately measure, benchmark and improve their energy use, whilst encouraging landlords and tenants to work together to maximise their reduction of energy consumption in the buildings they own and occupy.

2.8.3 Conclusion

We recommend separate stand-alone voluntary guidance on the CRC for landlords to illustrate how costs and benefits could be allocated to tenants. It is important to be aware that there is no certainty that landlords could pass on the costs and benefits of the CRC scheme to tenants in the case of existing leases. The evidence from case studies has not provided sufficient balanced evidence to form a clear recommendation on whether landlords should be required to pass on costs and benefits of the CRC scheme. Ultimately, the only way to ensure that landlords are able to pass through costs and benefits would be to legislate; however, the CRC regulations may not be the appropriate forum to review laws on lease arrangements, as to do so would be against the principles of Better Regulation.

Defra will need to develop a well-administered and clear cut process for transferring emissions responsibility from landlords to tenants, as suggested in the step-by-step process outlined above, which could be by either mutual or unilateral consent.

3 Strand 2: Business sector

3.1 Introduction

Taken at its simplest level, any organisation in the public and private sector that uses in excess of 6,000MWh of electricity per year through half-hourly meters in Great Britain (and 70kW metering systems in Northern Ireland), would qualify in their own right for inclusion in the CRC scheme. However, for the scheme to leverage the correct financial and reputational drivers and to capture organisations at the highest level within their structure, a number of elements have to be considered in the design of the scheme.

This section covers the following issues with regards to the private sector:

1. Developing appropriate definitions to capture individual organisations, including those that do not qualify as a separate legal entity in their own right.
2. Defining a 'Group' to capture organisations within a group structure for the purposes of aggregation to maximise coverage of the scheme where appropriate.
3. How the scheme could work in the case of Joint Ventures, Joint Ownership, Private Equity and Venture Capital scenarios.
4. How the scheme should aggregate emissions and determine qualification for overseas organisations without a UK based parent.
5. How to reflect business changes that occur during a CRC phase.

3.2 Business Organisations

Issue 1: How to capture individual organisations, including those organisations (i.e. some partnerships, unincorporated associations, trusts, etc.) which, while not separate legal entities in their own right, would otherwise qualify for the scheme?

Recommended Solution: Capturing such individual organisations should not be an issue; if the recommended criterion for responsibility is applied, being the 'counterparty to the supply contract' then this will, in all cases, be a 'legal person' in law (i.e. someone who could be sued for breach or default under that contract). For organisations which are not separate legal entities, the counterparty to the supply contract will be the individuals running the organisation (i.e. partners, trustees, etc.), who individually are unlikely to meet the inclusion threshold.

Rationale: If the test for responsibility to be applied is the 'counterparty to the supply contract', this criterion is robust for all types of legal entity which would include, for instance, all companies, limited liability partnerships and industrial and provident societies. It would also apply to individual persons, unless an appropriate derogation expressly excluding individuals is included in the Regulations.

Figure 21

The application of the CRC scheme to organisations which are legal persons should not present any issues regarding their eligibility. The entity whose emissions are eligible for the purposes of the CRC will be the same entity which is the counterparty to the electricity supply contract. However, since this recommended eligibility criterion can only apply to legal persons (as only legal persons can contract for the supply of electricity), it is worth considering how the scheme will apply to those organisations which are not separate legal persons in their own right.

Individuals and companies are 'legal persons' and have 'legal personality' since they both can contract and attract legal liability in their own right. There are however certain organisations which are not legal persons in their own right; these include some types of partnership, unincorporated associations, trusts and other business organisations.

In organisations such as these, the 'counterparty to the supply contract' will not be the organisation itself since it is unable to contract for the supply of services. Instead, the counterparty will be the individual persons who run the organisation (for example, the names on the supply contract would be all of the individual partners, or all of the trustees, or the individual who owns that business organisation). Defra will need to decide whether or not individual people should be responsible within the scheme, if they would otherwise qualify. There is no legal barrier to this if they are counterparty to a supply contract with emissions arising from energy-use over the inclusion threshold.

There would probably be very few situations in which this might apply to an individual person, given the inclusion threshold. However, inclusion in the scheme of individual persons would reduce the risk that any business organisation which is run as a simple partnership, or through a trust, for example, would otherwise fall out of the scheme. Market research would be necessary to ascertain whether there are currently any business organisations which would fall into this category.

3.2.1 How to define a 'Group'

Issue 2: How to ensure that the wider business organisation, which an individual organisation forms part of, is included under the scheme? Capturing wider business organisations would enable emissions to be aggregated at the highest level where the CRC drivers are expected, in general, to act most strongly. It would also ensure that one legal person could be designated as the party responsible for compliance with the scheme.

Recommended Solution: Capture wider organisation by fashioning appropriate definition of group, targeting the highest parent undertaking, making use of the concept of undertaking from the Companies Act 2006.

Rationale: Simplicity is maintained as the administrative burden is placed at highest level of a Group and is consistent with current business practice. By aggregating emissions at the highest level, greater emissions coverage is achieved and the responsibility for these emissions is placed at the highest level of organisation where CRC drivers will have the greatest influence. However, various additions to the Companies Act definition of "undertaking" will be required to address the fact that certain types businesses and organisations will not necessarily fall within the definition of 'undertaking' (including individuals and trusts, industrial and provident societies, Limited Partnerships, Limited Liability Partnerships and universities, for example).

Figure 22

Default Position

The Defra consultation document of June 2007, proposed that business organisations would be identified on the basis of group structures, with the highest UK parent organisation participating in the scheme and reporting on behalf of the whole group, with groups to be identified on the basis of definitions drawn from Part 38 of Companies Act 2006. To identify the CRC organisation, Government would require bill payers of qualifying electricity to pass the billing information to their highest UK parent organisation. This organisation would be responsible for returning the aggregated information to the scheme administrator.

Analysis: As set out in Strand 1, the *'counterparty to the supply contract'* should be relatively easy to ascertain on the basis that the name of the legal person liable to pay the bill will be stated on the face of the energy supply contract. The question will then be how to tie in other members of any corporate grouping of which that entity forms part, together with their respective emissions, for the purposes of aggregation and so as to maximise coverage of the scheme.

Where any counterparty to a supply contract is a corporate undertaking and forms part of a wider business organisation: (a) to ease the administrative burden on the relevant organisation; and (b) to ensure maximum coverage, it is intended that the qualification

test be applied to that Group as a whole, i.e. all emissions across the Group will be aggregated and, if emissions exceed the inclusion threshold, the scheme will include the whole Group. (Note that under the proposed approach for taking account of business changes, the participant parent undertaking would need to keep a record of the energy use of its individual subsidiary 'undertakings' which would qualify to participate in the scheme in their own right).

In line with this approach a suitable definition has been explored to identify the top 'undertaking' in a Group in a wide variety of situations (including with reference to joint ventures and private equity structures) so as to test how the CRC scheme might apply to that Group. Preliminary thinking suggested the definition of '*highest UK trading entity*' as a potential starting point.

We have now considered and tested this definition to see how it might apply in a number of scenarios. In doing so, it appears that the broader concept of 'undertaking' would be preferable in this context rather than 'entity', as the definition of 'entity' would tend to be restricted to a legal person (and would not therefore cover a simple partnership etc). The use of the word 'trading' in the definition is too restrictive since a 'holding' or 'parent' undertaking might be deemed, from a legal and accounting perspective, to be non-trading. In law, an 'entity' is merely something capable of having legal rights and obligations. An 'undertaking' is a wider concept which will encompass organisations which will not necessarily have corporate personality in their own right.

If the definition were restricted to undertakings incorporated in the UK, concerns may arise in the business community that this could operate to prejudice UK Groups when compared to overseas-owned Groups (see Overseas Ownership section). Therefore, the recommended option would be to revise the definition to capture the 'highest parent undertaking' in a Group, irrespective of the nationality of such undertaking.

3.2.2 Recommended solution

We recommend that, for every counterparty to an electricity supply contract, its "group" comprise of *"that person any subsidiary undertaking or any parent undertaking for the time being of that person or any subsidiary undertaking of any such parent undertaking."*

The phrase "*undertaking*" should be derived from the definition contained in section 1161 Companies Act 2006. The phrases 'subsidiary undertaking' and 'parent undertaking' should similarly be derived from definitions in section 1162 (2) (a) & (b).

Rationale

If the whole of s.1162(2) Companies Act 2006 is used as the basis for the definitions of 'parent undertaking' and 'subsidiary undertaking' the definition of 'control' could be extended for the purposes of grouping. This extension would take 'control' beyond simply voting rights or the ability to appoint or remove the majority of the board of directors (the usual bases on which 'control' is understood) and envisages the possibility of 'control' derived from either the exercise of a dominant influence or pursuant to the terms of an agreement entered into with other shareholders.

We anticipate that it will be highly difficult, if not impossible, for the administrator of the CRC scheme to ascertain whether or not a particular undertaking "exercises a dominant influence"⁶ over another undertaking or whether there is a shareholder's agreement in place which permits one undertaking to exercise control over another. Accordingly, we recommend that the definition of 'subsidiary undertaking' be limited for the purposes of the CRC to that part of the definition falling within s.1162(2)(a) and (b), which encompass the 'usual' bases for ascertaining 'control' referred to above.

This definition is broad enough to enable the scheme to capture organisations based outside the UK and therefore does not prejudice UK Groups when compared to overseas owned Groups.

It is worth noting that there are a number of other types of business or organisation which would not necessarily be covered by simply adopting the Companies Act definition as proposed (as it is very much tied to the Act itself), although in most cases these will be legal persons in their own right and could (or would in all likelihood) be also captured as a relevant '*counterparty to the supply contract*'.

This is not a significant disadvantage to the proposed solution, as the definition could be further developed for the purposes of the scheme to ensure that they are also covered. Examples of other such businesses/organisations which do not fall within the strict s.1161 CA 2006 definition of 'undertaking' include:

- individuals and trusts (who might hold a large property portfolio, for instance);
- industrial and provident societies (governed by the Industrial and Provident Societies Act 1965, as amended);
- LPs (Limited Partnerships Act 1907, as amended);
- LLPs (Limited Liability Partnership Act 2000, as amended, although legislation to deal with the application of the Companies Act 2006 to LLPs is in progress and this will need to be reviewed further in due course); and
- universities (some of which are established by charter of incorporation and/or specific statute).

Additional Definitions

Additional definitions which the parliamentary draughtsman might consider useful in refining the Companies Act definition for the purposes of the scheme, include that of an "associated company" as defined in Section 416(1) Income and Corporation Taxes Act 1988 and a "body of persons" at Section 832 ICTA 1988.

⁶ Note that Undertaking A is regarded as exercising a "dominant influence" over Undertaking B if it has a right to give directions with respect to the operating and financial policies of Undertaking B which the directors of Undertaking B are obliged to comply with whether or not they are for the benefit of Undertaking B

Individuals

By the same token, the definition of 'undertaking' could theoretically also be extended to encompass individuals. By doing so, one could relatively easily capture within the CRC any other business organisation run by that person (on the assumption that the individual would exercise the majority of the voting rights in such business organisations and therefore constitute the 'parent undertaking'). The 'Group' definition could be made to work in a similar way with a few simple modifications.

Whilst this may be feasible, however, and despite the potential for a certain expansion in coverage of the CRC, we are not convinced of the policy merits of including individuals in the CRC. Given the significant eligibility threshold, the only individuals likely to be caught by such a provision are likely to be wealthy entrepreneurs (e.g. Sir Richard Branson, Phillip Green, etc) and our recommendation is that the reputational drivers are likely to operate better at the level of the highest parent corporate entity (i.e. the Virgin Group Limited) rather than at an individual level, especially since most such entrepreneurs do not have the public profile of the individuals named.

The only instance where we would recommend that the Regulations provide for inclusion of individuals within the scheme is where a particular individual is personally the counterparty to an electricity supply contract and consumption under that contract exceeds the eligibility threshold. In such a scenario, it would seem inequitable to neglect the emissions resulting from such energy use.

3.2.3 Conclusion

If the test for responsibility is to be applied so as to capture the 'counterparty to the supply contract' then this will, in all cases, be a 'legal person' in law (i.e. someone who could be sued for breach or default under that contract). This method is robust for all types of legal entity which would include, for instance, all companies, limited liability partnerships and industrial and provident societies. It would also apply to individual persons.

In terms of crafting an appropriate definition of group, by making use of the concept of undertaking from Companies Act 2006, this places responsibility at highest level of a Group which achieves wide emissions coverage.

3.3 Joint Ventures / Joint Ownership

Issue: Defra's June 2007 CRC consultation, which included targeting group structures based on Companies Act definitions did not explicitly state how various types of jointly owned undertakings would be treated. How should jointly owned undertakings be affected by CRC? Is an alternative approach required to maximise emissions coverage from these undertakings?

Recommended Solution: In the case of majority equity stakes, emissions of the parent and subsidiaries would be aggregated to the majority stakeholder, making use of concept of undertaking from Companies Act 2006. Where an organisation only holds a minority stake (50% or less) of another company, the company's emissions should not be aggregated with that of its minority shareholder. In such cases the jointly owned company would qualify in its own right for the scheme, if it meets the inclusion threshold.

Rationale: Under this approach, it will be clear and simple to determine which organisation will be responsible for the purposes of the scheme. It is highly unlikely that a minority shareholder would make the final decisions on investment in energy efficiency measures in the companies it invests in. In the case of the majority shareholders, they exercise control over the company and have a direct responsibility for its activities, therefore the effectiveness of the financial and reputational drivers is maximised.

There would be a loss of coverage in cases where individual companies with no majority shareholder do not meet the inclusion threshold in their own right. However, this is outweighed by the goal of administrative simplicity. In those cases where the jointly owned company does pass the CRC inclusion threshold, it will of course be targeted in its own right, and in this context the financial and reputational drivers will be leveraged appropriately.

Figure 23

3.3.1 Introduction

There will be instances where businesses have been set up and are owned/ managed by two or more different organisations. There are very many potential, but typical scenarios, where there is no single controlling shareholder (i.e. no one with greater than 50% control) including multi-party joint ventures and private equity structures (where the Private Equity firm will frequently take only a minority stake in the investee company).

Joint ownership is also relevant in the public sector, since the structures regularly employed in PFI/PPP contracts result in the project company contractually liable to deliver the service to the public authority being owned by several minority shareholders with no overall parent undertaking. See Strand 1 for further analysis on this point.

Default position

The Defra consultation document (June 2007) did not propose to allocate responsibility for emissions of a jointly-owned organisation to any of its shareholders, except where one of those shareholders holds a majority stake.

There are a variety of ways in which emissions could be aggregated in the case of joint ventures and joint ownership, such as:

- aggregate the emissions of a jointly-owned organisation with that of the shareholder which holds a majority stake (over 50%);
- where there is no majority stakeholder, emissions of an organisation is not aggregated with that of any shareholder; the organisation would fall under the scheme in its own right only if it reaches the inclusion threshold;
- where there is no majority shareholder, each shareholder holding in excess of a certain, pre-determined percentage (for example, 30%) of the shares in a JV, allocation of responsibility for the undertaking's emissions to shareholders on a pro-rata basis according to equity share. For example, a shareholder holding a 35% stake would be responsible for 35% of the undertaking's emissions.
- Where no shareholder has majority control, but where one joint owner (or a contracted party) has specific operational control over the Joint Venture, pursuant to the Joint Venture agreement or a management agreement, the operator would participate and report on behalf of the Joint Venture.

3.3.2 Recommended solution

Where a parent undertaking exercises control of a Joint Venture (JV) as a majority shareholder (by owning in excess of 50% of the share capital), the parent undertaking will be obliged to aggregate the emissions of the JV with the rest of its Group. Where there is no such control, there should be no aggregation of emissions of the JV with that of any of its shareholders. Therefore, inclusion of the JV's emissions in the CRC scheme is dependent on whether the JV's emissions (taken together with its subsidiary undertakings, if any) exceeds the inclusion threshold.

It should be noted that, where reference is made in this JV/JO section to "equity shareholdings" and "majority shareholders", such terminology is merely used as shorthand for the ability of a shareholder to 'control' the activities of the subsidiary undertaking and is not intended to represent a narrowing of our recommended solution that subsidiary undertakings be ascertained on the basis of s.1162(a) and (b) Companies Act 2006. In the examples given, therefore, where reference is made to aggregation of emissions on the basis of one undertaking "having a majority shareholding" in another, such reference should be understood for the purposes of the examples as also including control by way of having the majority of the voting rights in another undertaking or the ability to appoint or remove the majority of the board of directors of such an undertaking.

Advantages

- a) Clarity, simplicity and administrative burden

Under this solution it will be clear and simple to determine which organisation will be responsible for the purposes of the scheme, as it would be determined on the basis of whether there is a majority shareholder of the JV.

b) Maximising the use of financial and reputational drivers

These drivers are best leveraged at the level of majority shareholders, who are in a better position to influence energy use compared to minority or equal shareholders.

Minority shareholders may well have little scope to influence the energy use of the JV, either under the articles of association of the JV or, if there is one, pursuant to the terms of the JV agreement with the other shareholders.

Disadvantages

a) Maximising emissions coverage

Emissions from organisations with no majority shareholder and which are below the inclusion threshold will not be included in the CRC. In these cases, however the alternative solutions would not place the financial and reputational drivers at a level which would be effective in encouraging emissions reduction.

Where a JV has a majority shareholder, costs incurred through participation in the scheme would fall on the majority shareholder in the first instance. The majority shareholder may in practice, however, seek to reallocate the costs contractually to the other parties to the JV.

The first two diagrams below illustrate those situations where the JV's emissions would be aggregated with the controlling shareholder organisation under the proposed solution:

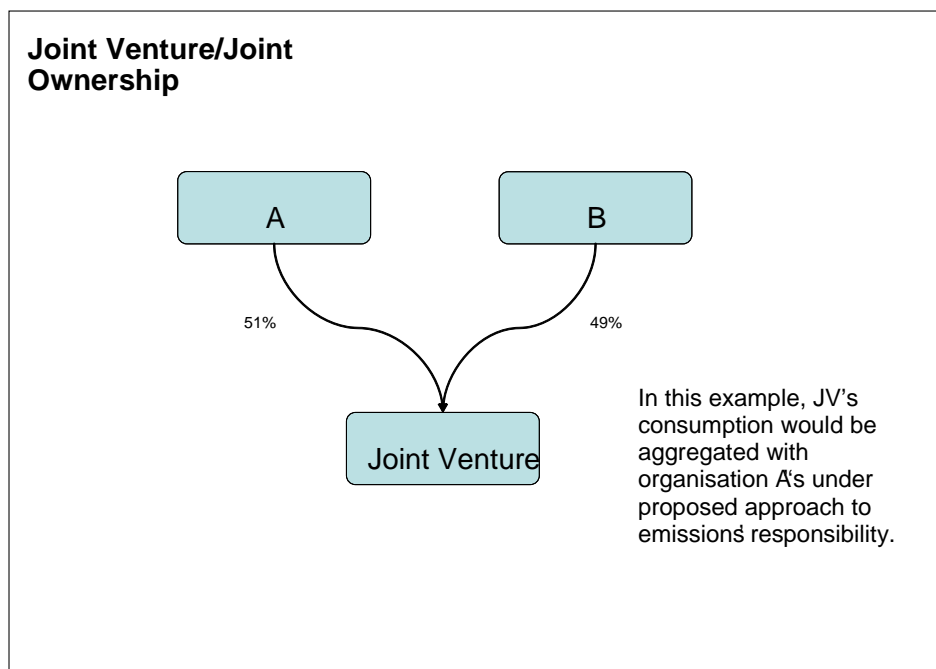


Figure 24 Joint Venture Example 1

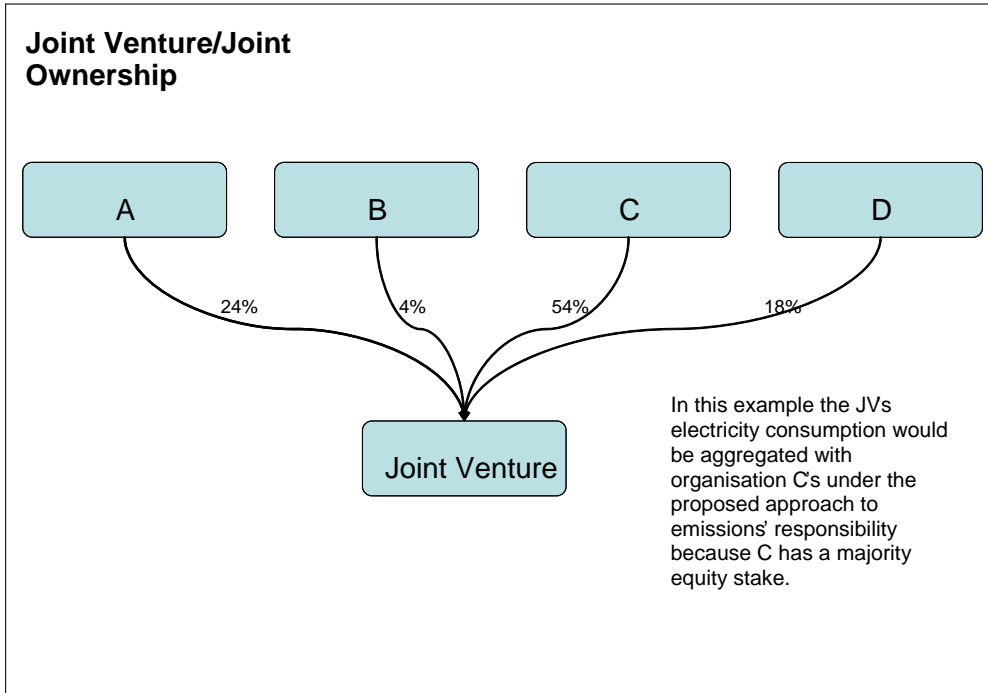


Figure 25 Joint Venture Example 2

The third diagram illustrates a situation where there will be no such aggregation of emissions:

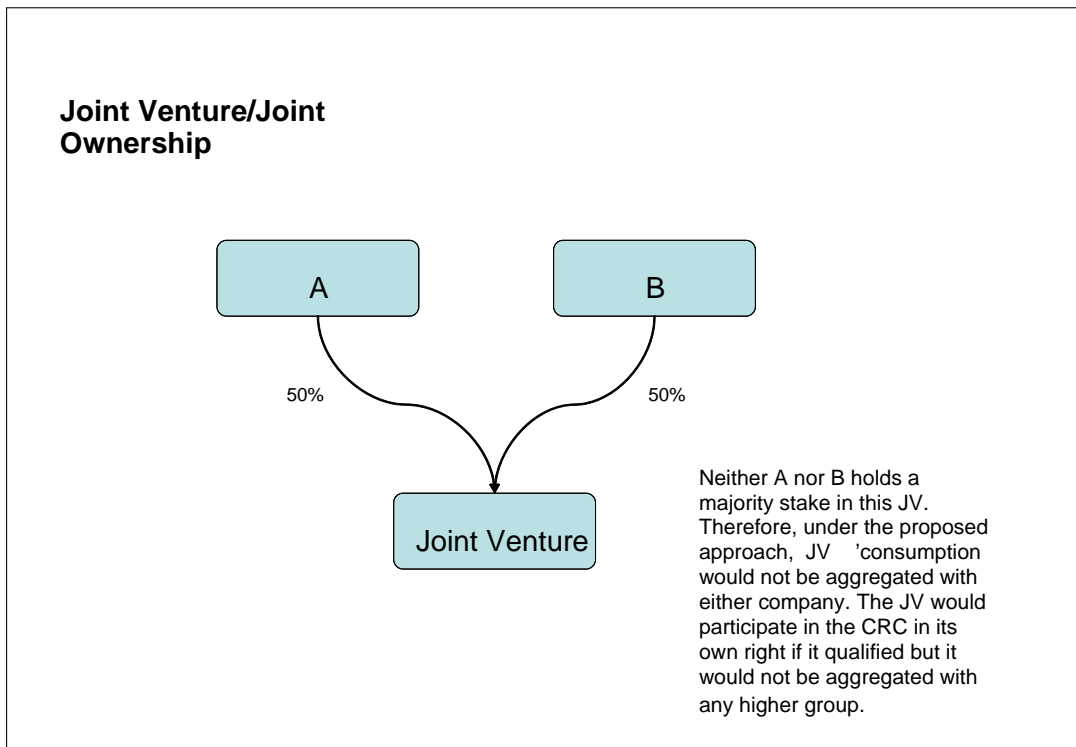


Figure 26 Joint venture Example 3

3.3.3 Alternative solution 1

Where no shareholder has majority control, an alternative would be that each shareholder holding in excess of a certain, pre-determined percentage threshold (for example 30% share threshold) in a JV, will be obliged to aggregate that percentage of the JV's emissions with its own for the purposes of the scheme. For example, a shareholder holding a 35% stake would be responsible for 35% of the undertaking's emissions.

Advantages

- a) Maximising emissions coverage

This would bring wider emissions coverage of the scheme than the recommended solution.

Disadvantages

- a) Clarity, simplicity and administrative burden

An equity percentage threshold would need to be chosen to determine whether a JV's emissions is aggregated with that of its shareholders or not. This percentage would need to be set at a reasonably high level, for example 25% or 30% in order to avoid capturing very small shareholdings, (such as those held by pension funds or unit trusts). However, any figure chosen would necessarily be somewhat arbitrary and could lead to future JVs being established so as not to trigger the percentage chosen.

- b) Maximising the use of financial and reputational drivers

These drivers are unlikely to be leveraged, if this solution is chosen, since minority shareholders are not necessarily in a position to influence energy use nor will they necessarily be associated with the JV in the public's perception in the same way as if the JV were a member of their Group.

Defra should be aware that there may well be commercial objections from the wider business community if this solution is chosen, since they are likely to have little or no control over the JVs in which they may have minority stakes. It may therefore also feel the need to renegotiate the cost provisions of their JV agreement with their co-owners.

Whilst there are no legal problems with pursuing this option, the real issues will be practical, commercial and political; if adopted the choice of the relevant equity percentage threshold would ultimately be a policy choice rather than a legal one.

The following diagram illustrates how alternative solution 1 would work. In this case, if a 30% equity share was the threshold, then the emissions of the JV would be aggregated on a pro rata basis to Organisations A, B and C for the purposes of the scheme. In this way, each of the three shareholders is responsible for a proportion of the emissions from the JV.

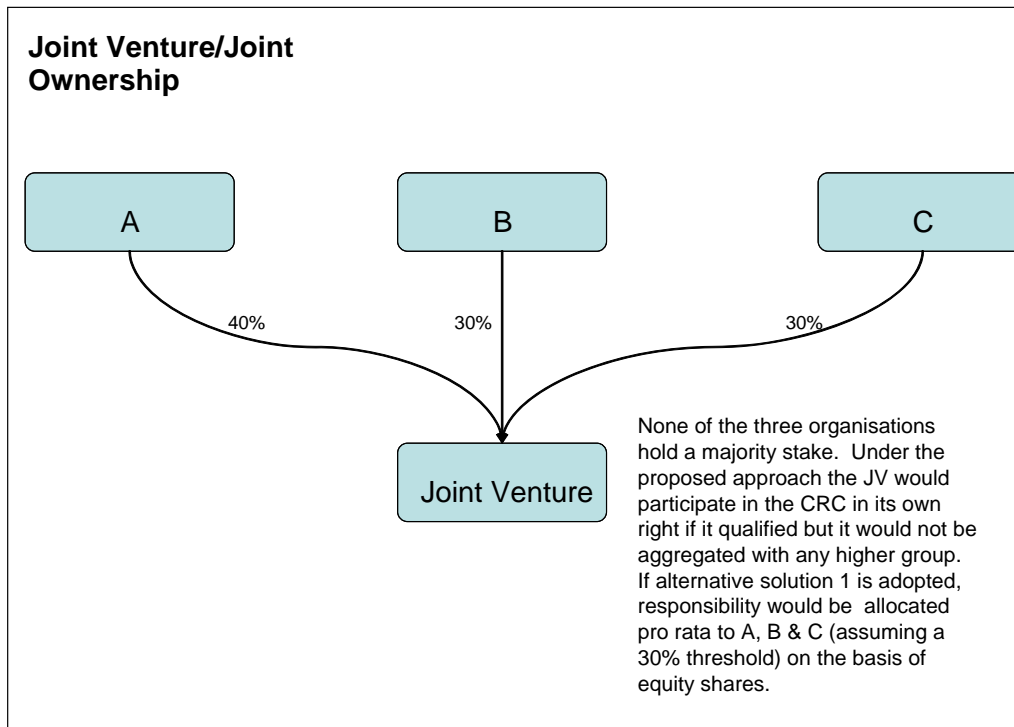


Figure 27 Joint Ownership Example 4

3.3.4 Alternative solution 2

Where no shareholder has majority control, but where one joint owner (or a contracted party) has specific operational control over the JV (pursuant to the JV agreement, the JV's articles of association, or a management agreement). An alternative would be for the operator to participate and report on behalf of the JV. This would be similar to situation regarding compliance in the EU Emissions Trading Scheme. The CRC Regulations could potentially be drafted along similar lines to require the operator to aggregate the JV's emissions with its own.

