

6 July 2012

UK Proposes Mandatory Carbon Reporting for Quoted Companies

On 20 June 2012, UK Deputy Prime Minister Nick Clegg announced that the UK Government plans to introduce regulations from April 2013 requiring all UK companies whose shares are officially listed on the Main Market of the London Stock Exchange and certain other exchanges to report on their greenhouse gas (“GHG”) emissions.

Background

Mr. Clegg made the announcement amidst the backdrop of the United Nations Conference on Sustainable Development (“Rio + 20”), which took place between 20 and 22 June 2012. The UK announcement is being viewed as the most concrete pledge to emerge from the Rio + 20 summit. Nevertheless, its building blocks were laid out in the UK Climate Change Act, which was enacted in late 2008. Section 85 of the UK Climate Change Act 2008 required the Secretary of State, by 6 April 2012, either to (i) make regulations under section 416(4) of the UK Companies Act 2006 requiring directors’ reports to contain information about GHG emissions from activities for which a company is responsible, or (ii) explain to the UK Parliament why it had not introduced such regulations.

In May 2011 the Department for Environment, Food and Rural Affairs (“Defra”), the agency administering this requirement, started a public consultation to determine the scope of these regulations. Defra ran a cost-benefit analysis of four alternative methods to introduce such reporting:

- **Option 1:** enhanced voluntary reporting;
- **Option 2:** mandatory reporting for all “quoted companies” as defined in the Companies Act 2006 (*i.e.*, UK companies whose equity share capital is (i) included in the official list as defined by section 103(1) FSMA 2000, which includes a listing on the Main Market of the London Stock Exchange; (ii) officially listed in an EEA state; or (iii) admitted to dealing on the New York Stock Exchange or Nasdaq);
- **Option 3:** mandatory reporting for all “large companies” (*i.e.*, public or private UK companies exceeding thresholds under at least two of the following criteria: size, measures of employment, gross assets and turnover);¹ and

¹ Large companies being those UK companies not defined as either “small companies” or “medium sized companies” in sections 382, 383, 465, and 466 of the Companies Act 2006.

- **Option 4:** mandatory reporting for all companies whose UK electricity consumption exceeds a threshold.²

Whilst Defra missed the 6 April 2012 deadline to introduce regulations, on 20 June 2012, Defra published a summary of the various stakeholder responses to this consultation, including the UK Government's proposed next step to introduce the regulations under Option 2.

The Proposed Requirements

It will not be evident what the specific facets of the proposed reporting requirements are until Defra publishes the draft regulations. Nevertheless, Defra has stated the following in its publication of the Government's plans:

- **Reporting boundaries.** Companies will be required to report on GHG emissions within their organisational boundaries, including from activities outside the UK where appropriate. The boundaries should be the same as those used for reporting in the financial portion of the annual report - companies will not be able to choose different boundaries. However, a breakdown of GHG emissions by geographic area will not be mandatory.
- **Comply or explain.** The regulations will take a "comply or explain" approach so that, where it has not been possible for a company to collect the information required, a company would be able to state the extent to which it is able to report and therefore "explain" gaps.
- **Relevant GHGs.** The regulations will require reporting on the six GHGs covered by the Kyoto Protocol where they are material, namely: carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride.
- **Scope of emissions to be covered.** Companies will be required to report on their material "scope 1", or direct, emissions and "scope 2", or indirect energy, emissions. "Scope 3" emissions, or indirect emissions that are a consequence of a company's actions, will not be mandatory but are encouraged to be included voluntarily. Emissions should be reported in CO₂e (carbon dioxide equivalent). Defra has previously published guidelines on how to measure and report GHG emissions³ and GHG conversion factors for company reporting.⁴
- **Intensity ratio.** Companies will be required to include an "intensity ratio" of their choice. Intensity ratios compare GHG emissions data with an appropriate business metric or financial indicator, such as sales revenues or square metres of floor space, and allow companies to compare their performance over time and with similar types of organisations.
- **Base year.** Companies will be required to report their emissions from a base year of their choice, and they should report if the base year is subsequently changed/recalculated. Defra separately provides guidance on how a company should determine if the base year it uses should be recalculated.
- **Methodology used.** The regulations will require companies to report on the methodology they have used to calculate their GHG emissions - *e.g.*, the Government's own guidance or another recognised standard or framework - but they will not prescribe the particular methodology.

² <http://www.defra.gov.uk/consult/2011/05/11/ghg-emissions/>.

³ <http://www.defra.gov.uk/publications/files/pb13309-ghg-guidance-0909011.pdf>.

⁴ <http://www.defra.gov.uk/publications/files/pb13625-emission-factor-methodology-paper-110905.pdf> and <http://www.defra.gov.uk/publications/files/pb13773-ghg-conversionfactors-2012.pdf>.

- **Assurance or verification.** Because the regulations will require GHG emissions to be reported in the directors' report, the data will be included in the scope of existing audit requirements for directors' reports/annual accounts set out in the UK Companies Act. The regulations will not prescribe any further assurance or verification requirement specifically for the GHG emissions data. Companies will continue to be able to carry out assurance or verification on a voluntary basis.

Timing

The Government has stated its intent to publish the draft regulations and consult on them shortly, but to date they have not been published. The Government intends the final regulations to take effect from April 2013. They will be reviewed in 2015 in order to decide whether to extend the approach to all large companies from 2016.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or:

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Special thanks to European Corporate Group Trainee Ben Burton for his contributions to this client publication.