Business Energy Use
Department for Business, Energy & Industrial Strategy
6th Floor
1 Victoria Street
London
SW1H 0ET

By email: reporting@beis.gov.uk

4 January 2018

Dear Sirs,

Re: Streamlined Energy & Carbon Reporting consultation paper (the "Consultation") – BVCA response

I am writing on behalf of the British Private Equity & Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 650 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Our members have invested over £27 billion in nearly 3,800 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses.

(A) BVCA'S OVERALL VIEW ON THE PROPOSALS

We welcome the opportunity to comment on the questions posed in the Consultation.

Responsible Investment is an important aspect of the BVCA's agenda. Consideration of environmental, social and governance (ESG) matters are important for many of our members to both minimise risk and create value throughout the private equity and venture capital deal cycle. As such, we are supportive of the government's proposal for a streamlined system for energy and carbon reporting, and of the ultimate aim of raising awareness, reducing bills, and saving carbon. Such a regime, if properly implemented, would not only assist our member firms in monitoring the related performance of their more energy-intensive portfolio companies, but may also help inform investment decision-making.

However, as expressed in our previous consultation responses, whilst the BVCA was also supportive of the carbon reduction objectives behind the CRC Energy Efficiency Scheme (the "CRC"), our member firms and their portfolio companies generally found the implementation and administration of that scheme to be complex, time consuming, administratively burdensome and costly. This ultimately undermined the otherwise significant achievements of the regime. It is therefore important to take the learnings from the CRC and ensure that the current proposals do not similarly impose an unnecessary burden. The focus should be on larger organisations and energy users, and it should be made reasonably straightforward to determine who qualifies in more natural groupings, using analysis and information generated for existing regimes (e.g. the Energy Savings Opportunity Scheme, "ESOS"). From a private equity perspective, small organisations with

minimal energy should not be drawn in simply by virtue of an arguable corporate link to an asset manager based on the broad Companies Act 2006 parent / subsidiary undertaking grouping rules.

(B) SCOPE OF OUR RESPONSE

We anticipate that BEIS will receive feedback on the numerous Consultation questions from a wide variety of participants. Our response principally focuses on the aspects of the proposals that are of particular relevance to the private equity industry (and caused significant difficulties under the CRC) – in particular, the qualification, grouping and disaggregation mechanics.

(C) BVCA RESPONSE TO SELECTED QUESTIONS

Q3: Do you agree that reporting should be done through annual reports?

No, we do not agree that reporting should be done through annual reports. Annual reports are becoming increasingly loaded with information. There is a risk that including energy data here means it is effectively lost and/or difficult to systematically access and analyse. We would question how suited the annual reporting regulatory regime is to verifying information of this nature.

There is also a risk of misalignment. Unless the annual reporting framework, grouping and thresholds are followed in their entirety for carbon reporting qualification purposes (which we do not consider appropriate – see Q7 below), it is not clear how companies/groups who qualify for carbon reporting, but who are not required to file annual reports under the Companies Act 2006, would participate. We appreciate this would likely only arise in a limited number of instances.

As discussed in our responses below, we suggest the reporting framework be aligned as fully as possible with ESOS. This would support reporting being done by existing ESOS participants through the ESOS portal, and information therefore being accessible in a simpler and more useful and informative way. We note the government's concern, outlined in chapter 6 of the Consultation, about the achievability of a separate carbon reporting framework by 2019. However, by adapting the ESOS framework, synergies may be realised. We would also suggest it is better to (if necessary) delay carbon reporting coming into effect whilst the optimal solution is developed, rather than implement an interim solution through the annual reports and cause further confusion by changing it later.

Q6: Do you think that the policy should apply to:
A) all 'large' companies based on employee numbers and financial tests;
B) companies who meet the 6GWh ex-CRC annual electricity use threshold described; or
C) another threshold?
Please explain your answer. Please state if you have any views on whether reporting should be required to operate at the group or individual company level:

We suggest (C), another threshold. However what we propose is, to an extent, a combination of (A) and (B).

We suggest that the carbon reporting regime be aligned, as far as possible, with ESOS. This includes adopting its 'large' undertakings definition, based on employee numbers and financial tests (as well as its 'grouping' criteria - see further discussion on this in response to Q7 below). ESOS is the regime

most naturally aligned with these carbon reporting proposals. It is also, we assume, set to remain for the foreseeable future (not least as it implements EU Energy Efficiency Directive requirements - setting aside the unknown longer term implications of Brexit).

Organisations recently considered their ESOS 'large' undertaking and grouping status for the December 2015 compliance deadline. Many are already considering this again ahead of the December 2019 compliance deadline. Using precisely the same analysis to determine qualification for (and indeed participation in) carbon reporting would reduce the burden on businesses (particularly where complex corporate / investment structures are involved). It will also allow various other compliance synergies to be realised – see our response to Q7.

