BVCA Response to DECC Consultation on Simplifying the CRC Energy Efficiency Scheme

This response is submitted by the Legal and Technical Committee of the British Private Equity and Venture Capital Association ("BVCA").

The BVCA is the industry body and public policy advocate for the private equity and venture capital industry in the UK. The BVCA membership comprises over 230 private equity, midmarket and venture capital firms with an accumulated total of over £200 billion funds under management; as well as nearly 300 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

The objectives of the BVCA Legal and Technical Committee include shaping policy and the implementation of policy to ensure that it accommodates the needs of the British venture capital and private equity community.

A. BVCA's overall views on simplification proposals

1. Overall, the BVCA welcomes the simplification proposals put forward in the consultation paper. While the BVCA supports the carbon reduction objectives behind the CRC Energy Efficiency Scheme, our member firms and their portfolio companies have generally found the implementation and administration of the Scheme to be complex, time consuming, administratively burdensome and costly. We are therefore wholly supportive of the Government's stated intention to streamline and simplify the Scheme with a view to making compliance easier and less burdensome for participants.

2. Specifically, the BVCA welcomes Proposal 19 of the Consultation paper to increase the flexibility for disaggregation.

    - The BVCA agrees with the comment that the current rules have caused a number of difficulties and can lead to an increased administrative burden on participants.

    - Accordingly the BVCA fully supports Proposal 19 in removing any minimum threshold for subsidiaries to disaggregate and any requirement that the remainder of the group has to exceed the qualification threshold.

B. BVCA's view on the CRC organisation rules

3. We anticipate that DECC will receive feedback on the detail of the simplification proposals from a wide variety of participants. We have therefore focused our response on one aspect of the CRC Energy Efficiency Scheme that is of particular relevance to the private equity industry.

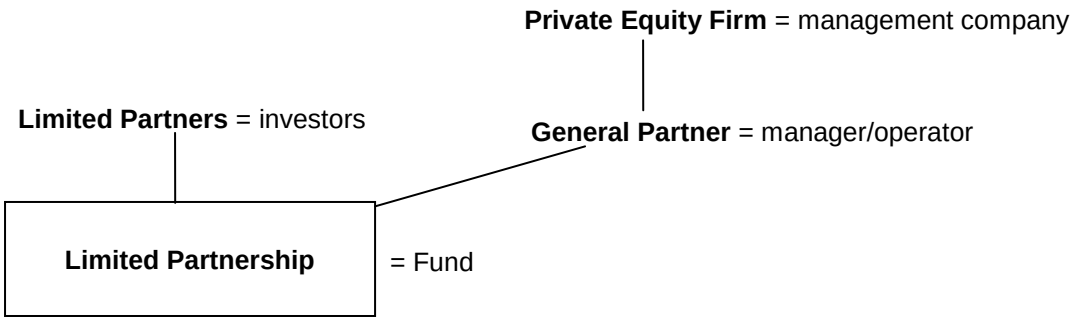
4. As indicated in our previous consultation responses, the provisions of the CRC Energy Efficiency Scheme Order 2010 that determine whether entities form part of a single CRC group have caused particular difficulties for the private equity industry (and also for managers of other types of investment fund, such as real estate funds or infrastructure funds).

5. We are very pleased to note that in paragraph 144 of the consultation document and paragraph 26 of the draft order (set out in Appendix 2 for reference), the consultation recognises that private equity and venture capital funds should be treated as separate entities for qualification purposes and participation in CRC.

However, this is part of the section on the CRC organisation rules in so far as they affect trusts; the vast majority of private equity and venture capital funds are not structured as trusts but are instead structured as limited partnerships with the following features:

- by law a limited partnership is required to have a general partner
- the general partner will be the manager/operator of the fund and, although it will have fiduciary duties towards the fund and its investors, it will not be a trustee as such
- the investors in the limited partnership are its limited partners, who will normally own the majority of the fund.

Typically, each fund will look like this:



C. Consequences of the organisational rules – aggregation of portfolio companies

6. Since the initial proposals for CRC were first published, the principal concern of the BVCA's member firms has been and continues to be the requirement of the organisational rules to aggregate individual portfolio companies within a particular fund notwithstanding the fact that each of these companies is legally and operationally separate from the other companies, is run independently and has its own management team.