Advantages

a) Maximising emissions coverage

There is a potential for wider coverage of the scheme, than under the recommended solution, as this ensures that the emissions from the JV will fall under the scheme, regardless of whether it meets the inclusion threshold in its own right. Under this solution, the JV's emissions will be aggregated with the emissions from the organisation with operational control.

b) Clarity, simplicity and administrative burden

This alternative solution would be relatively simple to implement since the definition of 'parent undertaking' in section 1162 Companies Act 2006 already incorporates a concept of 'control' deriving from something other than simply equity voting rights. (It is worth noting that the recommended solution does not incorporate a broader concept of 'control', since it excludes section 1162 (2) (c) and (d)).

c) Maximising the use of financial and reputational drivers

Financial drivers are fairly well placed since an operator who can exercise control over the JV will, even if only a minority shareholder, be in a position to implement energy efficiency savings.

Disadvantages

a) Clarity, simplicity and administrative burden

Although operators in the oil and gas sector may be used to assuming compliance responsibilities on behalf of JVs, this may not be the case in all other JVs. Imposing a compliance obligation on other JV participants might well create an administrative burden disproportionate to the extra emissions which would be captured by the scheme.

It may be desirable for 'control' in this scenario to be drafted more widely than even section 1162 CA 2006 would cover. Further thought would need to be given as to how to define 'control' in an operational sense so as to capture all potential variations. However, a broad concept of 'control' would necessarily create significant administrative complexity which is unlikely to be appropriate or desirable.

b) Maximising the use of financial and reputational drivers

A minority shareholder (as noted regarding alternative solution 1 above), whether or not it exercises control, is unlikely to have its reputation associated with the JV in the public perception in the same way as a majority shareholder might.

This alternative solution might be at odds with the proposed principle that the '*counterparty to the supply contract*' is the responsible party since, if that person is the operator then the operator would be caught anyway and, if it is not, this would need to form an exception to that rule in this type of situation. Given that the responsible party would differ on a case by case basis, this issue may well be better left to the contractual relationship between the relevant JV parties.

Using the same ownership structures as set out in figure 25 above, if Organisation C has operational control of the JV under the terms of the JV agreement, under this approach, responsibility for the JV's emissions would be aggregated with those of Organisation C.

Feedback from the oil and gas sectors suggests that using the 'designated operator' to participate and report on behalf of the JV would be consistent with current operational practice. However, it is worth noting that the designated operator can vary; in general it is the majority stakeholder, but it is not always the case. It is up to partners to decide as the decision is not based on shareholding but it is up to the partners.

Joint Venture/Joint Ownership: Oil & Gas UK

Oil & Gas UK is the trade association representing the offshore oil and gas sector in the UK – operating companies, non-operators and suppliers. The association offered some general comments on how joint ventures could fit into the scheme:

“Every installation in the sector, whether owned by a joint venture or not, has a designated operator which has a statutory and regulatory responsibilities on behalf of the joint venture partners in various matters, such as health & safety and environment, at the installation. The EU ETS is an example of this. The costs of discharging these responsibilities are managed through each joint venture’s operating arrangement – this is a standard practice throughout the industry. Oil & Gas UK advise that the CRC should be managed in the same way through the designated operator of an installation, on behalf of all joint venture partners. Anything else would risk administrative complexity of inordinate proportions and would be counter to any concept of better regulation.”

Figure 28 Case Study Joint Ownership: Oil & Gas UK

3.3.5 Conclusion

In this case the default position in the case of JV/JO appears to be most appropriate. Where a parent undertaking exercises control of a Joint Venture by owning in excess of 50% of the share capital the parent undertaking will be required to aggregate the emissions of the JV with the rest of its Group. Where there is no such control, inclusion of the JV's emissions in the CRC is dependent on whether it exceeds the inclusion threshold. This appears to be simple to apply and makes good use of financial and reputational drivers.

3.4 Private Equity and Venture Capital

Issue: Defra's June 2007 CRC consultation, which included targeting group structures based on Companies Act definitions did not explicitly state how various types of jointly owned undertakings including Private Equity (PE) and Venture Capital (VC) would be treated. Therefore investigation into how VC/PE firms would be affected by the current proposal has been carried out to determine whether an alternative approach is required.

As far as PE and VC joint ownership scenarios are concerned, crafting a specific derogation from the standard 'counter-party to the supply contract' approach was investigated. Such firms may have significant control over financial input into the company, and therefore financial drivers for energy efficiency investments. However, to create such a derogation (special treatment to ensure coverage of CRC extends to such firms) would present significant legal and administrative complexities, as undertakings qualified as PE and VC companies do not differ constitutionally or structurally from other companies.

Recommended Solution: In the case of majority equity stakes, emissions of the parent and subsidiaries would be aggregated to the majority stakeholder, making use of concept of undertaking from Companies Act 2006 (as outlined in the Joint Ventures section, above). Where a VC/PE firm only holds a minority stake (in other words 50% or less) of another company, the company's electricity consumption should not be aggregated with its minority shareholder. In such cases the company would qualify in its own right for the scheme if it meets the inclusion threshold.

Rationale: Under this approach, it will be clear and simple to determine which organisation will be responsible for the purposes of the scheme. Although the financial and reputational drivers are not best leveraged at the level of VC/PE firms, this approach is simple and legally robust. Crafting a specific derogation for VC/PE firms would present significant legal complexities, as undertakings qualified as PE and VC companies do not differ constitutionally or structurally from other companies.

There would be a loss of coverage in cases where individual companies with no majority shareholder do not meet the inclusion threshold in their own right. However, this is outweighed by the goal of administrative simplicity. In those cases where the jointly owned company does pass the CRC inclusion threshold, it will of course be targeted in its own right, and in this context the financial and reputational drivers will be leveraged appropriately.

Figure 29

3.4.1 Introduction

Venture Capital firms act mainly as a source of income to growing businesses. In general VC firms take a stake in the businesses that they invest in and this is often a minority

shareholding. The other owners will be private owners or other investors. Often there will be several stages of investment during which the VC firms may increase their ownership, and this may end up amounting to a majority share.

Private Equity companies frequently take only a minority stake in companies that they invest in and they aim to make changes in these companies to sell them for greater value in a 2-10 year timeframe. The firms will introduce members onto the board, heavily influence the management of the company and make significant changes beyond the simple injection of capital in order to add value to a business and for example, increase efficiencies, market share, diversity, or rescue businesses in distress.

The PE/VC firms themselves could invest in a wide range of significantly different companies, with their portfolio make up changing over a relatively short period of time. Many institutional investors and others put their money into PE/VC firms as an investment.

3.4.2 Recommended Solution

The analysis of the recommended solutions and alternative options outlined above in the case of Joint Ventures and Joint Ownership situations, applies equally to Private Equity (PE) / Venture Capital (VC) structures, as well as to joint ownership in the public sector. Where minority stakes are taken, both private equity and venture capital structures are simply forms of joint ownership; therefore, no specific legal issues exist that would require any different solutions beyond those set out for Joint Ventures, above.

Where majority stakes are taken, however, the conclusions reached regarding grouping of subsidiary undertakings with the parent undertaking, as outlined above in 'How to define a group' will apply and the emissions of the majority-owned investee undertaking would be aggregated with that of the PE or VC firm for the purposes of the CRC.

Under the Joint Venture proposals above, where a PE/VC firm that has a majority stake in the businesses they invest in, the PE/VC firm will be the organisation responsible for emissions under CRC.

The PE/VC firm's main priority will be receiving a return on investment, rather than driving improved environmental performance. However, the individual companies that a PE/VC firm has invested in may well have a CSR reputation that is important and that they are keen to protect or enhance.

Given that the appropriate reputational and financial drivers are not found at the level of the PE/VC firm, but instead at the level of the individual company that the PE/VC firm invests in, an alternative to the default position for PE/VC firms has been investigated, below, to see whether a derogation should apply to VC/PE firms.

Green and Black's

Green and Black's is a chocolate company specialising in organic chocolate products, with a strong reputation for strong CSR values. It was founded in 1991 by Craig Sams, however, in 1996 Green and Blacks was purchased by William Kendall, along with 11 other investors who brought the turnover up to £22.4m by February 2005. (Green & Black's was then sold fully to Cadbury Schweppes in 2005).

Under the current proposals, *if* William Kendall's' investment consortium still owned Green and Black's, the organisation taking the majority stake would be responsible for Green and Blacks emissions under CRC, should it be eligible. The consortium held the chocolate company for a significant amount of time, probably long enough for the financial drivers, at least, to operate as intended.

Note: This example is based on publicly available information and is used only to illustrate the timeframe of private equity investments. However, the ownership structure could be highly complex and could include overseas ownership elements too.

Figure 30 Private Equity example: Green & Black's

3.4.3 Alternative Solution

If Alternative Solution 1 (section 3.3.3) regarding Joint Ownership was adopted, where responsibility for emissions is allocated on an equity share basis where there is no "controlling share holder" then, depending on the equity percentage threshold chosen to determine inclusion, the scheme could have a significant impact on large Private Equity providers.

To avoid the potential for misdirecting responsibility for these CRC emissions, a potential solution would be to allow the VC / PE firm to nominate large subsidiaries that are eligible for the scheme in their own right, to participate in place of the VC / PE firm. The business model for PE is such that it would be expected that a PE firm would elect for all of the firms it has invested in, where they meet the CRC inclusion threshold, to participate in the scheme independently. This approach would logically align CRC drivers without significant emissions loss and would avoid putting a legislative burden on a traditionally unregulated industry.

There are, however, various practical difficulties in pursuing this option. A nomination period would need to be set during which the VC / PE firms would have to elect large subsidiaries to participate in the scheme independently. In addition, significant legal difficulties would arise with devising a robust legal definition of which undertakings qualified as PE and VC companies, as they do not differ constitutionally or structurally from other companies. Therefore, such an approach might introduce excessive and unwanted administrative complexity into the CRC.

3.4.4 Application of the recommended solution

When private equity firm Kohlberg Kravis Roberts (KKR), together with Stefano Pessina and others, acquired the high street chemist Alliance Boots a JV called AB Acquisitions Ltd was established, which acquired 100% of the shares in Alliance Boots. Initially at least (shareholdings may of course have changed subsequently), both KKR and Pessina held 32.3% stakes in AB Acquisitions.

Under the recommended solution, the emissions of the group headed by AB Acquisitions Ltd would not be aggregated either with that of KKR or of Pessina. This fits well with the fact that the reputational and financial drivers are best placed on Alliance Boots, as the party best able to manage energy use and as the entity associated with the consumption in the public's perception.

If alternative solution 1 were adopted, with a notional 30% equity share threshold, both KKR and Pessina would be required to aggregate 32.3% of AB Acquisitions Ltd's emissions with their own and, if such aggregate emissions exceeded the inclusion threshold, participate in the CRC accordingly. In this situation, their positions would be analogous to those of Organisations B and C in figure 25 above, 'Joint Ownership Example 4'.

Note that in this example (as is frequently the case in PE transactions), there is a "shell" company (AB Acquisitions Ltd) between the equity shareholders and the principal trading entity. Whilst the legal obligation to participate in the CRC will fall on AB Acquisitions Ltd, we anticipate that in practice reporting and compliance will be carried out by Alliance Boots on behalf of its parent. To address situations where high street brand names may be "lost" from the league tables behind a bland corporate identity, Defra could consider inserting a section into the CRC reporting form to be completed by participant organisations, requesting them to list the principal brand names under which the various members of their group operate in the UK. Even if completion of this section is not made mandatory by the CRC Regulations, most organisations will probably complete the section anyway and may view it as a good opportunity to raise their profile and the resultant information would arguably give the league table greater resonance with the public at large.

3.4.5 Conclusion

In this case of VC / PE firms, the recommended solution of JV/JO appears to be most appropriate. Where a VC / PE firm exercises control of a company by owning in excess of 50%, the VC / PE firm will be obliged to aggregate the emissions of the company with the rest of its Group. Where there is no such control, inclusion of the company's emissions in the CRC is dependent on whether it exceeds the inclusion threshold. This appears to be simple to apply and makes good use of financial and reputational drivers.

3.5 Overseas Ownership

Issue: How should the CRC capture undertakings in the UK which do not individually qualify for the scheme but which are owned by the same overseas parent and which, if taken together as a group, would meet the inclusion threshold?

Recommended Solution: If the general inclusion threshold is passed (i.e. greater than 6,000 MWhr/year of half hourly metered electricity use through half-hourly meters in Great Britain and 70kW meters in Northern Ireland), as regards UK energy use emissions, overseas parent undertakings (whether as a 'counterparty to the supply contract' or an ultimate parent undertaking of a group) should participate in the CRC in respect of their UK energy use emissions (making use of the concept of parent undertaking from Companies Act 2006). This should be coupled with a requirement for such undertakings to nominate a UK-based proxy to meet compliance obligations on its behalf. This could be a UK subsidiary, if one exists.

Rationale: A foreign company carrying out activities in the UK would still fall under the jurisdiction of UK law, and therefore there is no reason why an overseas parent should not take responsibility for all its UK activities. There would be no loss of emissions coverage from small multiple undertakings which are owned by the same overseas parent, or emissions loss from the parent undertaking itself. This would be relatively simple to administer because the relevant undertaking will be named on the supply contract. There would be fair treatment between UK and non-UK business organisations and therefore equitable location of the financial driver as well as good location of reputation driver.

We recommend that there be a requirement for overseas incorporated undertakings to nominate a UK-based proxy forms part of the Regulations. Without such a requirement, there may be potential enforcement issues if action is taken against the overseas undertaking for failure to comply with the requirements of the regulations. This would be a particular issue where the overseas undertaking does not have a UK based subsidiary which could be made jointly and severally liable; the UK administrator of the scheme would need to pursue the overseas undertaking in a foreign court, incurring extra costs and administrative complexity. However, this risk is avoided if the regulations include a requirement for overseas incorporated undertakings to nominate a UK-based proxy.

Figure 31

3.5.1 Introduction

The position set out in the consultation document was that the participation and reporting obligation should be placed on the highest parent entity incorporated in the UK.

The risk in adopting such an approach is that this approach would not address those groups with overseas structures which have UK subsidiaries (which could be trading or dormant), but perhaps no single 'highest' UK undertaking, as outlined in the diagram

below (Figure 28). In such a scenario, the scheme might suffer emissions loss if a highest UK undertaking concept was employed (unless further references defining 'sister' or 'associate' undertakings were also incorporated). To illustrate this risk, if the highest UK undertaking definition is used, then the organisations A, B and C below would each be assessed for inclusion in the scheme independently of each other, as each represents the highest UK undertaking of its particular group. If each of A, B and C had emissions of 5,000MWh/year, the emissions of the group headed by ABC incorporated would not be included in the scheme. The organisations A, B and C would fall out of the scheme unless aggregated together either with each other, or at the level of their overseas parent.

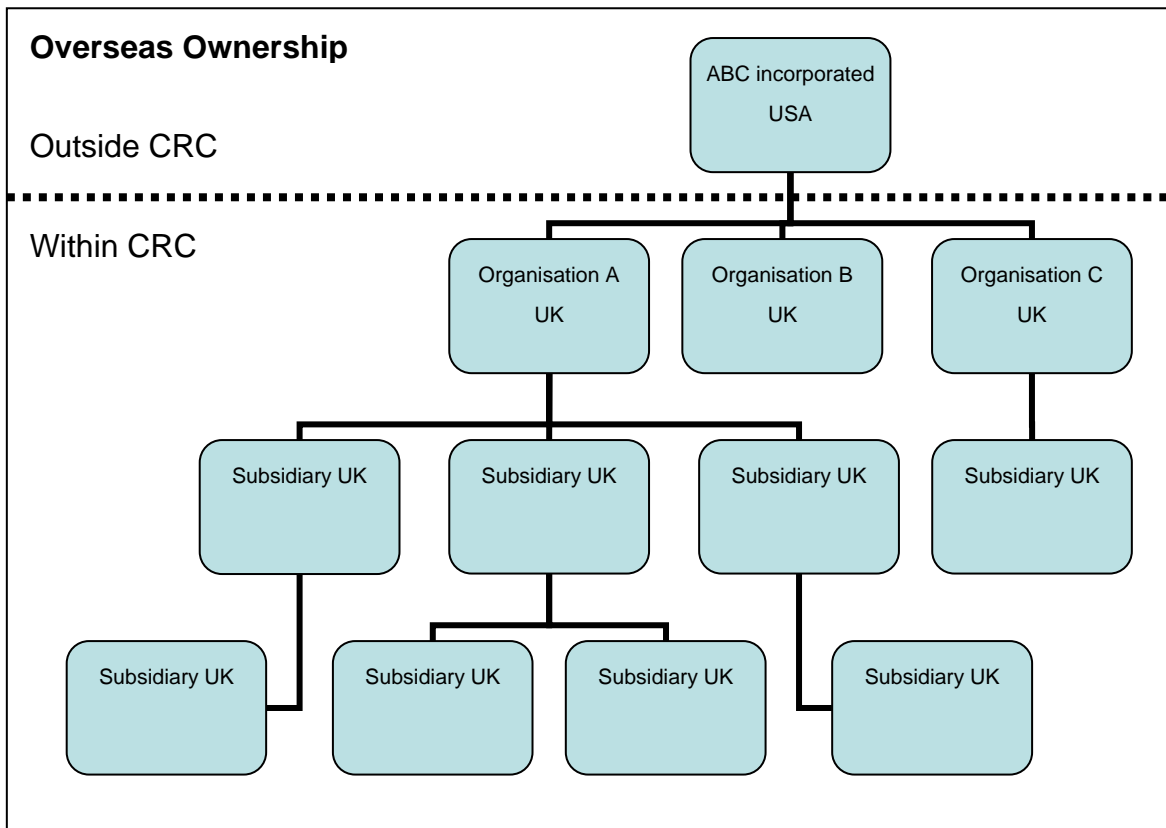


Figure 32 A potential overseas ownership structure

3.5.2 Recommended solution

As an initiative designed to focus on reducing carbon emissions in the UK, the CRC is intended to target UK-based emissions rather than UK-based organisations. Ultimately it is the location where energy is consumed rather than the nationality of the company consuming the energy which is relevant for the purposes of the scheme.

Our recommendation is therefore that the participation and reporting obligation ought to remain simply with the 'highest parent undertaking', in whatever jurisdiction that undertaking is established. Undertakings existing outside the UK should be required, or be given the option, to nominate a UK entity which will fulfil compliance obligations on its behalf. By doing so, this would limit potential enforcement issues, whereby the UK administrator of the scheme would need to pursue the overseas undertaking in a foreign court (unlikely to be desirable). Enforcement of the scheme would be relatively straightforward if the highest undertaking were required to place compliance responsibilities on a substantial UK-based subsidiary undertaking.

It is worth noting that for the purposes of this analysis we have assumed that any definition of "undertaking" would be drafted in the Regulations so as to capture corporate vehicles outside of the UK as well as those within.

Analysing the scheme from first principles, the aim of the CRC is to capture (and provide incentives for the reduction of) energy consumption in the UK. Accordingly:

- for the purposes of eligibility, relevant electricity consumption should be aggregate 6,000MWh of electricity consumption through half-hourly meters in Great Britain and 70kW meters in Northern Ireland (across an organisation) of counterparties to contracts for the supply of electricity in the UK; and
- for the purposes of participation, relevant energy consumption should be aggregate emissions (across an organisation) of counterparties to contracts for the supply of relevant energy in the UK.

For example, a German company (which may or may not be part of a UK Group) may carry out activities in the UK and may therefore be the counterparty to a contract, for the supply of electricity to enable it to carry out those activities. Any electricity consumption metered by a half-hourly meter, where the German company is counterparty to the contract, would be aggregated and tested against the inclusion threshold. There seems little if any reason for not placing the reporting and participation obligation on the German company's highest parent undertaking, whether or not that undertaking is present in the UK. The rationale for this is that the activities which the German company undertakes in the UK fall under the jurisdiction of UK law.

Advantages

- a) Although counterparties to energy supply contracts are likely, in the large majority of cases to be UK undertakings (principally because suppliers may well be reluctant to take the risk of having to chase debts abroad), there is no guarantee that this will be the case and there seems no practical or legal reason why foreign undertakings should not be included if they are responsible for emissions at a UK site.
- b) Participation by a foreign-incorporated highest parent undertaking avoids the potential loss of coverage that might arise in a scenario where such parent had 10 subsidiaries, each with UK-based consumption of 5,000MWh, but whose emissions would not get captured by the scheme if such subsidiaries represented the highest UK parent undertaking in each case.

Disadvantages

- a) Potential enforcement and compliance complexities if a UK-based proxy is not nominated by an overseas organisation to fulfil compliance obligations; in such situations, the UK administrator of the scheme would have to take legal action in a foreign court and incur costs in doing so, such as retaining foreign counsel.

In circumstances where such an overseas undertaking is the reporting / participant entity, we recommend that the scheme simply require that such an undertaking must nominate a substantial UK undertaking as its proxy for participation and compliance purposes.

Where it has no UK undertaking, then a UK-based proxy should be nominated for compliance purposes and made jointly and severally liable with the highest parent undertaking for the purposes of compliance with the scheme. This would avoid the administrative complexities and costs associated with taking action against foreign companies, as outlined above.

The parliamentary draughtsman might wish to consider Part 34 Companies Act 2006 concerning overseas companies. Whilst this is not currently scheduled to come into force until 1 October 2009 it provides a useful reference point - requiring overseas companies to register with the Registrar of Companies in certain situations which then provide for certain returns to be made and its operations to be monitored.

Overseas Ownership Case Study : Corus

Corus is an international company, providing steel and aluminium products and services to customers worldwide. Corus is a subsidiary of Tata Steel, formerly known as TISCO (Tata Iron and Steel Company Limited). Tata Steel is a steel company based in Mumbai, India. It is part of Tata Group of companies.

Corus UK Ltd holds the contract for the electricity supply on behalf of all its subsidiaries and individual sites or businesses. Accounts departments pay the bills.

Under the proposed recommendation, the parent company, Tata Steel would fall under the CRC scheme; depending on the policy option chosen, Tata Steel will either need to or may opt to nominate a UK-incorporated subsidiary (for example, Corus UK Ltd) or a proxy in the UK for compliance and reporting purposes.

Under the default position: Corus UK Ltd would be the CRC participant, and there is a risk that certain of the group's consumption would be lost from the CRC, specifically if, despite being incorporated overseas, Tata owns or occupies sites in the UK.

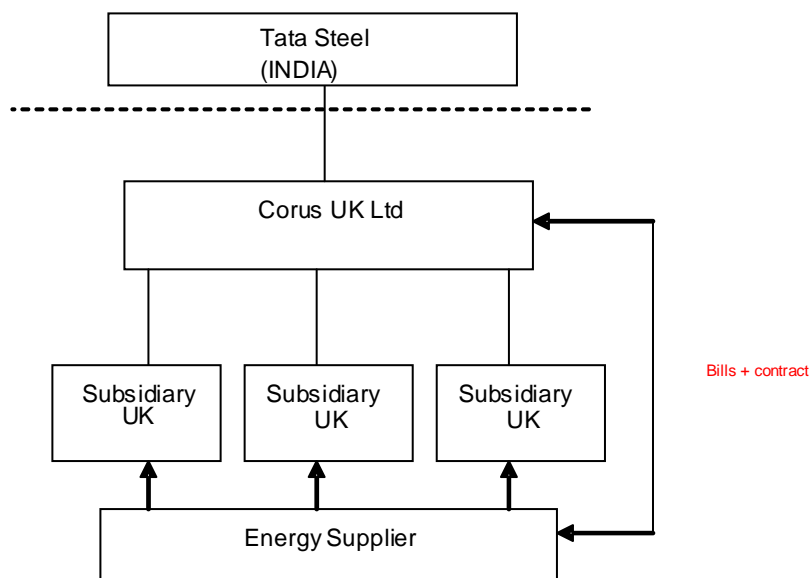


Figure 33

3.5.3 Conclusion

It is likely that amongst the business organisations to which the scheme will apply, there may be groups with overseas structures which have UK subsidiaries (which could be trading or dormant) but perhaps no UK intermediate holding company or parent company. Furthermore, it is feasible that an overseas company is the 'counterparty to a supply contract' in respect of UK operations but that there is no UK corporate entity within its group.

As outlined above, it is our recommendation that the country in which a corporate vehicle is incorporated be ignored for the purposes of participation in the scheme and for reporting purposes. The wider intention of the scheme is to capture energy consumption (and thereby emissions) from activities located in the UK and there is no guarantee that the undertaking responsible for these emissions will be a corporate vehicle established in the UK.

As noted above, the concept of "highest parent undertaking" is one which could be used to capture groups with an overseas undertaking at the top in the same way as UK-based groups. The same principles could equally be applied to overseas group structures, as outlined in the previous case studies.

3.6 Business Change

Issue: How to identify the most appropriate model to capture business changes for the purposes of the scheme?

Proposed Solution: At the start of each phase of the scheme, during the qualification process, organisations would be required to declare which of their subsidiaries would qualify for the scheme in their own right. Changes to baselines should be made when entire CRC participants or “large” subsidiaries (i.e. those that would qualify for the scheme in their own right) of CRC organisations are bought or sold (including purchase by or sale to another CRC organisation). Therefore, each year, as well as reporting its total emissions, the CRC organisation would have to report to the administrator its energy use emissions from its large subsidiaries.

Rationale: The approach is more equitable to all CRC undertakings, with regards to performance within the league table and revenue recycling calculations, as baselines would be updated to reflect purchase or sale of large subsidiaries. This approach leverages CSR drivers of large subsidiaries (by requiring reporting by CRC organisations of their large subsidiaries), it sustains scheme coverage (rather than have large subsidiaries drop out of the scheme if sold to a non-CRC participant) and is administratively acceptable (since CRC organisations will in any case have to collect energy use emissions data for their subsidiaries to honour their overall CRC compliance obligations). Whilst this approach may not be as simple as keeping baselines the same throughout a phase, we consider that the advantages of updating baselines as described above outweigh this disadvantage.

Figure 34

3.6.1 Introduction

One of Defra’s aims, when designing CRC, has been to minimise the administrative burden placed on participants wherever possible. As such the CRC scheme will not in general be designed to encompass a site based “Changes of Operation” process where emissions baselines are updated to reflect the sale or purchase of individual sites or small operations or subsidiaries. Such a process was administratively complex and challenging enough for the voluntary UK Emissions Trading Scheme – which featured just 33 organisations. The CRC is estimated to cover 4,000 – 5,000 organisations – and stakeholders have highlighted the importance of keeping the CRC administratively simple.

However, Defra recognises that large organisations are often structured (and restructured) into groups, the constituent parts of which are separate legal entities (subsidiaries), and that by capturing the highest parent undertaking, participants may perform well or badly within the scheme simply through the sale or purchase of these subsidiaries. There are also wider goals – to sustain coverage (if a large subsidiary is sold), to leverage CSR drivers of large subsidiaries (to secure energy efficiency improvements), and to have some fairness in the scheme league table (i.e. accounting for

sale / purchase of large subsidiaries). Accordingly, Defra recognises that CRC should be sufficiently flexible to account for the purchase and sale of major subsidiaries, which could take place at any stage during a scheme phase.

Default position

With regard to changes to an organisational structure, the Defra consultation document (June 2007) stated:

‘to minimise admin burden on organisations and the scheme regulators, organisations will not move into and out of the scheme on an annual basis, as a result of their falling above / below the 6,000 MWh inclusion threshold. Therefore, once an organisation is identified at the start of a phase to be included in the scheme, it will remain in for the duration of that phase.’

Under this approach, no changes would be made during a phase, due to sale/purchase of CRC subsidiaries/organisations.

The consultation does, however, recognise that there is a case for certain exceptions to this overall approach in which Government will update an organisation’s CRC baseline (for example, in the case of emissions transfers between EU Emissions Trading Scheme, Climate Change Agreements and the CRC which would only apply to the minority of CRC participants; adding/removing schools within an LA portfolio, and emissions transfers from landlords to tenants).

Advantages of Default position

- a) Clarity, simplicity and administrative burden
This approach emphasises administrative simplicity, as no baselines are updated during a phase. It also emphasises the polluter pays principle, as more energy efficiency effort is expected from successful, growing organisations, to sustain absolute cuts in carbon emissions.

- b) The growth / decline in organisations is accounted for by way of the relative metric in the league table and by way of the proposal to only use the last 5 years of data rather than ‘annual average emissions since the start of the scheme’. As such, all types of growth are treated equally. For example, even though purchase of entire CRC organisation A by entire CRC organisation B could be dealt with very easily through adjustment to organisation B’s baseline (since there is annual reporting for entire CRC organisations), there would nonetheless be no adjustment to CRC baselines. Under all types of growth, the organisation would find it harder to perform in the absolute metric, but the relative metric would aim to explain this context, and the 5 year rolling baseline proposal means this context would not be permanent.

Disadvantages of Default Position

- a) Maximising emissions coverage
If an entire CRC organisation was sold to a non-CRC organisation, or if a CRC organisation sold a major subsidiary to a non-CRC organisation, substantial emissions could be lost from the scheme (until the start of the next phase), making effective cap setting and environmental integrity hard to sustain.

b) Perceived fairness

one CRC organisation A buying a subsidiary of another CRC organisation B (or indeed an entire CRC organisation B) will find it hard to perform in the absolute metric part of the league table. Though this is also true for other types of growth (e.g. capture of market share from a competitor), the argument is that growth 'by purchase' is special, because it is demonstrably a case of emissions being simply transferred around the CRC scheme (whereas when a company grows organically it is not possible to tell whether it is increasing total CRC scheme emissions or taking market share from a CRC competitor).

