



GREATER SOUTH EAST ENERGY HUB

REPORT ON ENERGY PROCUREMENT AND INVESTMENT MODELS:

BUSINESS MODEL OPTIONS FOR DEVELOPING RENEWABLE
ENERGY INFRASTRUCTURE AND SUPPLIES



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1. **INTRODUCTION**

- 1.1 This report provides outline legal advice in relation to the different options available to Local Authorities to procure renewable energy and support the delivery of renewable energy infrastructure and energy supply. It has been prepared for the Greater South East Energy Hub (the "Hub") with the knowledge that it may be shared with Local Authorities which are pursuing a low carbon strategy and that the Hub is assisting.
- 1.2 Please note that the report states the current legal position at the time of writing and therefore advice should always be sought from the Hub prior to implementation of a low carbon strategy.
- 1.3 The Government's commitment to Carbon Net-Zero by 2050¹, with significant changes impacting housing and transport by 2030, means that the UK will need to undergo significant changes in the way communities, use, buy and sell energy in order to meet these changes. At the time of writing this report, the UK is caught in the midst of the Covid-19 Pandemic², which commentators consider will bring with it a potential "market reset", with issues of social value, public sector intervention and green energy at the heart of many policies identified to help kick start or "re-boot" the economy.
- 1.4 In this changing market place, it's clear that local authorities will have a role to play in bringing forward the low-carbon economy on a local and national basis. This is demonstrable in e-mobility where local authorities, alongside the Office of Low Emission Vehicles are investing heavily in public and taxi charging infrastructure³. Commentators anticipate that as the UK emerges from Covid-19, that such initiatives will gain greater momentum as the community and behavioural change will see a greater shift in investment in technologies and industries where it sees longer term benefits to society and the environment. This is a good example of how public sector may help bring forward energy infrastructure and supply where there may be, for the time being, less market engagement, but clear longer term benefits and payback.
- 1.5 This report is intended to be read in conjunction with the suite of guidance documents that the Hub has previously prepared or commissioned and does not replace or supersede any such guidance document. Where we are aware of a guidance document prepared by the Hub that already covers an area of relevance to this report⁴ we will refer to that guidance document rather than duplicating the information here.
- 1.6 This report is structured as follows:
- 1.6.1 **Part A** outlines each of the key business model options for developing renewable energy infrastructure and energy supplies. This includes:
- (a) local authority delivery;
 - (b) delivery via a separate legal entity (wholly owned by the local authority) or in conjunction with the private sector, utilising:
 - (i) an Energy Service Company (ESCO)
 - (ii) a joint venture arrangement⁵; or
 - (iii) a concession arrangement.

¹ <https://www.gov.uk/government/publications/net-zero-review-terms-of-reference>

² April – May 2020

³ The Charging Infrastructure and Investment Fund recently invested in Liberty Global Ventures' (Virgin Media) scheme to deploy 1,200 new charging points by end of FY21- May 2020

⁴ For example, of particular relevance is the document entitled "Establishing public-private Joint Ventures and partnerships for investment in and delivery of energy schemes" published by the Midlands Energy Hub and available [here](#).

⁵ Notwithstanding the guidance on Establishing public-private Joint Ventures and partnerships for investment in and delivery of energy schemes referred to above.

(c) Community Interest Companies and Community Partnerships; and

(d) sleeved supply of energy.

1.6.2 In relation to each option, our analysis in Part A considers the relevant considerations including in relation to:

(a) legal structures

(b) funding and finance

(c) energy supply

(d) local authority powers

(e) procurement and state aid; and

(f) risks and rewards,

Where appropriate, case studies that illustrate the 'real life' application of the above business model options and considerations.

1.6.3 Part B provides further detail on procurement and state aid considerations.

1.6.4 Part B provides further detail on relevant local authority powers.

1.6.5 Part C provides further detail on electricity licencing considerations.

1.7 Appendix 1 provides further detail on legal structures and relevant considerations

1.8 The reader should be aware that we make reference to the Public Contracts Regulations 2015, however, depending upon the nature of the energy services which the local authority seeks to undertake, it may be the case that the works and/or services are caught by the Utilities Contract Regulations 2016 *if* the contract it seeks to undertake is a "*utility activity*"⁶. Specific advice should be undertaken at the given time to understand the nature of the obligations and relevant procurement rules which apply to the given works and/or services tendered.

⁶ "Utility activities" include energy, transport, water and postal services. In the case of electricity, the Regulations apply to:

- the provision or operation of fixed networks intended to provide a service to the public in connection with the production, transport or distribution of electricity; and
- the supply of electricity to such networks: section 10(1) UCR

2. PART A: ANALYSIS OF BUSINESS MODEL OPTIONS

- 2.1 Part A provides a discussion of the main business model options available to local authorities who wish to deliver renewable energy infrastructure and energy supply, along with an analysis of the relevant factors local authorities will need to consider in relation to each option.
- 2.2 Determining which model is most appropriate for a particular local authority will largely depend on that local authority's **objectives** in deciding to delivery renewable energy infrastructure and energy supply, and how those objectives are best fulfilled. One growing area of concern for Councils is climate change, highlighted by pressure groups such as Extinction Rebellion and the fact that **274 of the 408 District, County, Unitary and Metropolitan Councils have issued a climate emergency**⁷. Some local authorities, such as Bristol, Manchester, Cornwall and Coventry have gone further seeking to understand how carbon neutrality can be achieved and air quality improved against a backdrop of some challenging targets.
- 2.3 The reasoning for why local authorities have considered local renewable energy infrastructure and energy supply depends on a number of factors, increasingly, social value has taken a greater stage, but Covid-19 has already begun to change the way that Central and Local Government intervene in the marketplace. Questions are already being raised as to whether the pandemic has created a market reset, with community, carbon and changing behaviours at its core. There is already a greater sense that there could be greater intervention by Central Government in future policy making, as part of the broader aspiration by the Conservative Government to "level up" social and economic disparity (post December 2019 General Election pledge/results). Key issues which local authorities will need to consider when looking at energy planning can include:
- 2.3.1 road to zero: looking at how we achieve 2030 and 2040 carbon targets for e-mobility and public transport;
 - 2.3.2 electrification of heat: all new homes from 2025 will need to be built without reliance on gas central heating, the UK's greatest energy usage is for heating (and strong reliance on natural gas);
 - 2.3.3 de-carbonisation of existing heat projects: all homes by 2050 may be required to be electrified, this could place significant strain on existing electrical infrastructure;
 - 2.3.4 sustainable energy pricing and community energy: tackling issues for the fuel poor and vulnerable families;
 - 2.3.5 air quality improvement: associated health issues with CO₂ and NO_x emissions;
 - 2.3.6 a pressing need for new homes: there is an acute housing shortage, particularly for low income families, under investment in electrical infrastructure potentially prevents these homes being built (at a cost that can absorb the infrastructure upgrades)
 - 2.3.7 financial (either generating income via energy sales or reducing costs via energy savings and improved energy efficiency),
 - 2.3.8 energy security: increasingly a concern following Covid-19 and the reliance on interconnectors for energy demand;
- 2.4 In this toolkit, we intend to look at the various options which are open to the relevant local authority to determine the best approach to delivery of its objectives. In the main, the local authority's starting point must be to consider whether there is a market failure position and the

⁷ <http://www.climateemergency.uk/blog/list-of-councils>

reason for why a market solution does not exist⁸.

Before considering the various delivery options open to a local authority, we consider that there are a number of considerations relevant to any decision which a local authority should consider before committing itself to a course of action/approach.

DOES THE LOCAL AUTHORITY REQUIRE AN ESCO TO ACHIEVE ITS OBJECTIVES?

2.5 We consider that the local authority needs to base its decision to establish a separate legal entity through a strongly developed business case, coupled with a clear governance structure and business plan. When undertaking the business case analysis, along with the "do nothing" option, a local authority should consider alternative options. It is possible for a local authority to manage the delivery of local renewable energy infrastructure and energy supply within the local authority itself without the need for a separate legal entity or ESCO and with limited or no private sector involvement.

2.6 The initial question which a local authority needs to ask itself *why* it requires a separate legal entity for the objectives it seeks to deliver⁹.

2.6.1 Can it be achieved contractually? A local authority may decide to procure private sector works or services contracts in relation to certain aspects of the project (such as the construction of a district heating network and/or energy centres, for example whilst operation, maintenance, heat supply and billing may be retained in house by the local authority), but in general there would be limited or no private sector involvement in an 'in house' model.

2.6.2 Does the Council require an ESCO? Whether or not a local authority decides to establish a separate legal entity and/or involve the private sector is largely a question of its objectives (see paragraph 2.3). Unless there is a commercial purpose (for example generating income from the delivery of renewable energy infrastructure and energy supply, such as by trading electricity for profit), existing local authority powers will allow a local authority to deliver many energy functions in fulfilment of these objectives without the need to establish a separate legal or corporate entity.

BlueSky Peterborough ESCO: Peterborough City Council led the way for many years in community energy strategy. It utilised alliance and joint venture arrangements with partners such as British Gas plc to develop the first regional energy tariff "Heatborough". It also pioneered energy performance contracting (EnPC) in the public sector with Honeywell and collective energy switching with iChoosr. Albeit, these were badged BlueSky, the Council identified quickly that it was more tax efficient and had greater impact in the market to do so via the Council.

2.7 In undertaking the business case, the local authority should consider (but not limit itself to considering):

2.7.1 what are the commercial drivers underpinning the decision?

2.7.2 is the public sector best placed to manage the risk?

2.7.3 how will this be funded and what are the anticipated returns?

⁸ For example, the retail energy supply market in the UK is highly competitive and works as a turnover business model given low margin return. Clearly, it would be inequitable for a local authority to establish a retail energy supply business for a limited marketplace, but looking to joint venture and "white-label" with an existing energy supplier, may (subject to any competition advice) be a more meaningful solution.

⁹ In our experience we have found that Councils can achieve a lot of its objectives via using levers, such as planning constraints, promotion of schemes and contracts for works and services e.g. BlueSky Peterborough utilised a lot of solutions in energy outside of the ESCO and via contract. A key learning point for Councils is to take advice early on the nature of the objectives and whether there are alternatives open to it given its approach to risk and reward.

- 2.7.4 what soft market testing has been undertaken to justify the investment?
- 2.7.5 what is the resourcing and participation requirement of the public sector?
- 2.7.6 does the proposed decision mean the public sector will be undertaking a regulated activity?
- 2.7.7 what local political support is there for this project?
- 2.7.8 what is the exit strategy for the local authority?

Advice should be undertaken by the local authority early to determine an initial gateway decision and pathway.

We outline the differing delivery models below:

A. OPTION 1: DELIVERY BY THE LOCAL AUTHORITY

Legal Structure

- 2.8 Legal structures are not a relevant consideration for a stand-alone public sector model as no separate legal entity needs to be established. The local authority would instead rely on its existing local authority powers in order to deliver energy functions 'in house'. These are discussed in further detail in paragraph 2.16.

