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Climate change agreements: are they "hidden assets?"

KEY POINTS

- Climate Change Agreements (CCAs) are increasingly valuable to energy-intensive businesses at a time of rising energy prices.
- Under a "new" CCA, a business could now claim up to 90 per cent discount on the Climate Change Levy (CCL) chargeable for electricity.
- CCAs can amount to a hidden asset of a company.
- Insolvency practitioners must therefore determine whether clients have any CCAs applicable to any of their sites and, if so, ensure reporting obligations are complied with to preserve the benefit.

Last May, major German company Voerde Aluminium announced its insolvency as a direct result of lowering aluminium prices combined with rising production costs. The president of Germany's trade body for the metal industry said at the time: "Production of metals, particularly aluminium, is at risk in Germany due to high electricity prices that are no longer internationally competitive."

It's a story that could be repeated in the UK. In June last year, Business Juice, the UK business energy expert, reported the results of its first Business Energy Barometer (see www.businessjuice.co.uk/energy-forecaster/business-energy-barometer), which revealed deep concerns over rising energy prices with one in 12 of 500 business surveyed saying that if the trend for 25% year-on-year price rises continued, it would be catastrophic, forcing them out of business.

Higher energy prices are undoubtedly an increasing cost pressure for many businesses, particularly those that are energy-intensive. Energy price rises over recent times have been driven by various international factors and an overall increase in demand for gas and coal.

In the UK, energy-intensive businesses can save substantial sums under Climate Change Agreements (CCAs). A CCA allows an energy intensive business to claim a discount of up to 65% on the Climate Change Levy (CCL) – rising to 90% for electricity this April – in return for meeting energy efficiency or carbon saving targets. By way of example, the current rate of climate change levy for electricity is 0.509 pence per KWh. If a factory consumes 10,000MWh of electricity in a year, the CCL would exceed £50,000.

However, under the new CCAs, that £50,000 figure could be reduced by 90% to £5,000 – a colossal financial benefit to any business. This means insolvency practitioners (IPs) should not ignore the relevance of CCAs to some of their clients.

The CCA itself was introduced by the Finance Act 2000 and is entered into via an umbrella agreement between a sector association and the Secretary of State for Energy and Climate Change. A list of members of the sector association is scheduled to the agreement. Those members also enter into an underlying agreement with the secretary of state (under the existing scheme and within certain sectors, these agreements were made with the sector association). Existing CCAs expired on 31 March 2013 and a new suite of agreements replaced them with effect from 1 April.

Critical for businesses party to these agreements are the reporting obligations under the CCA: to retain their CCA and continue to get a significant reduction on the CCL business, they must ensure they report specified data every two years. Failure to report (or failure to demonstrate targets met) means they will lose their CCA exemption and this could substantially affect the value of the business. Conversely, if reporting obligations are complied with, the company will be eligible for the discount from the CCL for the following two years. This potentially adds value to the facility on a potential sale.

The DECC published findings in 2011 demonstrating that the CCA incentive appears to have had a positive impact, with 28.5m tonnes per year of CO_2 emissions saved, and a general continued improvement across the sectors. The trend for CCAs is likely to continue.

> "With CCAs becoming increasingly attractive to energy-intensive businesses, raising the profile of "hidden assets" such as CCAs to potential buyers of insolvent businesses is increasingly important"

CCAS, INSOLVENCY AND HIDDEN ASSETS

A hidden asset is a company asset which does not appear on its financial balance sheet. A CCA, by its very nature, will not appear on a company's balance sheet – but is highly likely to be valuable to the company and, thus, a hidden asset.

As far back as June 2007, Defra asked the Insolvency Service to draw IPs' attention to the relevance of CCAs. The Insolvency Service duly published guidance to IPs "to look out for environmental schemes that may affect the company's balance sheet, profitability and re-sale value" such as CCAs. Failure to keep records as required could "have serious implications for the viability of some companies, and hence for their re-sale value".

It also said IPs "must also ensure that data is preserved and if necessary passed onto a new owner, especially if ownership is transferred within, or just at the end of, the reporting period".

they are subscribed to a CCA.

"It is also key for insolvency practitioners to understand whether the terms of the CCA have been complied with in order to preserve the benefit of the reduction in the CCL."

"The more information an organisation has about whether it is a member of a subscribed sector association, how many units of energy it has used and the projected tax saving this will provide, the better"

So is there a danger the presence of a CCA could be overlooked by practitioners? Devinder Singh, a partner in the restructuring and insolvency group at Squires Sanders, believes so: "The benefit of an organisation's climate change levy reduction may not be taken into account at first instance. So, the more information an organisation has about whether it is a member of a subscribed sector association, how many units of energy it has used and the projected tax saving this will provide, the better. Insolvency practitioners should consider whether an insolvent organisation falls within one of the umbrella agreements and ask the staff of that organisation whether

He adds that practitioners should also have regard to reporting requirements under the CCA and "factor in the risk of having to pay the full rate of CCL where an insolvent company fails to meet its energy reduction targets". Singh says: "They should also be aware of the milestones applicable to the relevant sector, such as recertification dates and build these into their strategy for dealing with the insolvency. However, the benefit of a CCA is not transferable to another organisation, so in a typical business sale situation, the benefit of a CCA would be lost. It would, of course, be open to the purchaser to discuss and agree a new underlying agreement."