7. A portfolio of private equity or venture capital backed companies is not the same as a normal group of companies with a single management structure. Private equity or venture capital backed companies will each have separate ownership structures and separate sets of investment documentation entered into with individual management teams. Separate investment decisions will be made on the acquisition of each of these companies. However, the consequence of the CRC organisational rules is to artificially and arbitrarily lump these together into one group simply because they have a common general partner and/or manager. Furthermore, we do not believe that aggregating portfolio companies in this way achieves the policy objectives of the CRC Scheme in practice.

D. Consequences of the organisational rules – general partner and manager treated as "parent undertaking"

8. Structures vary from firm to firm, but a typical private equity or venture capital multi-investment fund structure is shown in Appendix 1.

9. From a commercial and economic perspective, each fund is separate and must be managed and operated separately in the interests of its own investors, who may be different from fund to fund. The administrative difficulty arises because, although its economic interest will usually be small, the manager/operator company for each fund may in some cases be treated as a parent undertaking of the fund because of the level of management control it exercises.

10. This has a number of consequences:

- The Companies Act tests for determining whether the manager/operator company is a parent undertaking of the fund are technically complex. The legal position is unclear, and the outcome will depend on detailed terms of the documentation setting up each private equity or venture capital fund. Hence:
    - firms are incurring substantial legal costs in determining the extent of their CRC group(s); and
    - the position can very from firm to firm in a somewhat arbitrary way depending on the underlying legal arrangements, which creates inconsistency of treatment between firms carrying on essentially the same business.
- Where the outcome is that the manager/operator companies are all subsidiaries of the main private equity or venture capital firm so that the multiple funds form part of a single CRC group, it creates administrative difficulties for the private equity or venture capital firm. This is because the private equity or venture capital firm will be obliged to ensure that there is no cross-subsidy between funds, both in respect of administrative costs and in respect of the real cost of purchasing allowances. It has therefore been necessary for these firms to put in place appropriate cost sharing arrangements between funds, adding both complexity and cost.

E. Costs to investment funds of the organisational rules

11. We wrote to you at the beginning of December on the question of CRC costs incurred by investment funds. We came up with a number of examples of costs incurred by investment funds comprising legal and in some cases environmental costs. In each case a large part of the costs incurred would have related to working out who forms part of the "group" for CRC purposes which, as we explained, is a particularly complex question for investment funds.

- Some of the funds reported to us in December 2011 on the following external costs they have incurred on CRC:
    - £40-45,000
    - £17,000

- £ 5,000
- £35,000
- £ 5-10,000 per individual fund
- £40-50,000
- £ 7.5-15,000

- In addition to this the BVCA incurred the cost of obtaining specialist advice from Counsel for its members' benefit.

- The above amounts did not include the considerable cost to investment funds of management time both in working out the members of their group as well as registration and on-going compliance. Simplifying the definition of "group" so that each limited partnership is treated as a separate undertaking would significantly reduce both external and internal costs.

