Business Energy Use
Department for Business, Energy & Industrial Strategy
6th Floor
1 Victoria Street
London
SW1H 0ET

By email: reporting@beis.gov.uk

14 January 2019

Dear Sirs,

Re: Streamlined Energy & Carbon Reporting draft guidance (the "Guidance") – BVCA response

I am writing on behalf of the British Private Equity & Venture Capital Association ("**BVCA**"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 650 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Our members have invested over £27 billion in nearly 3,800 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses.

(A) BVCA'S OVERALL VIEW ON THE PROPOSALS

We welcome the opportunity to comment on the draft Guidance, which has been prepared by BEIS in relation to The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (the "**2018 Regulations**").

Responsible Investment is an important aspect of the BVCA's agenda. Consideration of environmental, social and governance ("**ESG**") matters are important for many of our members to both minimise risk and create value throughout the private equity and venture capital deal cycle. As such, we are supportive of the government's proposal for a streamlined system for energy and carbon reporting ("**SECR**"), and of the ultimate aim of raising awareness, reducing bills, and saving carbon. Such a regime, if properly implemented, would not only assist our member firms in monitoring the related performance of their more energy-intensive portfolio companies, but may also help inform investment decision-making.

However, as expressed in our previous consultation responses, whilst the BVCA was also supportive of the carbon reduction objectives behind the CRC Energy Efficiency Scheme (the "**CRC**"), our member firms and their portfolio companies generally found the implementation and administration of that scheme to be complex, time consuming, administratively burdensome and costly. This ultimately undermined the otherwise significant achievements of the regime. It is

therefore important to take the learnings from the CRC and ensure that the current proposals are clear in their application and do not similarly impose an unnecessary burden. We think the Guidance will be particularly important in this respect, as there are (as explained below) a number of aspects of the legislation which are not entirely clear and could cause significant confusion and inconsistency in the approach, particularly for more complex structures which often include both offshore and onshore entities, such as those seen in the private equity sectors.

As we have previously stated, the focus should be on larger organisations and energy users, and it should be made reasonably straightforward to determine who qualifies in more natural groupings. Given the accounting framework is to be used, it seems natural that grouping should be based on the consolidated group as for accounting purposes. From a private equity perspective, it should be clearly stated to avoid confusion that 'small' organisations should not be drawn in simply by virtue of a technical link arising through the investment structure. Under the new SECR regime there is not the same broad grouping mechanism, based on the Companies Act 2006 ("**Companies Act**") parent / subsidiary undertaking grouping rules, as was the case under the CRC.

(B) SCOPE OF OUR RESPONSE

We anticipate that BEIS will receive feedback on the numerous Guidance questions from a wide variety of participants. Our response principally focuses on the aspects of the proposals that are of particular relevance to the private equity industry (and caused significant difficulties under the CRC) – in particular, qualification and grouping.

(C) BVCA RESPONSE TO SELECTED QUESTIONS

Q1: Is the Guidance clear to follow?

Whilst we appreciate the efforts that have been made in preparing the Guidance, we do have some concerns in respect to clarity, and have set our response to this question in the following sub-sections:

I. Group Reporting, Consolidation and Applicability

One of the major concerns we have with the proposed SECR regime is potential confusion as to the approach it takes to qualification and grouping - especially given the differing approaches taken under the Energy Savings Opportunity Scheme ("**ESOS**") and, to an extent, the CRC - which while nearly at an end, many will use as a reference point. The SECR approach is based on accounting concepts, but the implications of this (when compared to the ESOS and CRC approach) are not readily apparent from the legislation[1] (nor the draft Guidance). It is therefore critical that the Guidance is expanded to clarify these areas. This is particularly important for sectors where more complex corporate structures are common, such as private equity.

[1] Where we refer to the legislation here and below, we are referring to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (in the case of companies) and the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (in the case of LLPs), each as amended by the 2018 Regulations, and as read and interpreted in accordance with the provisions of the overarching Companies Act 2006.

Again, we would strongly argue that the disproportionate administrative burden and complexities the CRC gave rise to for private equity structures, which undermined the positive achievements of that regime, should be avoided. Greater clarity in the Guidance on the points set out below would go a long way towards achieving that.

