

CRC Energy Efficiency Scheme Application to Fund and Trust Structures



The scheme may result in you needing to undertake a significant information-gathering operation. You need to be prepared.

What is the CRC Energy Efficiency Scheme?

The CRC Energy Efficiency Scheme ('the Scheme') is a mandatory emissions trading scheme designed to encourage large, non-energy intensive organisations to reduce energy. Participant organisations will have to monitor their energy use and purchase allowances for each tonne of CO₂ they emit. Allowances will be sold from April 2011, initially at a fixed price of £12 per tonne of CO₂. From 2013, allowances will be sold in an online auction, where their price will be driven by market traded rates. Participants can trade allowances between themselves, creating a financial incentive to reduce CO₂ emissions and sell surplus allowances. In July each year, participants must surrender sufficient allowances to cover their carbon emissions for that year.

Who does the CRC scheme affect?

The main criterion for participation in the Scheme is whether an organisation was supplied with electricity through at least one settled half hourly meter during 2008. Only UK energy consumption is counted for the purposes of the CRC, both when assessing the level of participation required and when reporting annual usage and surrendering allowances.

However, organisations are required to participate in the CRC on a group-wide basis and all members of the group, even non-UK members, are jointly and severally liable for CRC compliance. In particular, the highest parent entity within a structure has additional administrative responsibilities.

When does it start?

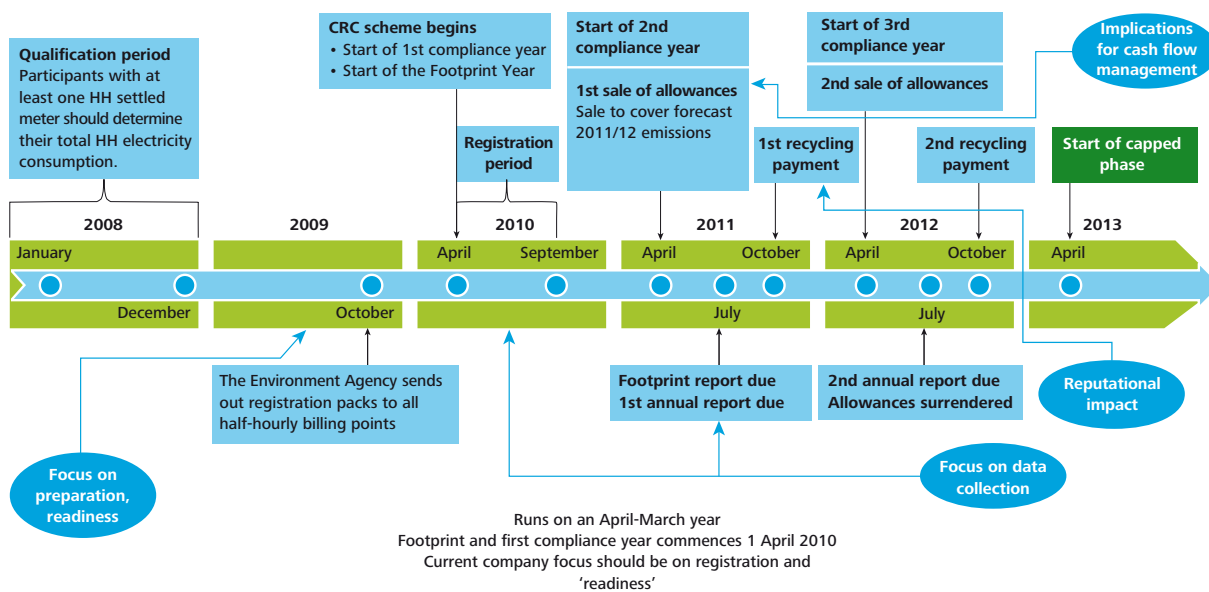
Organisations must register by September 2010. Those within the scope of the Scheme rules should be measuring the relevant qualification data from 2008. They will need to submit this to the Environment Agency by 30 September 2010. The first allowances will be sold in April 2011.

Application to Private Equity Funds

Any private equity firm whose portfolio included, on 31 December 2008, a controlling stake in a company with UK operations must consider whether it is required to register with the Environment Agency as a CRC participant.

In order to determine who is a CRC participant or group the CRC legislation uses the Companies Act 2006 parent and subsidiary undertaking definitions. The application of the Companies Act 2006 group testing to limited partnerships is complex and the British Venture Capital Association (BVCA) has issued detailed guidance for private equity firms following advice from Counsel.

However, the position of individual firms will vary as a result of differences in fund structure and/or terms of the limited partnership agreements governing funds, and specific legal advice may need to be sought.



Source: DECC

In summary, where a limited partnership has a majority (>50%) stake in a portfolio company, the limited partnership will typically satisfy one of the Companies Act 2006 'parent undertaking tests' and so should be treated as a parent undertaking of that portfolio company for CRC purposes.

If the general partner is deemed to exercise sufficient control over the limited partnership to qualify as its parent undertaking pursuant to the Companies Act tests, the limited partnership will usually need to be grouped with the general partner and the general partner's group for CRC purposes. Where the general partner can be removed and replaced at the discretion of the limited partners (for example, under a no fault divorce clause that is immediately exercisable at the relevant point in time), the most likely outcome is that the general partner is not deemed to exercise sufficient control and therefore is not considered to be the parent undertaking of the limited partnership.