F. BVCA's proposed changes to the organisational rules

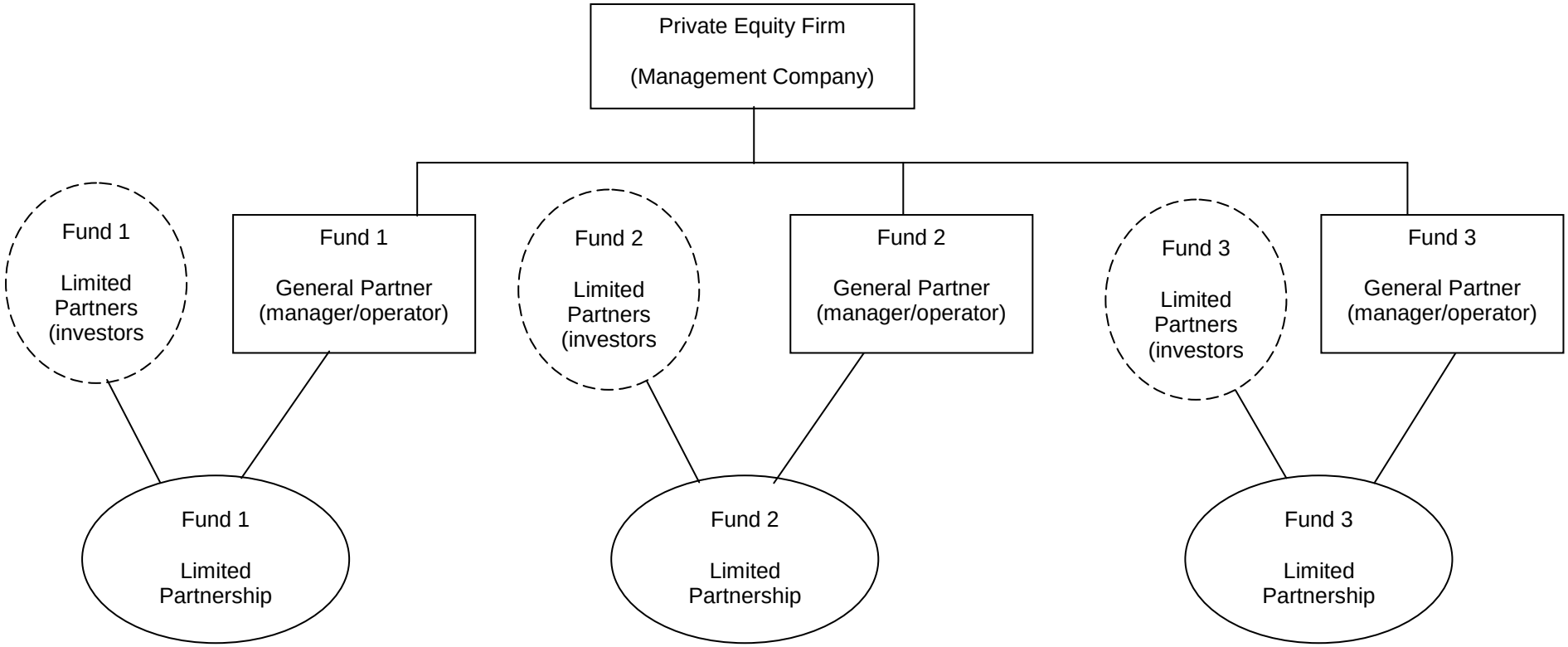
12. To deal with our point in C. above regarding aggregation of portfolio companies, we propose that portfolio companies of private equity or venture capital funds are not aggregated for the purposes of the CRC organisational rules.

13. To deal with our point in D. above, our proposal is that a general partner and/or manager is only treated as a "parent undertaking if it has a more than 50% stake in the fund, making it a parent undertaking in the ordinary sense.

- We originally suggested that the definition of "collective investment scheme" in section 235 of the Financial Services and Markets Act 2000 could be used to determine the entities to which this rule would apply. However, we note that the Financial Services Authority is currently consulting on whether this definition should be retained or abolished following implementation of the EU Alternative Investment Managers Directive in July 2013.

- We would therefore suggest that the CRC Order should utilise the definition of "alternative investment fund" as it is ultimately enacted in the UK, rather than the potentially obsolete definition of section 235.

Appendix 1
Typical Private Equity/Venture Capital Fund Structure[1]



[1] In many cases, for UK-based structures, the Manager/Operator Company will delegate the manager/operator role to the Private Equity/Venture Capital Firm itself under a management agreement, as this entity will have the necessary FSA authorisation to perform this role.

Appendix 2

144. Government proposes to treat the following trusts as undertakings for the purposes of CRC. Treating trusts as undertakings would keep the CRC responsibility of individual trusts separate from each other and trustees. This option would ensure the removal of joint and several liability among separate trusts.

- For trusts that carry out activities under the Financial Services and Market Act 2000 (FMSA 2000) such as private equity funds or collective investments, these should be treated as separate entities for qualification purposes and participation in CRC. CRC responsibility should rest with the operator for the trust/private equity fund.

- For all other trusts that do not meet either of the above criteria, including discretionary trusts and unincorporated property joint ventures, these trusts should each be treated as separate entities for qualification and participation in CRC purposes. CRC responsibility should remain with the trustee, with each trust being registered separately. Unrelated trusts would not have to be grouped together, unlike the current arrangement.

Undertakings: applications by trusts

26. [This article, to be drafted, would make provision in the case of trusts for one of the following persons to apply for registration:(a) an operator of a trust that carries out a regulated activity under the Financial Services and Markets Act 2000; (b) a trustee of a discretionary trust; or (c) a trustee of an unincorporated joint venture.]