When considering qualification and reporting by 'large' unquoted companies and LLPs as well as subsequent reporting of groups (paragraphs 2.4 to 2.9), it would be helpful to make the following points clearer in the Guidance (generally we discuss points in relation to companies for simplicity, but the same points apply equally to LLPs):

1. **UK Jurisdiction:** there is currently no clear and express confirmation in the Guidance that only companies and LLPs who are incorporated in the UK will need to participate directly in SECR (although the flow chart on page 6 does refer to 'UK' companies and LLPs). This is in contrast to the existing Chapter 2 guidance (for the previous regime applying to quoted companies only), which states on the first page that the requirements only apply to 'UK incorporated' quoted companies. Whilst in some ways this may be self-evident (given SECR reporting is to be undertaken via UK corporate reporting structures), it is vital to have absolute clarity on this key point – particularly given the legislation is not itself explicit. Furthermore, this is important to a proper understanding of the nuances around parent companies, and group reporting obligations, discussed below.

   There should also be a clear confirmatory statement that the SECR requirements do not apply to other forms of undertaking in the UK, including partnerships which are not LLPs (e.g. limited partnerships).

   Finally, it should also be clearly stated whether, where a 'group report' (see 3 below) is being prepared by a UK parent and there are overseas subsidiaries within the 'group', those overseas subsidiaries must be included for SECR qualification and reporting purposes (and if so for the latter, making clear that they would only be reporting their UK energy usage).

2. **Parent:** there is no meaningful discussion of the concepts of 'parents' and 'group' qualification in the Guidance, other than the unqualified reference to section 466 of the Companies Act 2006 (which is not itself referred to in the 2018 Regulations). This will give rise to confusion.

   We assume that the intent is that when considering whether a 'parent company' is 'large' for the purposes of the 2018 Regulations (and the legislation which they amend), this is limited to the **uppermost UK parent** in a 'group' (i.e. any 'parent' test will <u>not</u> look to overseas ultimate parents or fund entities, and there will be only one UK parent in a given group). So, where Company A is incorporated overseas, and owns Company B incorporated in the UK, which in turn owns Companies C and D which are also incorporated in the UK –

then 'Company B' would be the uppermost UK parent, who needs to consider whether its downward 'group' qualifies as 'large'. Neither Company A would be a 'parent' as it is overseas, nor Company C as it is not the highest UK parent in the group.[2]

If this is the case, as we strongly believe it should be, we would ask that this is clearly stated in the Guidance. This confirmation is important, because the legislation is not itself clear on what constitutes a 'parent company' for these purposes. In particular, if it is not limited to the uppermost UK-parent then this could result in disproportionate complexity – as larger groups could have multiple parents who are all required to report. This will be particularly onerous if the 'group' for qualification purposes is allowed to differ from the 'group' for reporting purposes – see (3) below.

3. **'Qualification' and 'Reporting' Grouping:** the legislation is not clear, but seems to give rise to a possibility of two differing 'group' concepts:

    a. *for 'qualification' purposes*: a 'parent' (see above – we assume this to be the uppermost UK parent) which heads a 'group' (based on corporate grouping rules) which in aggregate meets the 'large company' criteria qualifies for SECR; but

    b. *for 'reporting' purposes*: a 'group' is only required to report as a group to the extent that it prepares consolidated accounts.

Were there to be such a distinction, this could give rise to disproportionate complexity, and inconsistency in compliance and enforcement of the regime.

There are a number of exemptions that apply to 'group' financial reporting. Companies that avail themselves of these may report individually, notwithstanding that they are in a 'group'. It would be disproportionate if a 'parent' (who is not itself large) of a 'large group' which does not report on a consolidated basis is required to undertake SECR reporting for itself only.[3] We do not see that this would serve a useful purpose or meet the intent of the regime. This will be particularly confusing if it is not made clear that only the 'top' parent need participate (see (2) above) – as otherwise there could be numerous 'small parents' within an unconsolidated group (for financial reporting purposes) who must then participate individually.

It would be far clearer and more transparent if this ambiguity was addressed, and qualification and reporting groupings were aligned. To achieve this, the Guidance could simply clarify that the 'uppermost UK parent' will only need to consider the 'group' for

[2] For further illustration, the above interpretation would mean that if Company X (non-UK) had two UK subsidiaries (Y and Z), then both Company Y and Z would be UK-top entities/parents and if 'large' would report separately (unless they account on a consolidated basis).

[3] We appreciate the de minimis exemption of 40MWh may mean it is otherwise exempt.

which it reports in consolidated financial reporting to determine whether that group is 'large' (in which case it must also report for the group in that consolidated report). The parent of a group which does not undertake consolidated reporting will otherwise only need to report if it itself qualifies (i.e. is a large company or LLP). This would also simplify the position for 'small' subsidiaries, discussed below.