Electrical infrastructure Reinforcement: We have found that a significant number of Garden City and urban extension programmes have suffered due to insufficient capacity on the Grid. Pinsent Masons is working with the GLA, Old Oak Common Development Corporation, Ebbsfleet Development Corporation, Central Bedfordshire Council, Cambridgeshire and Peterborough Combined Authority and Buckinghamshire Council to assist them in bringing forward the infrastructure to encourage development on these schemes. The area is highly regulated and requires careful negotiation with the network operators. These solutions lend themselves to being led by the local authority, as opposed to a structured approach, funding tends to be HM Government and/or Homes England led. Particular focus is required on the State Aid analysis to ensure that the grid connection agreements sufficiently cater for clawback of the funding to ensure the arrangements are not seen as aid in the hands of network operators, landowners and developers/utility providers.

Funding Structure

- 2.9 A stand-alone public sector model will be funded from the public sector, either using the local authority's reserves, or central Government funding. Central Government funding may take the form of a low-cost loan from HM Treasury via the Public Works Loan Board¹⁰ ("PWLB") or grant funding, for example through the Housing Infrastructure Fund if the renewable energy infrastructure is needed to unlock housing development.
- 2.10 The funding arrangements are complex. In our experience, Homes England and MHCLG are only beginning to understand and appreciate the complexity of the funding issues which local authorities are facing when dealing with network and utility operators. The development and funding agreements tend to require significant changes in order to "marry-up" funding pre-conditions under HIF and Central Government funding and the regulatory environment which utilities operate within. Local authorities should seek early advice even before submission of an Outline Business Case to assess the commercial and financial approach to funding solutions.

¹⁰ Note that that the Government is currently consulting on revising the terms of PWLB. This consultation is due to close on 4 June 2020 and can be accessed [here](#).

Energy Supply

- 2.11 Local authorities have a range of statutory powers available to them in connection with the generation and supply of electricity and heat. However, none of these powers exempt a local authority from the requirement to obtain a licence to generate, transmit, distribute or supply electricity, unless a statutory exemption applies. The Electricity Act 1989 makes it an offence to carry out certain activities (generation, transmission, distribution, supply, smart meter communication) within the United Kingdom without a licence or obtaining an exemption from this requirement. This is a key regulatory barrier to a local authority providing energy services.
- 2.12 The generation and supply of heat is currently unregulated; engaging in the generation or the supply of heat would not require a local authority to obtain a licence¹¹.
- 2.13 Please refer to Part D at page 36 for further detail on the licensing considerations that local authorities should be aware of in relation to the generation, distribution and supply of electricity.

Local Authority Powers

- 2.14 The relevant statutory powers that a local authority would need to rely on in order to deliver energy functions 'in house' are summarised in Figure 1 below and discussed in further detail in Part C at page 31.

Procurement and State Aid

- 2.15 Please refer to Part B at page 26 for a summary of the relevant procurement and state aid considerations.

Risks and Rewards

KEY REWARDS / BENEFITS	KEY RISKS / DISADVANTAGES
High level of control and governance over energy functions	Does not take advantage of private sector expertise
Allows agility for the public sector to respond well to changing economic climate e.g. Net-Zero, Covid-19 etc	Limited access to funding (other than PWLB/relevant central Government grant funding)
Retention of all profits from energy functions	In essence maintains the status quo
Tailored to local authority's objectives	Limited examples of local authorities successfully delivering energy functions in house
Flexibility to change scope of energy service provision	

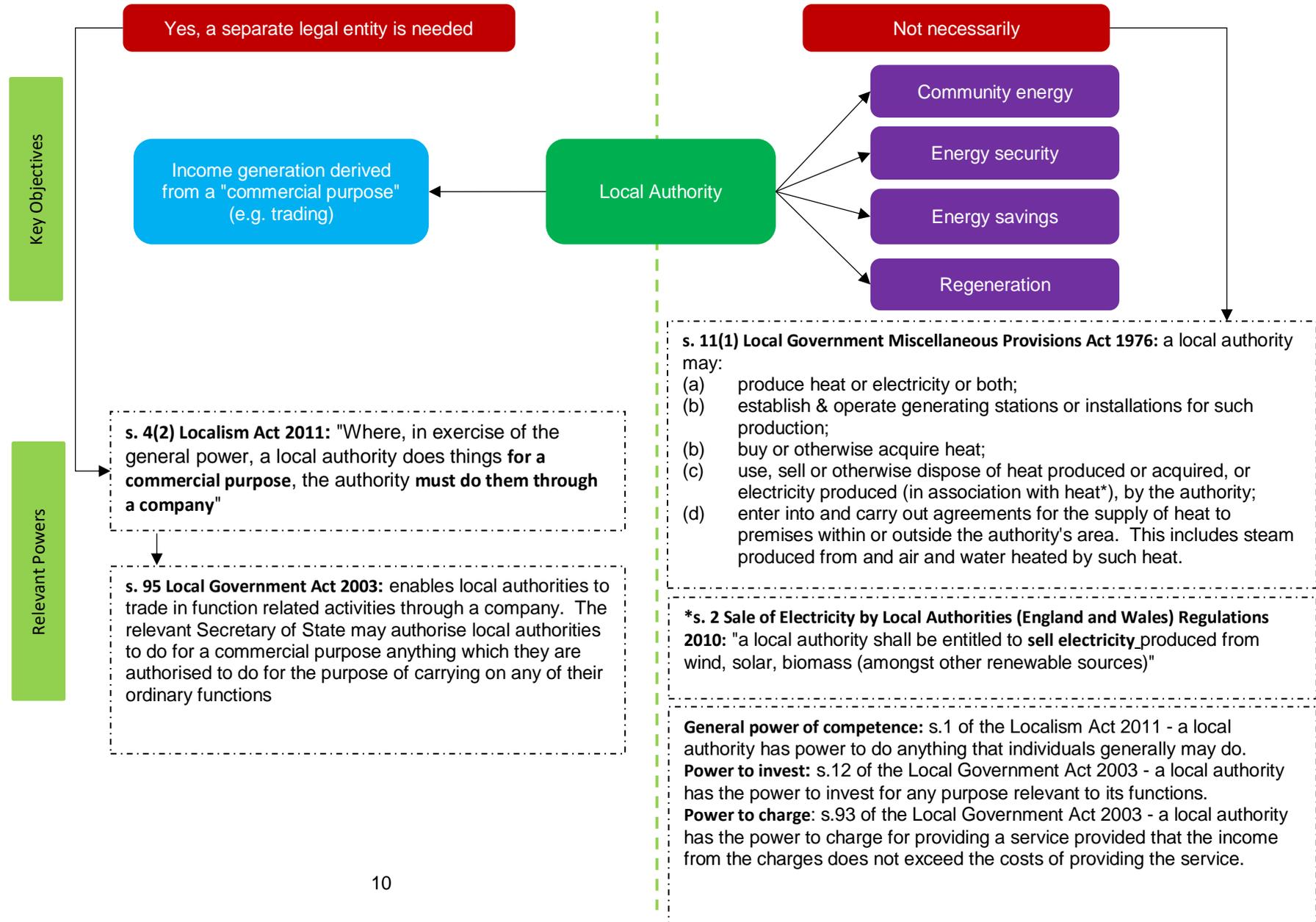
¹¹ Please note that the HM Government announced on 6 February 2020 that it seeks a market view on the future regulation of heat markets and whether the same approach in heat should be taken as exists in gas and electricity. HM Government considers that the de-carbonisation of heat is a crucial factor in achieving 2050 net-zero carbon emissions. The consultation seeks a market response to the options for: (a) regulating heat; and (b) ensuring fair pricing. This consultation is open until 1 June 2020. <https://www.gov.uk/government/consultations/heat-networks-building-a-market-framework>

More favourable tax position	Potential for slower decision-making if solutions go into the political arena
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2.16 There are a number of risks/disadvantages and rewards/benefits to the 'in house' approach that a local authority will need to consider. We have summarised the key risks and rewards in Table 1 below. Please note that this is only an indicative list. A full analysis of the risks and rewards will depend on the agreed objectives regarding the required provision of energy service by the relevant local authority, as discussed in paragraph 2.3.

Table 2: Pros and Cons of an 'in house' approach to energy provision

Figure 1: Is a separate legal entity required? Key local authority powers for standalone public sector energy provision



B. OPTION 2: DELIVERY VIA A SEPARATE LEGAL STRUCTURE OR IN CONJUNCTION WITH THE PRIVATE SECTOR

Below we set out the differing options for delivery utilising a separate legal structure.

These structures have differing levels of involvement of the public sector and really the choice taken is a factor of the risk/reward criteria and availability of funding. Specific legal and tax advice should be sought by the relevant local authority before entering into the structure with the private sector (and whether there would be value in undertaking soft market testing prior to committing the public sector to a particular pathway)¹².

In practice, we find that the more "novel" the solution, the less likelihood there will be of available funding in the private sector marketplace, as the market will query whether it is a nascent marketplace and/or potential for market failure, therefore limiting the attractiveness to the private sector. This may primarily be a function of the private sector marketplace not being able to readily understand the income revenue stack. This is particularly true in emerging energy markets e.g. e-mobility and electric vehicles. In these instances, the local authority may want to consider whether a 'phased' approach may create a more positive response from the market, i.e. introduce/sell share capital to the private sector once established, or provide the initial funding from the public sector, with additional funding to be provided from the private sector once milestones are achieved. Please be aware that any solution which involves the public sector will potentially need specific procurement and state aid analysis.

In Part B, we consider the following key options available for private sector involvement:

- (i) an energy service company or ESCO;
- (ii) a contractual joint venture or partnership; and/or
- (iii) a concession agreement.

The reader should be aware, that alongside assessment of the suitability of each structure, it is important to consider the relevant procurement pathway. We consider that the local authority would need to consider whether it was necessary to procure the private sector partner(s) under an OJEU Procurement. There may be grounds (particularly around the establishment of a joint venture) to consider "off-market" approaches, however, these will be limited and should not be considered without undertaking specific legal advice.

Clearly individual circumstances and objectives of local authorities will differ, but we summarise below the potential range of services which may take advantage or be suitable for the type of arrangements suggested below:

ENERGY SERVICES COMPANY	CONTRACTUAL JOINT VENTURE/ PARTNERSHIP/ ALLIANCE	CONCESSION ARRANGEMENTS
Development of energy infrastructure and utilities (e.g. energy network ownership)	e-mobility, EV and air quality Domestic energy efficiency measures	e-mobility and EV (city wide schemes and public charging networks)
Development of generation assets (e.g. storage, solar and wind)	Initiatives to assist the fuel poor and vulnerable Collective switching measures	City wide heat network schemes Waste to Energy
Undertaking of a licensed/regulated activity which requires the relevant activity to be operated by a	Investment in energy infrastructure (e.g. Fund involvement in assets)	Garden City arrangements where the solution is driven by the usage of an IDNO

¹² We would suggest that the local authority also considers the HM Treasury Guidance: A guidance note for Public Sector bodies forming joint ventures with the private sector: March 2010. Whilst somewhat dated, it provides commentary on specific elements which should always be considered prior to undertaking an form of joint venture.

