



Climate Change Alert September 2008

Operational Control – the key test for determining the extent of your compliance obligations under the NGER System and the CPRS

- All businesses with facilities which produce emissions or generate/consume energy at levels above or near the compliance thresholds for the NGER System and the CPRS must identify the facilities over which they have operational control.
- A company has “operational control” over a facility if it has the authority to introduce and implement operating, health & safety and environmental policies for the facility. Only one company can have operational control over a facility at one time. If more than one company can introduce and implement policies for a facility, the company with the greatest authority to do so in respect of operating and environmental policies will be deemed to have “operational control”.
- In any M&A transaction, consideration of greenhouse gas emissions, energy production/consumption and “operational control” must form an integral part of the due diligence process. Acquiring a new business may push your corporate group over the compliance thresholds for the first time, crystallising the obligation to report and/or acquire permits.

What is the NGER System?

The *National Greenhouse and Energy Reporting Act 2007* (Cth) (**NGER Act**) establishes a mandatory corporate reporting system for greenhouse gas (**GHG**) emissions, energy consumption and energy production.

As of 1 July 2008, corporations are required to report prescribed data if their operations meet certain emissions and energy production/consumption thresholds (discussed further below).

What is the CPRS?

The Federal Government is proposing to introduce an emissions trading scheme called the Carbon Pollution Reduction Scheme (**CPRS**) (see our [Alert on the Green Paper](#)).

From 1 July 2010, the Government will set a cap on the amount of GHG emissions Australian industry can generate and then issue permits equalling the cap each year. Businesses in “covered sectors” which generate emissions at or above certain thresholds will be required to acquire and surrender a permit for each tonne of GHG they emit.



Why is “operational control” important?

“Operational control” is the key test used to determine which companies have reporting obligations under the National Greenhouse and Energy Reporting System (**NGER System**). The “operational control” test will also determine who is required to acquire permits under the proposed CPRS.

NGER System

Reporting obligations are imposed upon the controlling corporations of corporate groups (ie. the company at the top of the corporate hierarchy in Australia). In summary, a “corporate group” consists of the controlling corporation and its subsidiaries, joint ventures and partnerships.

There are two different compliance thresholds: **facility** thresholds and **corporate** thresholds.

- > If a **facility** emits 25,000 tonnes or more of GHGs or produces/consumes 100 terajoules or more of energy in a financial year, the controlling corporation of the company with “operational control” of that facility must report data for that facility.
- > If the aggregated GHG emissions and energy production/consumption of each facility under the “operational control” of members of a **corporate group** equals 125,000 tonnes or more of GHGs or 500 terajoules or more of energy in a financial year, the controlling corporation must report data for the whole group.

If a corporate group does not meet the corporate threshold, but has operational control over a facility that meets the facility threshold, the controlling corporation is only required to report on that facility.

Corporate thresholds will progressively decrease over the first 3 years of the reporting system until they reach 50,000 tonnes of GHG emissions and 200 terajoules of energy in 2010-11.

CPRS

The NGER System is the initial framework for monitoring, reporting and assurance of emissions under the CPRS. This means that, in most cases, the obligation to acquire permits will be placed on the controlling corporation of a corporate group where either the controlling corporation or a member of the group has “operational control” over a covered facility or activity with GHG emissions exceeding the threshold of 25,000 tonnes per financial year.

When does a company have “operational control” over a facility?

Only one company can have operational control over a facility at one time.

If more than one company has the power to introduce and implement operating, health and safety and environmental policies for a facility, the company with the greatest authority to introduce and implement operating and environmental policies for the facility will be deemed to have “operational control”.

For example, where a third party is contracted to manage or operate a facility on behalf of the owner, the party with the **greatest authority to introduce and implement policies** for the facility will be determined by terms of the contract between the parties. The ability of a facility owner to shut down operations or make large-scale capital investments does not necessarily equate to “greatest authority” to introduce and implement policies.

Companies must carefully consider how the current and future structures of their businesses will affect their reporting obligations under the NGER System and their liability to acquire permits under the CPRS.

Tips & Traps

Joint ventures and partnerships

One participant in a partnership or joint venture must be nominated as the responsible entity for reporting on facilities under the operational control of that partnership or joint venture. If no nomination is made, all participants must report. The submission of conflicting data could result in an audit being required and/or penalties being imposed.

Third party managers or operators

Where a third party is contracted to manage and operate a facility on behalf of the owner, the facility owner and the third party manager will often share authority to **introduce** policies. However, if the third party manager **implements** all policies without input from the owner, the third party manager will probably be taken to have operational control. These kinds of situations require an analysis of the contractual arrangements between the parties.

Contractors

Controlling corporations are responsible for reporting **all** GHG emissions and energy data associated with covered facilities, including the GHG emissions from and energy used/produced by the activities of contractors and subcontractors. This means that the company with operational control of a facility must collect contractor data and incorporate that data into its own report. This also means that contractors



who don't meet thresholds themselves will still have to collect emissions and energy data for provision to their clients. A specific contractual provision may be required to provide for this.

Mergers and Acquisitions

In any M&A transaction, consideration of greenhouse gas emissions, energy production/consumption and "operational control" must form an integral part of the due diligence process. Acquiring a new business may push your corporate group over the compliance thresholds for the first time, crystallising the obligation to report and/or acquire permits. The obligation to acquire permits under the CPRS may affect the commercial viability of certain transactions.

Anti-avoidance measures

Controlling corporations who are considering restructuring their corporate group in order to avoid reporting and/or permit obligations should be aware that the Greenhouse and Energy Data Officer has the power to investigate whether companies (registered to report or not) are attempting to minimise their reporting obligations or avoid meeting reporting thresholds. Penalties apply for non-compliance.

Unincorporated entities

Although the NGER System currently only applies to constitutional corporations, the Federal Government is proposing that the application of the NGER System and CPRS be extended to cover unincorporated

entities. These entities may find themselves unprepared come 1 July 2010 if they don't start preparing to report now.

What should you do?

All businesses should identify the facilities over which they have operational control. Once this issue is resolved, the next step is to determine whether these facilities are likely to produce emissions or generate/consume energy at levels above or near the compliance thresholds for the NGER System and the CPRS.

If you would like assistance in examining your corporate structure to determine which entities have operational control over which facilities, or if you would like advice on any other aspect of the NGER System or CPRS, please contact one of the people below:

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