There is evidently a case that the CRC should be sufficiently flexible to account for the sale and purchase of major subsidiaries, which could take place at any stage during a scheme phase.

3.6.2 Potential solution

A potential solution is that changes to baselines are made when entire CRC participants or "large" subsidiaries of CRC organisations (those using more than 6,000MWh of electricity through half-hourly meters in Great Britain and 70kW meters in Northern Ireland that would qualify in their own right) are bought or sold (including purchase or sale to another CRC organisation).

To do so, at the start of each phase of the scheme, during the qualification process, organisations would be required to declare which of their subsidiaries would qualify for the scheme in their own right.

Each year, as well as reporting its total emissions, the CRC organisation would have to report to the administrator its energy use emissions from its large subsidiaries. Participants' emissions baselines could then be updated in three more situations:

1. CRC Organisation A completely taken over by another CRC Organisation B;
2. 'Merger' of CRC Organisation A with another CRC Organisation B to form Organisation C;
3. 'Large' subsidiary Organisation A of CRC Organisation B taken over by CRC Organisation C;

Furthermore, to retain the scheme's emissions coverage, if a CRC participant or large subsidiary was sold to a non-CRC participant, the emissions baseline and the responsibility for participating in the scheme would be transferred with the undertaking being purchased.

However, to retain simplicity, in the following situations baselines should not be updated:

1. Part of Subsidiary Organisation A of CRC Organisation B taken over by non CRC Organisation C (e.g. an assets sale or partial share sale);

2. CRC Organisation A with separate CRC Subsidiaries B and C: restructures its subsidiaries into Subsidiary D (with parts of B and C) and Subsidiary E (with different parts of B and C);
3. 'Mergers': CRC organisation A merges with non-CRC organisation B (potentially forming new Organisation C)

Advantages of potential solution

- a) Maximising emissions coverage
Emissions would not be lost from the scheme if a CRC participant or large subsidiary was sold to a non CRC participant.
- b) Clarity, simplicity and administrative burden
This solution is more equitable to all undertakings affected during the CRC phase as it allows baselines to be updated in response to large business changes. The updated baselines will provide greater clarity of performance within the league table and revenue recycling calculations, compared to the default position.

Although administratively more complex (see below), there are no legal barriers of any consequence which would militate against adopting this alternative proposal.

Disadvantages of potential solution

- a) Clarity, simplicity and administrative burden
To an extent, this would be administratively more complex to administer than the default position, in that the CRC organisation would need to report total annual energy use emissions for each of its large subsidiaries. This is because there would need to be agreed, published and readily available data for use in cases where subsidiaries of CRC organisations are bought or sold. However, as part of the process to determine their CRC source list and to report emissions each year organisations would need to collect such energy-use data anyway in order to aggregate it at CRC organisation level. To minimise administrative burden in relation to subsidiaries, Defra is considering an approach whereby CRC organisations would only need to report annual energy use emissions for each of their large subsidiaries. The 'growth' metric (carbon intensity by turnover / revenue expenditure) and the 'early action' metric (extent of voluntary automatic metering [AMR] and extent of emissions covered by the Energy Efficiency Accreditation Scheme [EEAS]) would only apply to the CRC organisation as a whole – i.e. there would be no requirement to report such data in respect of large subsidiaries. The calculation of the 'growth' metric and 'early action' metric for the new consolidated group would, therefore, be made on the basis of ongoing data. Historic turnover / revenue expenditure data and AMR data would not be transferred, irrespective of changes of business / operation.

As regards the administrative burden placed on CRC participants, it is likely that organisations buying or selling large subsidiaries will also start providing (contractually in the acquisition documentation) for allocation and apportionment of CRC costs and liabilities as between the buyer and seller. The organisations

which will insist on this will be those where the CRC costs arising on acquisition or disposal of a large subsidiary are likely to have an immediate cash flow impact.

3.6.3 Interviews testing business change options

It is worth noting that interviews carried out with companies on this subject have not been able to support any particular approach over another, or suggest alternative approaches. Either the interviewees are not sufficiently informed to understand the implications of proposed solutions to take account of business changes or, due to commercial confidentiality, are unable to provide information about the practicality of preferred policy options. Other interviewees stated that companies would like to carry out research to understand the implications of this option in terms of costs and benefits to the organisation in each case. Interviews have not been able to draw out substantial conclusions regarding Business Change.

3.6.4 Conclusion

Based on policy and legal analysis, there are no legal constraints to Defra's proposed approach to account for major business changes. CRC organisations would have to report to the administrator their energy use emissions from large subsidiaries on an annual basis, which would be an additional administrative task for participants. However, CRC organisations would be collecting such data anyway in order to report at CRC organisation level, so the extent of additional burden would be limited. Moreover, it is highly likely that some CRC participants already collate such data on an annual basis for the purposes of annual reports on Corporate Social Responsibility, which could include annual energy use of their subsidiaries. Indeed the majority of parent organisations interviewed already have records of their subsidiaries' energy consumption because, in many cases, they deal with energy centrally. For these organisations, at least, any additional administrative burden would appear to be slight. Further it is likely that organisations buying or selling large subsidiaries will also start providing (contractually in the acquisition documentation) for allocation and apportionment of CRC costs and liabilities as between the buyer and seller. Therefore, it appears that the advantages of updating organisations' emissions baselines when large subsidiaries are bought or sold – in terms of being more equitable, as well as in terms of avoiding emissions loss and leveraging the CSR drivers of large subsidiaries – outweigh the increase in administrative burden associated with this approach.

4 Strand 3: Public Sector

4.1 Introduction

The public sector is made up of a range of diverse bodies in terms of size, structure and operations. Defra's objective is to capture emissions using organisational structures which are appropriate in the context of the public sector. Such an approach would best fit with, and leverage organisational CSR and financial drivers and encourage competition in the league table standings between bodies.

Defra expect the following types of public sector entities, if they meet the threshold, to be included in the CRC scheme: Government Departments, Non-departmental public bodies (NDPBs), Local Authorities, NHS bodies, Police and fire authorities and institutions in the further and higher education (FE/HE) sector.

As a general rule, the CRC scheme will apply to the 'highest parent undertaking' as defined in law. In the public sector however, many entities are established in law with defined and devolved authority that limits the direct influence of any nominal parent body. It is therefore appropriate to consider whether, in the public sector, the level of organisation in the public sector that will act as the CRC organisation should be something other than the equivalent of the "highest parent undertaking".

The 'parent and subsidiary' approach taken in the private sector to define overarching groups under the CRC will, in practice, have more limited practical applications to the public sector since public sector organisations do not hold equity stakes in other public sector organisations. In the private sector, it is the very financial control of the parent over the subsidiary which gives it the powers to influence emissions reductions. This is however not the case in the public sector: public sector bodies responsible for funding other bodies may not also have the power to influence emissions reductions. This is because funding streams and powers are granted by statute and do not necessarily correlate with one another in the same manner as in the private sector. Further, an ability to exercise control in the public sector over another body can only be provided for by legislation. Whilst some public bodies exercise control over others, the extent of that control may not include the ability to direct emissions reduction policy; the extent to which influence and control is exerted in the public sector is examined in the subsequent sections of this report.

This section explores different possible groupings of public sector entities and the degree to which these groupings would provide incentives for emissions reductions appropriately making the most of CSR and financial drivers. In the case where there are no groups, or grouping takes place at a lower organisational level, there may be some risk of emissions loss if some of the defined groups fall below the inclusion threshold. The CRC is intended to be an equitable policy that is applied comparably across the public and private sectors. Therefore, it is important that the public sector's participation in the CRC is designed in an appropriate manner so as to include as much of central Government

and the public sector's emissions as possible, whilst still employing the principle of leveraging appropriate financial and CSR drivers.

It should be noted that the solutions outlined in Strand 3 apply to the situation in England. With regards to the Devolved Administrations (DAs), we have highlighted known differences in the DAs and identified areas for investigation to be undertaken outside the scope of this project in at the end of this Strand.

For the purposes of this section, the term “public sector entities” is used to refer to any body sponsored by government and includes local authorities, NHS Trust, government departments etc. In the specific case of government departments and associated NDPBs, the term “governmental public body” is used to refer to a body sponsored by a central government department and associated directly with the business carried out by government departments. As such, these governmental public bodies are a distinct group from within the general set of public sector entities.

The terminology above has been employed for the purposes of the report. In the legal analysis, integral to this report, attention has been paid to whether or not the recommended approaches sufficiently separates out governmental public bodies from the broader set of public entities, as relevant.

4.2 Government departments and NDPBs

With the introduction to the section on the public sector in mind, it is important to carefully consider whether and at what level governmental public bodies should be grouped.

This section explores the concept of grouping governmental public bodies into “departmental families.” In the context of CRC, a departmental family would be a grouping of a Government Department with some, or all, of the bodies that it sponsors. Once defined, this family would participate in the CRC as one unit.

Default position: If Government adopts the recommended eligibility criterion, it is expected that NDPBs will only participate in the CRC together with their Government Departments, under the aegis of their Secretary of State, where those NDPBs do not have separate legal personality (i.e. where they are not independent of the Secretary of State). Where NDPBs (e.g. Executive NDPBs) do exist as individual legal entities they will take part in CRC if they themselves exceed the inclusion threshold.

Issue: Whether or not to group other public bodies within the remit of a Government Department to increase the emissions coverage of the scheme.

Recommended Solution: The recommended solution is to use the definition of responsibility for emissions as the “counterparty to the electricity supply contract.” Under this definition, the Secretary of State would be the counterparty to the electricity supply contract for each government department and for some of the department’s sponsored bodies. This approach would therefore define the relevant departmental grouping (called a “family” for the purposes of this report) as including all of the bodies for whom the Secretary of State acts as counterparty to the electricity supply contract. As a result, the departmental family, headed by the Secretary of State, will include some NDPBs, but not those that have separate legal personality and are therefore counterparty to the electricity supply contract in their own right. One possibility that may be worth exploring in the context of public sector leadership on climate change is the mandatory inclusion of all central UK Government departments within CRC (i.e. irrespective of whether they pass the 6,000 MWh/year inclusion threshold). As stated in the Energy White Paper, all UK central Government departments are publicly committed to ambitious carbon reduction goals – and in this context CRC could potentially be a valuable instrument to drive delivery.

Rationale: Using this definition, the governmental public bodies that fall outside of a departmental family are those that are most likely to have their own identity and their own financial and CSR drivers. This is a simple, straightforward approach that should include the majority of public sector emissions, and only exclude those from smaller organisations, maintaining the present CRC emphasis on the largest organisations for whom energy efficiency benefits should significantly outweigh administrative costs. This approach should put the right emphasis on the financial and CSR drivers in central government and public bodies.

It is possible that this approach may result in some loss of emissions coverage in the event of institutional change whereby government departments merge, split or amalgamate and their respective associated bodies change allegiances. However, this approach is aligned with the goal of simplicity. If Government wished to ensure no loss of emissions coverage from Government Departments and wished to fairly take account of all such ‘machinery of Government’ changes to Departments, then a site based ‘changes of operation’ process would be required, which would be substantially more burdensome and administratively complex.

Figure 35

Counterparty to the electricity supply contract

The counterparty to the electricity supply contract is the individual with whom the contractual obligation for the contract lies. For government departments and non-statutory governmental public bodies, the counterparty to the electricity supply contract is the relevant Secretary of State. This definition would define the relevant departmental grouping as including all of the bodies for whom the Secretary of State acts as counterparty to the electricity supply contract. As a result, each Government department CRC organisation – headed by the Secretary of State – will include some NDPBs, but not those that have separate legal personality (and are therefore counterparty to the electricity supply contract in their own right). . The governmental public bodies that fall outside of a department are those which are most likely to have their own identity and therefore financial and CSR drivers.

The proposed eligibility criterion ("counterparty to the electricity supply contract") will necessarily attribute responsibility for electricity to legal persons since only legal persons are able to enter into contracts, whether for the supply of electricity or anything else.

There are certain public bodies, however, which have no distinct legal personality and government departments are an example of such a body. In legal terms, departments have no substance whatsoever but are established for purely administrative purposes to carry out the functions and duties of the Secretary of State. By contrast, Secretaries of State do have separate legal personality (they are usually "corporations sole") and it is in the name of the Secretary of State that a government department will enter into contracts.

Therefore, the various Secretaries of State will be identified as the CRC participants for government departments, to the extent that their relevant electricity consumption exceeds the inclusion threshold.

Not only do Secretaries of State contract for the supply of electricity to their core department, but they also contract on behalf of all of the governmental public bodies which "form part" of their department but do not have separate legal status e.g. Executive Agencies, some non-departmental public bodies, etc. For example, the Rural Payments Agency will not be a counterparty to an electricity supply contract in its own right – the Secretary of State for Environment Food and Rural Affairs will contract on its behalf.

In this way, governmental public bodies with no separate legal personality will automatically form part of the relevant Secretary of State's "grouping" for the purposes of the CRC. Executive Agencies, Tribunal NDPBs, Independent Monitoring Boards and most Advisory NDPBs will fall into this category. Some Advisory NDPBs are however intentionally established with separate legal personality.

Governmental public bodies which do have their own separate legal personality (e.g. Executive NDPBs such as the Environment Agency) would be counterparties to electricity supply contracts and as such would participate in the CRC independently if they met the inclusion threshold. As a general rule, those bodies which have separate legal personality have greater operational independence from their sponsoring government department. It is therefore appropriate that such bodies participate in the CRC

separately, since they are best placed to respond to the financial and reputational drivers to reduce energy consumption.

As regards other types of public sector entities that could be considered part of central government, public corporations and most non-ministerial departments are bodies corporate and are legal entities in their own right. They would therefore participate in the CRC independently if they met the inclusion threshold. To the extent that public sector bodies own majority shareholdings in companies, the emissions of such companies will be aggregated with that of the public sector entity owning the shares in accordance with the standard corporate grouping rules set out in section 3.2 above.

The case study below, on the department of health, illustrates clearly the independence of Executive NDPBs, which would be treated independently from any government department under the proposed counterparty to the supply contract approach.

Case study: Department of Health and NDPBs

The Department of Health is the sponsoring department for a large number of Executive NDPBs e.g. Monitor, the Health Protection Agency, the Commission for Social Care Inspection etc. Discussions with the Department of Health reveal that it does not monitor nor have responsibility for the energy consumption of Executive NDPBs that it sponsors. Inclusion of Executive NDPBs which are separate legal entities in their own right in the Department of Health's CRC portfolio would not fit logically with existing financial and CSR drivers, as such drivers are placed at the level of the Executive NDPBs. The Department of Health does not exercise control over the Executive NDPBs in the same way as a 'parent' organisation would in the private sector; such control of one public body over another can only be provided for in statute.

Figure 36 Case Studies NDPBs Department of Health

4.2.1 An alternative approach to forming departmental families

An alternative approach to the counterparty to the electricity supply contract approach would be to develop a special decision rule – i.e. a set of criteria that can be used to allocate governmental public bodies to a particular governmental family, in this case for the purposes of the CRC. Such a decision rule should apportion all governmental public bodies to one or another central government department. For more details on how such a rule could be developed, see Annex C – Options for governmental public bodies.

Decision Rule 1, described further in Annex C, states that '*any body that is classified as a governmental public body by the Office of National Statistics (ONS) will be grouped with its sponsoring government department, as defined by the ONS for central government accounting purposes*'. Using this decision rule, departmental families would be formed that would include government departments and their Executive Agencies, as well as all governmental public bodies that are sponsored by the department. Therefore, unlike the departmental families formed using the counterparty to the supply contract definition, under the decision rule departmental families would include governmental public bodies with their own legal personality.

Once the decision rule has been applied, a set of departmental families of certain governmental public bodies (for example various NDPBs) will emerge. It would then be necessary to define how these families would be treated for the purposes of CRC. Will each departmental family participate in the CRC on its own? In full or in part? How would such treatment accord with the financial and CRC drivers for emissions reductions?

A series of options for the scale at which government “families” should participate in the CRC were considered. These options are described in more detail in Annex C.

These options explored ways to maximise the emissions coverage for governmental public bodies, for example by grouping smaller governmental public bodies with separate legal personality with their sponsoring department. In practical terms, none of these options were preferred either because they added unnecessary complexity or because they group governmental public bodies where the sponsoring department has a relatively weak influence on their emissions / operation, both in terms of financial controls and leveraging reputational drivers. While in general, the grouping implied by the counterparty to the supply contract is the recommended option, consideration of these alternatives has suggested one potential amendment to the general approach which we suggest merits further consideration. The potential amendment would be that government departments, and their family as defined by the counterparty to supply, should all be included regardless of whether they met the 6,000 MWhr/year inclusion threshold. Such a decision would be in line with government commitment to the CRC, and allow these departments access to the incentives provided for energy efficiency improvements.

4.3 Institutional Change

Regardless of the approach taken to grouping governmental bodies, in the event of institutional change – whereby government departments merge, split or amalgamate - it is possible that this will result in some loss of emissions coverage.

If Government wished to ensure no loss of emissions coverage from Government Departments and wished to fairly take account of all such ‘machinery of Government’ changes to Departments, then a site based ‘changes of operation’ process would be required, which would be substantially more burdensome and administratively complex.

Such an approach would also create different rules for public and private sector bodies, which is unlikely to be desirable.

4.3.1 Conclusion

Two alternative pathways have been defined to group departmental public bodies for the purposes of the CRC. These alternatives are shown in the figure below.

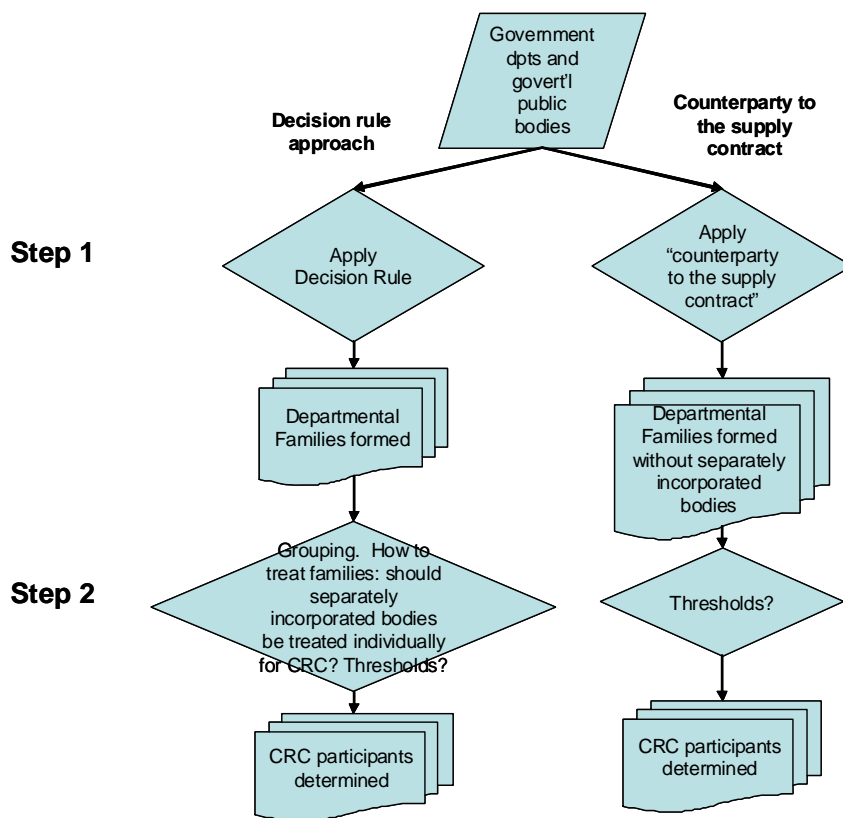


Figure 37 Process for determining governmental public body participation in CRC

The recommended approach is the “counterparty to the supply contract” approach shown above.

The recommended approach of assigning the responsibility for emissions to the counterparty to the supply contract, (i.e. the Secretary of State) will naturally create a departmental grouping. There appears to be no need to use a special decision rule to link governmental public bodies to their sponsoring government departments. The use of the administrative approach through the ONS as a decision rule, as outlined in Annex C, is a potential alternative, if unforeseen drafting challenges are encountered with the preferred option. We do not, however, envisage that this will be the case.

Using the preferred approach, any governmental public body that is a separate legal entity would be treated separately from its overarching department for the purposes of CRC and would only participate in the CRC if it reaches the 6,000MWh entry threshold itself.

4.4 Local Authorities

If the recommended eligibility criterion is adopted, local government and local public services will participate in the CRC at the level of the local authority, as a separate legal entity. Local authorities could be considered the “parent” organisation for other public bodies, in particular schools, but also fire authorities and perhaps others. These issues are considered in the chapters focusing on schools and on police and fire authorities respectively. Local authorities may also be involved in third party purchase, facilities management and outsourcing arrangements, these topics are also considered elsewhere (see earlier themes).

The default position is that individual Local Authorities, as separate legal undertakings defined in the Local Government Act, will be the CRC organisation taking responsibility for their own buildings and services, where they reach the inclusion threshold. The exception is where emissions responsibility falls to another party because of e.g. facilities management and outsourcing arrangements (as explored in earlier sections of this report). If local authorities participate on an individual basis for the purposes of the scheme, this places responsibility at the level at which carbon reductions are made in most instances, being within individual local authorities. It also uses the reputational driver, as individual participating local authorities would be clearly identified in the performance league table, providing further incentive for individual authorities to make emissions reductions.

The option of grouping local authorities together at the regional level has been explored for the purposes of the CRC to establish whether this type of grouping would be practical. A relevant example would be in the London region, where there is a strong regional government established, i.e. the Greater London Authority (GLA). Grouping of local authorities at a regional level may be less relevant in other regions in the UK. The Greater London Authority may constitute a special case and, as such, has been treated individually in the case study below.

Discussions with local authorities sought to explore the financial and reputational drivers that operate in local authorities in relation to energy management and carbon reductions, and in particular in the case of the Greater London Authority, to understand the extent to which grouping some local authorities together for the purposes of the CRC may be appropriate.

Issue: Should any local authorities be grouped together at the regional level for participation in the CRC? In particular, does the GLA constitute a sufficiently special case for this grouping to be justified?

Default position: Local authorities will participate individually in the CRC if they meet the 6,000MWh/year threshold.

Recommended Solution: The default position remains the most appropriate, where local authorities will participate individually in the CRC with no grouping.

Rationale: The default solution remains the most appropriate as it makes the best use of the financial and reputational drivers, placing responsibility for emissions at the level at which energy efficiency decisions are made. There may be some emissions loss where smaller local authorities do not meet the inclusion threshold. This loss however is likely to be outweighed by the benefits of placing responsibility at the appropriate level.

With regard to the GLA and its member organisations, there are a number of interesting options for grouping that Defra might want to consider further. Out of the three options identified we would suggest either solution 1 or 2 is the most suitable. Under Solution 1 each member organisation would participate individually in the scheme where they meet the inclusion threshold – i.e. in line with the default approach. In this case, only the Metropolitan Police Authority and Transport for London are likely to qualify in their own right for the scheme. This approach would make the best use of financial drivers within the GLA family. Alternatively, under solution 2 GLA, LDA and TfL would be grouped on basis that the Mayor has legal powers to direct these three organisations regarding emissions reductions, as set out in the Greater London Authority Act 1999. This approach makes broader use of the CSR drivers, as responsibility for emissions reflects the Mayor’s powers over these organisations; and this approach would achieve greater emissions coverage as four of the five organisations would fall in some way under the scheme: GLA, LDA, TfL and MPA. Note that the MPA would qualify in its own right and only the emissions of LFEPA would not fall under the CRC scheme. However it is not yet clear how costs and benefits of the scheme would be attributed to each organisation.

Figure 38

4.4.1 Regional Grouping

This section addresses two issues:

1. Grouping local authorities at the regional level for the purposes of the CRC; and
2. Grouping London boroughs with the GLA (in particular)

Grouping local authorities at the regional level for the purposes of the CRC

If local authorities were to be grouped at the regional level for the purposes of the CRC, a decision would need to be made regarding what would be the relevant CRC organisation.

One option could be to group Local Authorities together on the basis of their relevant Regional Assembly (RA), as environmental matters fall under the remit of the Assemblies.

In terms of a robust definition for this grouping, one is available as Schedule 1 of the Regional Development Agencies Act 1998 provides a clear link between local authorities and their Regional Assembly. However, it is doubtful how appropriate such a policy would be in practice. There no link between local authorities with the Regional Assemblies in law, although elected councillors from local authorities are nominated to the Assembly, and the financial drivers that a Regional Assembly could leverage are weak. In terms of reputation, Regional Assemblies are unelected and have little visibility with the public (unlike Local Authorities).

In addition, under the government's "Review of Sub-National Economic Development and Regeneration", the abolition of Regional Assemblies is planned: they will effectively cease to exist in 2010 when their executive functions will transfer to the Regional Development Agencies. It is unclear at this stage whether it would be feasible to consider Regional Development Agencies as the appropriate CRC organisation if local authorities were to be grouped at the regional level, given their remit will change from 2010.

In any case regardless of the issue of which organisation would be accountable for the emissions of grouped local authorities, it would seem that the financial and reputational drivers of the CRC are likely to be best placed on individual local authorities themselves, since they are far more likely to be in a position to carry out energy efficiency improvements.

4.4.2 Recommended Solution

Local authorities will participate individually in the CRC with no grouping.

Advantages

- a) Clarity, simplicity and administrative burden

It is administratively simple, as each local authority would participate if it exceeds the inclusion threshold on an individual basis.

As local authorities are separate legal entities there is no appropriate body under which local authorities could be grouped which would exert a similar level of control as a 'parent' organisation would over a subsidiary.

- b) Setting financial and reputational drivers at the correct level

It makes the best use of CSR drivers, as they are placed at the level of individual local authority, at which most energy efficiency decisions are made.

It also makes the best use of reputational drivers as poor and well performing local authorities are not grouped together but participate individually. Their relative position in the league tables should provide an additional incentive for further action on energy efficiency.

Disadvantages

- a) Maximising emissions coverage

There would be potential emissions loss when some local authorities do not meet the inclusion threshold. This loss however is expected to be outweighed by the advantages of placing responsibility at the correct level to encourage action.

4.4.3 Alternative Solution

Grouping local authorities at the regional level.

Advantages

a) Maximising emissions coverage

The grouping option would automatically increase the emissions coverage of the scheme, as a grouping of local authorities would be more likely to exceed the inclusion threshold.

Disadvantages

a) Clarity, simplicity and administrative burden

It is unclear how to link local authorities at the regional level as there is no regional body which exerts a similar level of control over local authorities as a parent organisation would in the private sector. Grouping at a regional level would be problematic, as outlined above as this does not reflect any legal relationship and, in any case, the remit of Regional Assemblies and Regional Development Agencies will change during the lifetime of the CRC.

This option would be administratively complex for the regional body as it would be responsible for reporting all local authority emissions within its portfolio. These reporting lines are not established.

b) Maximising use of the financial and reputational drivers

The lack of a strong financial relationship between regional bodies and local authorities means that it is unclear how the costs and benefits from the CRC should be apportioned to local authorities – whether it would be on an equal basis, proportionate to emissions reductions made by each local authority, or focused in poor performing local authorities to incentivise further action.

Under this option, there would be poor use of financial and reputational drivers: investments in energy efficiency are not made at the regional level and there would be a lack of visibility of those local authorities that make effective emissions reductions.

4.4.4 Conclusion

The most appropriate solution for local authorities would be that they participate individually in the CRC if they meet the inclusion threshold. This would ensure the most effective use of financial and reputational drivers in the scheme. There does not appear to be a suitable or logical alternative in terms of grouping local authorities at the regional level as local authorities are separate organisations which have their own legal status.

Grouping London Boroughs with the Greater London Authority (GLA)

Interviews with local authorities reveal that it would not be appropriate to group Local Authorities at a regional level because Local Authorities are separate organisations with separate powers. Equally, the Greater London Authority Act 1999 does not grant the Mayor powers to direct the London Boroughs to take actions as regards the London climate change mitigation and energy strategy, although the powers of the GLA may be expanded in the future. The GLA Act states that the GLA should work with London

Boroughs on specific issues such as air quality, but does not provide for the GLA to direct London Boroughs on issues of energy efficiency and climate change.

London Boroughs are responsible for the following functions:

- Education
- Housing
- Planning Applications
- Strategic Planning
- Highways
- Social Services
- Libraries
- Leisure & Recreation
- Waste Collection
- Environmental Health
- Revenue Collection

The GLA's is notably responsible for:

- Transport: underground, London buses, DLR and most main roads
- Economic Development: attract new investment
- Environment: working together with the boroughs on specific issues, such as air quality.
- Planning: strategic framework for the development of London
- Fire
- Culture
- Health

The majority of local authorities' income is coming from central government grants (45%); the remainder mainly comes from the council tax (25%) and the Non Domestic Rate (25%), a charge to businesses which is set by central government⁷.

⁷ Source: LGA, : www.lga.gov.uk/lga/aio/38679

Greater London Authority

The Mayor sets the annual budget for five organisations, known as the 'Greater London Authority Group', comprising of the Greater London Authority and four functional bodies:

- London Development Agency (LDA),
- Transport for London (TfL),
- Metropolitan Police Authority (MPA) to whom the Metropolitan Police Service (MPS) is accountable; and,
- London Fire and Emergency Planning Authority (LFEPA).