Application to trust structures

The Environment Agency published guidance on its interpretation of the application of the Scheme to trust structures and assets held on trust. The guidance states that the provisions of the Companies Act 2006 operate to treat shareholdings held in a fiduciary capacity differently from real property assets held in a fiduciary capacity. This distinction is fundamental in determining how trust assets are treated for the purposes of the Scheme.

To the extent that the assets of a trust constitute real property which the trustees hold directly, the trust property will be treated by the Environment Agency as held by the trustees, which would mean that qualifying electricity supplied to that trust property must be aggregated with all other qualifying electricity supplied to the trustees and the trustees' group.

The trustee, as legal owner of the relevant property, is generally assumed to be the undertaking responsible for any energy supplies to such assets, unless another undertaking can be shown to be responsible for such supplies. Electricity supplied to tenants in their own name would not form part of an organisation's energy consumption and any CRC Scheme participation would be the requirement of the individual tenant.

Where a corporate trust company directly holds significant amounts of real property and it is the undertaking responsible for energy supplies to such property, the requirement to aggregate qualifying electricity supplies to all the UK properties it owns may result in it needing to undertake a significant information-gathering operation regarding such properties. This may bring some real property assets within the Scheme which, if they had been considered on a discrete trust-by-trust basis, would not have qualified on the basis of their electricity consumption.

Where, however, the trustees hold real property through a shareholding in a company, including one or more nominee companies, then the ownership of the shares in the company will be attributed to the beneficiaries of the trust and not the trustees. Where the beneficiaries of the trust are individuals, any qualifying electricity supplied to the undertakings(s) in which shares are held will not need to be aggregated with that consumed by the beneficiaries, since individuals are outside the scope of the Scheme.

Where a corporate beneficiary has a majority of the units in the trust then any qualifying electricity supplied to such undertaking must be aggregated with that consumed by the relevant beneficiary (and its wider group) for the purposes of assessing qualification for CRC.

Steps to take

1. Determine your group structure as at 31 December 2008. Private equity funds may find the BVCA guidance helpful in making this determination. A trustee will need to determine whether it holds assets directly or whether it holds the title to such assets indirectly, via its ownership of the shares in one or more undertakings. You may need to take specific legal advice based on your individual circumstances.
2. Determine whether the UK-based operations of any portfolio company or any UK property assets forming part of that group had, at any time during 2008, a half hourly meter (HHM) which was supplied electricity settled on the half hourly market. If not, your group is not within the CRC and no further action is required.
3. If any member of the group had a HHM, it is necessary to assess the group's aggregate half hourly metered UK electricity consumption for the calendar year 2008, calculated on the basis set out in the CRC legislation.
 - a) If the total is less than 3,000MWh, the organisation must make an information disclosure to the Environment Agency through an online registration system.
 - b) If the total is between 3,000MWh and 6,000MWh, the organisation must make an information disclosure and declare the details of electricity consumption for 2008.
 - c) If the total is 6,000MWh or more (circa £0.5 million spend in 2008 prices), the group will be a full CRC participant, and must register online for the CRC.

What are the risks?

Non-compliance risks – fines may be significant if you fail to report data correctly and on time, or if you present insufficient allowances to cover your emissions.

Cash flow and cost – cash flow impacts may be significant for some organisations and are created by the time lag between purchase of allowances and recycling of revenue. Once trading starts, accurate forecasting will be important to mitigate exposure to high costs to purchase allowances.

Reputation – A key driver for incentivising good performance in the scheme is the publicly published league table which will highlight the best and worst performers. The publicity associated with being at the top end of the table could help those organisations secure competitive advantage, with obvious downsides for those at the bottom.

Leasing implications – there are particular considerations for landlord and tenant organisations, especially in circumstances where landlords are responsible for paying the energy bills of their occupiers. Establishing fair and transparent ways of sharing risks and benefits will be important from an early stage.

Our services – CRC and related offerings



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Meet the team

Audit & advisory

Jersey



Greg Branch
Partner
01534 824325
gbranch@deloitte.co.uk



Andy Isham
Director
01534 824297
aisham@deloitte.co.uk



Helen Gale
Director
01534 824358
hgale@deloitte.co.uk



Siobhan Durcan
Director
01534 824274
sdurcan@deloitte.co.uk

Guernsey



Rick Garrard
Partner
01481 703206
rgarrard@deloitte.co.uk



John Clacy
Partner
01481 703210
jclacy@deloitte.co.uk



David Becker
Director
01481 703335
davbecker@deloitte.co.uk



Nickie Paul
Director
01481 703314
npaul@deloitte.co.uk

Isle of Man



Sarah Sanders
Partner
01624 641225
sarahsanders@deloitte.co.uk

Tax Advisory

Jersey



Paul Eastwood
Director
01534 824268
peastwood@deloitte.co.uk

Guernsey



Jo Huxtable
Director
01481 703308
jhuxtable@deloitte.co.uk

Drivers Jonas Deloitte

Property Strategy



Helen Hensel
Senior Surveyor –
Sustainability
0161 455 6535
hhensel@deloitte.co.uk

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