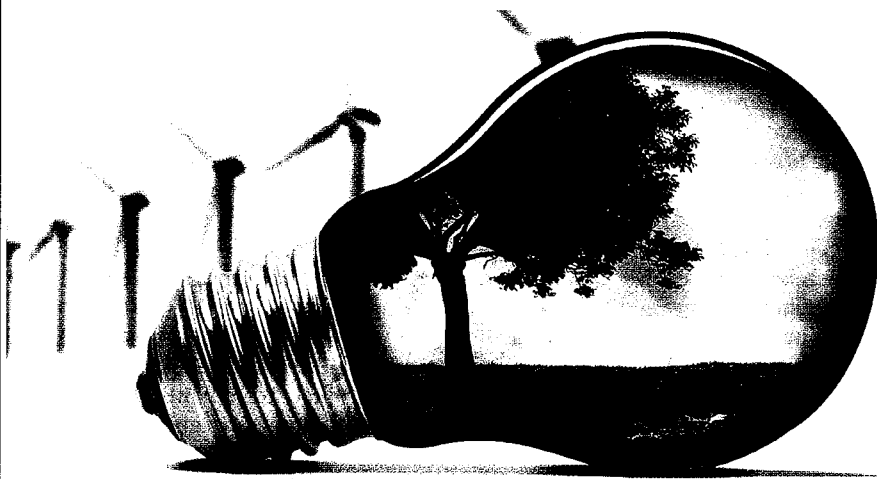


LEGAL AND REGULATORY

Committing to carbon reduction

Private equity firms could be hit by penalties if portfolio companies don't meet the requirements of new regulation aimed at improving the green credentials of British industry. **Steven McNab**, environment partner at Travers Smith, looks at the impact on UK business.



The Carbon Reduction Commitment (CRC) is a mandatory cap-and-trade scheme, which will target the UK's largest corporate groups and organisations, including private equity groups, in the non-energy intensive sector. Detailed reporting of all energy use will be required from October 2009.

A league table of energy saving performance will be published which will highlight weak performers and provide bonuses or penalties depending on their position in the league table. A new emissions trading scheme will operate from 2010.

Will the CRC apply to your organisation?

The scheme will apply to organisations in the non-energy intensive sector - i.e. those emissions that are not already subject to the European emissions trading scheme.

The scheme is likely to capture organisations with an aggregate energy usage of more than 6,000 MWh in 2008 (as measured on half-hourly meters). That equates to an electricity bill of approximately £500,000 and is likely to affect 5,000 organisations.

The test of ownership currently being suggested is likely to capture private equity organisations which have majority equity stakes in investee companies as well as corporate groups.

The CRC will apply whether the top organisation is a UK company or an overseas compa-

ny. Since the test as currently formulated would apply to some private equity organisations, the aggregation could bring every single majority-owned investee company into the CRC regime.

This will likely catch even much smaller companies than would qualify for inclusion in the CRC in their own right. It is the top entity - thought to be the relevant fund or fund manager in the case of private equity groups - that will have the obligations under the CRC both to report and make payments.

Another serious impact will be for companies involved in M&A activity since acquiring subsidiaries may lead to CRC implications in the future. This should be an additional due diligence consideration from now on.

What will the CRC require your organisation to do now and in the future?

The first action will be to determine whether your organisation will be affected by the CRC - the calendar year 2008 is the qualification year by reference to which usage will be measured for the first phase of the scheme.

If it is affected, participants will have to monitor all energy usage, not only electricity, and report this every July from 2011.

In the introductory phase, running from April 2010 to March 2013, a qualifying organisation will have to purchase enough emissions allowances to cover its total CO2 emissions for the year. For year one, these allowances will be purchased retrospectively so there will be a double purchase require-

ment in April 2011 for both 2010 and 2011. The fixed price is currently set at £12 per tonne of CO2. Organisations will be able to buy or sell any excess emissions through a secondary market.

During the next phase of the scheme, which will start in April 2013 and run for five years, emission allowances will be sold to participants in an auction at the start of each scheme year. The total number of available emission allowances will be capped by the government and the purchase price will therefore depend on the demand. There will be significant penalties for non-compliance with the scheme which could require payments equal to £40 per tonne of CO2 from 2013 onwards.

The scheme is designed to be revenue neutral overall so that the proceeds of the annual sales will be recycled back to participant organisations. A league table will be drawn up showing those participants which have achieved the greatest reductions in their energy consumption and this league table will determine what level of bonus or penalty the participant will incur and therefore how much, if any, of the proceeds from the emissions sales will be returned to it or whether further payments must be made.

The league table will also give a chance for participants to display their green credentials or otherwise be criticised for failing to meet their own targets or the targets adopted by other companies.

Next Steps

Organisations may expect to be contacted by the Environment Agency during the course of 2009 with reminders in relation to qualification under the CRC.

Private equity groups should consider aggregating energy usage of majority owned investee companies to consider whether the 6,000 MWh threshold for the CRC has been passed.

Monitoring of CO2 emissions should be started across all investee companies.

Early action to reduce energy use and hence obligations under the CRC is likely to deliver higher cost savings than before. ■

Steven McNab is the environment partner and head of the change and renewable energy practice at Travers Smith Climate.