Funding

The planned spending of the GLA Group after deducting any specific grants, reserves and other income is known as their budget requirement. "The difference between the budget requirement and government funding and after taking account of any surplus on borough collection funds, represents the amount to be raised from council tax". The Mayor decides the level of council tax for all the functional bodies, except for LDA whose funding comes from specific grants and other income, including Central Government:

Table – External financing

	Total to be financed	Police Grant	General GLA Grant	RSG/NDR	Council Tax income	Band D Amount
	£m	£m	£m	£m	£m	£
Metropolitan Police Authority	2,595.0	-1,053.3	-	-876.7	665.0	227.02
London Fire and Emergency Planning Authority	405.1	-	-	-257.0	148.1	50.46
Greater London Authority	136.5	-	-48.0	-	88.5	30.15
Transport for London	12.0	-	-	-	12.0	4.09
London Development Agency	-	-	-	-	-	Nil
Collection fund surplus	-5.6	-	-	-	-5.6	-1.90
Total Other Services	548.0	-	-48.0	-257.0	243.0	82.80
Total GLA Group	3,143.0	-1,053.3	-48.0	-1,133.7	908.0	309.82

Source: Mayor's draft component and consolidated budgets 2008-09

Further details on the funding of GLA Group are available in Mayor's draft component and consolidated budgets 2008-09.

Energy efficiency decisions

Each member organisation makes its own decisions on energy efficiency investments. The GLA provides the overall strategic direction for London through the production of the Mayor's Sustainable Development Framework and supporting Environment Strategies. Member organisations are asked to ensure that their existing environmental strategy and action plan contribute to delivering Mayoral strategies. This is done through internal consultation, consultation with the GLA and analysis of the environmental strategies and priorities of the GLA.

As stated in 'Action Today to Protect Tomorrow', the Mayor's Climate Change Action Plan a target to stabilise London's CO₂ emissions has been set at 60% below 1990 levels by 2025. The Plan states that 'The Mayoral Group is committed to reduce emissions from its own operations to deliver its share of London's reduction.' In principle, the GLA supports separate participation for local authorities but recognises that under a grouped approach, all members of the GLA Group will fall within the CRC scheme but taken individually, some would not (see London Fire Brigade case study below).

In aggregate, the activity of the GLA group currently produces around 226,000 tonnes of CO₂ per year - 0.5% of London's total emissions. Nearly 78% of the GLA group's emissions are from its buildings, with vehicle fleet and air travel contributing to nearly 80%. The responsibility for total emissions is divided as follows: GLA (1%), LDA (1%), MPS (78%) and TfL (10%).

Figure 39 Case Study: The Greater London Authority Group

4.4.5 The Greater London Authority Group

Interviews reveal that a grouped approach would present significant difficulties to the GLA, chiefly in collecting CRC information from group member organisations with a large number of premises, for example the MPS. Interviews have not been able to reveal the extent to which reporting structures currently exist between these organisations to facilitate such data collection and the transfer of responsibility for emissions to the GLA from all five organisations.

The Mayor's Climate Change Action Plan reveals a commitment by the five organisations to reduce emissions from their own operations to deliver its share of London's emissions reduction. This will be monitored through a variety of mechanisms and the Mayor will report annually on London-wide CO₂ emissions and progress against the targets set out in this Action Plan, as part of the Mayoral Group budget and business planning process. The Climate Change Action Plan states that 'progress in implementing these actions and delivering CO₂ reductions will also be reported in the following publications and reports:

- Annual review of progress against Mayor's Energy Strategy
- Mayor's State of the Environment Report
- London Sustainability Development Commission annual performance indicators
- TfL annual Environment Report, monitoring performance against TfL's environmental performance indicators
- LFEPA Environment Update & Monitoring Annual Report monitoring performance against LFEPA's Environmental Action Plan
- Metropolitan Police Environment Report.⁸

As with most public sector organisations, the relationships that the GLA has with most of its functional bodies are not all the same. For example, the case study above illustrates that the GLA does not provide funding to the LDA.

In addition, the power of the Mayor to give directions to the five organisations also varies: the Greater London Authority Act 1999 requires the Mayor to prepare and publish a "London climate change mitigation and energy strategy". This strategy must contain information about "the measures to be taken, for the purpose of implementing the strategy, by each of the following (i) the Authority [i.e. the GLA itself], (ii) Transport for London, and (iii) the London Development Agency" and should also contain information on "the measures which other bodies or persons are to be encouraged by the Mayor to take for the purpose of implementing the strategy".

Therefore, the Mayor has the powers to specify measures which the GLA, LDA, and TfL must take regarding emissions reductions, yet there is no legal basis for the Mayor to exercise similar control over the London Boroughs, LFEPA and the Met, even if these organisations are encouraged to work with the GLA to achieve emissions reductions targets.

Therefore, for the purposes of the CRC there are three options that can be considered regarding the GLA:

⁸ 'Action today to protect tomorrow' , 2007 Chapter 6.

1. CRC responsibility be based upon the separate legal entities: in this way the GLA and its four member organisations would participate separately
2. GLA, LDA and TfL are grouped together on basis that the Mayor has legal powers to direct these three organisations regarding emissions reductions
3. Group GLA with its four member organisations for the purposes of the CRC to reflect the 'Mayoral Commitment' to deliver Mayor's Climate Change Action Plan.

The merits of each option are examined below:

Solution 1: CRC responsibility would be based upon the separate legal entities: in this way the GLA and its four member organisations would participate separately

Advantages

- a) Clarity, simplicity and administrative burden

This is administratively simple as each authority would participate as a separate legal entity, if it exceeds the inclusion threshold.

In addition, interviews suggest that the GLA is a slim line organisation and the administrative mechanisms are not in place to report on behalf of other member organisations.

- b) Setting reputational drivers at the right level

It makes good use of reputational drivers as they are placed at the level of the individual organisations: The public profile for the Met and TfL is high and distinct from the GLA. The response to a league table showing performance is therefore also likely to be higher if they are shown separately.

Disadvantages

- a) Emissions coverage

It is anticipated that under separate participation, only the Metropolitan Police Authority and Transport for London would qualify for the scheme, as the MPA consumed a total of 358,000 MWh of energy in 2005/2006, at a cost of £16.4 million. Transport for London accounts for 3,5% of London's total electricity consumption: in 2006/2007, a total of 1,139,000 MWh was consumed, including station, depot, traction and offices.

- b) Setting financial drivers at the right level

Individual participation would not maximise the use of financial drivers for all organisations, given that four of the five organisations receive funding from both the GLA, Central Government and other sources; the LDA does not receive any funding from the GLA.

Solution 2: GLA, LDA and TfL are grouped together on basis that the Mayor has legal powers to direct these three organisations regarding emissions reductions

Advantages

a) Clarity, simplicity and administrative burden

This is still simple to implement from a legal perspective, as the GLA Act 1999 provides powers to the Mayor to direct the GLA, LDA and TfL on issues such as emissions reductions.

b) Setting reputational drivers at the right level

This approach makes best use of the CSR drivers, as responsibility for emissions reflects the Mayor's powers over these organisations and also the commitment by these organisations to deliver the Mayor's climate Change Action Plan 2007.

c) Emissions coverage

Under this approach, four of the five organisations would fall under the scheme: GLA, LDA, TfL. The MPA would qualify in its own right and only the emissions of LFEPA would not fall under the CRC scheme.

Disadvantages

a) Clarity, simplicity and administrative burden

Interviews suggest that the GLA does not currently have the administrative mechanisms in place to report on behalf of other member organisations for the purposes of the CRC scheme.

It is not yet clear how costs and benefits would be apportioned between the three organisations and on what basis.

Solution 3: Group GLA with its four member organisations for the purposes of the CRC to reflect the 'Mayoral Commitment' to deliver Mayor's Climate Change Action Plan

Advantages

a) Emissions coverage

Under this approach, the emissions of all five organisations would fall under the scheme, under the responsibility of the GLA, so there would be no emissions loss.

b) Setting reputational drivers at the right level

This approach makes good use of the CSR drivers, as responsibility for emissions reflects the commitment by all five organisations to deliver the Mayor's Climate Change Action Plan 2007.

Disadvantages

a) Clarity, simplicity and administrative burden

Interviews suggest that the GLA does not currently have the administrative mechanisms in place to report on behalf of other member organisations for the purposes of the CRC scheme.

It is not clear how costs and benefits would be apportioned between the three organisations and on what basis.

It is not clear that there is a sound legal basis to group these five organisations together for the purposes of the CRC, as the Mayor is only granted powers to direct the GLA, TfL and LDA as regards achieving emissions reductions.

4.4.6 Conclusion

Whilst there are a number of possible solutions, in terms of grouping GLA member organisations with the GLA for the purposes of the scheme, solution 1 or 2 appear to be the most promising and Defra might want to consider these further.

However it should be recognised that interviews with some of the GLA organisations have not provided evidence to suggest that the mechanisms are in place for the GLA to assume responsibility for emissions of any of the other member organisations. Under solution 1, the GLA and its member organisations would participate individually in the scheme as they are separate legal entities. In this case, only the Metropolitan Police Authority and Transport for London would qualify in their own right for the scheme. The GLA itself is intended to be a slim line strategic body setting the direction and aspirations of the GLA group organisations and the public profile for the Met and TfL is high and distinct from the GLA. The response to a league table showing performance is therefore also likely to be higher if they are shown separately. However, solution 2 would not only increase emissions coverage of the scheme but also make better use of the reputational driver, as the Mayor has power over the GLA, TfL and LDA to reduce emissions, and this solution would reflect the public commitment that these organisations have made to achieving the emissions reductions as stated in the Mayor's Climate Change Action Plan, 2007.

4.5 Schools

4.5.1 Introduction

Defra's proposal for the treatment of schools in the consultation document⁹ was a voluntary one, with Local Authorities (LA) taking responsibility for school emissions in those specific cases where the LA paid the energy bill for that school. However, a large number of stakeholders have expressed support for a mandatory approach with all state schools being included under the Local Authority portfolio i.e. the LA would be the participating CRC organisation and would be responsible for school emissions under CRC, regardless of whether they were the counterparty to the electricity supply contract or not.

The following reasons support a mandatory approach to include state schools:

- In the main LAs do not pay the energy bill for schools and as such the voluntary approach is likely to lead to a variable and patchy coverage of schools across the UK.
- CRC, as an instrument, is well suited to targeting schools as part of the LA estate since LAs exercise a significant degree of influence over the schools for which they are responsible and it would also encourage LAs to provide energy management support to schools. The scheme is designed to tackle energy use emissions of organisations with many small emissions sources by placing obligations essentially on the 'corporate centre' (which is in a position to direct or influence the conduct of those subsidiary bodies for which it is responsible) rather than on individual emitters. The principle is that the 'corporate centre' is much better placed in terms of expertise and resources to respond to the administrative requirements of a cap and trade scheme, compared with the individual emitters (who can nonetheless still benefit from the incentives provided by being covered by such a scheme). LAs as 'corporate centres' and schools as individual emitters closely follow this model.
- There are significant opportunities for cost-effective energy efficiency savings in schools.

Once an approach on the grouping of schools has been agreed, a second question is how to share the costs and benefits of the CRC.

⁹ June 2007 consultation document: <http://www.defra.gov.uk/corporate/consult/carbon-reduc/consultation.pdf>

School X, under Southampton City Council

School X is a voluntary-controlled school, under Southampton City Council. The school purchases its energy via the LEA's energy contract (i.e. the energy contract is between the LEA and the energy supplier). The school reads its own meters every week, will be implementing voluntary half-hourly meters in the New Year and self-funds energy efficiency projects at the school, through grants and its own funds.

School X advises that their biggest driver for implementing energy efficiency is awareness raising and curriculum development for the students, rather than financial or reputational drivers. School X perceives that the LEA's biggest driver for implementing energy efficiency at schools is financial. By contrast, the LEA considers its biggest driver to be reputational, and, since schools directly gain/lose financially from implementing energy efficiency, that financial drivers would have most effect if placed with schools.

The buildings/maintenance/facilities department of the LEA, whilst holding valuable intellectual capital about the building stock and often having control of capital budgets allocated to schools, is not always motivated to fund energy efficiency initiatives on the request of schools, unless it is influenced by a third party to do so. For example, by being influenced from within the LEA (for example, from the sustainability department). One of the issues here is that the buildings/maintenance/facilities department does not always take a strategic or long term outlook in the allocation of the capital budget; for example, investing in an energy efficiency or renewables initiative that will not pay back in one or two budget cycles, but may take several years to pay back.

However, School X considers that it receives good support from the LEA's sustainability manager and their officer, and that having a specific officer in the LEA who is tasked with sustainability and can lobby for schools to receive funding for energy efficiency and other carbon initiatives, is important. It should be noted that there are limits to the amount of individual support School X can receive, given that the sustainability manager is spread across around 80 schools and the rest of the LEA's portfolio.

Figure 42 Case Study School X under Southampton City Council

Case Study: Groundwork and energy efficiency in schools

Groundwork is a sustainability-focussed NGO, and has five officers who are dedicated specifically to schools.

With regards to energy management, Groundwork has been engaging with schools to implement the LEA's energy management system EMS. When a school joins the LEA's EMS, this provides a structure for mutual support between the school and the LEA, which includes schools receiving support on energy efficiency, waste management and renewables. Groundwork has also undertaken attitude surveys and other programmes at schools orientated towards social and environmental sustainability.

Groundwork, as an independent third party, has a useful perspective on the LEA-schools relationship. For example, when approaching schools, Groundwork have found that schools can have a greater receptivity to engagement from a third party rather than from the LEA, as some schools can be "switched off" by the LEA. Other issues, such as the sometimes long timeframes for decision-making and generally low priority that environmental issues can take within an LEA overall, mean that LEAs are not always in the best position to enable the implementation of energy efficiency at schools. In addition, while some departments in the LEA may be supportive of implementing energy efficiency initiatives at schools, there may not always be the support needed across all the relevant departments.

However, while challenges have been described within the LEA-schools relationship, Groundwork appears to have been able to bridge these issues and facilitate the implementation of the LEA's EMS at schools. In turn, this has opened dialogue and a flow of resources from LEA to schools for the implementation of energy efficiency.

This case study provides an interesting example of a three-party cooperation (between an NGO, schools and an LEA) that has facilitated the implementation of energy efficiency in schools. The NGO has built the rapport and the individual relationships with schools needed to support the introduction of energy efficiency. A tool provided by the LEA (i.e. the EMS) has then been used to provide additional resources to schools to support the implementation of energy efficiency.

Figure 41 Case Study: Groundwork and Energy Efficiency in schools

Issue: How and whether to pass on the costs and benefits of CRC from local authorities to the schools

Recommended Solution: Good practice guidelines of how schools and LAs can work together on energy efficiency can be established. Agreements between LAs and schools could be reached in respect of how LAs could usefully pass on costs and benefits to schools (e.g. award funds to the schools which performed well on energy efficiency or to those which have the greatest emission reduction potential; hold the monies in a separate fund held by the local authority, for investment in energy efficiency in schools generally).

Advantages: Passing on benefits will provide more resources to schools to reduce emissions and strengthen the relationship between LEAs and schools. The CRC scheme would both reduce emissions and act as an educational tool. It may not be appropriate to prescribe centrally how this done – hence the suggested approach of allowing local authorities to determine the most appropriate mechanism. Sharing best practice should be encouraged.

Disadvantages: It could be administratively complex for LEAs to allocate benefits to schools in a fair and transparent way, as there are a number of ways this allocation could be made, for example on performance or on potential for savings. If agreement can be reached between LAs and schools, allocation to a fund for the purpose of energy efficiency investment could provide a simple route.

Figure 44

This section will look at schools and the CRC by covering the following topics:

1. Information on the funding structures that exist to support schools in making energy efficiency investments.
2. Best practice in terms of relationships between local authorities and schools.
3. Proposals of how to share costs and benefits of the CRC policies between schools and Local Authorities, along with an indication of the way in which these issues are viewed by some local authorities interviewed.

Irrespective of which policy option is chosen in terms of including schools, the relationship between the school and the local authority is crucial to ensure successful emissions reduction. To this end, examples of good practice can effectively illustrate how such a relationship can work.

Examples of good practice suggested by schools include:

- providing specific resources to support energy efficiency at schools;
- ensuring that this support is delivered from the right department within the LA; and,
- providing of adequate information regarding emission reduction opportunities at schools.

Providing specific resources to support energy efficiency at schools

Several schools and LAs mentioned the importance of having specific energy management resources within the LA, that are either schools-specific or to which schools have ready access. In terms of the type of support that schools need from their LA, this is very school-specific: some want the LA to manage the data only, some want funding, some want a more hands-on approach to providing advice, whilst others want a more hands-off approach.

There is a general consensus that LAs are the best location from which these resources should be delivered. However, Groundwork provides a good example of an NGO successfully delivering these resources. Groundwork is an NGO which supports schools to make changes and has five officers who are dedicated to schools. Groundwork suggested that being an independent party, i.e. not from Council, in their experience, 'opens more doors' at schools.

It is interesting to note that, after winning buy-in from schools, one of the key tools being used by Groundwork to implement energy efficiency is the LA's environmental management system. Schools which join the EMS then get access to additional support from the LA on energy efficiency, waste management and renewables. This is an example of a three-way cooperation between a LA, a NGO and schools which appears to be working well.

Ensuring that this support is delivered from the department in the LA which is best equipped to do so

Many schools mentioned the importance of getting support from the right department in the LA, noting that the optimum department will vary from LA to LA.

For many schools, their key contact on energy issues is the maintenance department. One school expressed the view that the culture of the maintenance department was perhaps not the right culture for getting support for energy efficiency, as energy efficiency was not the core business for that department and the payback timeframes for most energy efficiency projects were considered too long. This school indicated that the sustainability department was generally more supportive of their energy efficiency initiatives and was better equipped to give them the support they needed.

Conversely, another school identified that the maintenance department was a good place to get support for energy management issues because they understood the issues technically and understood limitations and opportunities within the building stock.

One way of taking this on board, could be for specific energy efficiency training to be provided to the departments of LAs which will be handling the relationship with the schools for the CRC, or the department which already have contact with schools on energy. High level support within each LA should be arranged so that the department

supporting schools on energy has a mandate (and budget, where relevant) to ensure that energy efficiency initiatives are implemented.

Provision of adequate information regarding energy reduction opportunities at schools

Most of the schools spoken to indicated that while they were generally aware of energy efficiency measures that could be undertaken (for example: double-glazing of windows, insulation and installing energy efficient equipment for new facilities). However, they would like an itemised list of the various emission reduction opportunities available for their school so that they knew where to focus their efforts. Related to this, is the issue of different schools having different energy reduction potentials and opportunities (e.g. new schools vs. Edwardian vs. Victorian schools).

There may be a need for an energy efficiency study to be undertaken across each LA's school portfolio, so that energy efficiency opportunities are identified and can be better targeted and prioritised by schools. This may also provide some valuable baseline data regarding schools energy performance. Further examples of approaches to managing energy efficiency in schools are given in the case study of Southampton City Council.

Reducing emissions with schools: Southampton City Council recommendations

- 1. Build a business case for employing an energy manager**
- 2. Local Education Authorities work with existing initiatives, such as the Carbon Trust to reduce emissions within schools**

1. Employ energy managers

A recent assessment by The Energy Systems Trade Association (ESTA) indicated that an energy manager could personally save at least 5% (probably higher) of a typical company's energy bill. This would be achieved through good management processes rather than plant investment (plant investment could save much more). If the cost of employing an energy manager is £70k pa, then at 5% saving this gives a break even at £1.4M pa. If the saving figure was higher (10-15% is not uncommon) or employment costs lower then this will reduce to £1M or less. Hence under current market conditions it is not unreasonable to say that: "1 energy manager per £1.4M utility expenditure is an economic resource".

There may be a case for employing an energy manager to help schools cut energy, paid for out of the schools overall budgets. If a LEA had many schools but not enough energy management staff, there could be a business case for the schools to employ an energy manager per £1m / £1.4m of energy expenditure, out of their devolved capital formula funds to help reduce their energy expenditure.

2. Work with the Carbon Trust

Southampton City Council is part of the Carbon Trust's Carbon Management Programme (CT CMP); the emissions from schools are included in the council's profile. As part of the programme, energy efficiency was highlighted a first area to focus on, therefore the council recruited an energy manager and bid to Salix to set up an Energy Efficiency Fund. Currently the council has committed to the Sustainable Schools Initiative of the DCSF and now has a Sustainable Schools Manager. The council is assisting schools to become ecoschools; one school intends to become a low carbon school. The council uses the Salix energy efficiency programme and work with other officers in council to consider how the council are supporting schools across the 10 gateways, energy, water, transport, as examples.

Salix Energy Efficiency Programme (part of the council's carbon management programme with carbon trust):

- If school agrees to a Salix project, the council implements it in the school
- The school has to agree to pay back the capital cost of a Salix energy efficiency project through the energy savings made
- The process is managed by the Southampton City Council energy manager.
- For Salix energy efficiency projects funded through the SCC/Salix energy efficiency fund, the school has to pay back the capital cost of the projects through the energy savings estimated upfront. Once the capital is paid back the school keeps the energy savings. Only 75% of estimated savings are paid back each year, allowing the school to benefit from 25% of the savings and to act as a buffer should the estimated savings not materialise.

Figure 45 Case study: Best practice relationship schools and Southampton City Council

4.5.2 Key challenge: Sharing of Costs/Benefits of CRC

The most vital issue as regards schools is how the costs and benefits of inclusion in the CRC are shared between schools and the local authority. This section provides some information that Defra will want to consider in producing guidance for schools and LAs.

Benefits

The schools interviewed generally agreed that any financial benefits of CRC should flow directly to schools, especially if the LA received financial benefits due to the efforts of schools themselves. There were a range of different ideas about how this could best be done:

- provide the funds to the schools which performed well on energy efficiency;
- provide the funds to the schools which have the greatest emission reduction potential; these may be schools which performed the best or those which performed worst over the last year;
- keep the funds separately, held by the local authority, for investment in energy efficiency in schools generally. One option would be that this should be regardless of performance. Another option would be to give schools access to the energy efficiency fund in proportion to the size of their total energy use emissions.

Whilst, initially, the first suggestion was the most supported option (as it was considered to give incentives to schools to perform well and gave recognition and encouragement to high performing schools), stakeholders went on to emphasise that identifying which schools performed well on energy efficiency and their relative financial gain will be challenging:

- data will need to be of comparable quality and accuracy between schools;
- there may be a need to take into account the percentage uptake of the emission reduction potential at each school as well as absolute emission reductions achieved;
- evaluation will be needed of extent to which schools are responsible for the financial benefits received by the LA and to 'fairly' apportion these benefits between schools and other parts of the council.

Costs

The general view among schools – given concern over current financial pressures and school services – was that financial costs should not flow to schools, whilst the LAs retained some of the CRC benefits. Equally, local authorities did not wish to see a system where CRC benefits were passed through, whilst the LAs retained the costs. Importantly, a view shared by both schools and LAs was the desire for administrative simplicity, given the potential for administrative complexity to erode benefits to all parties. In particular, reasons given against developing an administrative formula to pass through costs in a manner linked to school energy efficiency performance were as follows:

- Financially penalising schools which are not performing well on energy may not address the reasons for poor performance and does not build a school's capacity to improve its performance.

- In particular, the age of a school building may significantly affect the ability of the school to make costs savings, so sharing of costs would need to include an assessment of reduction potential, not just achievement.
- Some schools may have high energy usage because they are simply providing more services and facilities for its students and it would not seem fair for a school to be penalised for doing so. Services and facilities include:
 - more ICT equipment and the greater use of technology generally and,
 - increased after-hours activity such as activities for students or evening meetings.

Some alternative views were expressed. One school interviewed took the view that costs (as well as benefits) should flow directly to individual schools which performed badly, because this would provide a fully incentivised system for schools to improve their energy performance. One council suggested that the devolved formula capital budget, which is ring-fenced for capital expenditure in schools, is top-sliced to pay for CRC credits. These costs and benefits could be apportioned to schools on the basis of the energy performance from year to year, much like the mechanism for the CRC as a whole.

However, this means that there is a risk of serious costs to schools that are not sufficiently equipped to make timely energy savings investments. Also, such an approach would not take into account key factors relating to the potential to make improvements, such as the age of a school. There is little scope for improving the energy performance of e.g. very old Victorian schools without a rebuild programme versus potential of schools of a different era. The costs that schools would bear as a result of CRC would be at the expense of other capital expenditure, for example ICT etc. This extra burden could be damaging for schools and the reputation of the policy.

One council highlighted the default position that any costs/benefits would be kept by Council in Central Finance and would not be passed onto schools, but would be expected to be passed onto all Council areas more or less equally.

To move beyond the default position of all the costs and benefits simply falling on the LA, good practice guidance could play a valuable role in encouraging schools and LAs to agree how to best pass through CRC costs and benefits. Maintaining administrative simplicity is clearly key, to avoid benefits being eroded to all parties. There also needs to be equity in terms of CRC costs being passed through alongside CRC benefits. It would not be appropriate for only costs to be passed through – or indeed, for only benefits to be passed through. Accordingly, LAs and schools may wish to consider simply passing through costs as a small percentage increase on the energy bill (or in proportion to school energy use emissions), in line with the polluter pays principle – alongside an agreement on an administratively simple method of passing through benefits. LAs placing a proportion of their CRC revenue recycling payments into a dedicated fund for school energy efficiency investment could be a simple and valuable way to drive carbon saving. LAs and schools would need to agree criteria in case demand on the fund exceeded available monies (e.g. in such a scenario, to relate each schools' access to the fund to the size of school energy use emissions, or to the size of expected energy efficiency benefits from a particular investment). Government guidance could usefully encourage

LAs and schools to build on effective working relationships, potentially to develop agreements along such lines.

4.6 NHS Bodies

In England, The NHS is managed by the Department of Health, which controls the Strategic Health Authorities (SHAs), which oversee all NHS operations in an area of England, except for NHS Foundation Trusts.

The Department of Health is responsible for running and improving the NHS. It is notably responsible for providing strategic direction and setting national standards. The Strategic Health Authorities (SHAs) manage the NHS on a regional basis. Primary Care Trusts (PCTs) are contract managing bodies. They are allocated 75% of the NHS Budget to fund services and are accountable to their regional SHAs. A recent Audit Commission report¹⁰ states that in England, there are currently 10 Strategic Health Authorities, 152 Primary Care Trusts (PCTs); there are approximately 210 NHS Trusts and 59 NHS Foundation Trusts¹¹.

The NHS Purchasing Agency (PASA) is an Executive Agency of the Department of Health; it is centrally funded by the Department and is an integral part of the Department. To this end, the PASA would come under the Department of Health (see NDPBs section) for the purposes of the CRC scheme. It is responsible for negotiating energy supply contracts on behalf of a number of NHS bodies, but it is not compulsory for NHS bodies to use the services provided by PASA. PASA bulk buy energy at a negotiated rate, but each individual NHS body signs up its own contract with the energy supplier.

The diagram below¹¹ illustrates these structures in the NHS in England in terms of the various funding sources and different accountability structures and may suggest alternative options to group NHS bodies, for example at the level of the Strategic Health Authority:

¹⁰ *Review of the NHS financial year 2006/07*, Audit Commission October 2007

¹¹ *Report on the NHS Summarised Accounts 2006-07: Achieving Financial Balance*, National Audit Office December 2007

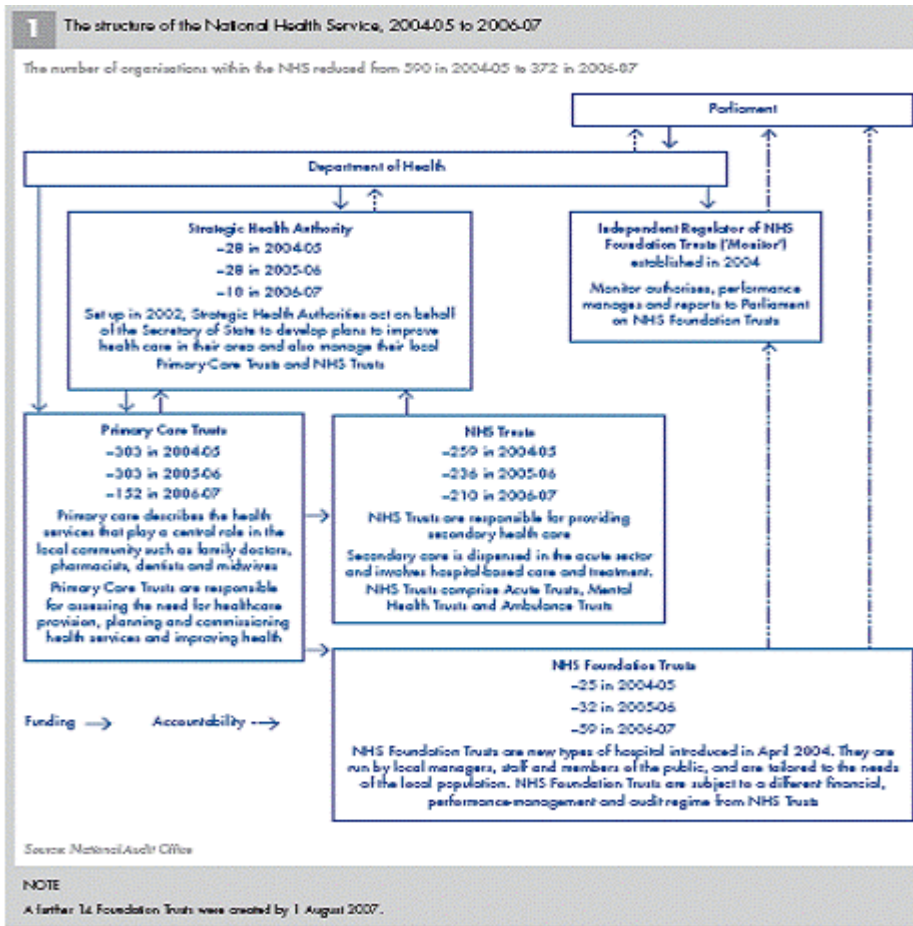


Figure 46 NHS structures in England

Issue: Is there a potential structure in place that can be used to group NHS bodies in order to leverage financial and reputational drivers?

