

2 December 2014

UK Energy Savings Opportunity Scheme

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

Contacts

Mehran Massih
London
+44 20 7655 5603
mmassih@shearman.com

Jason Y. Pratt
New York
+1 212 848 5449
jpratt@shearman.com

Jeffrey L. Salinger
New York
+1 212 848 7574
jsalinger@shearman.com

What is the Energy Savings Opportunity Scheme?

The Energy Savings Opportunity Scheme, or ESOS, is a new, mandatory energy assessment and efficiency scheme in the UK that implements parts of the EU Energy Efficiency Directive (2012/27/EU). ESOS requires participants to carry out energy savings assessments every four years that audit energy used by their buildings, industrial processes and transport, as applicable, in order to identify cost-effective energy saving measures. The UK Department of Energy and Climate Change expects about 9,400 participants in the first phase of the scheme, which ends in 2015. Thereafter, ESOS will run in four-year phases.

ESOS is not exclusive of, and may overlap with, other notable energy use/greenhouse gas reduction schemes in the UK, in particular the CRC Energy Efficiency Scheme, Climate Change Agreements and the EU Emissions Trading System. Broadly speaking, ESOS places a greater emphasis on the identification of energy saving opportunities than these other schemes. In addition, the energy use covered by ESOS is likely to be broader than these schemes for many participants.

Who is Caught by the Scheme?

ESOS will apply to all entities that are “large undertakings.” Large undertakings are, among others, corporate bodies or partnerships organised in the UK and carrying on trade or business that either:

- employ at least 250 people; or
- have an annual turnover over €50 million AND an annual balance sheet over €43 million.

For the first phase, these are measured during the financial year ending at, or in the 12 months immediately preceding, 31 December 2014, which is known as the “qualification date.”

Owners, managers and partners count as employees for purposes of assessing whether an undertaking exceeds the 250 people threshold. There are additional rules about how to count employees in light of changes to headcount during the financial year.

Corporate Groups

Corporate groups must comply with ESOS if at least one UK group member meets the definition of a large undertaking. In this event, the entire UK operations of the corporate group will be required to participate (the energy usage of overseas undertakings in a group is outside scope). To determine the extent of a participant's corporate group for ESOS, companies must apply the UK Companies Act 2006 definitions of parent undertaking and subsidiary undertaking to the participant's corporate structure.

The default expectation is that the highest partner undertaking organised in the UK will take the lead responsibility for compliance on the group's behalf. However, ESOS allows flexibility for group members to "disaggregate," meaning that, for example, subsidiaries may participate in ESOS separately from other members of the wider corporate group. Participants must notify the Environment Agency, the regulator that administers ESOS, of any disaggregation when they notify of compliance with the scheme.

Changes in Organisational Structure and Their Impact on Qualification for the Scheme

Any organisation that qualifies for ESOS on the qualification date (31 December 2014 for the first phase) will need to comply with ESOS, including organisations that qualify via their group on the qualification date but leave this group prior to the compliance date (which, as explained below, is 5 December 2015 for the first phase). Such an undertaking, or group thereof, can do this in any one of the following ways:

- Agreeing in writing with its previous highest parent that it will participate in ESOS along with this previous group.
- Agreeing in writing with its new highest parent that it will participate in ESOS as part of its new group.
- Participating separately from either its previous or new group and notifying the Environment Agency of its compliance independently.

What Must Group Companies Do if They are Required to Participate in ESOS?

Measure Their Total Energy Consumption

ESOS participants are required to measure their total energy consumption across any 12-month period of their choice that overlaps with the qualification date, which for the first phase is 31 December 2014. This is known as the "reference period." ESOS's scope covers energy consumed in all of the following - depending on certain criteria:

- buildings
- industrial processes
- transport

There are detailed rules about what participants must consider as part of their energy consumption. In general terms, energy that is supplied to and consumed by the participants is in scope. Energy includes combustible fuels, heat, renewable energy and electricity.

Changes in Organisational Structure and Their Impact on Measuring Total Energy Consumption

The energy use in the reference period from assets or activities that are sold or discontinued by a participant group after the qualification date (31 December 2014 for the first phase) but before the compliance date (5 December 2015 for the first phase) does not need to be included in the group's total energy consumption.

Similarly, the energy use in the reference period of assets or activities purchased or commenced after the qualification date but before the compliance date does not need to be included in the group's total energy consumption.

Identify Their Areas of Significant Energy Consumption, which will be Subject to a New ESOS Audit Unless Exempted
Within a phase, all areas of a participant group's "significant" energy consumption must be covered either by (i) an energy audit commissioned specifically for ESOS or (ii) an alternative route to compliance. In this regard, significant means the energy use that accounts for at least 90% of the group's total energy consumption.

There are four alternative routes to compliance. As long as 90% of a participant group's total energy consumption is covered, the group can use a mix of approaches to achieve ESOS compliance:

- Energy management systems certified under ISO 50001
- "Display Energy Certificates" and accompanying advisory reports
- "Green Deal" assessments
- Energy audits undertaken during the audit period under other schemes, such as the Carbon Trust Standard or Logistics Carbon Reduction Scheme, as long as those audits meet the minimum standards of an ESOS audit

There are detailed requirements on what ESOS audits must contain. Broadly, they must be based on 12 months' verifiable data, analyse the group's energy consumption and efficiency, and identify energy saving opportunities.

Appoint a Lead Assessor to Carry Out, Oversee or Approve the Energy Audit(s)

The participant group must appoint a "lead assessor" to carry out, oversee or approve an energy audit commissioned for ESOS compliance. Lead assessors can also review audits carried out pursuant to the alternate routes to compliance, in order to confirm they meet the minimum ESOS standards.

Lead assessors may be either in-house experts or external consultants, as long as they are members of professional registers approved by the Environment Agency.

Report ESOS Compliance to the Environment Agency

The participant group must notify the Environment Agency that it has completed the required ESOS assessment on or before the "compliance date," which for the first phase is 5 December 2015. The notification is done on a prescribed form. There is no pre-registration of qualification required under ESOS.

The participant group must keep internal records of how it has complied with ESOS in an evidence pack, although there is no set format for this.

What Happens if a Company Does not Comply?

The relevant regulator, including the Environment Agency, is empowered to issue enforcement notices and civil sanctions (including civil penalties) to non-complying ESOS participants. The regulator will also be empowered to publicly name non-compliant entities on its website and describe the nature of the breach and the amount of penalty imposed on them.