WHAT ARE CCLS AND CCAS?

- A CCL is a consumer tax levied on the supply of energy (ie heating and lighting) for business use. Charities and domestic supply are exempt from the CCL. Taxable commodities include electricity, natural gas, liquid petroleum gas (lpg), and coke fuel.
- The levy (which is subject to VAT) is charged per unit of the energy commodity with each of the four commodities attracting a separate charge scale. Consumers eligible to pay CCL must register - penalties apply for those failing to do so.
- CCAs are typically held by manufacturing industries which are subject to Part A of the Integrated Pollution Prevention and Control Regulations 2000, or qualify as energy-intensive. Industry sectors subject to the Regulations include food and drink; foundries and glass; aluminium, cement, ceramics and chemicals.
- The current CCA scheme is administered by the Department of Energy and Climate Change and will end in March 2013. The new CCA scheme will be administered by the Environment Agency and will come into force in April 2013 (with a potential rise to a 90% discount).
- The benefit of a CCA is not transferable so a new owner would have to enter into a new CCA. Also, the CCA relates to a facility (eg, a factory) rather than the land itself.

Frances Coulson, head of insolvency and business recovery at Moon Beaver, says the potential value of a CCA depends on the type of company. She explains: "If, for example, the company is a high energy user, a climate change agreement may well be highly relevant to the company's value as well as generally in terms of its profitability and solvency. With well-publicised rising energy prices this can be a significant asset.

"You may be selling the business as an administrator and preserving and reporting the data can make a difference to the value to the purchaser, which can so easily be lost."

Coulson warns there are many hidden assets that could be overlooked – intellectual property assets for instance. And she warns: "There is also the risk of losing the asset if you are unaware of it and the required data reporting necessary to obtain the discount is not complied with. So IPs should add it to the checklist of things to look for in high energy usage companies and take great care to make sure that the data is preserved and reports submitted. The data will need to be passed onto any new owner, especially if ownership is transferred within the reporting period. A change of ownership will not be taken into account when the targets are assessed, because the agreements cover the site, not the owner. Thus value is affected."

Coulson offers the following advice to practitioners: "First, consider the type of company you are dealing with and whether it is a high energy user. Advise the client to check with the company's staff whether there are any CCAs applicable to any of the company's sites (remember it adheres to the site not the entity). If they don't know or relevant staff have left, then check with the trade association for the business, or with HMRC."

In addition, she adds: "They may wish to revalue their qualifying land assets as this may enable further funding; they should claim the enhanced capital allowance if they have purchased qualifying equipment in the last year to enhance cashflow; and should consider the difference to cashflow and budgets the CCA will make over a longer period, if the CCAs are recent, so that proper projections can be prepared and restructuring considered maybe via CVA or other procedure."

Biog box

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However, Bond Pearce partner, Joanne Rumley, believes the benefit to a company of a CCA is purely financial, doubting a CCA would in itself generate additional goodwill. But though she acknowledges it is likely that if an Oldco was granted a CCA and the Newco operates in the same way – the Newco will get one as well. She adds: "Not having a CCA in place may have an impact on value of the business for purchaser depending on how profitable the business is with or without the reduced levy."

Rumley says: "Insolvency practitioners may be keen to consider the terms of the CCA if they are considering continuing to trade the company such that the company will remain eligible for the reduced levy. There is nothing in the specimen CCAs to suggest that they terminate on insolvency and therefore they ought to remain in force in insolvency provided they are complied with."

HIGHLIGHTING THE PRESENCE OF CCAS TO POTENTIAL BUYERS

With CCAs becoming increasingly attractive to energy-intensive businesses, raising the profile of "hidden assets" such as CCAs to potential buyers of insolvent businesses is increasingly important. Coulson says: "If CCAs exist and enhance value it may be sensible to mention it [in advertising] as it may attract more buyers."

John Watson, business director at TMP Reynell, a company which specialises in statutory advertising, stresses: "Any IP would have to be doing his best to investigate any assets which weren't obvious: they would be under a duty to."

What is undoubtedly clear is IPs must be alert to the potential existence of CCAs. If the company in administration has not kept required records showing its targets have been met, it may lose its eligibility for a discount under the CCA. The implications are clear: if a CCA is withdrawn the viability of a company may decrease; and its re-sale value may be reduced. But in other instances, a CCA may be identified and assessed as a valuable asset.

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Many companies don't realise they have unrealised assets and, with CCAs becoming increasingly valuable to some businesses, Watson says: "We increasingly ask insolvent companies when advising them as to what potential assets they might not have identified. We can then publicise the full picture of the company's value via advertisements, marketing a business before any insolvency process."

IPs ought to note Coulson's warning of the negative impact on creditors where insolvent organisations have lost the benefit of their CCA. She says: "This may give rise to claims against directors for misfeasance/breach of duty and will give rise to greater losses than would otherwise have been the case had the company been compliant, greater liabilities will exist, as well as a reduced value for onward sale of the business if any is possible." ■