Recommended Solution: NHS bodies (Strategic Health Authorities, Primary Care Trusts, National Health Service Trusts, Special Health Authorities, NHS Foundation Trusts) would participate in the CRC individually, if the organisation exceeds the inclusion threshold.

Rationale: This approach maintains the principles of simplicity and clarity for scheme participants, in line with the standard approach to definition of organisation. By not grouping bodies where no appropriate basis for grouping exists, this approach minimises the administrative burden of reporting emissions. It sets financial and reputational drivers at the correct level as the CRC responsibility would be placed on those organisations best placed to take up energy efficiency measures.

There are a variety of complex arrangements with regards to the funding streams and accountability structures of NHS bodies to other public sector bodies. As such, there is no clear 'parent' organisation which can clearly exercise control over NHS bodies in terms of delivering emissions reductions in the same way that a 'parent' organisation can exercise control in the private sector.

This approach does not maximise coverage, as some NHS bodies (e.g. PCTs) will not exceed the inclusion threshold. However, there will be many NHS bodies (e.g. most, if not all, NHS Trusts) which are of a sufficient scale to exceed the inclusion threshold. The potential loss of emissions coverage is outweighed by the benefits of clarity and better targetting of the drivers.

Figure 42

Default position:

Under the default position all NHS organisations would participate in the scheme on an individual basis, as separate legal entities.

4.6.1 NHS Trusts and NHS Foundation Trusts

In the case of Foundation Trusts, they have different reporting arrangements to NHS Trusts, as outlined in Figure 44 above. Trusts are already requested to submit information regarding their energy performance through the Department of Health's online Estate Return Information Collection (ERIC) system. The Estate Return is submitted by Trusts annually. The energy performance report provides statistics and commentary on energy performance and carbon/CO₂ emissions by NHS trusts in England between 1990 and 2004/05 as well as predictions for 2009/10.

Interviews undertaken by the project team with NHS Foundation Trusts and NHS Trusts indicate that most are likely to qualify for the scheme under the default position, as they meet the inclusion threshold in the majority of cases.

Unlike NHS Trusts, however, NHS Foundation Trusts are authorised and regulated by Monitor, the Independent Regulator of NHS Foundation Trusts. Monitor is responsible for monitoring the financial performance of Foundation Trusts. NHS Foundation Trusts also operate under a different financial and accounting regime from NHS Trusts, as outlined by the National Audit Office: *'Key differences are that NHS Foundation Trusts have no statutory duty to break even, do not have access to brokerage or financial support from the Strategic Health Authority or the Department.'*¹¹

4.6.2 Appraisal of recommended Solution

Advantages

a) Simplicity, clarity and lowering administrative burden

This approach is simple and it relies on the existence of separate legal entities which makes the application of the Strand 1 eligibility criteria test easier.

b) Maximising use of the financial and reputational drivers

The focus of the CRC would be placed on those organisations best placed to take up energy efficiency measures, as research indicates that such organisations have significant control over energy use, investments to a greater extent than any other single public body has control over such issues.

In most cases, NHS Trusts and NHS Foundation Trusts are the bodies with the most recognised public profile. Comparison with other Trusts in the league tables would therefore be likely to provide an incentive to improve performance.

Disadvantages

a) Maximising emissions coverage

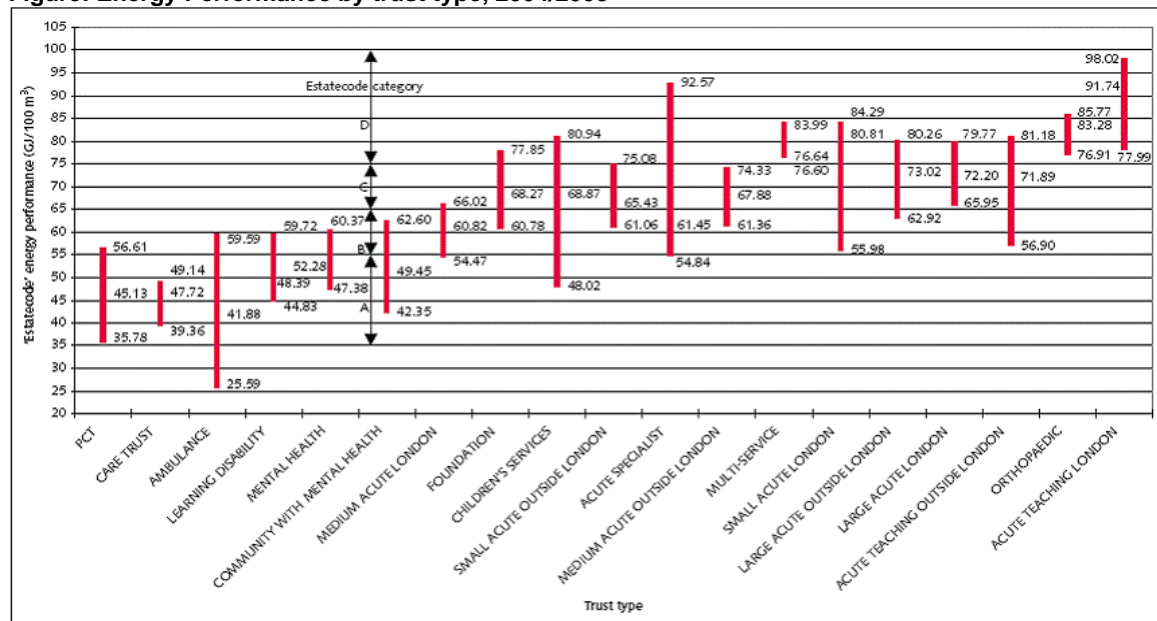
Under the recommended solution, there will be many NHS bodies (for example, most NHS Trusts) which are of a sufficient scale to exceed the inclusion threshold. There is a risk that some NHS bodies (including all PCTs) will not exceed the inclusion threshold. An alternative approach has been considered that would include additional bodies by way of 'grouping'. However, interviews with NHS bodies indicates that such an approach would not appear practical (see discussion below).

The diagram below illustrates data taken from 'Statistics on energy performance and carbon and CO₂ emissions - NHS England 1999/00 to 2004/05 (with projections to 2009/10)'. This diagram illustrates the different NHS bodies' emissions and helps inform the degree of risk associated with emissions loss for those NHS bodies which would not qualify for the scheme in their own right. Whilst it has not been possible to obtain data regarding each Trust type to determine whether they would meet the inclusion threshold on an individual basis, one can assume that PCTS and Care Trusts, for example, amongst others would fall below the inclusion threshold under the recommended solution:

Emissions in the NHS Bodies

In August 2006, The Department of Health has published its energy performance report : *'Statistics on energy performance and carbon and CO₂ emissions - NHS England 1999/00 to 2004/05 (with projections to 2009/10)'*. The energy performance report provides statistics and commentary on energy performance and carbon/CO₂ emissions by NHS trusts in England between 1999/00 and 2004/05.

Figure: Energy Performance by trust type, 2004/2005



Source: NHS

Figure 48 Emissions levels in the NHS bodies

4.6.3 Alternative approach: Grouping NHS bodies

Another alternative grouping considered was to group all NHS bodies at the level of the Strategic Health Authorities (SHAs). Initial discussion with a Strategic Health Authority indicated that SHAs do not have any control over PCTs' or Trusts' energy performance. SHAs mainly monitor financial performances and approve large capital investments. Energy management is not part of SHAs' role, however they encourage the implementation of energy efficiency.

This approach would not appear to be effective, as illustrated in Figure 37, the lines of accountability, responsibility and funding streams vary across the NHS organisations and are complex. Although the SHA acts as a strategic body for many of the NHS-related organisations, Foundation Trusts, for example, are not accountable to SHAs and the SHAs are not in charge of all of the operational elements, in the way that a private sector parent would be expected to be.

Advantages

a) Maximising emissions coverage

A grouped approach would increase the number of NHS bodies included in the CRC scheme by aggregating their emissions for eligibility purposes.

Disadvantages

a) Clarity, simplicity and administrative burden

This approach would create extra administrative burden as it may conflict with the way such organisations are dealt with for the purposes of public expenditure. Whilst Trusts submit their ERIC return on an annual basis to the Department of Health, this is merely a reporting mechanism. Superimposing financial obligations under the CRC on this report mechanism would be difficult. In addition there is a significant degree of independence held by each Trust for example in determining expenditure.

b) Maximising use of the financial and reputational drivers

With such aggregation, the focus would not be with the individual NHS bodies which are directly responsible for making energy purchases and energy management decisions and thus in the best position to manage energy use. This is different from the situation on the private sector, where private companies are in a position to control their subsidiaries financially and can impose energy reduction requirements; there is not an equivalent public body to which emissions responsibility of NHS bodies can be transferred in order to deliver effective emissions reduction for the purposes of the scheme.

There would also be limited visibility of individual performances of each NHS body under the grouped approach and therefore the leverage from reputational drivers would be weak.

4.6.4 Conclusion

In the case of NHS bodies, if the CRC scheme aims to maximise the use of financial and reputational drivers, it appears that the default position of NHS bodies participating separately in the scheme would be the most appropriate solution.

4.7 Police and Fire Authorities

Issue: Is there a potential structure in place that can be used to group Police and Fire Authorities to leverage financial and reputational drivers?

Recommended Solution: The default position remains the most practical, where police and fire authorities would participate in their own right if they meet the inclusion threshold. In the case of fire authorities which are part of the county council, they would fall under the local authority portfolio as the local authority itself is designated as the fire and rescue authority in law.

Rationale: This solution is legally robust, making use of existing legal structures; it maintains simplicity of the scheme for participants, whilst leveraging financial and reputational drivers at the correct level with the organisation. In the case of fire authorities which form part of the county council, if the local authority meets the inclusion threshold, then those fire authorities will come into the CRC scheme.

Whilst there may be some emissions loss from those police and fire authorities which do not meet the eligibility criteria in their own right as separate legal entities, this loss is outweighed by the advantages outlined above.

Figure 43

Default position

Under the default position all police and fire authorities would participate in the scheme on an individual basis, where they are separate legal entities and meet the inclusion threshold criterion.

This section analyses whether there are any existing structures within the police or fire authorities that can be used to group such authorities for the purposes of the CRC.

4.7.1 Police Authorities

Police Authorities in England are funded by the Home Office which provides around 42% of funds directly, Department for Communities and Local Government (DCLG) which provides a further 37% of Revenue Support Grant and Business rates with the balance of around 21% funded locally from council tax precept.

The Home Office sets out targets that Police Authorities need to include in their plans; the force is inspected by Her Majesty's Inspectorate of Constabulary (HMIC), audited by the Audit Commission and the Home Office receives a range of data on their performance.

Each police force is overseen by a Police Authority; police forces do not have separate legal personality and as such, each police force has its own police authority which would be counterparty to energy supply contracts.

Police Authorities are independent bodies made up of a number of individuals (local councillors, independent members, magistrates). Police Authorities are bodies corporate, and as such, have responsibility for management of the budget, employment of staff, as outlined in the Police Act 1996. The overall responsibility of Police Authorities is to maintain an efficient and effective police force in their area.

Police Authorities' responsibilities include, amongst others:

- holding the police budget and deciding how much council tax should be raised for policing;
- employment of the chief constable and senior police officers;
- monitoring the performance of the police force throughout the year, including performance against budget, and,
- publishing a 3 year plan and an annual plan and reporting at the end of each financial year on the extent to which the force has achieved the targets set out in the plan

There is no overarching body which is able to exercise control over the energy use emissions of several police authorities.

The case study below illustrates that, in the case of West Yorkshire Police, it is one of the police authorities that would qualify for the scheme and is counterparty to the supply contract:

Case Study: West Yorkshire Police

As shown in the diagram below, West Yorkshire Police is funded by three bodies: the Home Office, the DCLG and the local authorities. These bodies have no control over the supply of energy to the Police Authorities which are free to decide if they want to purchase energy directly from a supplier or want to go through a third party purchaser, such as OGC, to negotiate a contract. In each case the Police Authority, will be counterparty to the supply contract on behalf of their police force, as police forces do not have legal personality.

West Yorkshire Police meet the 6,000MWh/year inclusion threshold and are counterparty to the supply contract. The current approach would be to include police forces at the level of the individual force (about 50% of police forces in England, Wales, Scotland and Northern Ireland qualify in their own right).

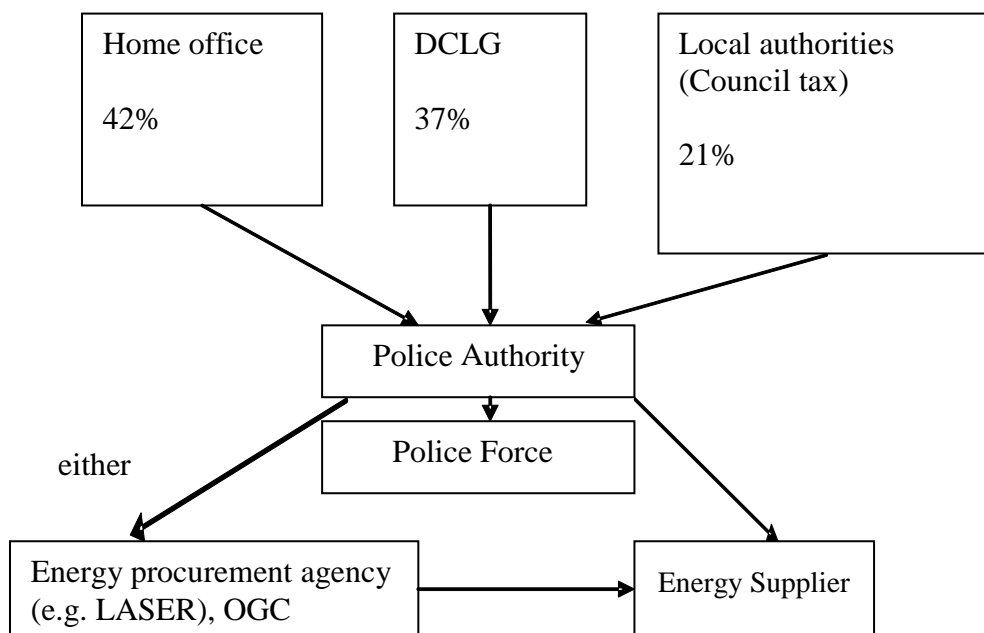


Figure 44 Case Study: West Yorkshire Police

According to the case study above, the organisation eligible and captured under scheme would be the West Yorkshire Police Authority. Interviews with West Yorkshire Police suggest that there is no appropriate grouping or structure currently in existence which could be used as the basis to group police authorities for the purposes of the CRC scheme, supporting the complexity of the funding arrangements for police as a whole.

4.7.2 Fire Authorities

The structure of the Fire Service in England currently is comprised of:

- 16 County Fire Authorities¹²
- 24 Fire and Rescue Authorities (which set their own budget)
- 6 Metropolitan Fire & Civil Defence Authorities (which receive a grant directly from government)
- Fire Authority for London: London Fire & Emergency Planning Authority (LFEPA, a functional body of the GLA)

In the case of the 16 county fire authorities in England, these would participate in the scheme if the local authority of which they form part participates in the scheme - this is because it is the local authorities themselves which are legally designated as the fire authorities and have the responsibility of maintaining the local fire brigade.

In England, metropolitan fire and rescue authorities are (pursuant to s.26 Local Government Act 1985) bodies corporate - they have their own separate legal personality and will therefore be counterparties to the electricity supply contract. Fire brigades have no separate legal personality - it is simply the responsibility of each fire authority to maintain a fire brigade in the area for which it is the fire authority.

The following case study illustrates that, under the proposed approach, those fire authorities that are separate legal entities (i.e. they are not part of the local authority) would not meet the inclusion threshold and therefore not fall under the scheme.

¹² Cornwall, Cumbria, Gloucestershire, Hertfordshire, Isle of Wight, Isles of Scilly, Lincolnshire, Norfolk, Northamptonshire, Northumberland, Oxfordshire, Somerset, Suffolk, Surrey, Warwickshire, West Sussex

London Fire Brigade

The London Fire Brigade is run by the London Fire and Emergency Planning Authority (LFEPA) and is part of a group of organisations operating under the “umbrella” of the Greater London Authority (GLA). LFEPA gets parts of its funding from the GLA through the council tax and reports annually to the

It is the largest fire-fighting organisation in the world and the third largest in the world. It currently occupies nine million half-heating meters. This will reduce to 6 million by 2008, as some buildings will be vacated. The organisation will then have 6 mandatory half-heating meters and 150 non-mandatory half-heating meters (NHH). Each site has its own local supply and boilers.

For 2007/8 electricity consumption totalled 4,597 MWh for MHH and 10,993 MWh for NHH (10,993 MWh for NHH).

LFEPA, as the legal entity representing London Fire Brigade is counterparty to the energy supply contract. The diagram below illustrates the energy supply arrangements between the GLA and its four member organisations.

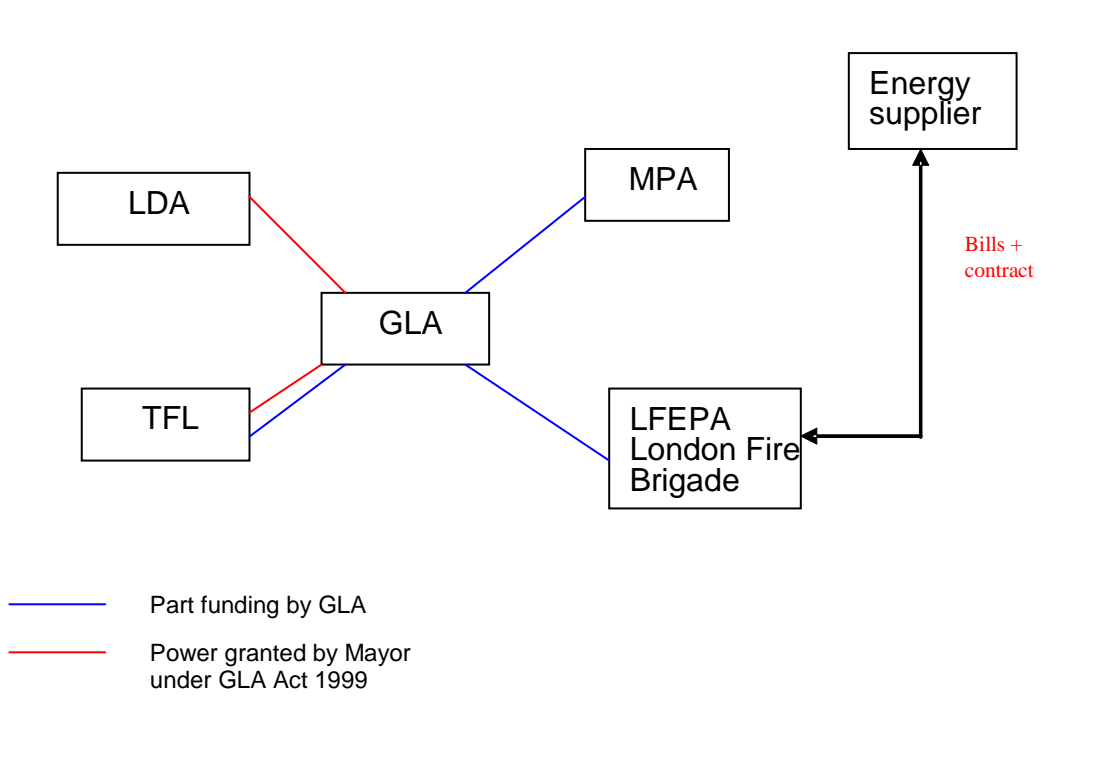


Figure 45 The London Fire Brigade

The case study above illustrates that, under the proposed approach, the London Fire Brigade, which is the largest fire authority in the country, would fall below 6,000MWh/year inclusion threshold. As all the other Fire Authorities are smaller then it can be concluded

that none would qualify in their own right. County Fire Authorities, however, would be included as part of the County Council portfolio.

Regional Management Boards

The 2004 Fire and Rescue Services Act 2004 requires fire authorities to establish new joint committees called Regional Management Boards (RMBs) by the 1 April 2004 to deliver, in accordance with national policies, six strategic functions as follows:

1. Resilience plans for large scale emergencies
2. Specialist and common services
3. Regional control rooms
4. Regional procurement
5. Regional approach to training
6. Regional personnel and human resources management

Theoretically, these Regional Management Boards could be a useful level at which to group Fire Services for the purposes of the CRC. However, since these RMBs are not "legal persons" (they are mere committees), it is difficult to see how RMBs could participate in the scheme legally.

As with public sector bodies in the health sector, these regional management boards could be seen as a practical level of grouping, but solely have a strategic function, not an operational one. Therefore, the regional management boards are not a genuine "parent" to the fire services in their region.

Recommended Solution

Police and fire authorities would participate in their own right if they meet the inclusion threshold. In the case of fire authorities which are part of the county council, their emissions will fall within the local authority's emissions portfolio.

Advantages

- a) Simplicity, clarity and lowering administrative burden

The benefit of such an approach is that it is simple. The proposed approach has the benefit of being able to rely upon the existence of separate legal entities which makes the application of the policy and the Strand 1 test (responsibility for emissions) easier.

- b) Maximising use of the financial and reputational drivers

The independent fire authorities are generally responsible for paying their own bills and making decisions about energy management. The fire authorities interviewed are housed in their own owner/occupied buildings and so have a high degree of control. This is also true for some police forces; others are tenants, however the landlord/tenant split should be dealt with by the definition of responsibility for emissions in Strand 1 which will apply to both public and private sector tenants.

As an exception, some police and fire authorities are engaged in various different third party purchase, facilities management and outsourcing arrangements which may limit their control over emissions. These issues are discussed in Strand 1.

In the case of fire authorities which form part of the county council, their emissions would be automatically aggregated with that of the local authority, since they are in essence the same body. Assuming that the local authority' emissions exceed the inclusion threshold, then the emissions from such fire authorities would be captured in the CRC scheme together with that of the relevant local authority.

Therefore this approach seems to set the financial and reputational drivers at the correct level.

Disadvantages

a) Maximising emissions coverage

Some police and fire authorities will not exceed the inclusion threshold:

- i. Evidence collected through interviews suggests that up to approximately 50% of all police authorities¹³ may not meet the threshold (between approximately 21-31 police authorities captured out of a total of 43 police authorities).
- ii. Interviews with Fire authorities suggest that under this approach, no independent fire authorities would qualify for the scheme. The London Fire brigade is the largest in England and would not qualify for the scheme. However the 16 county fire authorities are likely to fall within the scheme as part of their county council.

4.7.3 Alternative Approach

Group the Police and fire authorities at a regional level for the purposes of CRC.

Advantages

a) Maximising emissions coverage

The key benefit of such an approach would be that it would capture more emissions from the police and fire services sector. By grouping them together at a higher level, there will be a larger number of authorities that pass the inclusion threshold.

b) Maximising use of the financial and reputational drivers

In the case of fire services, the Regional Management Boards have strategic responsibilities including regional procurement and regional Human Resources (HR) management. Although these could both act as important levers in relation to energy management and emissions reduction, fire services and police forces are still fairly autonomous in function from these strategic bodies.

¹³ Note: This is out of total of 43 authorities in England, Scotland, Wales and Northern Ireland.

Disadvantages

a) Simplicity, clarity and administrative burden

This would not be an easy option to implement legally. Police and fire authorities are generally separate legal entities. In the case of police authorities there are no existing regional groupings that could be used as a potential model for grouping for the purposes of the scheme.

In the case of Fire Authorities, there are different organisational structures within authorities and no formal link between authorities. Regional Management Boards exist for fire authorities and have a strategic role, but these bodies have no legal status and could not currently be used as a basis for participation in the CRC.

This approach would also introduce an additional level of complexity regarding the redistribution of benefits/allocation of penalties between services or forces.

c) Maximising use of the financial and reputational drivers

An aggregation of the CRC responsibility might not actually focus on those who are ultimately in the best position to manage energy consumption. It is generally the fire services and police forces themselves who are directly responsible for making energy purchases.

This option would result in limited visibility of individual Authority performances in a published league table and would therefore not maximise the reputational drivers.

4.7.4 Conclusion

In the case of police and fire authorities, the default position of such authorities participating separately in the scheme would focus the CRC responsibility at the level where the financial and reputational drivers are strongest. There is no organisation that holds a strong enough degree of organisational and financial control to be considered a viable alternative under a parent/subsidiary approach.

4.8 Further and Higher Education

Issue: If all institutions are treated individually for the purposes of the scheme, then in the case of collegiate universities would it be beneficial to group the colleges to increase emissions coverage?

Recommended Solution: As a general rule further and higher education bodies should participate in the CRC as separate organisations. However in the case of collegiate universities we recommend that provision should be made in the regulations for the collegiate parts of named universities (for example, Oxford, Cambridge and Durham) so that these colleges participate as a group, as part of their respective university.

Rationale: By making provision in the legislation in certain cases, this would achieve a greater leverage of reputational drivers, as the emissions and performance of each individual college would be aggregated and attributed to the University's name in the performance league table. This approach would also result in a greater amount of emissions coverage, since in specific cases, colleges would not have reached the inclusion threshold without being grouped with the university.

Figure 46

Default position

All Further Education / Higher Education (FE/HE) institutions would be treated individually for the purposes of the scheme.

This default approach would mean that, in the cases of universities, such as Durham University, for example, neither the university nor the colleges would meet the inclusion threshold (see case study below). This could result in some high profile universities not being included in the scheme.

Therefore, it may be more effective for the purposes of the scheme to have a derogation from the default position to enable individual colleges to be grouped with the university in certain named cases. As visibility to the public is at the level of the University in most cases, rather than at the level of each individual college this would be a more effective use of the reputational driver as it can be argued that many colleges use the 'brand' of the university itself. A grouped approach would maximise the use of the reputational driver, externally at least, as well as increasing emissions coverage and would appear more in keeping with the parent/subsidiary approach taken in the private sector. In some collegiate universities, colleges are separate legal entities in their own right, therefore legal provision would need to be made in the regulations to enable a grouped approach.

However, such a derogation would only apply in the case of named universities. In the case of some collegiate universities, such as the University of London, for example, each

individual college (for example, King's College London, University College London) has a high degree of public visibility and their own distinct reputation. Therefore, it may not be an effective use of the reputational driver to simply group all of the colleges under the 'University of London' for the purposes of the CRC scheme. In this case, the default position would place the reputational drivers more effectively at the level of each college. The project team was not able to interview the University of London or any of its colleges within the period of the project to determine to what extent individual colleges would qualify for the scheme, or whether each individual college is counterparty to the energy supply contract.

In the case study below, Durham University governs most of the colleges; however provision would still need to be made in the regulations as some colleges are independent and are unlikely to reach the inclusion threshold if they are not grouped with the university:

Case Study: The University of Durham

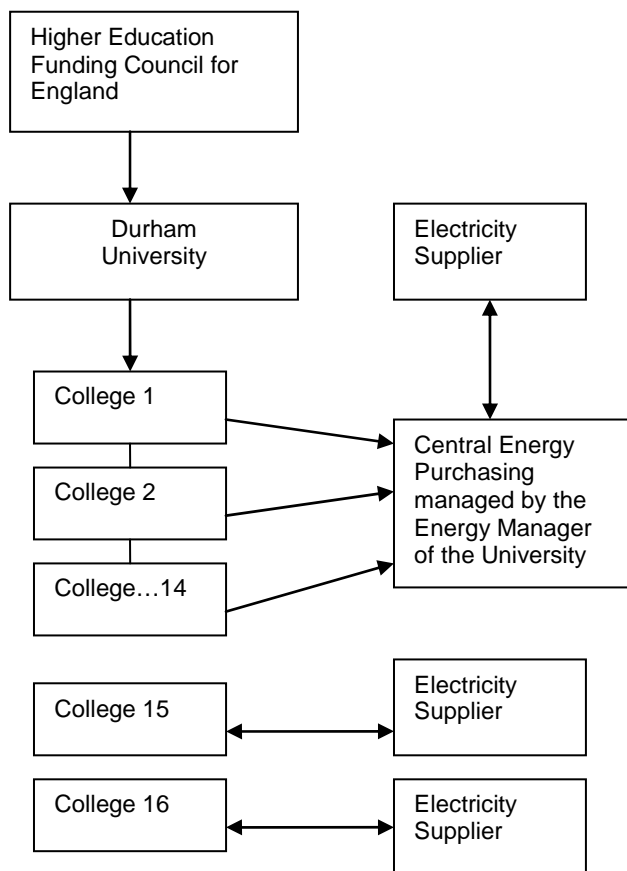
The University of Durham operates 16 Colleges out of which 14 are governed and owned directly by the University itself.

Energy Procurement

The energy contract is negotiated by the University on behalf of 14 colleges, with the exception of the two independent colleges.