However, we also suggest that an energy use threshold be overlaid onto this. Only where an ESOS 'participant group' (see response to Q7 below for discussion on this) exceeds this energy use threshold should the carbon reporting requirements then apply. We believe this is important, as:

(i) the CRC rightly focused on larger energy users. The intent was for the burden and scrutiny to fall on businesses which had greater carbon impact, and who were better placed (and more incentivised) to realise efficiencies. The fact that now, the revenue currently collected from the CRC is to be collected via the climate change levy will (perversely) move a proportion of the CRC 'cost on carbon' away from these larger users and onto smaller energy users. It would be unfortunate if these carbon reporting proposals also placed additional strain on those smaller energy users;

(ii) it will help avoid anomalous results. Many organisations with little or no UK energy use are technically required to participate in ESOS. This may be because they are corporately linked to a 'large' organisation in the UK for ESOS qualification purposes or have some form of UK 'business presence', despite their employees all being based overseas. The former is particularly an issue for private equity structures, where various organisations may be arbitrarily linked to the same fund or manager, based on the over-broad grouping tests used. These organisations being required to carbon report would only undermine trust in the regime, and make it more unwieldy to administer;

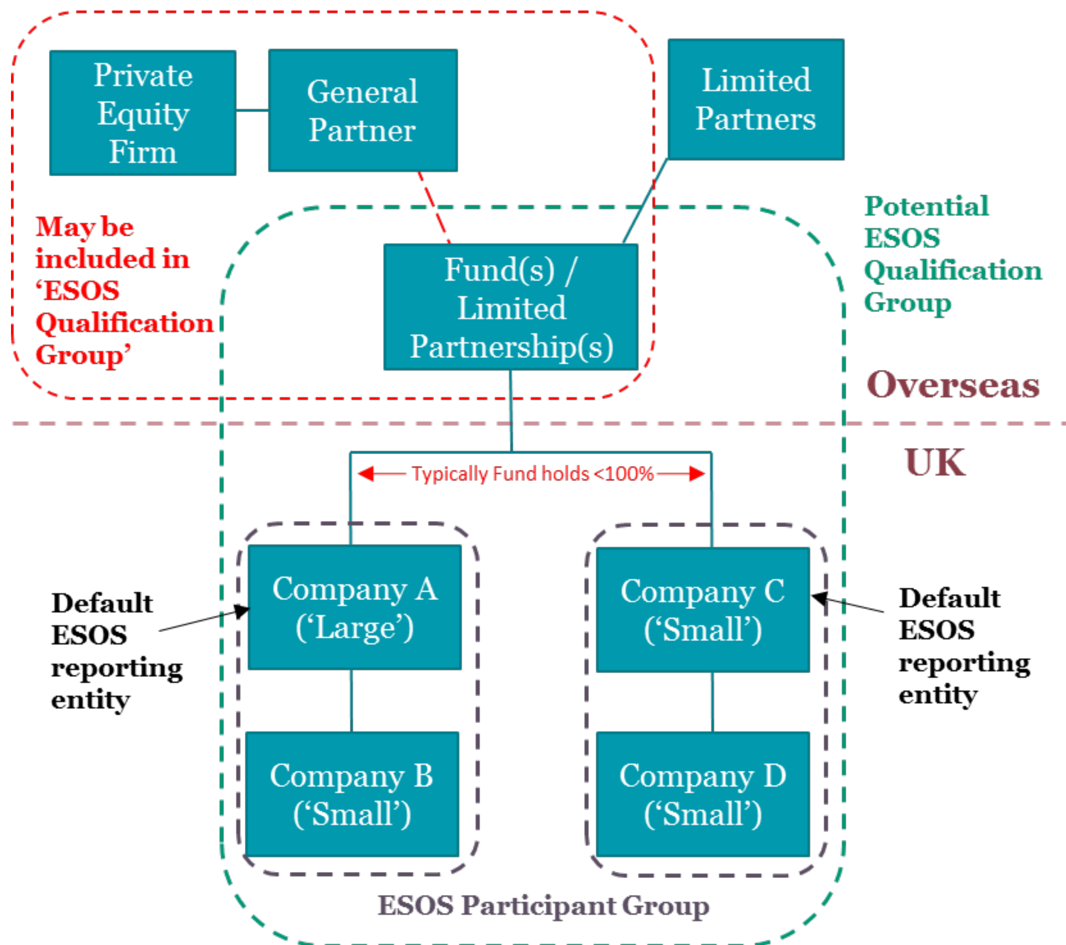
(iii) the energy use threshold could be set at a level which leads to a similar level of participation in reporting as the CRC (see Q8 for further discussion). It would also incentivise businesses close to the threshold to reduce their energy usage and so avoid the burden of future carbon reporting. This would reward the better performers.