4. **'Small' Subsidiaries** – the legislation and draft Guidance suggests that if within a UK group there is a 'small' subsidiary (i.e. one that does not meet the tests in its own right) then it should not be required to participate and report its relevant energy and carbon. It would seem clear that where a group does not account on a consolidated basis, a 'small' entity within that group should not include energy and carbon information when reporting in its annual filings (and that its parent would also not include such information). A clear statement to this effect should be included. However, if the relevant group of that 'small' subsidiary did account on a consolidated basis, then the position is less clear under the Guidance (see below).

5. **Group Reporting** – as is set out in paragraph 2.7 of the Guidance, for a financial year in which a group is required to prepare a group Directors' Report (or, in the case of LLPs, a group Energy and Carbon Report) you must take into account your own energy and carbon information and the energy and carbon information of any subsidiaries included in the consolidation which are quoted companies, unquoted companies, or LLPs. However, the guidance goes on to state that in relation to these subsidiaries you are permitted to *"exclude from your report any energy and carbon information relating to a subsidiary which the subsidiary would not itself be obliged to include if reporting on its own account."*

   By way of example, and on our current understanding, if company A is a 'small' UK parent ("**Company A**") and it has two UK subsidiaries, one of which is a 'large' company for the purposes of the Companies Act test ("**Company B**") and one of which is 'small' ("**Company C**") and the three companies do not report on a consolidated basis but instead report independently, the only company that will be required to report their energy and carbon information in this scenario is Company B (and potentially Company A as 'parent', albeit, as discussed at point 4 above, this is not clear and should be expressly clarified).

   Taking this example a step further, if Company A usually reports for Company B and Company C on a consolidated basis, we think it would be useful for the Guidance to explicitly confirm that only Company A's and B's energy and carbon information will be reported in the group Directors Report (or equivalent). The current wording of the Guidance would seem to go further than the relevant legislation and could be interpreted as suggesting that only energy and carbon information excluded by virtue of narrower exemptions and derivations should apply (as opposed to a broad exclusion on the basis the subsidiary did not qualify in its own right).

II. Application of exemptions

As is set out in section 3.5 of the Guidance, the 2018 Regulations permit the exclusion of energy and carbon information *"where it would be seriously prejudicial to the interests of the organisation."* We would be grateful if BEIS could provide some examples of *"exceptional commercial sensitivity considerations"* in the Guidance. This will help companies and LLPs to accurately benchmark what BEIS considers to be an exceptional commercially sensitive situation.

Equally, we would welcome some examples of what BEIS consider to be genuine instances where the provision of energy and carbon information would be impractical for an organisation to provide.

III. Regime for enforcement and monitoring

Finally, on the topic of enforcement and monitoring, we understand that the Conduct Committee of the Financial Reporting Council ("**FRC**") will be the responsible body for enforcement and monitoring. This is a departure from the CRC, where the Environment Agency was the body for enforcement and monitoring. The Guidance is silent as to whether the Environment Agency, or, for that matter, any other statutory body, will have a role to play in either enforcing or monitoring compliance with the relevant reporting requirements. Equally, when it comes to questions in relation to the preparation of energy and carbon information, the Guidance does not set out a designated statutory authority to contact with questions and concerns, which will be important, particularly in the first few compliance cycles.

On a separate note, we would query whether the FRC has the requisite technical expertise to accurately assess carbon and energy reporting standards, and would welcome further information on the team that has been assigned to the enforcement and monitoring of this new regime.

IV. Wider technical comments

The descriptions contained in the Guidance, of the types of data and disclosures, appear to be generally premised on the assumption that energy use and the corresponding environmental impact can be determined and calculated with precision. This may be unrealistic in some cases, even for a company with a relatively straightforward and 'simple' carbon footprint

Paragraphs 9.9 to 9.13 recognise that energy use may need to be estimated, although this is presented as an exception, rather than a rule. There does not appear to be any corresponding acknowledgment that environmental impact calculations will likely have to be based on generic and more or less entirely modelled approaches, resulting in directional estimates rather than actual calculations. Naturally a manufacturing company, with a greater focus on operational efficiency, will have tighter controls (e.g. metering by machine) and therefore will have a more accurate measurement of energy use. However, for others, such as financial services companies, or those in shared occupancy buildings with reliance on a landlord to collect data, this might present more of

a challenge. We would be grateful if this could be presented in a more nuanced manner, reflecting the real world context of the varied environment that businesses operate in.

We would be happy to discuss the contents of this letter further with you. Please contact (sjadeja@bvca.co.uk) at the BVCA in the first instance.

Yours faithfully,

Amy Mahon
Chair, BVCA Legal & Accounting Committee