<p>licensing holding entity (e.g. retail energy supply (as/electricity) or energy distribution)</p> <p>"Behind the meter" generation for affordable housing and community assets</p> <p>Community Garden City solutions</p>	<p>Smart City schemes (which require broader service provision than simply energy (e.g. IT/Tech)</p> <p>Electrification of heat</p> <p>Community energy assets</p>	
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We discuss the characteristics of each model below:

(i) ENERGY SERVICE COMPANY

Overview

- 2.17 An energy service company or "ESCO" is a separate legal entity or corporate vehicle, most commonly established as a company limited by shares or a company limited by guarantee. The company is typically set up as a subsidiary of the local authority that is 100% owned by the local authority. This is commonly referred to as a special purpose vehicle, or "SPV".
- 2.18 It is also possible to establish an ESCO as a limited liability partnership¹³, however in experience there are limited advantages (other than tax efficiency) in energy structuring. The reader should note that a limited liability partnership can only ever be used if there is more than one party. When considering whether a limited liability partnership is appropriate is important for the local authority to consider carefully the nature of the partner or partner(s) which it requires. Typically, limited liability partnerships are used where the private sector partner(s) also seeks tax efficiencies (such as an institutional investor). Since the decision in *Haringey*¹⁴ careful consideration should be made in utilising partnership structures. It is more commonplace to see partnerships used in development vehicles, the advantages and common practice in energy companies is to use a company limited by shares or "not-for-profit" vehicle, given there typically is a driver for income revenue by the local authority¹⁵. An overview of the differences between these corporate structures (company limited by shares, company limited by guarantee and limited liability partnership) is set out in the Appendix at page 38.
- 2.19 It is common to set up an ESCO as a separate legal entity to ensure separate accountability and risk management, limited liability, more flexible funding solutions and in order to retain flexibility for future exit. A local authority is required to establish a company where it intends to do something for a commercial purpose, such as trading for profit, for example (please see Figure 1 and Part C at page 31 for further detail). As such, an ESCO is likely to be the best option where a local authority's key objective for delivering renewable energy infrastructure and supplying energy is financial, and to generate income.

¹³ Section 4(2) Localism Act 2011: *Where, in exercise of the general power, a local authority does things for a commercial purpose, the authority must do them through a company* if established for commercial purpose, Section 95 Local Government Act 2003: *enables local authorities to trade in function related activities through a company. The relevant Secretary of State may authorise local authorities to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions*

¹⁴ *Peters v London Borough of Haringey* [2018] EWHC 192 (Admin)

¹⁵ section 95 Local Government Act 2003 suggests that where a local authority seeks to make a profit, it should utilise a company limited by shares

Peterborough City Council, Cornwall Council, Bristol City Council (Bristol Energy Holdings Limited) and Nottingham City Council (Robin Hood Energy) are all strong examples of where local authorities have sought to incorporate trading vehicles to provide energy services. In the case of Bristol and Nottingham, these also hold retail energy supply licenses for gas and electricity. Pinsent Masons would urge local authorities to undertake detailed financial, legal and commercial advice before seeking to compete in retail energy markets as the competition is strong and very price sensitive within very low margin return. Where local authorities have been more successful is on investment in energy asset classes, such as renewable and low carbon generation, e.g. Bristol, Cornwall, South Somerset, Ashford, Newcastle (Helix) and Glasgow – this is because the incomes streams are better understood, either because they qualified for Government subsidies (FiT or ROC) or are providing "sleeved" power via Corporate PPAs.

Legal Structure

- 2.20 There are a number of different types of vehicles that can be considered for an ESCO, including:
- 2.20.1 company limited by shares
 - 2.20.2 company limited by guarantee
 - 2.20.3 limited liability partnership
 - 2.20.4 community interest company; and/or
 - 2.20.5 co-operative and community benefit societies.
- 2.21 An overview of the differences between these structures is set out in the Appendix at page 38. The corporate vehicle utilised by the local authority needs careful consideration and will depend on any number of factors, however, the key factor will be if the vehicle is established with a view to profit or otherwise. Commonly, where the ESCO is established for the benefit of the broader community and/or broader public sector engagement it is common to see structures utilising companies limited by guarantee or community interest companies.
- 2.22 When determining the appropriate choice of vehicle for both the ESCO and any project level entities, key factors to consider will include:
- 2.22.1 whether the entity is to make a profit or if it is to be a 'not for profit' entity
 - 2.22.2 ownership/number of stakeholders and/or involvement of other public sector organisations and/or community
 - 2.22.3 flexibility (aligned with ESCO objectives)
 - 2.22.4 financing – certain types of vehicle are more suitable for financing than others
 - 2.22.5 liability – what level of liability is to be assumed
 - 2.22.6 Exit planning – shares in a company (or its assets) may be sold without significant legal restriction. This is not the case for all other types of vehicle
 - 2.22.7 Tax treatment – whether the local authority is to be taxed in its own person (LLP) or as a company (CLS) given its need to pay corporation tax on profits
- 2.23 A full analysis of each of these factors is beyond the scope of this report but care must be taken to select the most appropriate vehicle depending on these considerations as each type of vehicle has

different attributes. The type of vehicle that may be used for each project will need to be determined on a case by case basis taking account of the factors mentioned above.

Governance

- 2.24 The mechanics of setting up the ESCO are fairly procedural but it will be important to consider the governance arrangements in the terms of the memorandum and articles of association of the ESCO and who the directors will be to ensure that key stakeholders interests are properly represented and that appropriate expertise is available for the delivery of the scheme.
- 2.25 The directors of the ESCO are responsible for managing the business of the ESCO on a day to day basis. It will be important to understand the differing role between that of a shareholder as "owner" of the ESCO (which has no obligation to the ESCO and can act in self interest) and the fiduciary duties of the directors of the ESCO who must act at all times in the best commercial interests of the ESCO.
- 2.26 Senior officer representation from the local authority on the board of directors of the ESCO should also be considered. The advantage of senior officer representation is that it provides for continuity upon changes in administration and ensures that the business plan of the ESCO continues in the long term.
- 2.27 We advise that the local authority considers the need for a business plan for the ESCO which is adopted upon commercial close. The business plan will give the strategic direction for the ESCO and will assist in establishing the independence of the ESCO from the relevant local authority. **It also provides comfort to any private sector investor as to the objectives and targets of the ESCO, giving a clear picture of investment and capital requirements for the pipeline projects which it is envisaged that the ESCO will undertake.**

Key Stakeholders

- 2.28 The participation of key stakeholders will require to be determined following key stakeholder meetings.
- 2.29 Levels of participation by key stakeholders will depend on issues such as assets/services/funding that may be provided by each stakeholder and what liability they are prepared to accept. It will also be important to understand what their expectations are regarding taking an ownership stake in the ESCO or any project company and also their requirement for board representation.
- 2.30 Differing levels of participation may also be achieved through the creation of differing classes of shares in the ESCO and pre-emption rights on any sale of shares. Where there is more than one stakeholder, interests will require to be managed through a shareholders or joint venture agreement particularly given that there may be a divergence of interests between stakeholders regarding social, political and commercial interests. Key stakeholder participation may also vary at project level (and be subject to committed funding levels).

Surplus Income

- 2.31 Where the ESCO is set up as a 'not-for-profit' entity, for example where the local authority's key objectives in establishing it are social value, community initiatives to aid the fuel poor or environmental, any surplus income could potentially be paid to shareholders as dividends (subject to potential thresholds) or used to develop further schemes or other projects.
- 2.32 Where an ESCO is established by the local authority for the provision of energy services, from a public perception perspective it may be perceived less favourably if the local authority were to take profit out and not recycle it into further energy services or future energy schemes. Whether the

ESCO is to be set up 'for profit' or 'not for profit' will also impact on the choice of vehicle used for the ESCO (please refer to the Appendix at page 38).

- 2.33 The choice of whether the ESCO is "not-for-profit" or otherwise, is a key issue which needs to be decided at the outset, as it will have a key bearing on the appetite for investment by the private sector. It is not the case that a "not-for-profit" ESCO is at odds with the private sector interest, it may more simply be a factor of how it should be structured. For example, the private sector may identify that it takes its profit as OPEX via the operation of a heat network and owning the customer relationship (and will commonly be undertaken via a subsidiary, please see below para 2.35). Understanding cash/revenue flow early in the planning process of an ESCO will be essential for identifying the types of roles which the private sector will be interested in participating alongside the local authority. A local authority should always consider early market engagement via market testing to obtain feedback on its approach prior to committing fully. Local authorities tend to utilise these structures more where there is intended participation by the community in a local energy project (e.g. roof-top solar and/or battery solution projects).

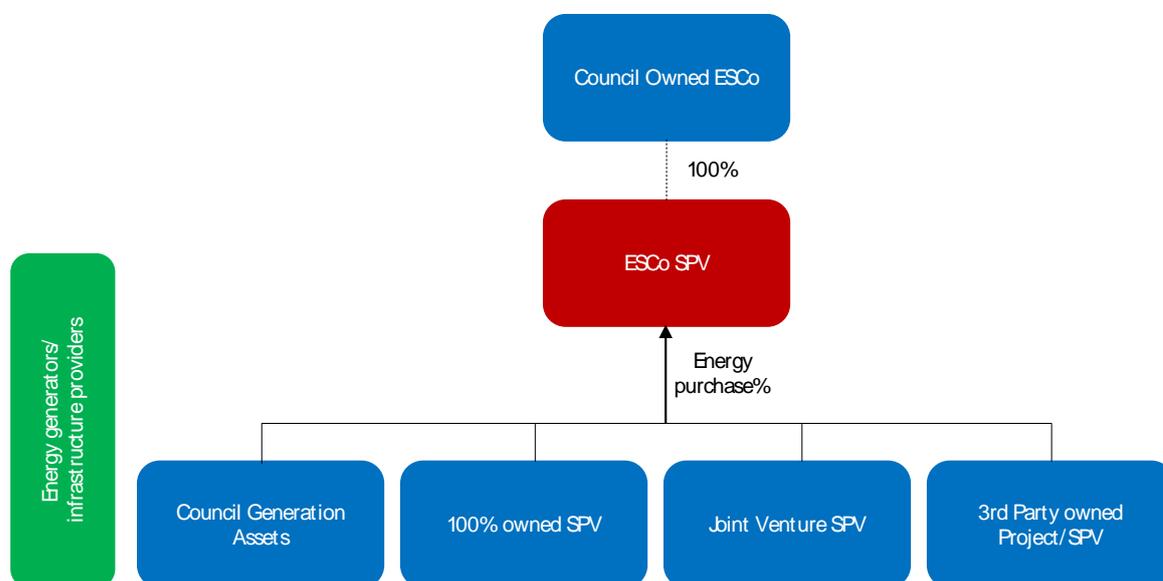
Exit Strategy

- 2.34 It is envisaged that it will be important for the local authority not to be locked in to the ESCO (either through funding mechanisms or inadequate contractual provision for a smooth exit) should it wish to exit from one or more schemes that are developed or owned by the ESCO or to enable the unbundling of projects into their constituent businesses. However, any potential exit route will also need to take into account any non-monetary/social objectives of the delivery of the ESCO.