Q7: If you prefer Population Approach A (all ‘large’ companies) which of the proposed company size definitions seems the most appropriate to you: (i) Companies Act 2006, or (ii) ESOS, or (iii) any others?

As discussed in response to Q6, we suggest using the ESOS 'large' undertakings approach to determining population (but, importantly, with the overlay of an energy threshold), as organisations are now familiar with this framework. However, it is important to consider the way in which the 'group' is determined for these purposes and ensure it avoids anomalous results, and does not place a disproportionate burden on investment structures and certain portfolio companies.

GROUPING

The following diagram depicts how ESOS may currently apply to a typical private equity fund investment structure.



(1) PE general partners / managers should not be grouped for these purposes

Under ESOS if any single entity in the group is 'large' (in our diagram, Company A) then the whole 'group' (including overseas) qualifies. As the broad parent / subsidiary undertaking grouping tests in section 1158 of the Companies Act 2006 are used to determine the group, it is possible for this to include the fund and, in certain circumstances the private equity manager / general partner. The legal position here can be unclear, and the outcome will depend on the specific ownership of the portfolio company and / or detailed terms of the documentation setting up each private equity or venture capital fund.

This has led to disproportionate cost and complexity for these structures (and their portfolio companies) in determining qualification. It creates administrative difficulties in compliance. In some circumstances it can lead to completely operationally and economically separate portfolio companies, owned and financed by entirely different shareholder groups, but involving funds with a common private equity managing firm, being conflated into a single 'group'. This can unfairly lead

to 'small' organisations (with little to no relevant UK energy usage) needing to participate simply by reason of a technical link to the fund manager.

The ESOS grouping rules should be amended (or at least varied in their application for the purposes of these carbon reporting proposals) to avoid these outcomes. In our response to the prior consultation on simplifying the CRC[1], we proposed that these general partners and/or managers should not be treated as a "parent undertaking" unless they have a more than 50% controlling stake in the fund, which, in turn, controls the underlying portfolio company, making it a parent undertaking in the ordinary sense.

(2) Qualification for carbon reporting should be based on the ESOS 'participant group'

Under ESOS, by default all subsidiaries participate together under their highest UK parent. So, in the above diagram, Company A/B form one 'participant group' whereas Company C/D (who do not share a common UK parent with A/B) form a separate 'participant group'. The default reporting entity will be the UK parent (A and C respectively).

In practice, this has gone some way to mitigating the potential impact of the broad Companies Act 2006 parent/subsidiary undertaking grouping tests on certain private equity structures, as discussed above. It helps ensure organisations participate in ESOS in their more natural 'UK groupings' rather than as a global conglomerate.

We strongly suggest that the starting qualification for carbon reporting should be based on these same ESOS participant groups. (For the avoidance of doubt, these are the individual, 'automatically disaggregated' groups explained above, each headed by a UK parent, within the wider ESOS 'qualification group'. This is important to ensure alignment between ESOS and carbon reporting regimes, and to ensure a secondary energy usage criteria can be practicably applied.) This would help entities report in their more natural grouping. It would also simplify the qualification process and then allow an appropriate secondary energy use threshold to be included, as each ESOS participant group will (in most cases) be able to determine its energy usage from existing ESOS data.

(3) Disaggregation should be allowed for in the same way as ESOS

ESOS allows for a relatively practical approach to disaggregation. Essentially, UK parents will effectively disaggregate from a global parent automatically (due to the operation of the 'participant groups' discussed above). Any further UK subsidiary under that UK parent then need only agree in writing with the UK parent that it will be disaggregated. It will then participate in ESOS separately.

We suggest the same should apply for the carbon reporting regime proposed. Qualification for carbon reporting would be based on the whole participant group (i.e. take no account of any agreed UK subsidiary disaggregation). By default, the 'highest UK' parent should then report for all of that participant group. However if it determines that the more natural position would be for an individual entity within that group to report separately, then it may do so, where agreed by both parties in writing. A dedicated central energy and carbon reporting regime could allow for this data to be 're-aggregated' between linked organisations (i.e. the combined group energy usage to be

[1]https://www.bvca.co.uk/Portals/0/library/Files/Government%20Submissions/Simplifying%20the%20CRC%20Energy%20Efficiency%20Scheme%20%E2%80%93%20June%202012.pdf

easily accessible) to avoid groups being able to disguise their combined energy usage via an aggressive disaggregation strategy.

