bvca The voice of long-term investment

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By email: crc@decc.gsi.gov.uk
From: BVCA Legal & Technical Committee

Dear Mr Francis

Response to consultation on amendments to the CRC Energy Efficiency Scheme Order 2010

The British Private Equity and Venture Capital Association (BVCA) is the industry body for the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms and their advisers. This submission has been prepared by the BVCA's Legal & Technical Committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

The BVCA welcomes the announcement by the Government that it intends to simplify the CRC Energy Efficiency Scheme (CRC). Whilst supporting the policy objectives behind the CRC, the BVCA is strongly of the view that the CRC is too complicated in its current form and has created a lot of uncertainty and unnecessary cost for UK businesses.

In addition to responding to the specific questions raised in the consultation paper, we would also like to make a number of recommendations to simplify the CRC which we do not believe would adversely impact on the Government's policy of reducing UK carbon emissions.

A. BVCA recommendations to simplify the CRC

1. The current grouping requirements of the CRC have created a lot of difficulties for private equity and venture capital funds. The application of the Companies Act 2006 'parent and subsidiary undertaking' tests to limited partnership structures is not straightforward, either legally or factually, and our members have incurred, and continue to incur, significant legal fees in determining their CRC group(s). We would emphasise that a portfolio of private equity backed companies is not the same as a conglomerate; each portfolio company is legally and operationally separate and will have its own management team.

   The BVCA recommends that:

   (a) For CRC purposes the better approach would be for shares held for investment purposes to be disregarded when assessing whether companies fall within a single CRC group, so that individual portfolio companies (and portfolio company groups) participate separately and do not have joint and several liability.

   (b) If this is not possible an investment fund (and not its general partner, manager or adviser) should be treated as the highest parent undertaking of each of its portfolio companies for the purpose of determining whether the group is required to register for

the CRC. This is because economic ownership of the portfolio rests with the fund investors and not the private equity firm.

2. The provisions relating to changes in organisational structure are also causing practical difficulties, as private equity funds buy and sell portfolio companies on a reasonably regular basis.

The BVCA recommends that:

(a) The period between the qualification day and registration period for each phase should be as short as is reasonably practicable to minimise the number of situations in which parent undertakings qualify for the CRC on the basis of the half hourly metered electricity consumption of companies they no longer own.

(b) Where a company changes ownership between the qualification day and the registration deadline, the new owners should be required to provide all necessary information to the highest parent undertaking of the CRC group, and no liability should attach to entities within the residual CRC group if the necessary information is not provided.

3. The requirement to identify the "highest UK parent" and to nominate a UK member of the group as the compliance account holder has caused practical difficulties to private equity funds, particularly where the fund is an overseas entity with a number of UK portfolio companies that have no common UK parent. The Environment Agency's suggestion that any one of the UK portfolio companies should register as the "highest UK parent" is unworkable as no portfolio company has ownership or control over any other.

In addition, unwillingness on the part of both portfolio companies and private equity firms for a single portfolio company to assume responsibility for the other companies in the portfolio has resulted in funds having to set up special purpose companies whose sole purpose is to be the CRC account holder for the fund. This is an additional administrative burden on business.

The BVCA recommends that:

(a) The CRC registration form simply requires details of the highest parent undertaking (whether UK or non-UK), followed by details of the UK compliance account holder (or primary member). The 'highest UK parent' has no functional role, so it should not be necessary to identify that entity (which may not exist).

(b) Non-UK highest parent undertakings be permitted to register as compliance account holders (or primary members), provided that they give an address for service of documents in the UK. Since there is joint and several liability for all entities in an organisation, the BVCA does not see that this would affect the Environment Agency's ability to enforce the scheme.

(c) In addition, or alternatively, non-UK highest parent undertakings be permitted to appoint a UK-based agent as compliance account holder that need not be a member of the CRC group. This could be an external CRC compliance consultant, but might equally be the private equity firm's UK office (which will often not be grouped with the fund or its portfolio companies applying the Companies Act 2006 tests).

4. CRC requires each participant to nominate a primary contact, secondary contact and senior officer contact; these individuals are then subject to checks by the Environment Agency

before the registration can be approved. This leads to timing uncertainties as to when an application needs to be submitted to meet a particular deadline, and also creates additional administration and costs. Other environmental legislation, such as REACH, allows third party agents to be nominated.

The BVCA recommends that:

(a) participants are allowed to nominate third party agents as their primary and secondary contacts;

(b) the CRC Order makes it clear that it is the initial submission of the application which is relevant for determining whether the registration deadline has been met.

5. The on-line registration system takes an approach to the identification of significant group undertakings (SGUs) which is inconsistent with the CRC Order. This has caused BVCA members difficulties on registration and led to uncertainty.

The BVCA recommends that:

(a) It should be possible within the online registration system to disaggregate an SGU at any level within the holding structure, provided that the conditions in the CRC Order are met (i.e. the company or group being disaggregated qualifies as an SGU and the residual group is over the threshold). This would be consistent with the CRC Order.