'Project' or delivery level entities

- 2.35 Once established as a local authority-owned subsidiary, an ESCO can establish and/or contract with different 'project' level entities (each of which can be established as a separate legal entity for the reasons set out in paragraph 2.25) for the development of renewable energy infrastructure and the supply of energy within the area. This is illustrated in Figure 2.
- 2.36 The 'project' level entities set up to deliver specific projects or energy services may each be structured according to the requirements/most appropriate structuring solution for each particular project. This structure would allow for different projects to be set up in different ways, for example, from full ownership and energy purchase by the local authority to no ownership or commitment to purchase energy by the local authority, which would be akin to the concession model discussed at 2.56.
- 2.37 This structure also allows for the ability to bring in third party funding on a project by project basis depending on market conditions and market interest. This is a flexible structure and allows for phasing of future development of projects within the area. It also provides the local authority with a more flexible exit route and/or partial exit from one or more projects should the local authority's investment strategy or policy change in future years.
- 2.38 It will be important for the local authority to obtain financial advice and undertake financial modelling to provide a credible proposition to the private sector. These financial elements are commonly discussed during procurement as the solutions are worked up by the parties during competitive dialogue.

Figure 2: A basic ESCO SPV structure with separate heat/energy generation projects supplying heat to the ESCO.



(ii) CONTRACTUAL JOINT VENTURE OR PARTNERSHIP

Overview

2.39 A partnership is a contractual arrangement between two or more parties that is typically set up via a partnership agreement. This governs the relationship between the parties, their approach to achieving their shared objectives and the profit share arrangements agreed between them. While it can be established quickly and cheaply, a partnership does not establish a separate legal entity, or provide the parties with limited liability for any debts. It is simply a voluntary agreement between the parties and can be withdrawn or varied in line with the provisions of the partnership agreement. If there is no agreement and an 'implied' partnership has been created, the Partnerships Act 1980 sets out what will happen in the event of a default.

2.40 For these reasons, we would generally recommend that a local authority that wishes to enter into a partnership arrangement with a private sector partner in relation to the delivery of renewable energy infrastructure or energy supply does so via a contractual joint venture arrangement, either via the establishment of a separate legal entity (a company or a limited liability partnership) or contractually.

2.41 The key issue which the local authority must contend with in deciding whether to utilise this approach is to consider how risk and reward is presented to the market. Commonly, contractual arrangements are used where a local authority wants to divest of the risk and limits its involvement to scheme promotion and/or funding. Clearly, in such an arrangement there is limited or no reward for the public sector, but this is indicative of the need to address key issues within its administrative area, such as fuel poverty or "pump priming" of new sectors, such as e-mobility. This is a key example of where the local authority may have to act in a more interventionist manner to address social need or requirement.

Legal Structure

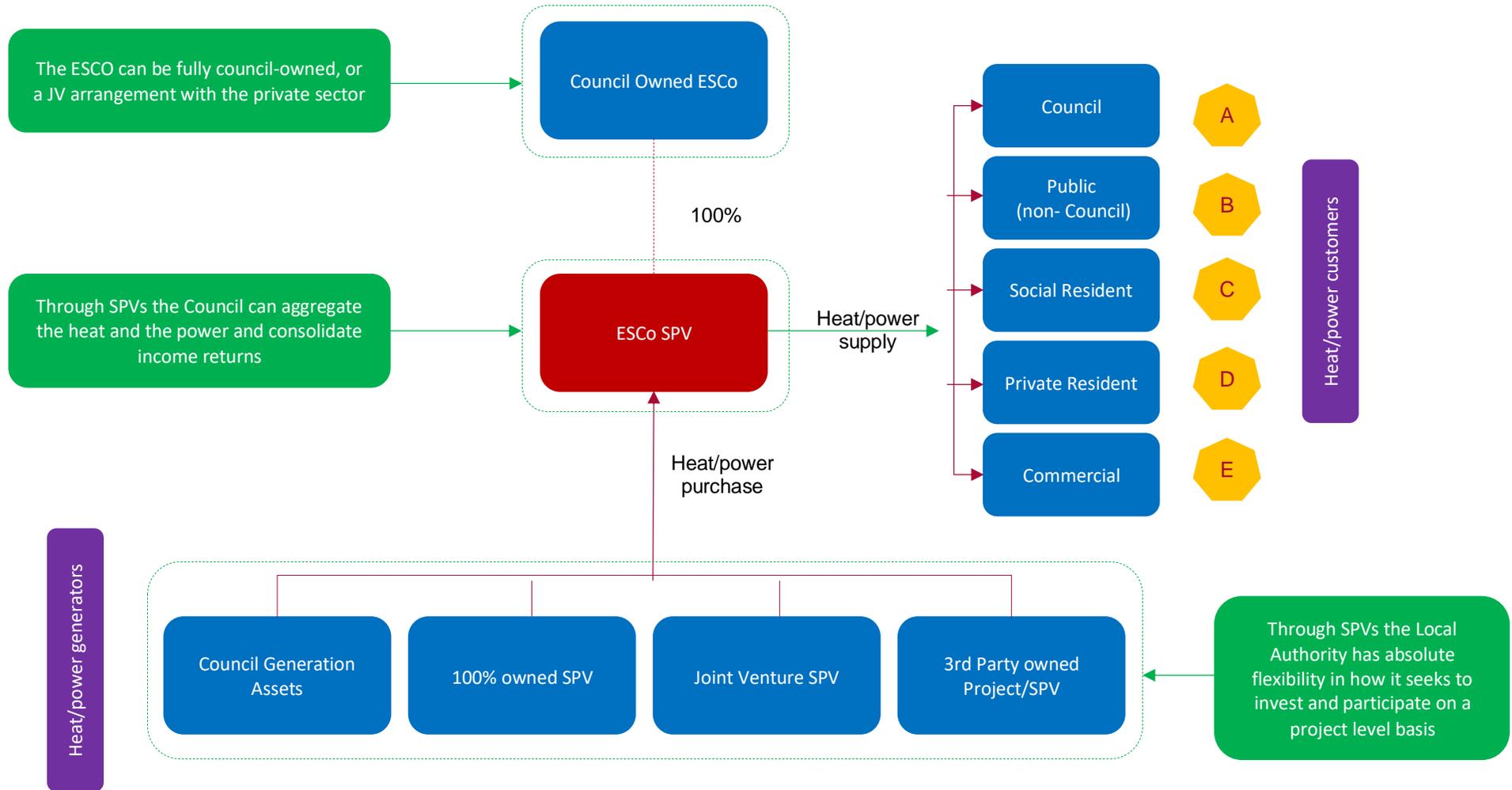
2.42 This structure would be used to limit the liability and risk to the public sector.

2.43 A local authority can enter into a joint venture arrangement with a private sector entity either through a corporate vehicle or as a contractual arrangement. It is relatively uncommon for a joint venture between public/private sector for energy services to be set up as a corporate joint venture

(e.g. a corporate entity where there are both private and public sector shareholders) and it is more likely that such an arrangement would be set up through a contractual arrangement. Joint ventures may also be set up for specific projects/an SPV set up for the provision of specific energy services at the 'project' level. This is reflected in.

- 2.44 Whilst, in principle, there may be a sharing of risk and reward through a joint venture arrangement, there is also a much higher likelihood of competing or conflicting objectives between the joint venture parties and therefore arrangements for matters such as decision making, funding and exit as well as control over the day to day operation will need to be carefully considered in the joint venture agreement.
- 2.45 We would consider that a joint venture should only be considered by a local authority for a specific objective and/or infrastructure delivery (where risk, reward and liability can be ring-fenced to a project specific basis). It may also allow for differing funding solutions on a non-recourse/asset backed basis and the opportunity to ring-fence project risk/liability from the main ESCO.

Figure 3: Joint Venture Arrangement



(iii) CONCESSION ARRANGEMENT

Overview

- 2.46 If structured correctly, these structures can help bring much needed investment into an administrative area. Key to the success will be the local authority achieving the right balance between risk/reward and term/exclusivity. In short, to encourage the private sector to take risk, the local authority must provide a platform which gives the private sector sufficient scope and vision for it to see the "road to profit" (and therefore enticing them to invest). This is why heat concessions tend to have reasonably significant length of terms and/or why anchor heat off-takes can be offered by local authorities. There has to be sufficient benefit for both parties in order for these schemes to work.
- 2.47 Renewable energy infrastructure can be designed, built and managed by a special purpose vehicle set up for that purpose (for example an ESCO or a joint venture) or alternatively, a contract for the design, build and operation of such a network can be entered into with a private sector installer/operator. This is known as a concession structure. A concession structure may be appropriate where, for example, the local authority considers that the provision of energy services detracts from its core activities or where it does not have the capability to manage and provide the services itself.
- 2.48 Where a concession structure is considered, the long-term objectives of the local authority must also be considered. It will be harder to control the future development and growth of an energy solution where investment and commitment to new projects are within the control of the private sector concession partner and therefore a concession structure may not guarantee the delivery of the local authority's objectives or future ambitions.

Newcastle City Council – Citywide District Heating Scheme (Helix Project): The ability to distribute heat over distance has until recently impacted the viability of many city projects. Technology advancement and now the ability to utilise exhaust/waste heat and connection of smaller heat projects is possible. Key to the Newcastle project was the commitment by public sector organisations to offtake the heat, this is one positive way which public sector can help with the financial viability of projects, by essentially lending their covenant to them

Cory Riverside Energy in Bexley will potentially heat up to 10,500 new homes supplying low and ultimately zero-carbon heat. This is a trend we have seen on a number of projects, particularly in the South East, where higher unit prices can sustain the investment.

The Elephant & Castle ESCO is operated by E.ON, but Southwark Council cleverly required the heat to be zero-carbon within three years of operation (via planning controls). The scheme already runs on bio-gas. This too is another example of how local authorities can use their existing powers to influence outcomes.