SUMMARY - COMPLIANCE CYCLE

Following the approach above could lead to a streamlined compliance cycle for ESOS and carbon reporting as follows:

(1) organisation determines whether it has any 'large' undertakings and its 'qualification group' under ESOS rules;

(2) if there is a 'large' undertaking in the qualification group, organisation then determines its 'participant groups' (each under their highest UK parents);

(3) each 'participant group' (which will always have a UK parent company) then audits its energy use via an energy assessment. [2] This must be completed by 5 December 2019;

(4) based on that energy assessment, the 'participant group' at the same time determines its aggregate annual energy usage. If this exceeds an appropriate energy usage threshold then it qualifies for carbon reporting;

(5) should the 'participant group' qualify, then for the following 4 years (until the next compliance deadline, 2023) it will report annually under the proposed regime – by default, through the highest UK parent. It may choose to disaggregate subsidiaries to report separately, via the same mechanism as ESOS; and

(6) qualification would be reassessed over the next ESOS cycle. For example, any users who qualified in 2019, but reduced their energy usage below the threshold by 2023, would no longer be required to carbon report.

Q8: If you prefer Population Approach C, which energy use threshold is most appropriate? Please explain your answer, and state who you think should be required to report, describing any other energy threshold(s) you may favour (with options including but not limited to 6GWh per year across all energy products, and 500MWh per year for each of electricity, gas, and transport).

The type and nature of energy usage used to determine whether the secondary qualification threshold is met should be aligned with the data that entities are required to collect for ESOS - which supports a move away from the rigid CRC approach to the calculation.

We are not in a position to comment on what that threshold should be in terms of MWh. However following our approach outlined above would suggest a lower threshold than the CRC (i.e. less than 6GWh) may be required to achieve a similar level of overall participation. This is because an ESOS 'UK parent' based grouping approach would lead to a higher number of smaller qualification groups than the CRC, disproportionately fewer of whom would therefore meet the 6GWh threshold.

[2] We recognise that there are some businesses who comply with ESOS through an alternative compliance route (i.e. ISO accreditation) rather than carrying out an audit – but in these cases, they will typically have robust environmental management systems which makes energy usage data relatively easy to obtain. Some alignment may be needed to ensure that the data collected in a typical ESOS audit is appropriate for 'threshold qualification' purposes.

We suggest that data generated for ESOS purposes could be used to determine the appropriate threshold (we are aware that government does not hold ESOS data, but this could be based on any information gleaned from the sample it has audited).

Q8: Should reporting requirements within the Companies Act regime also apply to Limited Liability Partnerships (LLPs)?

No. As discussed above, we support a streamlining of the approach with ESOS, and adding a secondary energy usage criteria, which should act to avoid disproportionate burden being placed on LLPs. However, if this is not to be the case, then we do not believe that the reporting requirements within the Companies Act regime should also apply to LLPs. Typically, the larger energy users who should properly be caught by this regulation will be companies, and including LLPs could capture a number of smaller entities who are not subject to the same type of corporate reporting obligations.

Q13. B) Building on the energy and carbon disclosures proposed here, please provide views on whether in the long-term any of the TCFD recommended voluntary disclosures should become mandatory disclosures within companies' annual reports.
C) Please specify what support government could provide to support uptake of TCFD disclosures by companies from all sectors.

We acknowledge the work of the TCFD in encouraging firms to consider the potential financial impacts of climate change on their organisation. Increasingly private equity and venture firms are considering climate change risk along with carbon emissions and energy use as part of their due diligence when acquiring companies, as well as utilising such analysis during ownership to minimise risk and take advantage of any value creation opportunities.

However, we urge caution with making any of the TCFD recommended disclosures mandatory without detailed assessment of the potential impact on UK business, especially smaller organisations that may be required to produce such disclosures. Many businesses will lack the capability to undertake the technical analysis recommended by the TCFD, which could result in significant cost / burden, particularly if climate change is not a material risk to the business.

Q17: If replacing the proposed regime in future, please set out how a dedicated central energy and carbon reporting regime could continue to meet the needs of investors and others in relation to GHG reporting by UK quoted companies, currently required to be alongside financial information in annual reports.

The private equity and venture capital industry increasingly takes carbon metrics (as part of environmental impact and sustainability more generally) into account in their investment decisions and strategy. This often forms part of any commitments made under the UN Principles of Responsible Investment. A dedicated, centralised energy and carbon reporting regime would provide a useful tool for this. Were the information simply contained in financial reports, it would be far more difficult to systematically access / benchmark.

Any future regime should also strive to be aligned with international reporting standards. Private equity and venture capital funds, in particular, typically have an international investor base. Thus, measurement of energy and carbon emissions on an equivalent basis will ensure data collected is

user friendly and allows investors to make comparisons and benchmark when making investment decisions.

We would be happy to discuss the contents of this letter further with you. Please contact Gurpreet Manku (gmanku@bvca.co.uk) at the BVCA in the first instance.

Yours faithfully,

Amy Mahon
Chair, BVCA Legal & Accounting Committee