The annual electricity consumption for the 14 colleges in Durham University is about 34,000 MWh. This covers residential (student accommodation) and non residential (academic department) premises.

The emissions of all 16 colleges would come under the scheme as a group but the two independent colleges are unlikely to be included if they are not grouped with the university, as it is unlikely that they would reach the inclusion threshold.



Analysis: Organisation eligible and captured under scheme under recommended policy: Durham University (*and* all 16 colleges).

Organisation eligible under the alternative criteria:

"Undertaking which pays the bill" (Definition 1): Durham University (14 colleges)

"Undertaking to which electricity is supplied" (Definition 2): Durham University (14 colleges)

Figure 47 Case Study: University of Durham

4.8.1 Recommended Solution

Further and higher education bodies would be CRC entities in their own right except in the cases of named collegiate universities, where the colleges would participate as part of a larger university.

Provision could be made in the regulations for the collegiate parts of collegiate universities to be grouped together with their central university. This would be effected by creating a derogation from the standard eligibility criterion in the Regulations. The derogation would then apply to those specified universities where, to ensure coverage and to best leverage CSR drivers of the university, it is considered appropriate for the colleges to be grouped with the central university (e.g. Oxford, Cambridge, Durham). The derogation would not apply to those other federated or collegiate universities (e.g. London) which were not so specified.

Advantages

a) Maximising emissions coverage

Without the grouped approach, there would be loss of emissions coverage; for example, in the case of Durham University, it is unlikely that either of the independent colleges would qualify for the scheme in their own right.

b) Maximising use of financial and reputational drivers

In some collegiate universities, colleges manage and negotiate energy prices centrally, either by one college on behalf of all colleges, or by the university itself as in the case of Durham University. Therefore in such cases, a grouped approach would sit well with existing arrangements, complementing the drivers for emissions reductions. In other cases, a grouped approach under CRC would help drive the establishment of central energy management co-ordination.

Most importantly, the public generally recognise the profile and reputation of a University in its entirety, rather than that of each of the individual colleges, so the external (i.e. public) reputational driver is better placed at the University level.

Disadvantages

a) Simplicity, clarity and administrative burden

To the extent that Government decides to group colleges under their respective named university, there will be additional administrative tasks imposed on such universities (e.g. to gather data centrally). A grouped approach applied to all collegiate universities may not be appropriate for all such institutions. The analysis of some collegiate universities' organisational structures indicates that the "University" currently does not have responsibility for, or complete control over, the colleges (though it does have some influence, in allowing its university wide brand to be used by its respective colleges and, in some cases, the provision of teaching to those colleges. It is not clear, however, how far this influence might extend to energy use). In such cases, each college is established as separate legal entity "with its own property and income". Therefore, any requirement assigning the responsibility of emissions to a single organisation (i.e. University as a "parent"

organisation) would constitute a significant departure in some cases from established arrangements (though in other cases central energy procurement already takes place).

The redistribution of benefits and/or allocation of penalties would need to be determined by each university and its colleges.

b) Maximising use of financial drivers

Whilst grouping colleges under their respective university for the CRC would leverage the CSR drivers of the university brand, it would focus less directly on the financial drivers facing the individual colleges which may be directly responsible for energy management decisions and, in some cases, energy purchases.

An alternative approach which the draughtsman of the CRC Regulations might like to consider in order to affect a grouping of collegiate universities is the use of the concept of "body of persons" from s.832 ICTA. It is not immediately clear however that such a term would operate to capture Oxford, Cambridge and Durham but exclude London, so the proposed approach of listing in the Regulations the universities to which the derogation should apply, would appear the simplest and most effective.

4.8.2 Conclusion

There is little difference between Oxford, Cambridge Durham and University of London from a legal perspective. The only difference is the ability to award degrees, which has little relevance for drawing a distinction between University of London and other collegiate universities for the purposes of the CRC. However, we suggest that there are significant and tangible policy reasons for making such a distinction on the basis of:

1. Emissions coverage – the independent colleges of Oxford, Cambridge and Durham would not qualify for the scheme in their own right unlike a significant number of the larger independent colleges which form part of the University of London.
2. Reputation – The independent colleges of Oxford, Cambridge and Durham are associated with the teaching reputation of the university and, as such, teaching responsibilities are split between the faculties (which are part of the University) and the Colleges. However in the case of the University of London, it has no teaching responsibilities - the constituent colleges of the University of London perform almost all the duties of a university, with the exception of the awarding of degrees (which, until recently at least, was the sole prerogative of the University of London). Therefore the reputational driver is not as strong in the case of University of London.

Therefore, for the purposes of the scheme, an opportunity to increase emissions coverage and also to make effective use of the financial and reputational drivers would be to group colleges together with their universities in certain cases by creating a derogation

from the standard eligibility criterion in the Regulations (e.g. Oxford, Cambridge, Durham). This would reflect the fact that, publicly at least, the reputational drivers operate at the level of the university in its entirety, as well as at the level of each individual college within a university. However, the derogation would not apply to those other federated or collegiate universities which were not so specified. For example, in the case of the University of London, the derogation would not apply, as the reputational driver operates most effectively at the level of each of the individual colleges.

4.9 Devolved Administrations

It is the intention that the CRC policy would be applied within the Devolved Administrations (DAs) in the same manner as within England, in as much as it is legally practical. In general, the DAs should therefore be included in the CRC in the same ways as English governmental public bodies.

The DAs were contacted directly to understand:

1. the degree to which it is legally practical to apply the CRC policy in a similar manner across the UK;
2. the degree to which the solutions to the organisational challenges in the public sector identified in this report would also be applicable in the individual DAs; and
3. to isolate key areas for further work.

Broadly speaking, the DAs notified the project team that they are working directly with Defra and therefore these issues are not comprehensively covered in this report.

The information that was deemed of most value is presented below:

Case Study: Northern Ireland Government and Structure

The Government of Northern Ireland is made up of the NI Executive, and then several departments. As with the case of the UK government, many of these are likely to be large enough to qualify for CRC in their own right, based on the number of people employed in each department. These departments take responsibility for, and fund, a range of non-departmental bodies in the same way that the UK departments do. The Northern Irish Executive should be treated independently of the UK government in order to make appropriate use of the strong independent identity of the separate government.

The Northern Irish Department for the Environment, employs roughly 3000 people, has three Executive Agencies, three statutory bodies and two Executive NDPBs. There are 10 other government departments including, for example, the Department of Enterprise, Trade and Investment, and The Department for Social Development, the Department for Education.

Northern Ireland officials indicated that they could see potential merit in using a decision rule that groups Agencies and NDPBs together with their sponsoring department unless those Agencies or Departments qualify in their own right – but careful consideration would need to be given to ensure an approach that would most effectively leverage reputational drivers. At the same time, it is recognised that consultation responses indicated clear stakeholder support for a common UK wide approach as far as practicable.

The Departments in Northern Ireland do not have Secretaries of States at their head. The Northern Ireland Interpretation Act identifies “relevant departments” as legal entities so these can be used to create departmental groupings. NI has a public bodies database, as does the UK, but the legal status of this database is unknown and it is likely to be predominantly an administrative arrangement.

Figure 48 Case study DAs: Northern Ireland Government

Devolved Administrations: Fire Authorities in the UK

England: In May 2006, the ODPM was re-structured creating the Department for Communities and Local Government (DCLG), which became the central government department for fire authorities in England.

Northern Ireland: Fire and rescue services are provided by a single entity, the Northern Ireland Fire and Rescue Service, a Statutory Corporation funded by the Department of Health, Social Services and Public Safety.

Scotland: Fire services are the responsibility of the Cabinet Secretary for Justice in the Scottish Executive. Previously the responsibility lay with the Secretary of State for Scotland.

Wales: The Government of Wales Act 2006 gave the National Assembly for Wales powers to pass laws on "Fire and rescue services."

Figure 49 Devolved Administrations and Fire authorities

Devolved Administrations and Schools in the UK

England: The Secretary of State for Children, Schools and Families (DCSF) oversees education policy in England. Local authorities (LAs) are primarily responsible for public spending on schools. Schools used to be the responsibility of local education authorities (LEAs), but these are no longer distinct from the rest of the local authority.

North Ireland: The Department of Education in Northern Ireland oversees the central administration of education in Northern Ireland. There are five Education and Library Boards, which are the local education authorities and library authorities for their areas. They fund controlled schools and meet the running costs of maintained schools.

Scotland: The Scottish Government Education Directorate is in charge of education in Scotland. State schools are funded by the 32 local authorities in Scotland which deliver education.

Wales: The Welsh Assembly Department of Education, Lifelong Learning and Skills is ultimately responsible for education in Wales. Each council in Wales has a local education authority, and it is primarily responsible for public spending on schools.

Figure 50 Devolved Administrations and Schools

Devolved Administrations: NHS in the UK

England: The Department of Health is responsible for the NHS in England. It controls 10 Strategic Health Authorities (SHAs), which oversee all NHS operations in a particular area.

Northern Ireland: The Department of Health, Social Services and Public Safety is responsible for NHS Ireland.

Scotland: The Scottish Government Health Directorate is responsible both for NHS Scotland and for the development and implementation of health and community care policy. Provision of healthcare is the responsibility of 14 NHS Boards.

Wales: The Health and Social Care Department of the Welsh Assembly Government is responsible for the NHS Wales. Strategic Health Authorities in Wales are known as Local Health Boards (LHBs).

Figure 51 Devolved Administrations and the NHS

There is a general need to continue co-operation with the DA departments that deal directly with fire authorities, schools, higher education and health to ensure that the proposed solutions for the UK case can be effectively transferred to the DA situation.

Further research will be needed into the particular situations in each of the DAs. The conclusions reached in this report are generally applicable only to the situation in England. It is worth noting however that:

- There is no mandatory HHM of electricity in Northern Ireland, so an alternative basis for the eligibility criterion will have to be crafted.

Areas where further research into the situation in the DAs will be appropriate include:

- Options for police and fire authorities in the DAs.
- Treatment of NDPBs that are related to bodies in England.
- The structure of health authorities in the DAs.
- The structure of higher education establishments in the DAs.
- Any central legal issues relating to the private sector that could result in differential treatment of businesses incorporated and operating in the DAs.
- Issues of administrative ease and coherence between the UK and DAs in interpreting policy and mobilising more complex policy decisions, for example landlord/tenant emissions transfer.
- Further areas of concern as identified by the DAs themselves.

Annex A – Questions for interviews

MASTER QUESTION LIST

Strand 1 – Responsibility for emissions under CRC

General questions: Responsibility for emissions (all)

Considering the options above and the structure of your organisation, or broader holding organisations:

- a) Can you please describe the structure of your organisation in terms of daughter companies, parent companies, subsidiaries, franchises etc? If you can provide an organogram, or describe such a diagram this may also be helpful. Please indicate where some subsidiaries or parents may be overseas, to the best of your knowledge.
- b) Who pays the electricity bill for your organisation, or your part of the organisation?
- c) Who has the contract for the electricity supply for your organisation, or your part of the organisation?
- d) Who would you describe as the organisation, individual or department *to whom the electricity is supplied?*
- e) Is this concept of *to whom the electricity supplied* specified in any way e.g. in contracts or in practical terms e.g. through the use of sub-metering?
- f) Is your organisation responsible for paying the electricity bill for other organisations or for subsidiaries of your own organisation?
- g) In your organisation, who is responsible for making the energy supply arrangements and choosing the energy supplier(s)?
- h) Do you have access to your organisation's energy consumption data? If not, who has access to this data?
- i) Do you have access to the energy consumption data for the organisations you are responsible for (subsidiaries, related organisations etc.)?
- j) Does your organisation report energy-use emissions? If yes, who is responsible for this task and to whom are emissions reported?
- k) Has your organisation implemented energy efficiency improvement or carbon management measures? If yes, who implements and who monitors the implementation of these measures?
- l) How many of the sites you occupy/ what proportion is supplied with electricity on a mandatory half-hourly metered basis? [Given the eligibility threshold of 6000MWh/year of mandatory half-hourly metered electricity consumption, do you think your MHHM electricity consumption across your organisation will be at a level which would require you to participate in the scheme?]"

Theme 1 and 2: Landlords and Tenants

- a. In the context of your own premises and tenancy arrangements, do you think it is more straightforward to apportion responsibility for emissions to the person to whom electricity is supplied or the person who pays the electricity bill?
- b. What practical difficulties can you envisage with defining a person or organisation “to whom the electricity is supplied”?
- c. How would you suggest the landlord should pass through benefits and costs from the CRC scheme could to tenants?
- d. How practical and likely are the following approaches pass through of benefits and costs? Please comment on these possible approaches:
 1. Where sub-metering is not in place the landlord could simply increase the service charge by a fixed percentage, passing through fixed costs and not passing through any CRC benefits.
 2. Where sub-metering is in place, the landlord could break down the service charge, if not done so already, so that the energy component of the bill is visible to the tenant thus ensuring that the tenant accrues benefits or costs relating to energy efficiency improvements.
 3. Where sub-metering is in place, landlords could consider ranking their tenants according to their energy use as a means of determining how to award CRC bonuses and penalties between tenants. Do tenants and landlords see any merit in such an approach?
 4. Where sub-metering is in place, as an alternative to ranking, tenants could simply get a revenue recycling payment “X” proportional to their average annual emissions over the previous 5 years? Or, to provide more effective incentives, do landlords agree that adding a % bonus / penalty to this payment would be useful? (e.g. up to +/-100%, i.e. so a tenant could get a payment between zero and double “X”)
 - i. If there were to be ranking (with a bonus / penalty linked to rank), how would the landlord go about ranking their tenants based on energy use? E.g. What questions would the landlord want to ask? Could the ranking be done simply, e.g. % reduction relative to a baseline (consisting of the previous 5 years of emissions)? Where landlords have voluntarily put up display energy certificates, could this provide a means of ranking tenants in terms of energy use performance?
- e. Does the landlord has a direct relationship with the tenant or is there an intermediary between the two e.g. facilities management company? If there is an intermediary, will this affect the ability to pass through costs and/or benefits of the scheme?
- f. The current proposals envisage landlord-tenant relationships. The CRC proposals could refer to 'occupiers' and 'ultimate landlords', thereby, as a default setting, excluding sub-lettors/ intermediate tenants from responsibility. Would this be a legally practical way to deal with sub-tenants and licencees?

Theme 1 Landlords

- g. As a landlord, do you have centralised records of mandatory HH meters for the rented facilities? If not, who holds such data?
- h. As a landlord, do you have access to other energy use data in relation to the rented facilities i.e. all energy use, even not on HH meters? If not, who holds such data?
- i. In your buildings to what extent has responsibility for receiving energy supply been transferred from yourself as landlord to the tenant (e.g. do some tenants have their own separate fiscal meters, contracts with suppliers and get bills separate from the landlord)? Where the tenant now receives the energy supply, what do you know about how is this done, how often and what sort of relationships are established between tenants and energy suppliers?
- j. As a landlord, where private metering arrangements exist between tenants and suppliers – is it possible that this will reduce the amount of electricity that is directly supplied to you such that you would fall below the 6000MWh qualifying thresholds for your buildings i.e. the CRC eligibility requirements?
- k. If a tenant has a direct supply/pay relationship with suppliers, to what extent will landlords more rapidly move to install private metering arrangements in their properties? (whereby direct contractual relationship exists between supply and tenant).
- l. Is there a difference between electricity and other forms of energy (e.g. gas) in terms of who (landlord/tenant) pays which bills?
- m. Is there a different arrangement for heat, e.g. how it is supplied, who holds the contract or in how bills are paid?
- n. As a landlord, is your organisation able to manage its tenants' emissions as well as its own? Do you do this at present? If so, how?
- o. Who in the organisation can control or influence energy use (hierarchy – is it board level, energy manager, etc.)?
- p. Who makes investment decisions (on energy management)?
- q. What (if any) arrangements are in place between landlord and tenant regarding energy consumption and emissions (e.g. benchmarking, consumption targets, emission targets, use of energy efficient products etc)?
- r. Are these arrangements contractual?
- s. How, where and by whom are these targets monitored?
- t. In a multi-occupied premises, where tenants' electricity consumption is captured by sub-metering, what does this mean in practice – have you noticed a drop in tenants' energy consumption?

Theme 2 Tenants

- u. To what extent do you consider participation or non-participation in the CRC by landlords may become a criterion for tenants when choosing properties to rent i.e. because if a tenant participates in CRC then the tenant itself would be responsible for its CRC emissions, otherwise these emissions would become the landlords responsibility. This could affect the landlord's eligibility for the scheme?
- v. Is your organisation able to manage its own emissions at its rented property/ies? What influence can you exert over the emissions at the common parts?
- w. Who in the organisation can control or influence energy use (hierarchy – is it board level, energy manager, etc.)?

- x. Who makes investment decisions (on energy management)?
- y. What (if any) arrangements are in place between your landlord and yourself regarding energy consumption and emissions (e.g. benchmarking, consumption targets, emission targets, use of energy efficient products etc?)
- z. Are these arrangements contractual and how are costs/benefits passed through, if at all? (Please comment on the suggestions on cost/benefit pass through set out in the questions for landlords **and** tenants above)

Theme 3-5: Outsourcing, Facilities Management and Third Party Purchase

Theme 3 Purchasers of outsourced functions

What functions/services do you outsource?

Do you retain control over energy supply or procurement for the outsourced services/functions?

Is the provider of the outsourced function(s) located internally or externally in relation to the entity to whom services are being provided?

Do you outsource services/functions to more than one party?

Are the outsourced functions provided at a single or multiple sites? If multiple sites, is any visibility available on a site by site basis over the energy consumption and emissions of the outsourced function(s)?

What visibility (if any) do you have over the energy consumption and emissions of the outsourced function(s)?

What powers do either party have to control energy consumption/emissions? Is this assigned to any party in particular? If no such powers exist, is there scope for incorporation of such powers into the contract?

Does the provider/ providers of outsourced functions just provide services to you or a number of other entities as well?

Are the functions you outsource provided to you from a company which is registered in the UK? If you do not know, are the functions themselves provided from within the UK?

Theme 3b Purchasers of facilities management

What facilities or buildings are managed by an external supplier?

Do you outsource facilities management to more than one party?

Do you retain control over energy supply or procurement for (any of) these buildings?

What visibility (if any) do you have over the energy consumption and emissions of the buildings managed by facilities management companies?

What powers do either party have to control energy consumption/emissions? Is this assigned to any party in particular? If no such powers exist, is there scope for incorporation of such powers into the contract?

Does the provider/ providers of facilities management functions just provide services to you or a number of other entities as well?

Are the functions you outsource provided to you from a company which is registered in the UK? If you do not know, are the functions themselves provided from within the UK?

Theme 3 and 4 Providers of outsourced functions (management, not purchase) and Facilities Managers

1. What type of facilities/services do you provide? Specifically what do you manage in relation to energy and is there a special arrangement for heat?
2. Do you provide services to only one entity, or to a number of other entities as well? If so, please provide the names of the entities and a brief outline of the services you provide.

3. Based on your organisation and how it functions, would there be a more straightforward way to assign responsibility for emissions under the CRC?
4. Are the outsourced functions provided at a single or multiple sites? If multiple sites, is any visibility available on a site by site basis over the energy consumption and emissions of the outsourced function(s)?
5. Are you located internally or externally in relation to the client?
6. What visibility (if any) do you provide to the client with regard to energy consumption and emissions of the outsourced function(s)?
7. What powers does either party have to control energy consumption/emissions? Is this assigned to any party in particular? If no such powers exist, is there scope for incorporation of such powers into the contract?
8. If the facilities management provider is responsible for paying for energy, how is this passed through to the entity utilising the facilities which are managed?
9. Is there a difference between electricity and heat in terms of who pays which bills?
10. Do you provide the outsourced functions from within the UK?

Theme 5: Third Party Purchasers

What purchasing functions do you carry out?

Which organisations do you purchase energy for? Is there a different arrangement for heat?

Are you owned by any of the organisations that you purchase energy for?

Do you make use of any of the energy that you purchase i.e. would you describe yourself as an organisation “to whom energy is supplied?”

To what extent do the organisations that you purchase energy for dictate the terms upon which such energy purchases are made? For example, do they have any involvement in specifying sustainability criteria etc?

[On what basis do you make energy purchases? For example, do you act as an agent (i.e. contracting with the supplier on behalf of the relevant organisation) or do you set up a framework agreement under which the organisation itself makes the purchases from the supplier?]

Theme 6: Franchises

- a. Please provide a brief overview of the nature of the franchise along with details of the locations from which the franchise is operated.
- b. Is the franchise delivered at a single or multiple sites? If single site, is any visibility available at that site over the energy consumption and emissions of the franchise? If multiple sites, is any visibility available on a site by site basis over the energy consumption and emissions of the franchise?
- c. If the franchisee is responsible for paying for energy, how is this passed through to the franchisor (if at all)? Is there a clear line in the relevant financial model to identify energy costs?
- d. If the franchisor is responsible for paying for energy, how is this passed through to the franchisee (if at all)?
- e. What powers do either party have to control energy consumption/emissions? Is this assigned to any party in particular? If no such powers exist, is there scope for incorporation of such powers into the contract?
- f. Looking to the possible options provided above in relation to the definition of CRC organisations in relation to franchises – are any of these practical in relation to your organisation?
- g. Does the franchisee just operate a single franchise or does it operate a number of other franchises or operate in a number of fields?
- h. Please provide an overview of your corporate structure including any holding companies and subsidiaries, together with an explanation of their operations.
- i. If franchisors were to participate in the scheme and report on behalf of the whole franchise in order to provide maximum coverage, what practical issues would be foreseen (including but not limited to administrative burden and any necessary franchise documentation amendments to enable timely and accurate information flow).

Strand 2 – Business sector

Theme 8 Business and Business Change

- a. Would a requirement to report separate emissions for subsidiaries with greater than 6,000 MWh create a significant additional administrative burden, or would this be a relatively simple reporting task (i.e. would the information need to be calculated anyway to establish the overall organisation's emissions)?
- b. Do you think that securing emissions coverage justifies an additional administrative burden?
- c. Do you think that perceived fairness justifies an additional administrative burden?
- d. In your opinion, which approach would be preferable for your organisation to participate in terms of the trade off between administrative simplicity and scheme perceived scheme fairness and why?
- e. Do you think that the structure of your organisation will mean there is any risk that your organisation may be treated differently to your competitors in the CRC scheme?

Theme 9 Joint ventures/joint ownership

- a. Do you anticipate difficulties with existing joint ventures in terms of allocation of responsibility for emissions where current shareholding arrangements make no provisions for this?
- b. How feasible is it to assign responsibility for emissions to the CRC organisation with operational control over the Joint Venture?
- c. Is there an alternative approach to apportioning responsibility for emissions to one of the other joint owners (not operational control, but perhaps financial control, CSR driver)?
- d. What relationship do the different owners of the business have with energy efficiency/carbon reduction investments in the organisations they own, if any?
- e. What role does CSR play in the way in which the joint venture owners interact with their investments? How may the CRC influence this role?
- f. For private equity institutional holdings, to what extent do you consider that investee company operations should be grouped for the purposes of the scheme where, for example, the private equity institution holds a majority stake in multiple investee companies?

Theme 10 Private Equity and Venture Capital

- a. If you are a private equity firm, do you share business best practice initiatives across your various investments?
- b. If 'highest UK trading entity' rather than 'highest UK entity' were adopted as a means for capturing organisations, what implications would this have for private equity &/ or venture capital?
- c. Do you have control over the energy use of your investments?
- d. To what extent do you consider that investee company operations should be grouped for the purposes of the scheme where, for example, the private equity institution holds a majority stake in multiple investee companies?
- e. What complexities (management issues, access to data etc.) would arise for your organisation if it were to be made responsible for the emissions of its investments?
- f. What type of organisation structure might prevent the approach from being workable? In other words, in which cases would your organisation find it difficult or impossible to be responsible for its investments' emissions (e.g. the existence of a plethora of investors for the same company etc.).
- g. What particularities should be taken into account when dealing with VC/PE responsibility over emissions?

Theme 11: Overseas Ownership

- a. If your organisation is part of an international group, does the international group have other UK based subsidiary organisations that report directly to an overseas parent?
- b. If so, would your parent organisation look to group its UK based subsidiaries and report emissions on a group wide basis?
- c. To what extent would you expect emissions of the UK subsidiaries of foreign companies within your group structure to be taken into account, in particular where the direct holding company of such subsidiaries may be overseas but an indirect holding company may be located in the UK?
- d. In light of the UK application of the proposed scheme, to what extent would you expect emissions of UK subsidiaries to be taken into account, in particular where the direct holding company of such subsidiaries may be overseas but an indirect holding company may be located in the UK?

Strand 3 – Public sector

Theme 12 Government Departments

- a. Which agencies (or other organisations) is your Department responsible for? Can you provide an organogram or other structural indications?
- b. What is the nature of your Department's responsibility for and relationship with each related agency or organisation? Do they help you fulfil your departmental targets? To whom are they accountable?
- c. What visibility (if any) does your Department have over the energy consumption and emissions of limb "a" above (individually and/or as a whole)?
- d. How do the current sustainable operations in the government's estates (SOGE) targets apportion responsibility between your agencies/other organisations?
- e. Are the suggestions made above practical in terms of energy purchases and energy savings investments, in particular the suggestion to group public bodies with their overarching sponsoring body?
- f. Are energy purchases for these associated agencies or organisations made by your Department directly, in collaboration with your NDPBs or executive arms or through a third party (such as OGC buying solutions) or individually by the NDPBs and agencies?
- g. If such purchases are made in collaboration with the other organisations or agencies or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your Department) or is there a framework agreement under which your Department makes the purchases from the supplier?
- h. For the purposes of the CRC, what type of grouping would you consider appropriate considering the suggestions above, in order to best incentivise emissions reductions and leverage CSR drivers?

Theme 13 NDPBs/ Agencies

- a. Which Government Department(s) is/are responsible for your operation?
- b. What is the nature of your Department's responsibility for you? Do they control your budget? Do they determine your KPIs and monitor your performance? Are you performing an important contributory role to the Department's KPIs or key targets?
- c. What visibility (if any) does your Department have over your energy consumption and emissions.
- d. Considering the nature of your organisation, and the CRC, which of the suggestions given above in relation to how public bodies might be grouped practical, especially the suggestion that you be grouped with your sponsoring government department?
- e. In your opinion, what other practical possibilities particularly in terms of energy supply arrangements, might there be for your organisation to be grouped with another organisation (sponsoring Organisation, Organisation with a similar structure, type etc.)?
 - Type of grouping, and why?

- Type of criteria?
 - If none, please state why
- f. Would it be more practical for your organisation to be considered on an individual basis? If yes, please state why, if not, why not?
 - g. How does your organisation approach CSR and its profile in relation to CSR issues – is this as a stand alone organisation, or as part of the sponsoring government department? What relationships and groupings are important in achieving the government sustainable operations targets?
 - h. How do the current sustainable operations in the governments' estates (SOGE) targets apportion responsibility between yourself and your sponsoring department?
 - i. Will grouping you together with other bodies help incentivise carbon reductions in your organisation?
 - j. Are energy purchases made by your organisation individually, in collaboration with other organisations or through a third party (such as OGC buying solutions)?
 - k. If such purchases are made in collaboration with other organisations or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your organisation) or is there a framework agreement under which your organisation makes the purchases from the supplier?
 - l. Can you provide an indication of your organisation's annual energy consumption or emissions?

Theme 14 Local Authorities

- a. Can you please describe the structure of your organisation in terms of relationships with other bodies e.g. Regional Assemblies/government etc. If you can provide an organogram, or describe such a diagram this may also be helpful.
- b. To what extent do you consider it practical for the range of organisations which fall under your portfolio, to be included within your responsibility under the CRC?
- c. Are there any types of organisations e.g. leisure facilities, schools, libraries, waste facilities etc. which may not be included under the local authorities auspices for the purposes of the CRC, because there is a case of outsourcing, third party purchase or external facilities management?
- d. Are energy purchases made by your authority individually, in collaboration with other organisations or through a third party (such as another authority or a purchasing organisation)? How are energy purchases made across the collective of different types of organisations that the local authority owns or manages?
- e. If energy purchases are made in collaboration with other organisations or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your authority) or is there a framework agreement under which your authority makes the purchases from the supplier?
- f. What visibility (if any) do you have over the energy consumption and emissions of those ranges of organisation falling under your portfolio in question "a" above (if applicable) (individually and/or as a whole)?
- g. To what extent would it be logical and practical for your local authority to be grouped together with other local authorities e.g. at the regional level, for the purpose of CRC? Would such an arrangement make better use of drivers for energy efficiency and emissions reductions or not? Please explain.

(see also questions on schools and LEAs below, and where relevant questions on PPP/PFI)

Theme 15 NHS Bodies

- a. To what extent is your organisation supervised or funded by another organisation? If so, please specify the organisation and the nature of the supervision and funding and the degree of accountability that your organisation has to the other?
- b. What is the most appropriate level for your organisation to report on its corporate social responsibility – or are CSR issues mainly important at the level of a higher NHS grouping?
- c. Is the proposed approach of grouping NHS organisations at the level of NHS Trust for the CRC considered practical and logical in relation to your current CSR initiatives and energy management structures?
- d. Are energy purchases made by your organisation individually, in collaboration with other organisations or through a third party (such as the NHS Purchasing and Supply Agency)?
- e. At what level (your organisation or others) are decisions made about energy efficiency investments?
- f. What visibility (if any) does your organisation have over energy consumption and emissions? Are you able to estimate the scale of your annual energy consumption or annual emissions? Who holds this data?
- g. If such purchases are made in collaboration with other organisations or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your organisation) or is there a framework agreement under which your organisation makes the purchases from the supplier?
- h. If your organisation does not meet the criteria for CRC (e.g. too small), would it be feasible to transfer the responsibility for energy procurement to another organisation? If yes, to whom and why; if not, why not?