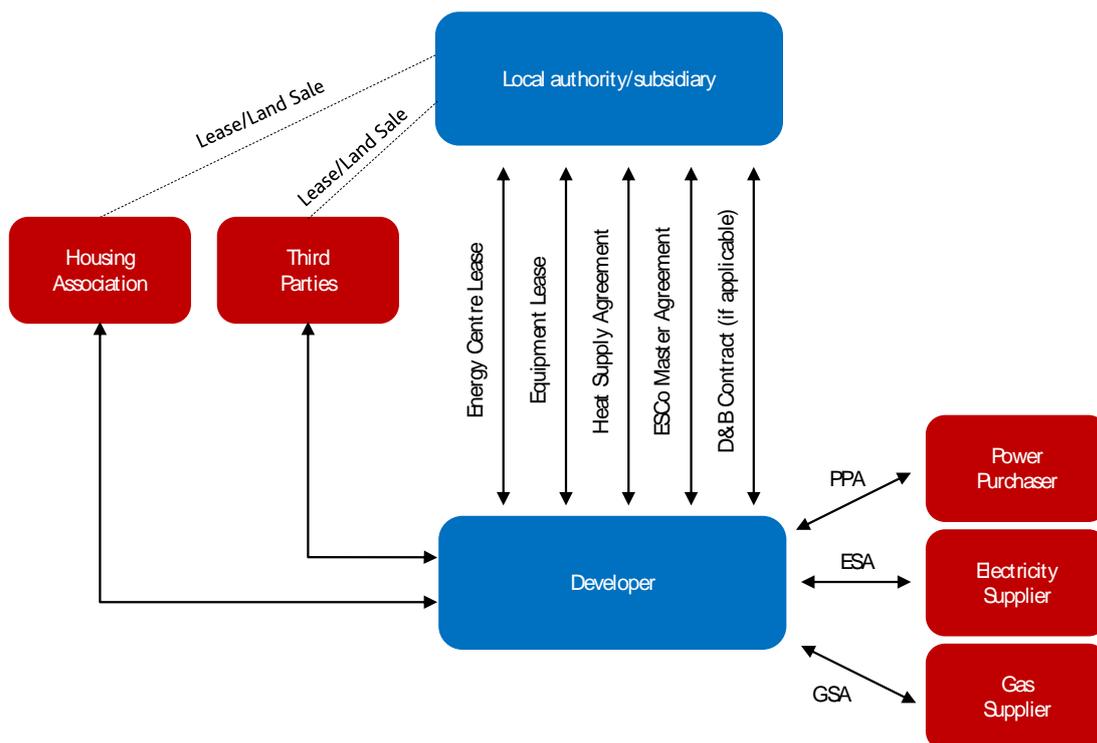
Legal Structure

- 2.49 A concession is a contractual arrangement between a local authority (or its subsidiary) and a concession partner. Typically a series of contracts is entered into with a private sector concession partner. These usually include a concession agreement (where the local authority grants the concession to its concession partner), separate design, build, operate and maintain agreements and leases granting the concession partner the necessary land rights. The diagram in Figure 4 below illustrates this.
- 2.50 Typically, concession arrangements/contracts will be administered by the Concession Contract Regulations 2016. Concessions fall into two main categories of works and services concessions (or both), depending upon the range of services which the relevant local

authority requires. These arrangements are particularly popular where a new energy asset class is to be developed (e.g. heat networks or e-mobility).

- 2.51 These arrangements are normally run in accordance with the Competitive Dialogue Procedure given the level of complexity, planning and requirements which the local authority may have. A key focus during dialogue tends to be on the phasing of the infrastructure delivery and funding of the same. The focus of the local authority will be to understand the deliverables, timings and remedies (such as step-in, hand-back, funding gaps etc) in default scenarios and the development of the solutions, both commercial and legal during dialogue to cater for the same.

Figure 4: A basic ESCO concession structure



Funding and Finance

- 2.52 As noted at paragraph 2.48, the ESCO structure is flexible and allows for a number of funding options. The structure could be funded via a combination of public (for example, PWLB) and private debt (for example, bank loans) and/or equity at the ESCO or 'project levels'. This would need to be established on a case by case basis, in line with the local authority's objectives for the ESCO.

As mentioned above, we would consider that the appetite of investment by the private sector partner is purely a factor of it understanding "what's in it for them", the greater the control, requirements etc of the local authority, the greater the likelihood of push back by the private sector on its interest in funding the same.

Energy Supply

- 2.53 Unless the supply of electricity falls within one of the statutory exemptions set out in Part D applies, a licence to generate, transmit, distribute or supply electricity would be required in relation to an ESCO, joint venture or concession structure. The Electricity Act 1989 makes it an offence to carry out certain activities (generation, transmission, distribution, supply, smart meter communication) within the United Kingdom without a licence or obtaining an exemption from this requirement.

- 2.54 The generation and supply of heat is currently unregulated and engaging in the generation or the supply of heat would not require a licence.
- 2.55 Please refer to Part D at page 36 for further detail on the licensing considerations that local authorities should be aware of in relation to the generation, distribution and supply of electricity.

Local Authority Powers

- 2.56 A full powers analysis would need to be undertaken in relation to a local authority's ability to establish a separate corporate vehicle and from previous experience the analysis tends to focus on a number of powers in order to bring forward the delivery and *vires* of the corporate vehicle. These include, but are not limited to: Section 1 (General Power of Competence) of the Localism Act 2014, Section 12 (Investment) and Section 111 (Subsidiary Powers) of the Local Government Act 1972 (please refer to Part C at page 31 for further discussion of the relevant local authority powers).

Procurement and State Aid

- 2.57 Please refer to Part B at page 26 for a summary of the relevant procurement and state aid considerations.

Risks and Rewards

- 2.58 Table 3: *Risks and rewards of an ESCO, Joint Venture and Concession structure* identifies the key rewards/advantages and risks/disadvantages of an ESCO structure.

Structure	Key Rewards / Benefits	Key Risks / Disadvantages
ESCO	<p>Alignment with local authority/stakeholder objectives. Positions Council well to intervene in low carbon and Net-Zero projects</p> <p>Delivery of range of energy services/projects</p> <p>Ability to structure project level entities differently</p> <p>Access to different funding/financing solutions</p> <p>Allows for investment and delivery of energy infrastructure and generation assets</p> <p>Potential stakeholder/community involvement in specific projects</p> <p>Board of directors with appropriate expertise</p> <p>Risk transfer to ESCO</p>	<p>Ensure that the ESCO has strong governance and business planning</p> <p>Resourcing and skills sets of the public sector (depending upon activities)</p> <p>Consider carefully how the community is involved and broader stakeholders</p> <p>Certain activities may be regulated/licensed activities and local authority may need to consider how to deal with these</p> <p>Potentially large financial outlay</p>
Joint Venture	<p>Lower capital commitment – private sector may fund and local authority commitment could be land.</p> <p>Profits shared on a risk/reward basis.</p> <p>Sharing of risk (subject to capital committed and value).</p>	<p>Future proofing may be reduced by JV agreement</p> <p>Potential for dilution if not managed.</p> <p>Longer delivery, given negotiation and agreeing risk sharing.</p>

	Balance of control and governance retained through JV agreement.	
Concession	<p>Low risk (financially) to the local authority (although majority of upside sits with partners given that they bear the majority of the risk)</p> <p>High level of control and governance maintained over the partner (mainly negative control via concession agreement)</p> <p>Encourages private sector involvement and funding.</p>	<p>Majority of upside and income is retained by private sector operator/partner.</p> <p>Longer delivery, given negotiation and agreeing risk sharing.</p> <p>Council cannot take an active role in decision making and limited flexibility in decision making once the concession agreement is signed.</p> <p>Potential for non-delivery.</p> <p>Limited future-proofing. Dependent on approach in the Concession Agreement.</p> <p>Potential for partner to dictate standards if specifications etc. are not fully agreed prior to signing.</p>

Table 3: Risks and rewards of an ESCO, Joint Venture and Concession structure

C. PUBLIC – COMMUNITY INTEREST COMPANIESECTOR PARTNERSHIPS/UNINCORPORATED ASSOCIATION

Ventures /or partnership with community groups will typically take the form of a corporate vehicle. The key factor which the local authority needs to consider is whether the corporate entity is established with a view to make a profit (please refer to Option 2 where we discuss the potential structures available) or otherwise. If profit is not the motive and community is core to the proposition (and the local authority seeks to champion issues, such as cleaner air, low-carbon or indeed socio-economic gain), local authorities may want to consider using Community Interest Company.

What is a Community Interest Company ("CIC") and when should a local authority consider using them?

A CIC is a limited liability company (either limited by shares or by guarantee), which has the specific aim of providing a benefit to a community and must use its income, assets and profits for the community it is formed to serve. A CIC:

- exists as an entity/corporate body in its own right, with its own legal identity;
- uses surplus funds are to be reinvested to achieve the CIC's social objectives or within the community;
- is not a charity, as its objects do not have to be exclusively charitable and it is not subject to regulation by the Charity Commission; and
- may declare dividends on its shares to investors who are not asset-locked bodies (subject to its constitution) and its directors may also receive reasonable remuneration.

A CIC must *satisfy the community interest test* at formation and continue to do so for as long as it remains a CIC:

- test is satisfied if CIC can demonstrate that a reasonable person might consider that its activities are being carried on for the benefit of the community;
- if activities only benefit members of a particular body or its activities are political, this test will not be satisfied; and

- not all of the CIC's activities need to have a direct benefit to the community to which it serves but everything a CIC does should somehow contribute to benefiting the community it is set up to serve e.g. a solar company CIC will only satisfy the community interest test if it provides a wider community benefit by making its power available to the local community (potentially at a rate below the prevailing standard variable tariff etc.).

These structures are less common than they were in circa 2015-18 when such solutions were utilised for ground mounted solar farms of less than 5MW in size. We consider that these mechanisms may start to resurface as local authorities seek to adjust to Net-Zero and the need to establish a low carbon economy for the fuel poor.

Warm Wales: Established in 2004 by National Grid as part of its corporate responsibility commitments to Government and delivers benefits to 1 million fuel poor homes. It was the first CIC in Wales and is a company limited by guarantee. Formed part of National Grid's 'Affordable Warmth' Programme and focusses on alleviating fuel poverty in Wales and the South West. Projects have included retrofitting energy efficiency and generation measures into homes (e.g. insulation, rooftop solar, heat pumps) and running a "warm schools" programme.

Together Social Business Group: Provides full-time employment for ex-offenders who are engaged to renovate empty properties and build new homes in the communities where they live. Originally established in Bristol in 2011, now expanded to Birmingham and Glasgow (and operates as a company limited by shares). Projects allow employees to gain skills with regards to demolition, decoration, joinery, health and safety procedures and general site operations as well as plumbing, bricklaying and landscaping. Employees are 10x less likely to re-offend whilst working with Together compared to the national average.