(b) It should be possible for a non-UK company to be identified as the highest parent undertaking of a disaggregated SGU (currently not possible as only entities registered at Companies House can be entered into the system).

(c) Only basic details of the highest parent undertaking of any SGU to be disaggregated should be entered into the system as part of the main group registration, and detailed information on the SGU should be deferred to the SGU's own registration application.

6. The requirement to continue to participate in the CRC for the duration of a phase creates unnecessary administrative burdens for firms that no longer have any UK operations; for example, if an overseas private equity fund sells its only UK portfolio company. The Environment Agency is currently advising that, in this situation, the private equity fund would have to incorporate a new UK company to act as the compliance account holder for the remainder of the phase purely for the purpose of filing nil returns each year.

The BVCA recommends that:

(a) the highest parent undertaking of an organisation that no longer has any UK operations should be able to file a notification confirming that the group contains no UK entities and has no UK operations; and

(b) the registration of this organisation should then become ‘dormant’ such that all reporting and compliance obligations are suspended until and unless the situation changes.

7. The system for claiming CCA exemptions is complex and causing confusion. There is a widespread misconception that a company with a climate change agreement covering more than 25% of its total emissions (a “CCA company”) can simply be largely disregarded for CRC purposes; however, this is not the case where the CCA company is part of a group.

The BVCA recommends that:

(a) Ideally, CCA companies should simply be excluded from the CRC for all purposes. Requiring them to register and then claim an exemption creates an administrative burden for both the companies (or their highest UK parents) and the Environment Agency.

(b) The residual group threshold in article 34(1)(b) be increased from 1,000MWh to 6,000MWh, so that companies are not disproportionately disadvantaged by reason of being in the same portfolio as a CCA company.

8. Firms are having significant practical difficulties in ensuring CRC compliance by portfolio companies that have gone into insolvency processes since the qualification date.

The BVCA recommends that:

(a) Companies in liquidation at the point of registration should be wholly disregarded for CRC purposes, as such companies are highly unlikely to produce future carbon emissions.

(b) Companies that are in administration at the point of registration should be treated separately, and responsibility for CRC compliance should rest with the administrator and not the highest parent undertaking.

(c) If this is not possible, liquidators and administrators should be under a statutory obligation to provide the highest parent undertaking of the CRC group with all information necessary to assess whether CRC registration is required and to effect such registration, and entities within the residual CRC group should not have any liability if such information is not forthcoming on request.

B. BVCA's general comments to the proposed changes

1. While the BVCA welcomes the proposed simplification of the CRC, at the same time it is disappointed that the Government is finding it necessary to make fundamental changes to the CRC within such a short period after its introduction and before the functioning and effectiveness of the scheme has been properly tested.

2. Many of the BVCA's members made decisions (on registration and on the acquisition and disposal of investments) on the basis of the CRC Order as currently in force. They have incurred substantial costs both in terms of professional fees and management time, and some of the changes will force them to incur further costs in deciding how they should now proceed.

3. BVCA members, like any other UK business, require legal certainty in order to make business decisions. Making radical changes to a scheme which has only been in force for a little over six months does not create legal certainty.

4. In particular, the decision to abolish recycling payments makes a carbon-intensive company a significantly different investment proposition; firms will have invested over the last few months on the basis that a company that significantly improves its carbon reduction performance will ultimately benefit financially from the CRC, whereas such companies will now incur significant costs in purchasing allowances. Moving the goalposts in this way acts as a disincentive to investment in UK companies.

C. BVCA's specific comments on the proposed changes

Proposal 1

1. Given the Government's stated intention to review elements of the CRC, the BVCA generally supports Proposal 1 which allows time for this review to take place. In particular, the BVCA believes that postponing the requirement to register for the second phase from 2011 to 2013 would make assessing whether an organisation qualifies more straightforward from an administrative perspective, as the period between the end of the qualification year and the start of the relevant phase would be reduced from two years to one.

2. The BVCA would welcome greater clarity from the Government on the timing and structuring of allowance sales. It is noted that the first sale of allowances will take place in 2012 instead of 2011 and that the first sale will be retrospective to cover 2011/2012 admissions. However, the BVCA is concerned that there should be no requirement to buy two years' worth of allowances simultaneously when the sale of allowances changes from being retrospective to being in advance.

Proposal 2

3. The BVCA supports Proposal 2, which removes a requirement for organisations who are not required to register as participants to make information disclosures. This will remove a significant administrative burden for firms below the CRC registration threshold.

Proposals 3 and 4

4. The BVCA has no comments on Proposals 3 or 4 of the consultation.

Proposals 5 and 6

5. The BVCA agrees with the proposal to correct cross-referencing errors and update the interpretation definitions.

The BVCA would welcome the opportunity to discuss these comments.

Yours sincerely,

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Chairman, BVCA Legal and Technical Committee

cc:
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