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CRC Energy Efficiency Scheme.
Impact of proposed changes on private equity funds.

Contents

The government has recently confirmed that a simplified version of the CRC Energy Efficiency Scheme ("**CRC**") will be retained until at least 2016. Subject to gaining Parliamentary approval, an Order implementing these charges will come into force on 1 June 2013.

Private equity funds should take note of the proposed changes and review existing processes, allocations and approvals, including whether CRC associated liabilities have been correctly allocated and whether existing CRC arrangements are appropriate for forthcoming years: portfolio companies will need to ensure that they are have sufficient information about the regime and the sponsor's expectations to support the group, whilst sponsors will require comfort that they will be furnished with the necessary detail to allow for notification and payment obligations to be met.

We have set out below the impact of the proposed changes for our private equity sponsor and portfolio company clients and our suggested points for action.

Impact of proposed changes on private equity funds

> **Sale and purchase of allowances**: there will be two fixed price sales per year in Phase 2: a forecast sale at the beginning of the year where prices will be lower and a "buy-to-comply" sale after the end of the reporting year where prices will be higher. Participants will continue to be able to bank allowances within a Phase but not between Phases. The deadline for surrender of allowances will be extended from 31 July to 31 October.

> **Price of allowances**: the price of CRC allowances will be £12/tCO2[1] for compliance years up to 2013/14, increasing to £16/tCO2 in 2014/15 and increasing thereafter in line with the retail price index if the scheme survives after 2016.

> **Disaggregation**: the rules on disaggregation will be simplified to allow any undertaking within the CRC Group to disaggregate for separate

[1] Carbon allowances traded under the EU emissions trading scheme have been trading at approximately €5/tCO2e.

participation, providing that mutual agreement is reached by all parties. The remainder of the Group will still be required to participate in CRC even if electricity consumption is very low.

> **Performance League Table**: the Department of Energy and Climate Change ("**DECC**") has confirmed that this will be abolished from 1 June 2013. The Environment Agency will publish data about participants' aggregated energy use and emissions.

> **Number of fuels**: at present participants are required to report on their energy supplies from 29 fuels. This will be reduced to just two: electricity and gas (where gas is used for heating). The 90 per cent applicable percentage rule will be removed. Instead, 100 per cent of relevant supplies will need to be reported on (subject to a 2 per cent *de minimis* rule on gas supplies). This change enables the removal of the requirement to submit a footprint report.

Treatment of private equity funds structured as limited partnerships

> The government will **not** amend the rules on private equity funds that are structured as limited partnerships. It considers that CRC responsibility is currently placed with the person who can most effectively improve the energy efficiency of the assets.

> Due to the statutory definition of "undertaking" and "group" in the CRC, a typical private equity limited partnership fund is likely to be a "Parent Undertaking" of a number of portfolio companies and each of those portfolio companies will be treated under CRC as part of the same group. Whilst liability under the CRC is joint and several, in practice the private equity limited partnership (as the highest parent undertaking) will be primarily responsible for the whole group's compliance with the CRC. In addition, some portfolio companies may be required to participate in the CRC (as part of the wider group) where, had they not been part of the group, they would not have met the qualification criteria in their own right.

What should private equity funds do next?

As CRC will apply until at least 2016, and we have pricing for this period, likely CRC costs can estimated on a per business basis. Those funds that were paying CRC at the partnership level should consider putting in place agreements with each business to enable the CRC cost to be passed through, and the third party consents required to achieve this.

Groups should also consider revisiting data monitoring/collection arrangements to align with the simplified CRC requirements. These actions can then be implemented as soon as the regulations are in final or near final form.

Background

On 10 December 2012 DECC published a response to the March 2012 consultation document on its proposals to simplify the CRC and reduce the administrative or regulatory burden on participants. The response confirms that the CRC will be retained. An Order implementing all relevant changes will come into force on 1 June 2013, subject to gaining Parliamentary approval.

The CRC applies to businesses that operate in the UK which were invoiced for more than 6,000 MWh of electricity through half-hourly metering during 2008 (for Phase 1) and during 2012/13 (for Phase 2) (the "**Qualification Criteria**").

The CRC came into force on 1 April 2010 and is divided into several phases, including:

> Phase 1, which runs from 1 April 2010 to 31 March 2014; and

> Phase 2, which runs from 1 April 2014 to 31 March 2019. The registration phase for Phase 2 is due to start on 1 April 2013.

Compliance obligations are discharged by the participant purchasing CRC allowances to offset their reportable CRC emissions. Where two or more entities have a relationship of "Parent Undertaking" and "Subsidiary Undertaking" pursuant to the definitions in section 1162 of the Companies Act 2006, those undertakings will form a "Group" for CRC purposes. In such cases it is the Group as a whole which must assess whether it meets the Qualification Criteria. It is this group concept that has caused such difficulties for private equity, aggregating businesses that are separate, and setting the payment obligation at the level of the general partnership. The government has confirmed that it will review the effectiveness of CRC in 2016 and consider whether the same policy objectives could be achieved in an alternative way.

Therefore, due to the statutory definition of "Undertaking" and "Group" in the CRC, a typical private equity limited partnership fund is likely to be a "Parent Undertaking" of a number of portfolio companies and each of those portfolio companies will be treated under CRC as part of the same group. Whilst liability under the CRC is joint and several, in practice the private equity limited partnership (as the highest parent undertaking) would be primarily responsible for the whole group's compliance with the CRC. In addition, some portfolio companies may be required to participate in the CRC (as part of the wider Group) where, had they not been part of the Group, they would not have met the Qualification Criteria in their own right.

Contacts

We will keep you updated on changes to the CRC regime and let you know when the draft of the Order implementing the changes has been published. In the meantime, please speak to your usual Linklaters LLP contact or one of the contacts listed.

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