CIC and asset locks

Establishing a vehicle utilising a CIC may be preferable where the private sector/ or operators are less likely to participate due to the need to create meaningful returns on investment (such as small scale heat networks etc.). Please note that a unique feature of a CIC, is that the CIC cannot transfer its assets to third parties (including any profits or other surpluses generated by its activities) for less than market value unless transferring them to another CIC or charity or if the transfer is for the benefit of the community it was set up to serve.

- This asset lock principle is enshrined in the CIC's articles of association.
- The asset lock is designed to protect the assets of the CIC and ensures that the assets and profits of the CIC will be devoted to the benefit of the community and not for rewarding shareholders and directors.

The local authority should consider the impact on future divestment of assets (and whether it seeks to recycle its capital at some future stage). Participation in these structures may be limited to circumstances where the local authority is providing money or money's worth to the transaction (i.e. land), where it does not seek to recover value (but is acting as an enabler to ring forward the solution). Please note, that state aid and procurement advice should always be undertaken before taking such approach.

Partnerships: Please refer to Part B (ii) for commentary on partnership approaches.

Unincorporated associations

An unincorporated association is an organisation of two or more people who are working together for a common purpose, but not intending to make a profit.

An unincorporated association has members who take part in decision making about how the organisation is run, either through direct regular involvement or by electing a management committee to oversee the running of the group. The association will often have a constitution, a management committee and could be registered as a charity, though there are no formal requirements for registration. However if any contracts are held or property owned the liability will be with the members, and so their role is limited. This model can suit residents' associations for example.

Advantages:

- easy to establish and involves minimal cost
- governance could involve the community either directly or via a management committee
- a constitution could be adopted to set out the organisations purpose in relation to neighbourhood management and a term of reference to set out its governance and activities.
- these could be used by community associations within the area rather than the organisation which is responsible for overall neighbourhood management.

Disadvantages:

- May be unsuitable for its scope as this form of organisation does not generally have any formal status (unless registered as a charity).

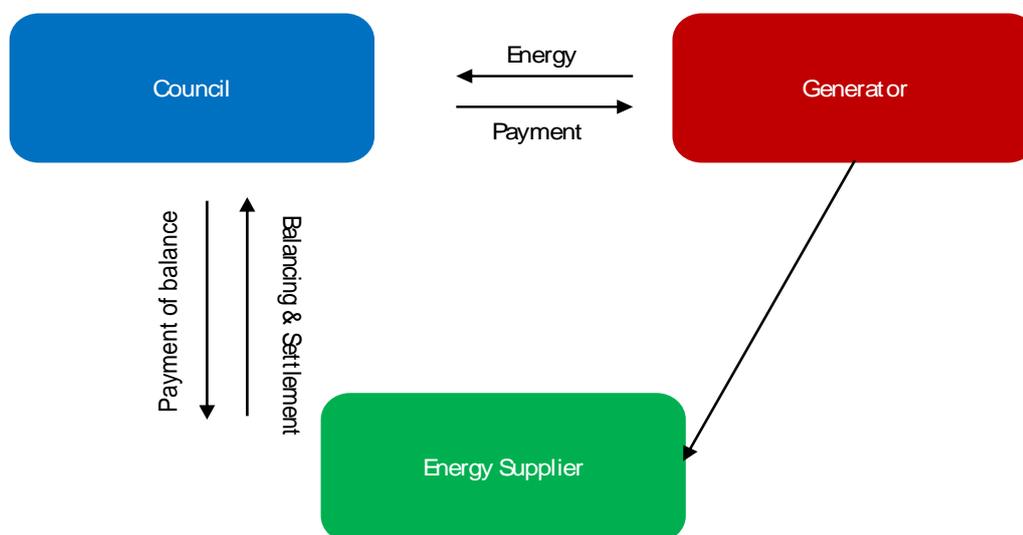
We would not typically advise that unincorporated associations are appropriate for holding energy assets and are more typically reserved for organisations which seek to bring local stakeholders together for the advancement of a common purpose (such as Local Enterprise Partnerships etc.).

D. SLEEVED SUPPLY

2.59 Although not a "supply" of electricity in the traditional sense (in that a local authority would not have a supply contract with the end consumer), "sleeving" (or "netting off") is a contracting route that allows local generators and customers to net their export and import volumes off each other.

2.60 To give effect to this arrangement, a licenced electricity supplier provides the service necessary to transport the electricity from the generating station over the public distribution network to the consumer. This enables the end consumer to share in the benefits of a direct supply, while the supplier is able to gain a near-market price for the electricity generated (and has reduced imbalance exposure, assuming all volumes generated find their way to the customer). This is illustrated in Figure 5.

Figure 5: Sleeved supply



2.61 A sleeving arrangement is relatively quick (and therefore cost effective) to establish: the only resources required would be those needed to put in place the contractual arrangements between a local authority and the third-party licenced supplier providing the sleeving services. The sleeving contract typically covers network charges, imbalance payments, top-up/spill (to deal with instances when the generating plant is down for maintenance or demand is lower than export), and a service fee.

- 2.62 Sleeving is not a common route to market so information on the sleeving contract costs is not readily available. We would recommend that a local authority interested in this contractual structure seek further advice on the financial and commercial business case for a sleeved supply.
- 2.63 Figure 6 illustrates the key strengths and weaknesses of a sleeved supply model versus a fully licenced or 'licence-lite' supply model.

Fully Licensed Supply		Licence-lite Supply		Sleeved Supply	
Ease of Implementation	●	Ease of Implementation	●	Ease of Implementation	●
Costs (set-up and ongoing)	●	Costs (set-up and ongoing)	●	Costs (set-up and ongoing)	●
Time to implement	●	Time to implement	●	Time to implement	●
Revenue (£/MWh)	●	Revenue (£/MWh)	●	Revenue (£/MWh)	●
Customer Relationship	●	Customer Relationship	●	Customer Relationship	●
Operational/commercial flexibility	●	Operational/commercial flexibility	●	Operational/Commercial flexibility	●

Figure 6: Relative strengths and weaknesses of fully licenced, licence-lite and sleeved supply models (Source: Cornwall Insight).

- 2.64 The economic benefits of a sleeved supply need to be considered carefully. It may be more commercially attractive (and maximise a local authority's leverage) for a local authority to sell all electricity generated under a competitive power purchase agreement, and purchase electricity on a competitive basis (for example via the CCS framework) rather than sleeving power. This would need to be investigated on a case by case basis, but in our experience we have found that the purchasing power from the retail energy suppliers is such that the price per kWh which the public sector can command in the marketplace (given its commitment to large volumes of power), means that sleeving in the main has not been economically viable. Local authorities may need to consider wider objectives, such as climate emergencies and commitments to Net-Zero may justify higher utilisation of sleeved renewable energy. In order for this to happen, there needs to be a movement away from procurements focused purely on cost and a movement more to Environment, Social and Governance issues.

3. PART B: PROCUREMENT AND STATE AID ANALYSIS

Procurement and state aid analysis will specifically need to be undertaken on a case by case approach.

It is possible that if Covid-19 sees a tightening in the market that the potential for procurement challenges may become more common, as the private sector seeks to limit its cost exposure to losing to another bidder in a competitive environment.

Local authorities should be aware whether the nature of the works or services will be subject to the Public Contract Regulations 2015 ("PCR") and/or the Utilities Contract Regulations 2016 ("UCR"). Please note, that even if the local authority has created a corporate structure with the private sector, whilst it may be successfully structured in such terms that it is not caught by the PCR, it may still be subject to the UCR (as discussed below).

Buckinghamshire Council and Ebbsfleet Development Corporation— one two examples where procurement may not be necessary is where a local authority seeks to bring forward electricity infrastructure.

Where an authority is acting as a "utility" (see below), it may benefit from a Great Britain-wide exemption from the Utilities Directive/Regulations on the basis that electricity generation and supply in England, Wales and Scotland is directly exposed to competition and therefore no regulation of the market is required. This exemption is available to all entities involved in the generation or supply of electricity within England, Wales or Scotland and also applies in respect of contracts which are "intended to enable those entities to carry out electricity generation or electricity supply in England, Scotland and Wales".¹

This exemption was granted by the European Commission under Article 30 of the former Utilities Directive 2004/17/EC. That Directive was superseded by the 2014/25/EU Utilities Directive, which contains the same provisions under Article 34 (known as the "Article 34 Exemption"). Local authorities have successfully relied on the Article 34 Exemption to bring forward works by network operators to unlock development in urban areas or garden cities where the cost of infrastructure provision is so expensive, that it prohibits investment/development coming forward. Clearly, this example works best if the works can only be carried out by the network operator (the non-contestable works), where this is more challenging is in circumstances where the infrastructure works contain contestable elements which could be brought forward by third parties (other than the network operator). Reliance on this exemption should only be taken after seeking legal advice, but in practice we have found it of limited use as whilst it allows for a more streamlined approach to procurement, it may not always satisfy obligations of Value for Money (which can only be best achieved by undertaking a form of procurement).

3.1 Procurement Analysis

3.2 General: In most instances, Procurement law is agnostic to the potential structure which the local authority seeks to utilise to bring forward the solution.

3.3 The reader should note that dependent upon the energy works and/or services it seeks to bring forward, it may be possible to "call-off" services against an existing framework (e.g. REFit III for energy efficiency). Please note, that this may not apply to ESCOs and/or local authority subsidiary companies unless they have been specifically named in the initial letting of the relevant framework. The reader is advised to check with its legal department before utilising any potential framework solution.

3.4 The PCR or UCR (as defined below) will seek to identify whether the authority (or indeed ESCO) is seeking to procure works and/or services above the threshold values. There are only limited circumstances where the PCR and/or UCR may not apply in the context of energy services. These generally are limited to potential land transactions and/or where a local authority seeks to promote a scheme (similar to Blue Sky Peterborough's Heatborough solution discussed above). Any structuring to take an "off-market" approach should only be taken where specific legal advice has been taken.