Theme 16 Police and Fire Authorities

- a. What level police or fire body are you?
- b. To what extent is your organisation supervised or funded by another organisation? If so, please specify the organisation and the nature of the supervision and funding and the degree of accountability that your organisation has to the other?
- c. What is the most appropriate level for your organisation to report on its corporate social responsibility – or are CSR issues mainly important at the level of a higher police/fire authority grouping? What could be defined as a higher police/fire authority grouping?
- d. In your opinion, would it be practical to allocate responsibility for emissions at a regional force/authority level? If so, please explain why and, if not, why not.
- e. Are energy purchases made by your authority individually, in collaboration with other organisations or through a third party (e.g. central purchasing or a facilities management company)?
- f. At what level (your organisation or others) are decisions made about energy efficiency investments?
- g. What visibility (if any) does your authority have over energy consumption and emissions? Are you able to estimate the scale of your annual energy consumption or annual emissions? Who holds this data?
- h. If energy purchases are made in collaboration with other organisations or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your authority) or is there a framework agreement under which your authority makes the purchases from the supplier?
- i. At the force level, if your organisation does not meet the criteria for CRC (e.g. too small), would it be feasible to transfer the responsibility for energy supply to another organisation? If yes, to whom and why; if not, why not?

Theme 17 FE/HE Institutions

- a. To what extent is your institution federated or otherwise associated with any other institution or organisation? Please explain your relationship in terms of accountability, financial sponsorship, ownership and location of premises.
- b. In relation to your organisation, to what extent is it practical to group colleges together for the purposes of the CRC? Please explain your reasons.
- c. Are your energy purchases across all colleges made centrally or by each institution independently, or through a third party e.g. facilities management company?
- d. If your energy purchases are made in collaboration with other organisations or through a third party then on what basis are such purchases made? For example, is it on an agency basis (i.e. the third party contracts with the supplier on behalf of your institution) or is there a framework agreement under which your institution makes the purchases from the supplier?
- e. Across all of the colleges, who is responsible for energy management, and has power to make energy efficiency or carbon reduction type decisions in your organisation? Is this done centrally or do all colleges have separate responsibilities on energy management.
- f. At what level is corporate social responsibility incentivised in your organisation? Are there existing systems/protocols and publicity campaigns in place in relation to CSR activities?
- g. What are your annual emissions or energy consumption?
- h. In your opinion, would it be practical to allocate responsibility for emissions in relation to your broader HE/FE organisation on the basis of a federation arrangement, or on the basis of an alternate arrangement. Why/why not?
- i. As a college, institute etc. if your organisation does not meet the criteria for CRC (e.g. too small), would it be feasible to transfer the responsibility for energy procurement to another organisation? If yes, to whom and why; if not, why not?

Theme 18 LEAs/Schools

- a. Which types of schools are there in your local authority , and what is the proportion share between these schools:
- Community;
 - Foundation;
 - Trust
 - Voluntary-aided;
 - Voluntary-controlled;
 - Academy (not LA responsibility).
- And separately what is the ratio of primary to secondary schools?
Are there any further specialised schools?
- b. To what extent do you think the inclusion of all schools in the local authorities' portfolio is a practical approach to incentivising emissions reductions? To what extent are the other proposals, as given above, practical?
- c. Are there practical reasons to explicitly exclude certain types of schools from mandatory inclusion that relate e.g. to energy purchase, management or investment responsibilities?
- d. To what extent is your authority responsible for making energy purchases for its schools?
- e. Where the local authority is not responsible, explain what arrangements are in place. For example, are such purchases made by the schools individually, in collaboration with other organisations or through a third party?
- f. Do you have good data on the energy consumption and emissions from your schools? Or only for certain of your schools?
- g. At what level do CSR drivers act for schools? Are these activities important to the school's reputation, the reputation of the LA or both? Or do CSR decisions act at another level entirely?
- h. Who is financially responsible for making investments in energy efficiency improvements in schools?
- i. How are financial costs and benefits of investments in energy efficiency, carbon reductions or high-profile activities such as building-integrated renewables shared between the local authority, school and other investors?
- j. Do you think the relationship between school and LEA is such that participation in the CRC by schools would incentivise emissions reductions in schools?
- k. Where the LEA/Schools have developed a relationship that has enabled good investments in energy efficiency and carbon reductions, please explore the elements that make this relationship successful
1. What are the key outputs that you would consider best practise in relation to energy efficiency and emissions reduction?
 2. What difficulties were there in establishing the necessary relationship(s) to achieve this result?
 3. Does this relationship exist with all schools? Did it work best with certain types of schools in terms of size, funding, primary/secondary and if so, why?

4. Do both schools and the LAs benefit from the arrangements? If so, how are benefits shared? How could they be shared better?
5. What were the cost/financial savings implications of any energy efficiency investments?
6. What are the key factors for success?
7. Could this approach be adopted by other LAs?
8. Do you share this information regularly with others, as a best practise type of guidance? Do you have any “fact sheets” etc. on your projects in schools?

(PFI/PPP questions may also be relevant here)

Theme 7 PPP/PFI (Strands 1 & 3)

- a. Please provide a brief overview of the nature of the PPP/PFI along with details of the locations from which the PPP/PFI is delivered?
- b. If the PPP/PFI provider is responsible for paying for energy, how is this passed through to the contracting authority (if at all)? Is there a clear line in the relevant financial model to identify energy costs?
- c. Is the PPP/PFI delivered at a single or multiple sites? If multiple sites, is any visibility available on a site by site basis over the energy consumption and emissions of delivering the PPP/PFI?
- d. What powers does either party have to control energy consumption/emissions? Is this assigned to any party in particular? If no such powers exist, is there scope for incorporation of such powers into the contract?
- e. What visibility (if any) is there as to the energy consumption and emissions of the PPP/PFI?
- f. It is common that the PPP/PFI provider is a special purpose vehicle created to specifically deliver the service. Who are the shareholding entities? Please provide the names of the entities and a brief outline of their activities within the UK.
- g. Under your PFI/PPP arrangement, are there special incentives or arrangements for CSR related drivers?
- h. [To private sector contractor]: Upon the introduction of CRC, would you seek to use the change of law provisions to renegotiate the price to reflect the administrative burden?
- i. If the contracting authority within central or local government was to participate in the scheme and report on behalf of the ppp/pfi (together with other ppps and pfis it has put in place) in order to provide maximum coverage, what practical issues would be foreseen (including but not limited to administrative burden and any necessary ppp/pfi documentation amendments to enable timely and accurate information flow). Would any administrative burden be absorbed by current staff or do you believe a new post would need to be created, and if so at what approximate cost?

Annex B - Information on Public Sector

Information set out in this section informed our analysis of public sector entities and includes descriptions of different types of public bodies, which we have referred to in our main report as governmental public bodies for clarity, as well as their characteristics.

According to the Cabinet office, the term “public body” includes:

- **Non Departmental Public Bodies (NDPBs).** There are four types of NDPBs:
 - i. **Executive NDPBs:** these bodies are established by Ministers to carry out administrative, commercial, executive or regulatory functions. They are legally incorporated and are a separate legal entity. In addition, they employ their own staff and are allocated their own budgets. Unlike Agencies and NDPBs, they operate at some distance from central government.
 - ii. **Advisory NDPBs:** these bodies are established to provide advice to Ministers. Their costs are usually included in the department’s expenditure and they are usually supported by the department’s own staff.
 - iii. **Tribunal NDPBs:** these bodies have jurisdiction in a specific area of law. Like the Advisory NDPBs, they are usually supported by staff from their sponsoring department and do not have their own budgets.
 - iv. **Independent Monitoring Boards:** these bodies were formerly known as 'Boards of Visitors'. They are responsible for the state of the prisons, their administration and the treatment of prisoners. They are financed by their sponsoring department.
- **Public corporations:** These bodies are owned or controlled by central governments at 50%. They have substantial day to day operating independence and are in most respects similar to Executive NDPBs in terms of Governance.
- **NHS bodies**
- **Public Broadcasting Authorities (BBC and S4C)**

Two other kinds of public bodies are not listed in the Cabinet Office document: *Public Bodies Directory* because they are generally considered as part of central government:

1. **Agencies:** These bodies are either part of a government department, set up administratively, or, exceptionally, a department in its own right.
2. **Non-ministerial departments:** These bodies are part of central government but do not require direct permanent ministerial oversight, though a minister retains policy control and will answer for them to Parliament if needed.

The *Managing Public Money* Document¹⁴ provides some useful guidance on the relationship between government department and a range of public sector entities.

Note that the actual relationship between governmental public bodies and their department can vary e.g. for NMD the actual relationship can vary and only some are departments in their own right, while others are not. The information about these differences relate to the Framework Agreements that exist between departments and their sponsored bodies.

Distinguishing characteristics of arms length bodies:

Type of ALB	Agency	Non-ministerial	Non departmental
feature		department (NMD)	public body (NDPB)
Status	Part of department (or department in its own right).	Part of central government	Quasi-independent organisation
	Part of central government	Department in its own right	Part of central government
	Crown body	Remit usually in legislation Crown body	Not a Crown body (with rare exceptions)
			May be a company and/or
Established by	Administrative action (usually quick and easy)	Administrative action, often supplemented by primary legislation (if needed, may take time)	a charity Usually bespoke primary legislation (may need to wait for a suitable legislative slot for some time)
Ministerial accountability	A minister in the parent department makes	Rarely needed, but when necessary, a minister	A minister in the sponsor department decides

¹⁴ http://www.hm-treasury.gov.uk/documents/public_spending_reporting/governance_risk/psr_managingpublicmoney_publication.cfm

	key	in	key
	decisions on the agency's affairs	the parent department decides	matters, e.g. whether to adjust functions, whether
Parent department	Has direct control	Remote and rarely interferes	to wind it up. Subject to formally agreed memorandum, may be
Funding	Estimates own RfR) and/or income	(usually fee	Estimates own RfR) and/or income
			light touch Grant(s) from department(s), and/or income from fees or levies
Employees	Civil servants	Civil servants	Not usually civil servants
Accounts etc	Publishes plans and resource accounts as part	Publishes own plans and resource accounts	Publishes own plans and resource accounts
Parliamentary accountability	of parent department's CEO is Additional Accounting Officer	Permanent Secretary is Accounting Officer	CEO is normally the Accounting Officer
Business Profile	administration, typically implementation central policy	Advice administration, typically professional, expert or regulatory functions	or advice, administration or regulatory especially role, matters best not decided by ministers

Source: *Managing Public Bodies Money, 2007*

Figure 58 Distinguishing characteristics of arms length bodies

Information available on public sector entities

There are several sets of information publicly available from the government that set out different governmental public bodies and their relationships to each other. These sets of information can be useful in defining the different departmental families. However, some of the information available in these formats may not have sufficient legal status to use in the CRC drafting process.

HM Treasury's Public Expenditure Statistical Analysis (PESA¹⁵) sets out different government departments for accounting purposes. Annex B of this document uses sectoral headings. This could be one way of identifying the wider family associated with certain departments.

The Cabinet Office¹⁶, both on its website, and in published documents also sets out certain information about governmental public bodies, including associating governmental public bodies with sponsoring departments.

Following on the theme of using accounting procedures, the Accounting Officers system¹⁷ could be used to show to which government department public bodies are financially accountable, thus creating families. This system of public expenditure accountability would accord with the idea that the CRC should use existing financial drivers, and would be a logical way to trace departmental responsibility. The Managing Public Money Document¹⁸ specifies the division of these Officers.

The Cabinet office website¹⁹ provides an index of non-ministerial government departments with links for full details.

Further information to help inform the departmental families can be found in the departmental reports e.g. Defra's Annual Report 2007. This report clearly sets out Defra's agencies, describes the key Executive NDPBs, their work in the previous year and describes any institutional changes e.g. the creation of Natural England in 2006. However, the inclusion of bodies in this report is not statutory and is up to the decisions of the report's author each year. Although it could be expected that the key governmental public bodies will be included, a stronger legal basis will be required in the CRC legislation.

Departmental Classification

The Office of National Statistics (ONS) is responsible for classifying an organisation as a public or private body for Central Government Accounts purposes. The ONS determines the status of an organisation on the basis of the degree of control that government can exercise over its activities. To assess where the control lies, the ONS uses the following information provided by departments:

1. Cabinet office Treasury classification information pack and questionnaire;
2. Articles of Association; and

¹⁵ HM Treasury, Office of National Statistics Public Expenditure Statistical Analyses 2007, April 2007
http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pes_publications/pespub_pesa07.cfm

¹⁶ Cabinet Office, Public Bodies 2006, March 2006

¹⁷ www.hm-treasury.gov.uk

¹⁸ http://www.hm-treasury.gov.uk/documents/public_spending_reporting/governance_risk/psr_managingpublicmoney_publication.cfm

¹⁹ http://www.cabinetoffice.gov.uk/ministerial_responsibilities/nm_departments.aspx as of November 29 2007

3. any other publicly available information.

This information is assessed against the following documents to determine where control lies:

1. Treasury Class (2000) 1 classification paper
2. Accounting Standards Boards Financial Reporting Standards (FRS) 2

The Sector Classification Guide, called MA23²⁰, provides information on the classification of organisations and institutions in the National Accounts. This publication provides a list of all organisations including non-departmental public bodies, public corporations, central government and local government bodies, charities and trusts, banks and building societies.

This document (MA23) can be used to define departmental families, as it clearly states which department is the sponsor of each body.

Departments cannot *classify* a body themselves. The Cabinet Office is responsible for formally classifying the public bodies by type. Further information on the types of government bodies and on their characteristics can be found in Annex C to this report. It is also responsible for the annual publication of the “Public Bodies Directory” which sets out full information, summary statistics and analysis for public bodies and their sponsoring Departments.

The development of a Decision rule to determine Departmental families

A “decision rule” will determine which public bodies would fall into each central departmental family i.e. by applying decision rule x, we can obtain a list of the organisations and bodies that fall into the “Defra family” for the purposes of CRC. This is presented as an alternative to the responsibility for emissions approach, presented in Strand 3 of this report, in the section on Government and NDPBs.

A decision rule is a much more complex alternative to using the responsibility for emissions definition and therefore should only be used as a fallback option.

The proposed decision rules are as follows:

1. *“any body that is classified as a public body by the ONS will be grouped with its sponsoring government department, as defined by the ONS for central government accounting purposes.”* This decision rule has been applied to Defra and the resulting Defra family is set out in the table below.
2. *“any body for which there is an active Framework Agreement in place between the central government department and its sponsored body.”*

²⁰ <http://www.statistics.gov.uk/STATBASE/Product.asp?vlnk=7163&More=Y>

Decision Rule 1

Advantages

This option is based on National Accounting needs and on the practical steps that must be taken on upon the creation of any public body.²¹ This public classification information is available centrally through the ONS in a document called MA23.

- a) As this classification is carried out as a matter of course and this document is updated regularly, on the last working day of every month, this Decision Rule would be straightforward to apply and relatively accurate.
- b) This option appears to be legally practicable, despite being a classification created for administrative rather than legal reasons and would appear to be sufficiently robust for a parliamentary draughtsman's purposes; capitalises on reputational and financial levers for emissions reductions by enabling qualifying Executive NDPBs to participate separately.

Disadvantages

- a) The Cabinet Office classification of public bodies is not something which it is required to do legally and the Public Bodies Directory would appear to have no specific legal force.
- b) For this approach to work, it is also important that it could be said with certainty that the ONS will continue to exist (in its current form or at all) and continue to publish such a document indefinitely. This eventuality could be potentially be overcome by including a fallback scenario in the Regulations that provided for Parliament to be consulted on any replacement criteria.
- c) One problem with using this document is that there may be a risk of it not being comprehensive at all times (e.g. on the creation of a new public body, it may not appear in the MA23 document until the ONS republished the document). This challenge is illustrated more clearly in the text box on institutional change below.

The ONS is not always immediately updated to reflect to changes in status of public bodies. For example, it may take several months for the ONS to be made aware of disbanded public bodies and update the document accordingly. More importantly, re-classification of public bodies is dependent on information from the Cabinet Office's Public Bodies Directory, which is only updated once a year. This reclassification may be important where new Departments have been defined and therefore some public bodies officially remain in "non-existent" families. See the text box below on institutional change for an illustration.

²¹ More informaiton on the national government's classification procedures is available earlier in this Annex.

Decision Rule 2

Each governmental public body has a Framework agreement with its sponsoring department. Decision Rule 2 is based upon these agreements. The actual relationship between governmental public bodies and their departments can vary. The information about these differences relate to the Framework Agreements that exist between departments and their sponsored governmental bodies.

Advantages

- a) From a legal perspective this approach appears feasible and is likely to be relatively robust.

Disadvantages

- a) This approach would ensure that all public government are covered, but it could be quite complex to obtain all of the framework agreements and it would be necessary to contact each government department individually to do so.
- b) It is not clear that all governmental public bodies will necessarily have a framework agreement in place as yet or whether all governmental bodies will necessarily continue to have one in the future. This is a significant potential weakness.

Case study: Applying Decision Rule 1 to Defra

The wider sphere of the Defra family is set out in the diagram “Defra Delivery Landscape” below, as provided on the Defra⁵ website, and updated in October 2007. Document MA23 has been used to define which of these bodies would fall into the Defra family under Decision Rule 1 and this list can be found later in this Annex.

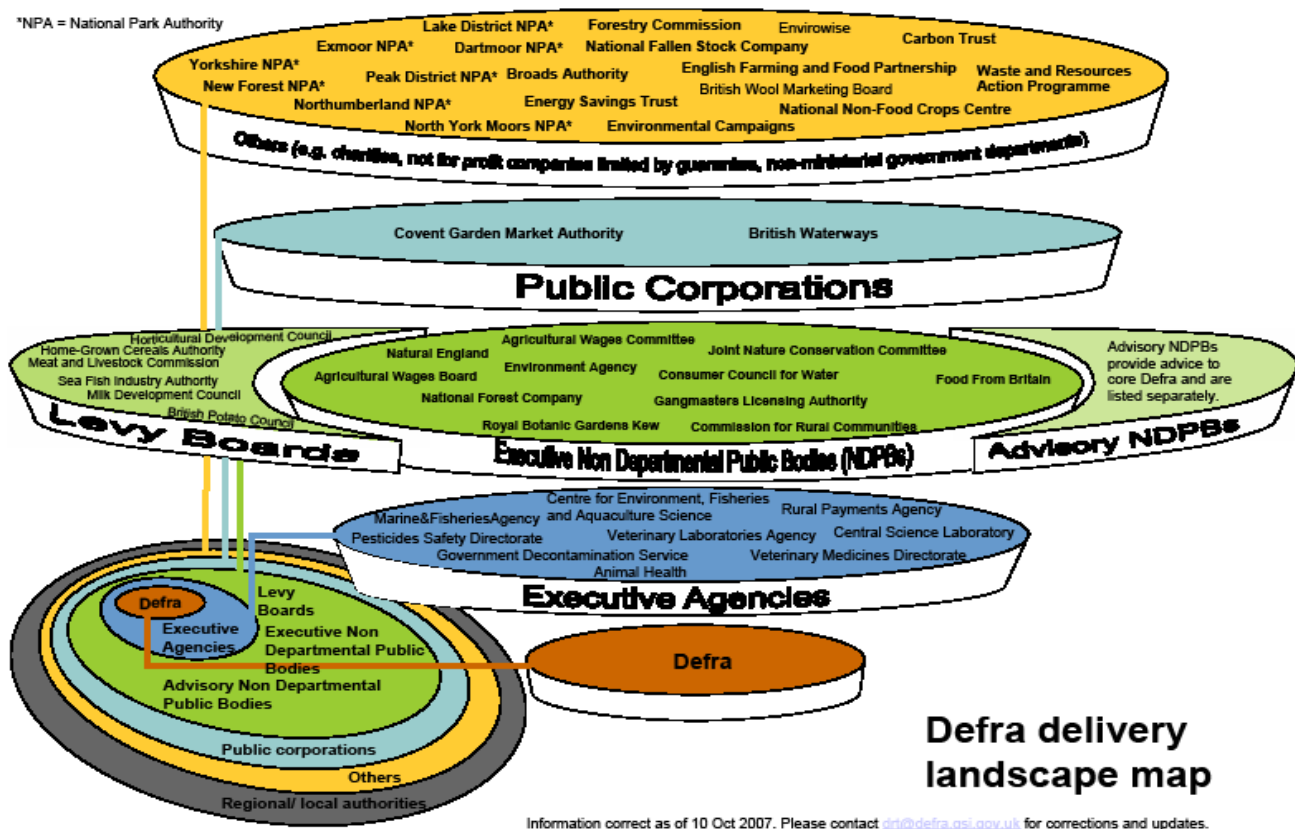
The list illustrated two key points. Firstly, the decision rule could be used successfully to apportion bodies such as the Spongiform Encephalopathy Advisory committee, which is co-funded by the Department of Health and Defra to one department alone – it only appears in MA23 under Defra. Secondly, the list illustrated that there was a proliferation of relic departments. The MA23 spreadsheet is divided into current central government and former central government and in one case a now defunct body – English Nature – still appears in Defra’s list, as does its replacement Natural England. For the purposes of the CRC, such duplication is not problematic in this case. Both the old and new organisations fall in the same department and emissions will be captured in the CRC under the correct CSR and financial drivers. Even if the body, and its emissions have moved to a different department, the emissions would still be captured within government as a whole and not lost from the scheme.

Unlike changes that affect entire departments, these type of operational changes are not likely to justify a large enough shift in emissions to be accounted for in their own right. Therefore, this deficiency in the MA23 document is not of significance in assessing the practicality of using this Decision rule would have moved to a different department, the emissions would still be captured within government as a whole and not lost from the scheme. Unlike changes that affect entire departments, these type of operational changes are not likely to justify a large enough shift in emissions to be accounted for in their own right. Therefore, this deficiency in the MA23 document is not of significance in assessing the practicality of using this Decision rule.

⁵ Information on Defra’s NDPBs has also been taken from Defra Delivery Strategy Team, Review of Defra’s non-executive bodies, 2007.

Figure 52 Case study: Applying Decision Rule 1 to Defra

*NPA = National Park Authority



According to the MA23 Publication Defra “Family” includes the following governmental public bodies

Sector: General Government S.13 / **Sub Sector:** Central Government S.1311

Advisory Committee on Business and the Environment	Advisory NDPB
Advisory Committee on Consumer Products and the Environment	Advisory NDPB
Advisory Committee on Hazardous Substances	Advisory NDPB
Advisory Committee on Packaging	Advisory NDPB
Advisory Committee on Pesticides	Advisory NDPB
Advisory Committee on Releases to the Environment	Advisory NDPB
Agricultural Dwelling House Advisory Committees (England) (ADHAC)	Advisory NDPB
Agricultural Land Tribunals (England)	Tribunal NDPB
Agricultural Wages Board for England and Wales	Executive NDPB
Agricultural Wages Committees for England	Executive NDPB
Agriculture and Environment Biotechnology Commission	Advisory NDPB
Airborne Particles Expert Group	Advisory NDPB
British Potato Council	Executive NDPB
Central Science Laboratory	Executive Agency
Centre for Environment, Fisheries and Aquaculture Science	Executive Agency
Commission for Rural Communities	
Committee of Investigation for Great Britain	Advisory NDPB
Committee on Agricultural Valuation	Advisory NDPB

Sector: General Government S.13 / Sub Sector: Central Government S.1311

Committee on Products and Processes for use in Public Water Supply	Advisory NDPB
Commons Commissioners	Tribunal NDPB
Consumer Council for Water (CCWater)	Executive NDPB
Consumers' Committee for Great Britain under the Agricultural Marketing Act 1958	Advisory NDPB
Countryside Agency	Executive NDPB
Dairy Produce Quota Tribunal	Tribunal NDPB
Darwin Advisory Committee	Advisory NDPB
Department for Environment, Food and Rural Affairs	
English Nature	Executive NDPB
Environment Agency	Executive NDPB
Expert Group on Cryptosporidium in Water Supplies	Advisory NDPB
Expert Panel on Air Quality Standards	Advisory NDPB
Farm Animal Welfare Council	Advisory NDPB
Farming and Rural Conservation Agency	Executive Agency
Food from Britain	Executive NDPB
Gangmasters Licensing Authority	
Government-Industry Forum on non-food uses of crops	Advisory NDPB
Hill Farming Advisory Committee for England, Wales and Northern Ireland (HFAC)	Advisory NDPB
Home-Grown Cereals Authority	Executive NDPB
Horticultural Development Council (HDC)	Executive NDPB
Horticulture Research International	Executive NDPB
Independent Scientific Group on Cattle TB	Advisory NDPB
Inland Waterways Amenity Advisory Council	Advisory NDPB
Intervention Board	
Joint Nature Conservation Committee (JNCC)	Executive NDPB
Meat and Livestock Commission (MLC)	Executive NDPB
Milk Development Council (MDC)	Executive NDPB
National Expert Group on Transboundary Air Pollution	Advisory NDPB
National Forest Company	Executive NDPB
Natural England	Executive NDPB
Pesticides Residue Committee	Advisory NDPB
Plant Varieties and Seeds Tribunal	Tribunal NDPB
Radioactive Waste Management Advisory Committee	Advisory NDPB
Regional Flood Defence Committees	Executive NDPB
Royal Botanic Gardens, Kew	Executive NDPB
Royal Commission on Environmental Pollution	Advisory NDPB
Rural Payments Agency	
Sea Fish Industry Authority	Executive NDPB
Spongiform Encephalopathy Advisory Committee	Advisory NDPB
Sustainable Development Commission	Advisory NDPB
Sustainable Development Education Panel	Advisory NDPB
United Kingdom Register of Organic Food Standards	Executive NDPB
Veterinary Laboratories Agency	
Veterinary Medicines Directorate	

Sector: General Government S.13 / Sub Sector: Central Government S.1311

Veterinary Products Committee	Advisory NDPB
Veterinary Residues Committee	Advisory NDPB
Water Regulations Advisory Committee	Advisory NDPB
Wine Standards Board of the Vintners' Company	Executive NDPB

World Poultry Science Association	Advisory NDPB
Zoos Forum	

Sector: Non-financial Corporations S.11/ Sub Sector: Public Non financial Corporations S.11001

British Waterways Board - (BWB)	Corporate Body
British Waterways Pension Trustees Ltd - (s BWB)	Corporate Body

Figure 60 MA23 Publication Defra "Family"

Annex C – Options for governmental public bodies

There are four key types of NDPBs, and several other types of governmental public bodies relevant to discussions of central government participation in the CRC, for example public corporations, non-ministerial government departments. The four types of NDPBs are:

1. Executive NDPBs: these bodies are established by Ministers to carry out administrative, commercial, executive or regulatory functions. They are legally incorporated and are a separate legal entity. In addition, they employ their own staff and are allocated their own budgets. Unlike Executive Agencies, which are the Executive arm of departments and an integral part of them, and other types of NDPBs, Executive NDPBs operate at some distance from central government.
2. Advisory NDPBs: these bodies are established to provide advice to Ministers. Their costs are usually included in the department's expenditure and they are usually supported by the department's own staff.
3. Tribunal NDPBs: these bodies have jurisdiction in a specific area of law. Like the Advisory NDPBs, they are usually supported by staff from their sponsoring department and do not have their own budgets.
4. Independent Monitoring Boards: these bodies were formerly known as 'Boards of Visitors'. They are responsible for the state of the prisons, their administration and the treatment of prisoners. They are financed by their sponsoring department.

From these descriptions it can be seen that Executive NDPBs are distinctive amongst public bodies that could be grouped with government departments through Decision Rule 1, because of their degree of independence. All Executive NDPBs have their own legal status, usually a distinct public profile, and financial and CSR drivers that are separate from their sponsoring department. These characteristics mean that participation in their own right would make the most effective use of financial and reputational drivers. In the case of the other types of NDPBs, the CSR and financial drivers are probably best aligned with those of their sponsoring department.

The different options, in terms of further groupings beyond the default case, are set out below. With each option there are different implications in terms of emissions coverage, leverage of CSR and financial drivers and simplicity of the scheme.

Option 1

1. All governmental public bodies are included in the scheme, regardless of eligibility, even if their electricity use is below the 6,000MWh entry threshold.
2. All governmental public bodies are grouped with their sponsoring departments regardless of size or nature.

Option 1A

1. All governmental public bodies are included in the scheme, regardless of eligibility, even if their electricity use is below the 6,000MWh/year inclusion threshold.
2. All governmental public bodies are grouped with their sponsoring departments with the exception of those described below.
3. Any governmental public body that is a separate legal entity **and** that reaches the 6,000MWh entry threshold itself will take part in CRC separately and not with their sponsoring department.
4. Any government department, and therefore associated departmental family, are included in the CRC, even if their electricity usage falls below the 6,000 MWh/year inclusion threshold on the removal of separate legal entities from the family grouping.

