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Client Update: Mandatory reporting of greenhouse gas emissions by quoted companies

Summary

> Plans to introduce a mandatory emissions reporting requirement for companies in the UK were announced on 20 June 2012 at the Rio+ 20 Summit.

> This reflects a long term trend whereby sustainability reporting is moving from the realm of Corporate Social Responsibility (CSR)/external affairs to a compliance obligation.

> From April 2013 all companies listed on the Main Market of the London Stock Exchange will have to include emissions data setting out the levels of greenhouse gas emissions for their entire organisation in their annual reports. The approach taken by Government aims to provide a level playing field on which each company's emissions performance can be judged in an open and transparent way. The new rules are primarily designed to encourage reductions in emissions and associated energy savings by companies. In addition, the introduction of mandatory reporting should assist institutional investors wishing to assess medium to long-term risks and hence provide a positive effect on the operation of the financial markets.

> A formal written consultation on the detail of the draft regulations is expected to be launched by the Department for Environment and Rural Affairs (Defra) by the end of July 2012. Listed companies should review this carefully, as it will afford one of the last opportunities to influence the compliance requirements they will have to fulfil.

Scope

> Initially the regulations will not cover private companies or those listed on other markets (such as the Alternative Investment Market) but the regulations will be reviewed in October 2015, before the Government decides whether to extend the approach to a wider group of companies from 2016.

> Defra has stated that companies will be required to report their emissions on the same organisational basis as for financial reporting and, where appropriate, this should include emissions which occurred overseas. This is viewed as important to ensure that the report gives a full picture of the company's emissions and to prevent "off-shoring" of emissions.

> Companies will be required to report on all six greenhouse gases covered in the Kyoto Protocol[1] in CO_2 equivalent where these are material but only scope 1 and scope 2 emissions[2] will be covered. Defra will continue to encourage companies to voluntarily report significant scope 3 emissions[3]. We understand emissions will be reported against a base year and the detail of this (including whether or not companies will be able to choose the base year) will be included in the regulations.

> Reporting will be on a "comply or explain" basis, thus requiring and enabling companies to explain if and why it hasn't been possible to provide certain information.

> The timing of the reports can be set by the companies themselves, provided they make the time period clear and it is on a year on year basis.

What does this mean for UK quoted companies?

> UK companies already have certain asset specific mandatory carbon reporting obligations under regimes such as the EU Emissions Trading Scheme, the CRC Energy Efficiency Scheme and the Climate Change Levy. To date, broader corporate carbon reporting has been largely voluntary. The new reporting regulations will introduce a mandatory obligation and, from April 2013, it will therefore become more important for quoted companies (and in particular senior management) to focus and engage more on the sources of greenhouse emissions and improved energy and resource efficiency.

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[1] Carbon dioxide (CO_2); Methane (CH4); Nitrous oxide (N2O); Hydrofluorocarbons (HFCs); Perfluorocarbons (PFCs); and Sulphur hexafluoride (SF6)

[2] Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy.

[3] Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

> Companies that are not already reporting on their emissions may find it useful to start under the voluntary scheme. Data collection is usually a challenge for companies when obtaining information on emissions for the first time. Defra publishes guidance for companies on how to measure and report their greenhouse gas emissions as well as on how to set targets to reduce them[4]. We understand that companies will be entitled to report in accordance with any established methodology, provided they are clear about which standard they have used (e.g. Defra guidelines or a recognised industry standard).

> Companies should bear in mind that the quality and accuracy of emissions data reported will come under increasing scrutiny, will be used for analytical purposes and may be used for structuring financial instruments. There are also likely to be cross-sectoral comparisons made.

> Defra has indicated that as the regulations will require emissions to be reported in the directors' report, the data will be included in the overall scope of the audit requirement pursuant to the Companies Act 2006. Further assurance or specific verification of the emissions data will not be required. Companies should nevertheless consider having emissions reports externally audited in order to improve the accuracy and adequacy of the reports.

Tie in with other emission reporting schemes

> Narrative reporting: Mandatory emissions reporting builds on the existing environmental reporting requirements on quoted companies pursuant to the Companies Act 2006. The Government has been revisiting the adequacy of narrative reporting in the UK and has stated that it intends to drive up the quality of environmental and social reporting. The latest consultation response was published in March 2012 through the Department for Business Innovation and Skills (BIS)[5] and it is expected that draft regulations and a full impact assessment will be published in late 2012. Defra has confirmed that they aim to align implementation of the mandatory emissions reporting with BIS' work on narrative reporting. This means that whilst the legal framework for mandatory reporting is expected to be in place by April 2013, it may not require the reporting to start immediately.

> CSR Directive: There has also been a drive to improve disclosure of corporate social responsibility issues (including emissions data) at EU level. Following a public consultation process, an expert group on the disclosure of non-financial information by EU companies was set up and most recently met in January 2012 in order to discuss high level issues such as the scope of application and the content of the disclosure. The European Commission has announced that it intends to present a legislative proposal on the transparency of the social and environmental information provided by companies later in 2012.

> CRC Energy Efficiency Scheme: The consultation on the simplification of the CRC has recently closed and the Confederation of British Industry (CBI) continues to press the Government to remove CRC entirely as it is now unnecessary as its reporting elements are being replaced by mandatory reporting. It is clear that DECC continues to work on the CRC, so it is by no means certain that the CBI's preferred outcome will prevail. That said, in the Budget 2012, the Government made clear that for the CRC to be retained, any revisions to it would have to deliver significant savings in the administrative burdens it imposes, failing which it would be replaced by an environmental tax. It remains to be seen whether it is possible to dramatically reduce the complexity of the current scheme to permit delivery of energy and carbon savings at minimum cost. If that test is applied, it seems unlikely that the CRC will survive long term, particularly now that corporate reporting is to be mandated.

[4] Available at: http://www.defra.gov.uk/publications/2011/03/26/ghg-guidance-pb13309/
[5] Available at: http://www.bis.gov.uk/assets/biscore/business-law/docs/f/12-588-future-of-narrative-reporting-Government-response.pdf

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