- 3.5 Purchasing services from an ESCO controlled by the host local authority: All contracting authorities in England and Wales are subject to the requirements of the PCR when procuring works, services and supplies above the relevant thresholds. A local authority is a contracting authority therefore any purchases which it makes from the ESCO will be subject to the PCR, unless the PCR "in-house" exemptions ("Teckal") apply.
- 3.6 The ESCO may be deemed to be a contracting authority depending on how it is constituted and what its exact activities are. This would need to be reviewed with the relevant local authority on a project by project basis.
- 3.7 Even in the event that the ESCO did fall outside the PCR definition of a contracting authority, we would advise that the ESCO treat itself as if it was a contracting authority if a local authority intends to rely upon the Teckal exemption (i.e. in instances where it is providing services back to itself). It would be contradictory to argue on one hand that the ESCO was an "in-house" entity and on the other that it had an entirely commercial character.
- 3.8 Where the ESCO or structure is deemed to be a Utility: Entities that fall within the definition of a "utility" will be subject to the Utilities Contracts Regulations 2016 ("UCR") (rather than the PCR) when procuring contracts for their "relevant activities" (e.g. supplying electricity to a network or the supply of heat).
- 3.9 The UCR have some different requirements to the PCR in respect of procuring contracts. These are considered to be "lighter touch" than the PCR and therefore a preferable alternative to the PCR. This report does not cover the differences between the procedures under the UCR and PCR.
- 3.10 Possible extension of EU procurement exemptions: It may be possible for the ESCO to be structured in such a way that it is classed as a "utility" under the UCR (and therefore excluded from the requirements of the PCR) but also be classed as exempt from the UCR by virtue of the Electricity Exemption (as defined at 3.11 below).
- 3.11 UK Utilities benefit from two European Commission Decisions (the "Commission Decisions") exempting them from regulated procurement requirements when contracting for activities which are intended to enable them to carry out electricity generation and/or supply in England, Scotland and Wales ("Electricity Exemption"). We have provided an example of how the Article 34 Exemption may apply above. Please always consult your legal department before making any decision to proceed under an Electricity Exemption.
- 3.12 The ESCO may not only be undertaking supply of electricity (which will be exempt under the Electricity Exemption) but also the supply of heat. The supply of heat is not subject to an equivalent exemption.
- 3.13 A note on Brexit: During the transition period, there is no change to the public procurement law regime. It is currently unclear what the position will be at the end of transition period (i.e. at the end of 2020, unless this is extended). It seems unlikely that in the next year or two there will be any radical change to the procurement regime.
- 3.14 **State Aid**
- 3.15 The European Commission (the "Commission") has powers to monitor, control and restrict the forms and levels of 'aid' provided by Member States. Put simply, State aid is any advantage or benefit provided by a public body or using state resources to any undertaking. This therefore extends beyond grants and can include (but is not limited to) loans, financial guarantees, the provision of goods or services on preferential terms, subsidies, consultancy advice and infrastructure projects benefitting specific users. Where State aid has been provided unlawfully (i.e. it has not been notified to the Commission in advance for approval – or potentially the Competition and Markets Authority following the end of the post-Brexit transition period – or where the aid measure does not fall within one of the available exemptions), it must be paid back with interest.
- 3.16 When assessing whether State aid is present in respect of the ESCO project, namely any Local Authority investment in the ESCO, it is necessary to consider whether Article 107(1)

of the Treaty on the Functioning of the European Union ("TFEU") is satisfied. Article 107(1) provides as follows:

Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

3.17 This Article gives rise to the "Four Part Test" for State aid. The Four Part Test is cumulative and State aid will only exist if all four parts of this test are met. For State aid to exist, the following must be satisfied:

3.17.1 Aid is granted by a Member State or through State resources;

3.17.2 To a certain undertaking;

3.17.3 Thereby creating a selective advantage; and

3.17.4 The transfer of resources distorts or has the potential to distort competition and trade between Member States.

3.18 **Part 1 - State Resources**

3.18.1 Article 107(1) refers to aid granted "by a Member State or through State resources"; this includes central and all local governments together with public or private bodies which use State resources or are controlled by the State. A "transfer of resources" can be positive (e.g. a grant) or negative (e.g. a tax rebate or loan at less than market rates of interest). If the transfer improves the beneficiaries' net financial position, or prevents it from deteriorating, then it is likely to constitute a transfer of State resources.

3.18.2 Any funding from the Local Authority, a local authority funded by government, will constitute State resources. An investment by the Local Authority in the ESCO will therefore constitute a transfer of State resources and this part of the Four Part Test will accordingly be satisfied.

3.19 **Part 2 - To an Undertaking**

3.19.1 This element of the Four Part Test requires an assessment of whether the recipient of State aid is an 'undertaking' within the meaning of the rules. An undertaking is an entity in any legal form whatsoever which is engaged in an economic activity i.e. an activity consisting of offering goods or services on a given market. Even if the recipient of aid is a publicly owned company, a non-profit making company or even a charity, it is irrelevant so long as it carries on an economic activity in competition with other operators.

3.19.2 The ESCO will be engaging in the supply of heat and electricity, which are activities which many different energy companies undertake in the pursuit of profit. As such, the ESCO will be engaged in an economic activity/s and this part of the Four Part Test will accordingly be satisfied.

3.20 **Part 3 - Selective Advantage**

3.20.1 There are two elements to this part of the test: is the measure selective and does it provide an advantage? A measure is selective where it is limited to a particular beneficiary or class of beneficiaries. The alternative is a general measure, which means it is applicable in the same manner to all undertakings, across all sectors in a Member State. In order to establish whether either party will derive an "advantage", it is necessary to consider whether the undertaking is in receipt of an economic advantage which could not have been obtained under normal market conditions. In most situations, such as a grant of money, it will be clear that an advantage has been provided.

- 3.20.2 Whether the Local Authority's investment in the ESCO could be said to confer a selective advantage will depend upon whether the investment is made on commercial terms. Sub-commercial terms, or terms with a private sector investor would not agree to, will be deemed to confer a selective advantage. In order to establish whether the Local Authority's investment can be said to have been made on commercial terms, it is necessary to apply the Market Economy Investor Principle ("MEIP") Test, set out in section 2 below.

3.21 Part 4 - Potential to Distort Competition

- 3.21.1 The key aspect of this last part of the Four Part Test is whether the selective advantage conferred on the undertaking has the potential to distort competition. There is no requirement for an actual distortion to be evidenced. As a general rule therefore, this part of the Four Part Test is easy to satisfy and, more often than not, the selective advantage will be found have the potential to distort competition.
- 3.21.2 If aid is found to have an appreciable effect on trade, it is inevitably found to distort or threaten to distort competition¹⁶. The ECJ stated in the *Philip Morris v Commission* judgement that, when State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-community trade, the latter *must* be regarded as affected by that aid¹⁷.
- 3.21.3 The energy market in Europe is sufficiently liberalised, with operators from many different Member States, such that it would be virtually impossible to argue that there was not even a potential to distort competition. As such, we are of the view that this part of the Four Part Test will likely be satisfied.

3.22 Basic MEIP Test

- 3.22.1 In order to assess whether an investment confers an advantage, the MEIP Test should be applied to the assessment. The MEIP Test involves a hypothetical assessment of the support provided by the public body in question. Would a private investor in comparable circumstances have provided such sums or support to the recipient if it were operating under normal market economy conditions?
- 3.22.2 The benefit received by the recipient can take a variety of forms and include equity investment, loans, guarantees and capital injections. No matter what form the benefit takes however, when conferring the benefit the public body must be behaving in the same way as a private investor would in similar circumstances.
- 3.22.3 The hypothetical private investor in the MEIP Test would not provide an advantage to another without demanding compensation for the value that its actions generated for the beneficiary. A private investor in normal market conditions is motivated solely by the possibility of making profits or a return on investment and all other objectives, no matter how worthy (e.g. lowering unemployment or increasing regional investment), are ignored by that private investor. As such, the MEIP Test requires a public body investor to behave in the same way. Any such financial assistance granted must therefore be motivated solely by the possibility of making profits and not by wider social issues.
- 3.22.4 The hypothetical private investor does not need to pursue the most profitable investment. It is sufficient for the investment to give average returns. The private investor will not, however, wilfully forego an obvious opportunity for profit.
- 3.22.5 There are restrictions on the MEIP Test and the concept of the hypothetical private investor. The concept of the hypothetical private investor is narrower than the possible actual behaviour of some real investors, who may take excessive financial risks in the hope that the returns will be commensurately high. Public

¹⁶ T-288/97, *Regione Autonoma Friuli Venezia Giulia v Commission*, 2001 ECR II-1169

¹⁷ 730/79, 1980 ECR 2671 at Para 11

bodies investing public money are expected to act with due prudence and care. Gambling or acting on speculation itself would not therefore be acceptable.

- 3.22.6 MEIP Test assessments are not carried out retrospectively and an analysis would be applied to the facts which were available at the time the relevant public body made the decision to invest. The financial measure or investment will not be assessed with the benefit of hindsight and it is irrelevant if the investment subsequently turns out to be profitable when at the outset there was no realistic benefit involved for the public body.

3.23 Application of MEIP to the ESCO Vehicle

- 3.23.1 If the Local Authority's investment in the ESCO is to avoid conferring a selective advantage upon the ESCO, it is essential that the investment, no matter whether that is equity (in the form of capital or land vestment) or debt, is made on commercial terms. That means that any equity investment made at incorporation needs to be supported by a sufficiently robust business plan, which demonstrates that an acceptable return will be made to the Local Authority in the long term. The return could either be the payment of a coupon at intervals over the life of the ESCO or alternatively the right to extract the return at the Local Authority's exit/dissolution of the ESCO. If the business plan cannot demonstrate an acceptable return to the Local Authority then it would beg the question as to why the Local Authority was investing money in a project which would not generate it a profit. A private sector investor would not do that, and the MEIP Test requires the Local Authority to behave in the same way. This means that the business plan must demonstrate commercial objectives of the ESCO vehicle, as well as the social objectives such as the relief of fuel poverty and affordable heat.
- 3.23.2 Without the structure and commercial terms of the ESCO vehicle being known, it is not possible to say whether the Local Authority's investment in the ESCO will constitute unlawful State aid. As such, we would recommend that the Local Authority maintain a "watching brief" over this matter as the project takes shape. Provided State aid and MEIP are issues which are factored in at the project planning stage, it should be possible to structure the ESCO vehicle and financing of it in such a way that State aid is avoided.