Option 1B

1. All governmental public bodies are grouped with their sponsoring departments with the exception of those described below.
2. Any governmental public body that is a separate legal entity will be treated separately from its sponsoring department for the purposes of CRC and will only participate in the CRC if it reaches the 6,000MWh/year inclusion threshold itself.
3. Any government department, and therefore associated departmental family, are included in the CRC, even if their electricity usage falls below the 6,000 MWh/year inclusion threshold on the removal of separate legal entities from the family grouping.

Option 2:

1. All governmental public bodies are grouped with their sponsoring departments regardless of size or nature.
2. Only those departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC.

Option 2A

1. All governmental public bodies are grouped with their sponsoring departments with the exceptions of those defined below.
2. Any governmental public body that is a separate legal entity **and** that reached the 6,000MWh entry threshold itself will take part in CRC separately and not with their sponsoring department.
3. Only these departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC.
4. In this case, departments that are then below the inclusion threshold without their participant NDPBs would not participate in the scheme.

Option 2B

1. All governmental public bodies are grouped with their sponsoring departments with the exceptions of those defined below.
2. Any governmental public body within a government department that is a separate legal entity, however, will be treated separately from its overarching department for the purposes of CRC and will only participate in the CRC if it reaches the 6,000MWh/ year inclusion threshold itself.
3. Only those departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC.
4. In this case, departmental families and governmental public bodies with a separate legal identity that are below the inclusion threshold would not participate in the scheme.

Option 3

1. All governmental public bodies are included in the scheme, regardless of eligibility and are included under the heading of UK government.
2. The UK government will be the CRC organisation and will apportion responsibility as it chooses.

The key characteristics of these options are shown in the table below:

Table 2 Key characteristics of grouping options

Option	Grouping into departmental families (Y/N)	Governmental public bodies that are separate legal entities over threshold excluded from families (Y/N)?	Governmental public bodies that are separate legal entities under threshold excluded from families (Y/N)?	Departmental families must participate in CRC even if they do not meet the threshold	Only departmental families meeting the inclusion threshold will participate in CRC
Option 1	Y	N	N	Y	N
Option 1A	Y	Y	N	Y	N
Option 1B	Y	Y	Y	Y	N
Option 2	Y	N	N	N	Y
Option 2A	Y	Y	N	N	Y
Option 2B	Y	Y	Y	N	Y
Option 3	All one group	N	N	Y	Y

All of the options above appear to be legally practicable. Option 1B is recommended as an option that merits further consideration as it is simple, legally practical and it can follow directly from applying the responsibility for emissions definition, without any recourse to a

decision rule nor any additional drafting. If the decision rule approach is used, then the use of Option 1B would also be consistent.

A strength of option 1B is with respect to setting financial and reputational drivers at the correct level for central UK government departments, whilst maximising emissions coverage within the governmental part of the public sector.

It is considered important, in terms of financial and legislative drivers, to separate “separately incorporated” governmental public bodies from their departmental families so that they participate in the CRC as individual entities. Separately incorporated bodies will capture all Executive NDPBs, which do have a high degree of reputational and financial autonomy, but may also include some small advisory boards which are also separated by legal statute by virtue of historical processes rather than a particularly independent character. The decision to use the term “separately incorporated”, rather than to just isolate Executive NDPBs is a compromise between the ideal policy approach and legal restrictions, as there is no such legal term as an “Executive NDPB.” Also, by using the “separately incorporated” terminology there is a clear methodology to the approach – those organisations with their own CSR and financial drivers are treated separately.

The following section sets out the advantages and disadvantages of the Options in more detail.

Option 1

All governmental public bodies are included in the scheme, regardless of eligibility i.e. even if their electricity use is below the 6,000MWh entry threshold. All governmental public bodies are grouped with their sponsoring departments and these departments are the CRC organisation regardless of the nature of the governmental public body (e.g. NDPBs etc. are all included with the parent sponsoring department).

This is not the preferred option due to the misalignment of financial and reputational drivers for some NDPBs.

Advantages

a) Maximising emissions coverage

This approach has good emissions coverage, as all government departments and governmental public bodies are included.

b) Simplicity, clarity and lowering administrative burden

This approach is consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government.

This option fits logically into the idea that Ministers are ultimately responsible to Parliament for the activities of the bodies sponsored by their department. Departments are responsible for funding and ensuring good governance of their governmental public bodies.

c) Maximising use of financial and reputational drivers

For the majority of governmental public bodies, such as advisory boards and executive agencies, grouping with the parent sponsoring department which controls their finances and holds ultimate responsibility, makes sense and should maximise the influence of the parent organisation over emissions reductions. This option should capitalise on financial and reputational drivers for the majority of governmental public bodies.

This approach will also stimulate energy efficiency awareness at the highest level of the organisational structure.

Disadvantages

a) Maximising emissions coverage

The policy is designed to target energy users of a given size, and under this option, departments that do not meet the inclusion threshold will still be forced to participate. According to approximate electricity consumption data²² departments that would otherwise NOT qualify include Department for International Development, Department for Culture, Media and Sport, Export Credit Guarantee Department, Forestry Commission, and the Food Standards Agency.

Departments that are borderline for qualification according to this rough assessment include her Majesty's Treasury, the Office of National Statistics, The Cabinet Office and the Department for Health.

d) Maximising use of financial and reputational drivers

Executive NDPBs have a high degree of financial and corporate independence and identity, therefore the inclusion of Executive NDPBs with their parent department will not make the most of financial and reputational drivers.

Other public bodies, such as public corporations or non-ministerial government departments may also have a high degree of reputational and operational independence from their sponsoring department. In the cases of these departments, the financial and reputational drivers should not be set at the level of the parent department.

For other bodies, the grouping would also pull together a range of disparate organisations that have a set of different reputational and financial drivers for making emissions reductions. This could be a disadvantage, but may also be a surmountable challenge that would encourage more poorly performing governmental public bodies to match the performance of their "sibling" organisations.

Within a grouping of many bodies, questions may arise about how to share out benefits or responsibility for paying penalties.

²² This data was obtained from Defra and assumed that 60% of metering on the government estate comes from MHHM.

Option 1A

All governmental public bodies are included in the scheme, regardless of eligibility i.e. even if their electricity use is below the 6,000MWh/ year inclusion threshold. Governmental public bodies are grouped with their sponsoring departments and the departments are the CRC organisation regardless of the nature of the governmental public body (e.g. NDPBs etc. are all included with the parent sponsoring department). Any governmental public body that is a separate legal entity **and** that reach the 6,000MWh entry threshold itself will take part in CRC separately and not with their sponsoring department. However, any department family, no matter how small their total emissions may be without their large Executive NDPBs, are still included in the CRC.

Option 1A is a compromise between capitalising on reputational and financial levers for emissions reductions, whilst limiting the resultant emissions losses with the application of this option. It is a “half-way house” between Option 1 and 1B and would add administrative complexity without the full advantage with respect to reputational and financial levers.

Advantages

a) Maximising emissions coverage

This approach still ensures complete emissions coverage.

b) Simplicity, clarity and lowering administrative burden

Consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government. At the same time, this approach also includes a logical and straightforward rule for omitting larger NDPBs. Therefore Option 1A remains simple and clear.

c) Maximising use of financial and reputational drivers

In addition to the advantages set out in Option 1, this Option has the further advantage of separating out Executive NDPBs that are large enough to be included on their own. This option will then align appropriately with the reputational and financial drivers for emissions reductions in the Executive NDPBs.

Disadvantages

a) Maximising emissions coverage

As with Option 1, the policy is designed to target energy users of a given size, and under this option departments that do not meet the inclusion threshold will still be forced to participate. According to approximate electricity consumption data²³ departments that would otherwise NOT qualify include Department for International Development, Department for Culture, Media and Sport, Export Credit Guarantee Department, Forestry Commission, and the Food Standards Agency.

²³ This data was obtained from Defra and assumed that 60% of metering on the government estate comes from MHHM.

Departments that are borderline for qualification according to this rough assessment include her Majesty's Treasury, the Office of National Statistics, The Cabinet Office and the Department for Health.

b) **Simplicity, clarity and lowering financial burden**

In comparison with Option 1B (below) the drivers are relatively similar, however, by excluding governmental public bodies on the basis of both emissions thresholds and legal status, the administering of this option may be complex.

c) **Maximising use of financial and reputational drivers**

The challenges here are as in Option 1. However, with the separation of some Executive NDPBs from the parent grouping, it is now only the inclusion of some Executive NDPBs with their parent department will continue to be at odds with their financial and reputational drivers. Therefore this option takes an incomplete approach to setting these drivers at the right level, and is a halfway house option between Option 1 and 1B.

The disadvantages for some other governmental public bodies and groups are as in Option 1.

Option 1B

All central UK Government departments are included in the scheme, regardless of eligibility i.e. even if their electricity use is below the 6,000MWh/ year inclusion threshold. Governmental public bodies (e.g. NDPBs) are grouped with their sponsoring departments and the departments are the CRC organisation. Any body that is a separate legal entity, however, will be treated separately from its overarching department for the purposes of CRC and will only participate in the CRC if it reaches the 6,000MWh entry threshold itself.

Option 1B is recommended as an option that merits further consideration because it is in line with a Government commitment to CRC, and sets financial and reputational drivers at the correct level for most governmental public bodies.

Advantages

a) **Simplicity, clarity and lowering administrative burden**

Consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government. At the same time, this approach also includes a logical and straightforward rule for omitting all separately incorporated bodies. Therefore Option 1B remains simple and clear.

b) **Maximising use of financial and reputational drivers**

In addition to the advantages set out in Option 1 and 1A, this Option has the further advantage of separating out all separately incorporated bodies. This option is the one that aligns the reputational and financial drivers for emissions reductions best of all the options explored here.

For most NDPBs and other governmental public bodies financial and reputational levels are now well-aligned.

Disadvantages

a) Maximising emissions coverage

As with Option 1, the policy is designed to target energy users of a given size, and under this option departments that do not meet the inclusion threshold will still be forced to participate. According to approximate electricity consumption data²⁴ departments that potentially would otherwise NOT qualify include Department for International Development, Department for Culture, Media and Sport, Export Credit Guarantee Department, Forestry Commission, and the Food Standards Agency.

Departments that are borderline for qualification according to this rough assessment include Her Majesty's Treasury, the Office of National Statistics, The Cabinet Office and the Department for Health. However, these departments are likely to be supported by central government initiatives, which would help them in managing their effective participation in the CRC, if they were included.

b) Maximising use of financial and reputational drivers

The challenges here are as in Option 1A for some governmental public bodies only, but no longer for any separately incorporated bodies, which are now treated as independent.

Option 2

All governmental public bodies are grouped with their sponsoring departments regardless of size or nature. Only those departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC.

This is not the preferred option due to the misalignment of financial and reputational drivers for some NDPBs.

Advantages

a) Maximising emissions coverage

This approach has good emissions coverage, as all of the government departments over the threshold are included, and then all of their associated NDPBs are also included.

b) Simplicity, clarity and lowering administrative burden

Consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government.

This option fits logically into the idea that Ministers are ultimately responsible to Parliament for the activities of the bodies sponsored by their department. Departments are responsible for funding and ensuring good governance of their governmental public bodies.

c) Maximising use of financial and reputational drivers

²⁴ This data was obtained from Defra and assumed that 60% of metering on the government estate comes from MHHM.

For the majority of governmental public bodies, such as advisory boards and executive agencies, grouping with the parent sponsoring department makes sense and should maximise the influence of the parent organisation over emissions reductions. This option should capitalise on financial and reputational drivers for the majority of governmental public bodies.

This approach will also stimulate energy efficiency awareness at the highest level of the organisational structure

Disadvantages

a) Maximising emissions coverage

Some government departments will fall out of the scheme because their emissions are below the 6,000MWh threshold. Government may wish to take a stronger leadership role through wider participation. According to approximate electricity consumption data²⁵ departments that would otherwise NOT qualify include Department for International Development, Department for Culture, Media and Sport, Export Credit Guarantee Department, Forestry Commission, and the Food Standards Agency.

Departments that are borderline for qualification according to this rough assessment include her Majesty's Treasury, the Office of National Statistics, The Cabinet Office and the Department for Health.

On the other hand, the policy is designed to target energy users of a given size, and under this option the government is complying appropriately with the policy.

b) Maximising use of financial and reputational drivers

Executive NDPBs have a high degree of financial and corporate independence and identity, therefore the inclusion of Executive NDPBs with their parent department will not make the most of financial and reputational drivers.

Other governmental public bodies, such as public corporations or non-ministerial government departments may also have a high degree of reputational and operational independence from their sponsoring department. In the cases of these departments, the financial and reputational drivers should not be set at the level of the parent department.

For other bodies, the grouping would also pull together a range of disparate organisations that have a set of different reputational and financial drivers for making emissions reductions. This could be a disadvantage, but may also be a surmountable challenge that would encourage more poorly performing governmental public bodies to match the performance of their "sibling" organisations.

Within a grouping of many bodies, questions may arise about how to share out benefits or responsibility for paying penalties.

²⁵ This data was obtained from Defra and assumed that 60% of metering on the government estate comes from MHHM.

Option 2A

All governmental public bodies are grouped with their sponsoring departments with the exceptions of those defined below. Any governmental public body that is a separate legal entity **and** that reach the 6,000MWh entry threshold itself will take part in CRC separately and not with their sponsoring department. Only these departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC. In this case, departments that are then below the eligibility threshold without their participant NDPBs would not participate in the scheme.

Option 2A is a compromise between capitalising on reputational and financial levers for emissions reductions, whilst limiting the resultant emissions losses with the application of this option. It is a “half-way house” between Option 2 and 2B and would not maximise the leverage of reputational and financial levers.

Advantages

a) Maximising emissions coverage

By only excluding NDPBs that are eligible in their own right, the emissions of the remaining NDPBs, otherwise too small for the scheme, will be retained within the relevant families.

b) Simplicity, clarity and lowering administrative burden

Consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government. At the same time, this approach also includes a logical and straightforward rule for omitting larger NDPBs. Therefore Option 2A remains simple and clear.

c) Maximising use of financial and reputational drivers

In addition to the advantages set out in Option 2, this Option has the further advantage of separating out Executive NDPBs that are large enough to be included on their own. This option will then align appropriately with the reputational and financial drivers for emissions reductions in the Executive NDPBs.

Disadvantages

a) Maximising emissions coverage

Some government departments will fall out of the scheme because their emissions are below the 6,000MWh threshold anyway. Once the Executive NDPBs larger than 6,000MWh are excluded, it is possible that other government departments will also fall out of the scheme as their emissions fall below the inclusion threshold.

This modest loss of emissions from the system should be balanced against the advantage of setting the reputational and financial drivers at the right level for some NDPBs.

b) Maximising use of financial and reputational drivers

The challenges here are as in Option 2. However, with the separation of some Executive NDPBs from the parent grouping, it is now only the inclusion of some

Executive NDPBs with their parent department will continue to be at odds with their financial and reputational drivers.

The disadvantages for some other governmental public bodies and groups are as in Option 2.

Option 2B

All governmental public bodies are grouped with their sponsoring departments with the exceptions of those defined below. Any governmental public body within a government department that is a separate legal entity, however, will be treated separately from its overarching department for the purposes of CRC and will only participate in the CRC if it reaches the 6,000MWh/ year inclusion threshold itself. Only those departmental families that reach the 6,000MWh eligibility requirement will be included in the CRC. In this case, departmental families and governmental public bodies with a separate legal identity that are below the inclusion threshold would not participate in the scheme.

This option is comparable to Option 1B, and sets financial and reputational drivers at the correct level, and could also be a good choice of approach. However, by excluding departments that fall below the inclusion threshold when separately incorporated governmental public bodies are separated out, the government may miss out on an important central leadership role. If the majority of departments are in favour of participating in CRC, there is no need to prevent their inclusion. Therefore, Option 1B would be preferable to 2B.

Advantages

a) Simplicity, clarity and lowering administrative burden

Consistent with the schemes main features, by having the parent grouping at a high, but relevant, organisational level in government. At the same time, this approach also includes a logical and straightforward rule for omitting all NDPBs. Therefore Option 2B remains simple and clear.

b) Maximising use of financial and reputational drivers

In addition to the advantages set out in Option 2 and 2A, this Option has the further advantage of separating out all Executive. This option is the one that aligns the reputational and financial drivers for emissions reductions best of all the options explored here.

For most public NDPBs and other governmental public bodies financial and reputational levels are now well-aligned.

Disadvantages

a) Maximising emissions coverage

As with option 2, some government departments will fall out of the scheme because their emissions are below the 6,000MWh threshold anyway. Under option 2B, even more so than under option 2A, once the Executive NDPBs are excluded from

departments, it is possible that some of the smaller government departments will fall out of the scheme as their emissions fall below the inclusion threshold.

This modest loss of emissions from the system should be balanced against the advantage of setting the reputational and financial drivers at the right level for all NDPBs.

b) Maximising use of financial and reputational drivers

The challenges here are as in Option 2A for some governmental public bodies only, but no longer for the Executive NDPBs which are now treated as independent.

Advantages and Disadvantages of Option 3

All governmental public bodies are included in the scheme, regardless of eligibility and are included under the heading of UK government. The UK government will be the CRC organisation and will apportion responsibility as it chooses.

Option 3 is not favoured because the UK government as a whole is not considered the correct level at which to lever reputational and financial drivers that currently operate mostly at the departmental level, or below.

Advantages

a) Maximising emissions coverage

This approach has good emissions coverage, as all governmental public bodies will be included. Treating Government as one unit will mean that clearly government will reach the eligibility threshold of 6,000MWh. Then, in keeping with the principle of covering all sources, all other governmental public bodies and NDPBs will also be included.

b) Simplicity, clarity and lowering administrative burden

Consistent with the schemes main features, by having the parent grouping at the highest possible organisational level. By grouping government centrally at the highest level, it may make sharing of penalties, bonuses, costs and targets more straightforward.

This approach may be the most straightforward way to engage with departments though, as it employs the top-down structures often used in government.

c) Maximising use of financial and reputational drivers

This option should capitalise on financial and reputational drivers for government as a whole, but not take into account the drivers operating within the individual units i.e. departments. This responsibility will have to be divided up appropriately by someone at the highest level in government, much the same as in large private sector organisations.

This approach will also stimulate energy efficiency awareness at the highest level of government

Disadvantages

a) Maximising use of financial and reputational drivers

This approach would not make the most of the individual financial and reputational drivers at the level of government departments, which are independent from each other. Furthermore, other governmental public bodies e.g. executive NDPBs and public corporations also have strongly independent financial and reputational drivers that won't be captured by this approach.

However, it could be possible for central government to target these departments etc. through the way that they apportion the responsibility for CRC centrally.

Defra Case Study

The text box below provides some relevant factual information about Defra that can illustrate the results that might come from some of the grouping decisions above. In particular the box illustrates that Defra will have to consider the compromise leveraging CSR and financial drivers versus emissions losses.

Case study of Options: How to treat The Defra Family

Both Options 1B and 2B would accord with the degree of control, and the strength of relationship, that Defra has with the public bodies that it relates to. The diagram of Defra's landscape, provided earlier, also shows that there are a wide range of bodies that Defra sponsors to some degree, or that help to carry out Defra's objectives, but many of these have a high degree of independence from Defra, and this independence is likely to apply both to financial and CSR drivers.

In Defra the Spongiform Encephalopathy Advisory Committee is jointly owned by the Food Standards Agency and the Department of Health. This issue of joint ownership will be clarified for CRC purposes through the decision rule approach or the responsibility for emissions approach.

Isolating Executive NDPBs from the rest of the Defra Family

It is legally possible to exclude public bodies which have separate legal status, such as Executive NDPBs. However, it is not only Defra's Executive NDPBs that are set up by statute. Most of the other NDPBs (approx 50) were set up using administrative procedures although eleven of those fifty were set up using a legal basis, according to Defra's review of its non departmental bodies (March 2007). Therefore, for the Defra family, any isolation of certain bodies from the Defra family for CRC purposes cannot be based on statute alone, but would have to specify the term Executive NDPB, or separately incorporated public body etc as relevant.

One consideration for a different approach to grouping could be on the basis of the scale of sponsorship. However, it is important to note that not all of the funding that Executive NDPBs receive is from Defra alone. The gross expenditure of Executive NDPBs often exceeds the funding it receives from sponsoring departments and in the case of levy boards, is mostly related to external funds.

In terms of which NDPBs to separate from their departmental families - in 2006 Defra spent over £898,391,623 funding public bodies of which £814,708,078 was on NDPBs alone. Executive NDPBs collectively employ over 15,000 staff. As a result, it appears important that the CRC covers these NDPBs, be it within Defra or by themselves.

However, data available for 2006 shows that many Executive NDPBs have quite a high e.g. £6-8m gross annual expenditure yet employ significantly less than 100 employees. It is unlikely that these types of organisations would be eligible for the CRC in their own right. The largest Executive NDPBs in the Defra Family are the Environment Agency, The Royal Botanical Gardens Kew and Natural England, all of which are likely to qualify in their own right.

It may be desirable to simply include Executive NDPBs on the basis of those which are over the inclusion threshold themselves, but such an approach would not reflect the financial and operational independence of all Executive NDPBs. However, if all Executive NDPBs are excluded from departmental groups, in the case of Defra, it is worth noting that only a few large NDPBs would participate separately in the CRC. The expenditure for these larger bodies varies greatly, with Kew only spending £44m/year and the Environment Agency spending over £1billion (only 2/3 of which comes from Defra).

Figure 61 How to Treat The Defra Family

Annex D – Glossary: Abbreviations and Terms

Acronyms and Abbreviations

AMR	Automatic Meter Reading
CRC	Carbon Reduction Commitment
CSR	Corporate Social Responsibility
CTCMP	Carbon Trust Carbon Management Programme
DAs	Devolved Administrations
DCLG	Department for Communities and Local Government
DCSF	Department for Children, Schools and Families
DoH	Department of Health
DWP	Department of Work and Pensions
EEAS	Energy Efficiency Accreditation Scheme
EMS	Energy Management System
ESTA	The Energy Systems Trade Association
EU ETS	EU Emissions Trading Scheme
ERIC	Estate Return Information Collection
FE/HE	Further Education / Higher Education
FM	Facilities Management
GLA	Greater London Authority
HMIC	Her Majesty's Inspectorate of Constabulary
HMRC	Her Majesty's Revenue and Customs
HO	Home Office
HQ	Headquarters
HR	Human Resources
ICT	Information and Communication Technology
JO	Joint Ownership
JV	Joint Venture
kWh	Kilowatt hours
LA	Local Authority
LAs	Local Authorities
LASER	Local Authority South East Region
LDA	London Development Agency
LST	Land Securities Trillium
TfL	Transport for London
LEA	Local Education Authority
LES-TER	Landlord Energy Statement / Tenant Energy Review
LFEPA	London Fire and Emergency Planning Authority
Met	Metropolitan Police
MHHM	Mandatory half hourly metering
MPA	Metropolitan Police Authority
MPS	Metropolitan Police Service

MWh	Megawatt hours
NDPB	Non-departmental Public Body
NEPO	Northern Eastern Purchasing Organisation
NGO	Non-Governmental Organisation
NHHM	Non-mandatory half-hourly meters
NHS PASA	NHS Purchasing Agency
NHS	National Health Service
ODPM	Office of the Deputy Prime Minister
PCT	Primary Care Trust
PE	Private Equity
PFI	Private Finance Initiatives
PPP	Public Private Partnerships
RA	Regional Assembly
RMB	Regional Management Board
SCC	Southampton County Council
SHA	Strategic Health Authority
SOGE	Sustainable Operations on the Government Estate
SMEs	Small and Medium Sized Enterprises
SPV	Special Purpose Vehicle
STEPS	The Strategic Transfer of Estate to the Private Sector
VC	Venture Capital

Terms and Definitions

Advisory NDPBs

These bodies are established to provide advice to Ministers. Their costs are usually included in the department's expenditure and they are usually supported by the department's own staff.

Change in Law

Change in Law is a provision in PPP/PFI contracts which determines the extent to which a contractor may seek an adjustment in costs in such contracts as a result of changes in legislation..

Competitive Dialogue

Competitive Dialogue is one of several processes under the Public Contracts Regulations 2006 pursuant to which contracts for the provision of services to the public sector may be awarded. It is used for complex contractual arrangements including PFIs and PPPs and may include successive stages during which participants have the opportunity to refine the solutions they are proposing to the relevant public sector contracting authority.

Corporation sole

An office, occupied by a single man or woman (for example, that of Secretary of State for Environment, Food & Rural Affairs), recognised by law as having a personality which is distinct from the separate personality of the individual holder for the time being of the office in question. The concept of a corporation sole allows the office to pass vertically in time from one office holder to the next successor-in-office, giving the position legal

continuity with each subsequent office holder having identical powers to his predecessor. [Halsbury's Laws of England define a corporation sole as "*a body politic having perpetual succession, constituted in a single person, who, in right of some office or function, has a capacity to take, purchase, hold and demise (and in some particular instances, under qualifications and restrictions introduced by statute, power to alienate) real property, and now, it would seem, also to take and hold personal property, to him and his successors in such office for ever, the succession being perpetual, but not always uninterruptedly continuous; that is, there may be, and often are, periods in the duration of a corporation sole, occurring irregularly, in which there is a vacancy, or no one in existence in whom the corporation resides and is visibly represented*"].

Counterparty to the electricity supply contract

Natural or legal person named on the face of the supply contract itself.

Eligibility criteria

The following three options for allocating emissions responsibility were tested in this report, and are referred to as eligibility criteria:

1. "Undertaking which pays the bill" (initial Defra proposal)
2. "Undertaking to which electricity is supplied" (we have taken "supply" in this context to have the meaning given to it in the Electricity Act 1989)
3. "Undertaking which is the counterparty to the electricity supply contract"

The recommended eligibility criterion is "Undertaking which is the counterparty to the electricity supply contract"

Executive Agency

An Executive Agency delivers government services for a particular government department, but cannot set policy or make decisions about resources.

Executive NDPBs

These bodies are established by Ministers to carry out administrative, commercial, executive or regulatory functions. They are legally incorporated and are a separate legal entity. In addition, they employ their own staff and are allocated their own budgets. Unlike Agencies and NDPBs, they operate at some distance from central government

ERIC Estate Return Information Collection

Department of Health's online system which trusts submit information on energy performance.

Inclusion Threshold

The inclusion threshold is the level of electricity consumption which if exceeded by an organisation means that organisation must participate in CRC. The threshold is electricity consumption of 6,000MWh per year through half-hourly meters in Great Britain and 70kW metering systems Northern Ireland.

Independent Monitoring Boards

These bodies were formerly known as 'Boards of Visitors'. They are responsible for the state of the prisons, their administration and the treatment of prisoners. They are financed by their sponsoring department

Legal persons

A legal person is shorthand for a body which can enter into legal relations (for example, a contract) with another such body. A body which can enter into such relations is said to have "legal personality", and a company is therefore a legal person just as much as an individual is. Confusingly the term "legal person" is sometimes used to denote purely "artificial" bodies such as companies (which, as mere legal constructs, owe their personality to the operation of the law) as opposed to "natural persons" (i.e. individuals). In this report however, we use the term to encompass both corporate entities and natural persons.

Monitor The Independent Regulator of NHS Foundation Trusts

NDPB Non-departmental Public Body

There are four types of NDPS: advisory NDPB, executive NDPB, tribunal and independent monitoring boards.

Profile classes 5-8

A recent Carbon Trust pilot (Advanced metering for SMEs) on the costs and benefits of advanced metering indicates that meters with profile classes 5 – 8 typically use between 80,000 kWh and 140,000 kWh of electricity annually. Using a £0.05 / kWh price for electricity, this would indicate that a meter with profile class 5 would typically have an annual electricity bill of around £4,000, whilst a meter with profile class 8 would typically have an annual electricity bill of around £7,000.²⁶

Outsourcer

Organisation that chooses to outsource provision of services

Outsourcee

Organisation which provides certain services under contract

RA Regional Assembly

A regional chamber established under the Regional Development Agencies Act 1998. Except in London, an RA's membership comprises appointees from county and district councils and unitary authorities in the relevant region and from other regional interest groups. London's RA (the London Assembly) is exceptional in that it comprises 25 directly elected members. The role of RAs includes scrutiny of the work of their local Regional Development Agencies and formulation of a Regional Spatial Strategy.

RMBs Regional Management Boards

The 2004 Fire and Rescue Services Act 2004 requires fire authorities to establish new joint committees called Regional Management Boards (RMBs) by the 1 April 2004 to

²⁶ (Taken from June 2007 consultation document: <http://www.defra.gov.uk/corporate/consult/carbon-reduc/consultation.pdf>

)

deliver six strategic functions (Resilience plans for large scale emergencies; Specialist and common services; Regional control rooms; Regional procurement; Regional approach to training; Regional personnel and human resources management)

s.832 ICTA - This section of the Income and Corporation Taxes Act 1988 defines "body of persons" as "any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate".

The Electricity Act 1989

Section 4(4) of the EA 1989 stipulates that: "supply", in relation to electricity, means its supply to premises in cases where—

- (a) it is conveyed to the premises wholly or partly by means of a distribution system, or
 - (b) (without being so conveyed) it is supplied to the premises from a substation to which it has been conveyed by means of a transmission system,
- but does not include its supply to premises occupied by a licence holder for the purpose of carrying on activities which he is authorised by his licence to carry on;

Tribunal NDPBs

These bodies have jurisdiction in a specific area of law. Like the Advisory NDPBs, they are usually supported by staff from their sponsoring department and do not have their own budgets.