Carbon questions

DAVID WILSON REPORTS ON THE DISCUSSION FROM THE RECENT LONDON REGIONAL GROUP ON THE ROLE THAT TREASURERS MAY PLAY IN THE CARBON REDUCTION COMMITMENT.

The October meeting of the London Regional Group covered what treasurers need to know about the carbon reduction commitment. A panel of four speakers approached the subject both from the point of view of energy users (Bill Wright from John Lewis, and Tim Morris from Corus) and energy consultants (Ashley Daffin from Utilyx and Ian McGowan from FirstCarbon Solutions).

It is fair to say that treasurers are unlikely to be first in the firing line when it comes to taking responsibility for the carbon reduction commitment. This view was supported by the results of a mini-survey that the ACT conducted alongside the meeting, which indicated that only 10% of respondents had been given that responsibility.

Nevertheless, there are several areas where treasurers will be affected and these are summarised below. And while it is absolutely clear that the carbon reduction commitment regime will soon be implemented (in April 2010), some of the mechanics will change over time – these are early days and politicians are involved. It should be noted that in the few weeks since the meeting, the name of the initiative has been changed to the CRC Energy Efficiency Scheme.

WHAT TREASURERS NEED TO KNOW A useful starting point to discover the details of the carbon reduction commitment scheme is the Department of Energy and Climate Change website (www.decc.gov.uk). Essentially, any entity that uses more than about £500,000 worth of energy will need to participate: it is estimated that this covers about 5,000 entities, both private and public sector. Each entity will need to purchase, in advance, carbon allowances, and these allowances will be rebated to those who perform well in a league table based on a set of metrics to determine an entity's early activity and then its relative efficiency. All money extracted from allowances will be recycled to good performers – it is not a tax on carbon. The effect of the scheme is that entities that perform well on the metrics will not only save the basic cost of their energy savings but will also be subsidised by poor performers. The maximum swing between good and bad performers will rise over the next few years to up to 50% of their energy bill.

HOW THE SCHEME AFFECTS TREASURERS The carbon reduction commitment scheme involves some trading – at a minimum the purchase of allowances (in later years by auction), and potentially selling them as well. Given treasurers' experience in handling all aspects of trading (internal controls, market information, documentation and compliance reporting), one would expect them to be consulted by their companies on these aspects, as well as

acting as a sounding board for trading strategies. The government is determined to make participants take the scheme seriously, so each entity must nominate a main board director to be responsible for their participation: if this is the finance director then the involvement of treasurers is even more likely.

There will also be an impact on working capital. At the least, entities will need to fund the annual allowances in advance, from April 2011 onwards. Do you know yet how much this might be for your company, or who has been designated to forecast the outflow? As another indicator of the fluid state of implementation, the original intent was for two years' worth of allowances to be bought in April 2011, but this was coincidentally reduced a couple of days after our meeting, following representations from companies citing the credit crunch. The scheme might increase, or decrease, your company's energy costs by up to 50%, which could affect competitiveness both directly and also indirectly in terms of a company's reputation. Naturally, there is the possibility of increased capital expenditure to improve energy efficiency, which would not previously have been economic. Trading with market counterparties will potentially consume capital.

UNANSWERED QUESTIONS The audience at the regional group meeting gave the panel a thorough workout, which they responded to well, although many of the questions that a treasurer or finance director might ask do not yet have answers. For example:

- Acquisitions and divestments: you will not only perhaps be buying or selling a company's pension scheme but also its carbon reduction commitment position.
- How will overseas businesses be factored into your group's energy performance? The UK is the only country to implement a carbon reduction scheme in this way, so competition within Europe is also a little distorted.
- Business startups will be handicapped because they will have no historical data to measure performance against: is this sustainable?
- Who will act as market-makers for the trading of allowances? If it's the banks, there will be implications for credit lines (see also the current debate about margin calls for OTC derivatives).
- Will there be opportunities for tax-efficient structures?

RADICAL AND AMBITIOUS The carbon reduction commitment energy efficiency scheme is a radical and ambitious attempt to change the behaviour of all significant energy consumers not already covered by climate change regulations. Accordingly, the scheme will have serious ramifications for a number of bodies – hospitals, for instance, as well as corporates. Corporate treasurers are unlikely to have the primary responsibility for complying with the scheme but there are a number of questions that they should be asking within their organisations – and keep asking, because some of the answers will change over time.

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www.treasurers.org/membership/regionalgroups