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CRC Update: One Year On...

The Government is simplifying the CRC Energy Efficiency Scheme as a result of criticism that it is overly complex and time-consuming. The first round of changes took effect on 1 April 2011 and further measures are expected at the end of the year.

The UK's mandatory carbon reduction scheme for businesses, the CRC Energy Efficiency Scheme (CRC), hasn't had the smoothest of starts. Businesses have generally been supportive of the scheme's carbon-reduction agenda, but the CRC has been criticised for being overly complex and time-consuming to administer. In particular, rules that aggregate emissions by related companies and require them to participate jointly in the scheme have been problematic for private equity firms.

In an effort to address the criticism, the Government is simplifying the scheme. The first round of changes has just taken effect, and further simplification measures are expected to be announced towards the end of the year.

There are two main changes in the first round: (1) the proceeds of the sale of CRC allowances will now be retained by the Government, rather than recycled to participants—effectively turning the CRC into a form of carbon tax, and (2) the introductory phase has been extended by two years (until 2013) to allow time for consultation on further changes.

The Existing Scheme

As a reminder, the original CRC works broadly as follows:

- The CRC operates in "Phases" lasting a number of years, with a CRC year running from 1 April to 31 March. Each Phase consists of a benchmarking "footprint" year, followed by a number of "trading" years.
- Participants are required to monitor and record their energy usage, submitting a benchmark "footprint report" by 31 July after the end of the footprint year. In each subsequent year within the Phase, participants must submit an annual emissions report, again by 31 July after year end, and surrender CRC allowances equal to their reported emissions. The proceeds from the sale of allowances were to be "recycled" to participants annually, based on their carbon reduction performance.
- In the initial Phase, an unlimited number of CRC allowances were to be sold by the government at a fixed price. In subsequent Phases, a fixed number of allowances were to be sold by auction, with the market setting the price. Participants were to purchase allowances based on their forecast emissions each year and could then trade allowances on a secondary market to cover any surplus or shortfall.
- An organisation using over 6,000MWh of electricity a year was required to register as a Phase 1 CRC participant by the end of September 2010. If the organisation—such as a private equity firm and its portfolio companies—could be divided into a number of qualifying sub-groups (known as "SGUs"), each SGU could register as a separate participant.
- An organisation using less than 6,000 MWh of electricity a year was required to make an information disclosure.

Changes Effective on 1 April 2011

The Government announced the following changes with effect from 1 April 2011:

- *No revenue recycling.* The proceeds from the sale of allowances will now be retained by HM Treasury instead of being recycled to participants, effectively transforming the CRC into a carbon tax. The Government expects this to raise £715m in 2011/12, rising to more than £1bn by 2013/14.
- *Abolition of information disclosure requirement*. The compliance scheme has been simplified to remove the requirement for organisations below the registration threshold to submit an information disclosure.
- *Delayed sale of carbon allowances*. The initial sale of allowances has been deferred until sometime between April and July 2012, when participants will need to buy allowances (retroactively) to cover their 2011/12 emissions.

- *Extension of Phase 1*. Phase 1 (effectively a trial phase) has been extended, with the footprint year for Phase 2 now starting on 1 April 2013. Thus, registration for Phase 2 will now take place between April and September 2013 and not in 2011.

Open Issues

The Government is considering further simplification measures (including possible changes to the treatment of related companies), but it is not yet clear whether additional changes will be made or whether any such changes would be helpful to private equity. Any further changes will not be implemented until the beginning of Phase 2.

Current action items

- Firms registered as participants in Phase 1 need to submit a footprint report to the Environment Agency by 29 July 2011 (as 31 July is a Sunday).
- Registered participants should also be maintaining "Evidence Packs" in the form required by the Environment Agency, in case of an audit.
- Where multiple portfolio companies are registered as a single CRC group (see our previous *KirklandPEN-Europe* dated 1 April 2010), firms may have internal arrangements in place setting out how compliance obligations are to be shared. Following the abolition of revenue recycling payments, any internal cost-sharing arrangements should be reviewed as this change may substantially alter the commercial consequences of such arrangements.
- Firms should monitor the acquisition or disposal of SGUs (whether disaggregated or not) on an ongoing basis, as this will trigger notification, and potentially registration, obligations.
- Firms no longer need to register for Phase 2 by 30 September 2011. However, firms should record electricity usage for 2012/13 in order to determine whether registration is required for Phase 2.

Should you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

Richard K. Watkins
http://www.kirkland.com/rwatkins
+44 20 7469 2185

Stephanie Biggs
http://www.kirkland.com/sbiggs
+44 20 7469 2235

Kirkland & Ellis International LLP
30 St Mary Axe
London, EC3A 8AF
United Kingdom

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