4. PART C: LOCAL AUTHORITY POWERS
- 4.1 'In House' Model: Energy Provision by a local authority
- 4.2 The main local authority powers relevant to the generation and supply of heat and electricity are set out in Section 11 of the Local Government (Miscellaneous Provisions) Act 1976 (the "1976 Act").
- 4.3 In summary, Section 11 of the 1976 Act permits a local authority to:
 - 4.3.1 produce heat or electricity or both and establish and, for the purpose of doing so, operate such generating stations and other installations as the authority thinks fit;
 - 4.3.2 buy or otherwise acquire heat;
 - 4.3.3 use, sell or otherwise dispose of heat produced or acquired, or electricity produced, by the authority (in accordance with section 11, as discussed at paragraph 4.4 below);
 - 4.3.4 enter into and carry out agreements for the supply by the authority, to premises within or outside the authority's area, of heat produced or acquired by the authority in accordance with section 11 of the Act. This includes steam produced from and air and water heated by such heat.
 - 4.3.5 produce heat or electricity or both
- 4.4 Section 11 of the 1976 Act permits the sale of heat or (subject to restrictions on how it was produced) electricity to public and private sector third parties. Note that a local authority *cannot* purchase electricity under section 11 of the 1976 Act, or sell electricity it has purchased or acquired. Section 11(3) limits the power to sell electricity to where it has been produced by the authority in association with heat, or electricity produced from the following sources (in accordance with section 2 of the Sale of Electricity by Local Authorities (England and Wales) Regulations 2010 (the "Regulations")):
 - 4.4.1 wind,
 - 4.4.2 solar,
 - 4.4.3 aerothermal,
 - 4.4.4 geothermal,
 - 4.4.5 hydrothermal and ocean energy,
 - 4.4.6 hydropower,
 - 4.4.7 biomass,
 - 4.4.8 landfill gas,
 - 4.4.9 sewage treatment plant gas, and biogases.
- 4.5 Note that nothing in the 1976 Act or the Regulations exempts a local authority from the requirement to obtain a licence (unless exempt) to generate, transmit, distribute or supply electricity
- 4.6 In relation to heat infrastructure:
 - 4.6.1 Section 11(4) of the 1976 Act provides power to:

- (a) construct, lay and maintain pipes and associated works for the purpose of conveying heat produced or acquired by the authority, and
 - (b) contribute towards costs incurred by another person in providing or maintaining pipes or associated works connected with pipes provided by the authority.
- 4.6.2 Section 11(5) of the 1976 Act provides power to break open roads to lay pipes and carry out associated works.
- 4.7 Section 12 provides power to make byelaws regarding works/apparatus to be provided/used by other persons in connection with supply of heat, hot air, hot water or steam supplied by a local authority under Section 11 and to prevent unauthorised use of the supply and unauthorised interference with the works and apparatus used in connection with the supply.
- 4.8 Note that under section 12(4) of the Act, any expenditure incurred or income generated by a local authority in connection with the powers conferred on it by section 11 of the Act must be accounted for separately in that authority's accounts.
- 4.9 Esco/Aggregator Model: Energy Provision via a local authority Owned SPV
- 4.10 There are a number of more general powers which can be relied on by a local authority for carrying out activities via an ESCO:
- 4.11 The General Power of Competence ("GPC"): Section 1 of the Localism Act 2011 (the "2011 Act") provides: "A local authority has power to do anything that individuals generally may do" even if:
 - 4.11.1 it is unlike anything else the authority may do.
 - 4.11.2 it is unlike anything that other public bodies may do.
 - 4.11.3 it is carried out in any way whatever, including:
 - 4.11.4 anywhere in the UK or elsewhere;
 - 4.11.5 for a commercial purpose or otherwise for a charge, or without charge (but see paragraph 4.14 below); and
 - 4.11.6 for, or otherwise than for, the benefit of the authority, its area or persons resident or present in its area.
- 4.12 The GPC is a very broad power and its general application is not limited by the existence of any other power of the authority that – to any extent – overlaps the GPC. However, there are limitations on the GPC set out in Sections 2 – 4 of the 2011 Act.
- 4.13 Under section 2, the limitations on the GPC are:
 - 4.13.1 if the exercise of the GPC overlaps with a power that pre-dated the commencement of the GPC, then the GPC is subject to the same restrictions as that power;
 - 4.13.2 the GPC does not enable a local authority to do anything which it is unable to do because of a limitation that pre-dated the commencement of the GPC; and
 - 4.13.3 the GPC does not enable a local authority to do anything that it is unable to do because of a post-commencement limitation imposed by a statutory provision which is expressed to apply to the GPC, or to all the local authority's powers with no exception for the GPC.

- 4.14 The Power to Trade: Section 4(2) of the 2011 Act states that “where, in exercise of the general power, a local authority does things for a commercial purpose, the authority must do them through a company”. A “company” is defined as:
- 4.14.1 a company within the meaning given by section 1(1) of the Companies Act 2006; or
 - 4.14.2 a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014 or a society registered or deemed to be registered under the Industrial and Provident Societies Act (Northern Ireland) 1969.
- 4.15 There is a further power to trade created under section 95 of the Local Government Act 2003 (the “2003 Act”). This section empowers the Secretary of State, by order, to authorise local authorities to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions. The power conferred on local authorities by an order made under section 95 may only be exercised through a “company” (similarly defined as in paragraph 4.14).
- 4.16 A local authority must have regard to any guidance issued by the Secretary of State in relation to the exercise of this power.
- 4.17 Under section 95 of the 2003 Act, a local authority cannot be authorised:
- 4.17.1 to do in relation to a person anything which it is required to do in relation to him under its ordinary functions; or
 - 4.17.2 to do in relation to a person anything which it is authorised, apart from that section, to do in relation to him for a commercial purpose.
- 4.18 The current implementing instrument for section 95 of the 2003 Act is the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the “2009 Order”). In conjunction with section 95 of the 2003 Act, the 2009 Order authorises all local authorities to trade in “function-related activities”, provided that certain conditions are fulfilled:
- 4.18.1 trading must be through a “company”;
 - 4.18.2 before exercising the power, the local authority must prepare and approve a business case in support of the exercise of the power; and
 - 4.18.3 the authority must recover the costs of any accommodation, goods, services, staff or any other thing that it supplies to a company in pursuance of an agreement or arrangement to facilitate the exercise of the power to trade.
- 4.19 A “business case” is defined in the 2009 Order as a comprehensive statement as to the objectives of the business, the investment and other resources required to achieve those objectives, any risks the business might face and how significant those risks are and the expected financial results of the business and the outcomes the business is expected to achieve.
- 4.20 Note that if relying on Section 11 of the 1976 Act, a local authority is not required to establish a Section 95 trading company in order to sell heat, irrespective of whether or not profits are generated.
- 4.21 Guidance on the exercise of the trading power under the 2003 Act: Guidance was issued by the Secretary of State for this purpose, initially in 2004 and updated in 2007, but was withdrawn in June 2014. However certain of the points made in the former guidance would remain relevant (although it did not purport to constitute legal advice). For example, the guidance noted that, in deciding whether and how to exercise the power to trade, authorities must still have regard to “their own procedural rules; Wednesbury principles of reasonableness; proper purposes; and fiduciary duty.”

- 4.22 The former guidance also outlined the limited extent to which it was expected that a local authority would assume the losses and obligations of a trading company. It stated that:
- "The local authority will only be responsible for debts and losses of a limited liability company to the extent of the nominal value of its shareholding, and, more significantly, to the extent of any guarantee or contractual arrangement that it has entered into. If there is no such guarantee or agreement, the local authority would not be under any obligation to meet the company's debts, and if it wished to do so it would have to satisfy itself that it had the legal power and that it was exercising that power properly.*
- "However there are other risks if the company cannot meet its debts, if that company provides services that would otherwise be provided by the authority. This might arise in the context of insolvency or where the company is unable to deliver on any contracts with the authority which may give rise to losses or liability on the authority in respect of any failure by the company to deliver. In considering structures, the authority should ensure that it takes appropriate steps to avoid automatically assuming responsibility for any aspects of an unsuccessful company. This should include the actual provision of services"*
- 4.23 Aside from highlighting various diligent precautions that a local authority should take before entering into any type of contractual arrangement in the exercise of its power to trade, the former guidance did not in principle preclude a local authority from giving a parent company guarantee to a subsidiary trading company. This is subject to the caveats that, not only has the guidance been withdrawn, but it did not constitute legal advice.
- 4.24 **Power to Invest:** Section 12 of the 2003 Act gives a local authority the power to invest for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. Note that the Secretary of State and the Chartered Institute of Public Finance and Accountancy (CIPFA) have issued guidance in relation to this power which a local authority must have regard to in exercising its investment power.
- 4.25 A local authority relying on this power as part of a transaction must ensure that this is consistent with its Annual Investment Strategy approved by full Council¹⁸ or that the Strategy has been amended to accord with any new proposal.
- 4.26 The statutory guidance issued by the Secretary of State in 2018 provides that local authority prudent investment strategies must consider security (protecting the capital sum from loss) and liquidity (keeping the money readily available when needed). It notes that yield is distinct from these prudential objectives. However it states that this does not mean local authorities are recommended to ignore such potential revenues and once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with the priorities of security and liquidity.
- 4.27 There are specific provisions which need to be taken into account with regard to the treatment of various types of investments and it should be noted that Section 12 does not refer to pension fund or trust fund investments which are subject to separate regulatory regimes.
- 4.28 **Power to Charge:** Section 93 of the 2003 Act gives a local authority the power to charge a person for providing a service to him, provided that the authority is authorised, but not required, by statute to provide the service, and the other party has agreed to the charge. Note that this power is subject to a duty to ensure that the income from the charges levied for a service do not exceed the costs of providing that service.
- 4.29 **Incidental Power:** Section 111 of the Local Government Act 1972 provides a local authority shall have power to do any thing (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated

¹⁸ Formulating a plan or strategy for the control of an authority's investments is not an executive function .

to facilitate, or is conducive or incidental to, the discharge of any of their functions. A "function" includes all of the duties and powers of a local authority.

- 4.30 However, a local authority does not have the power under this section to raise money, whether by means of rates, precepts or borrowing, or lend money except in accordance with the enactments relating to those matters. Section 111 must be used in association with an identified function and the activity concerned must be directly related to that identified function.
- 4.31 **Best Value:** Section 3 of the Local Government Act 1999 imposes a general duty on local authorities to "make arrangements" to "secure continuous improvement in the way [their] functions are exercised, having regard to a combination of economy, efficiency and effectiveness", for example through (in the operation of an ESCO):
- 4.31.1 securing continuous improvement in the performance and delivery of a district heating network
 - 4.31.2 maintaining an appropriate balance between quality and whole life cost
 - 4.31.3 having regard to efficiency, economy, effectiveness and equal opportunities and
 - 4.31.4 contributing to sustainable development.
- 4.32 In deciding how to fulfil the duty to "make arrangements" for the purpose of section 3 a local authority must have regard to the statutory guidance issued by the Secretary of State for this purpose and consult representatives of the persons specified in s3(2) and take their views into account.

5. PART D: ELECTRICITY LICENCING CONSIDERATIONS

5.1 **General position:** Section 4 of the Electricity Act 1989 (the "Act") states that it is an offence (punishable by a fine of up to the statutory maximum on summary conviction, or an unlimited fine on conviction on indictment) to generate, transmit, distribute or supply electricity unless authorised to do so by a licence or an exemption. Pursuant to section 6(2) of the Act, it is not possible for the same entity to hold a distribution licence and a supply licence. Licences are granted by, and at the discretion of, the Gas and Electricity Markets Authority (the "Authority"), and are administered by Ofgem.

5.1.1 Section 6 of the Act states that an application for a licence must be made in a form and manner prescribed in regulations made by the Authority. The relevant regulations are the Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2010 (the "Regulations"). These set out the manner, form, fees and supporting documentation required to apply for a licence. As licences are granted at the discretion of the Authority, neither the Act nor the Regulations set out the criteria against which licence applications will be assessed.

5.2 **Exemptions:** Individual or class exemptions to the general requirement for a licence imposed by section 4 of the Act may be granted by the Authority. The key class exemptions are contained in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001 (the "Order") and are summarised in Figure 7:

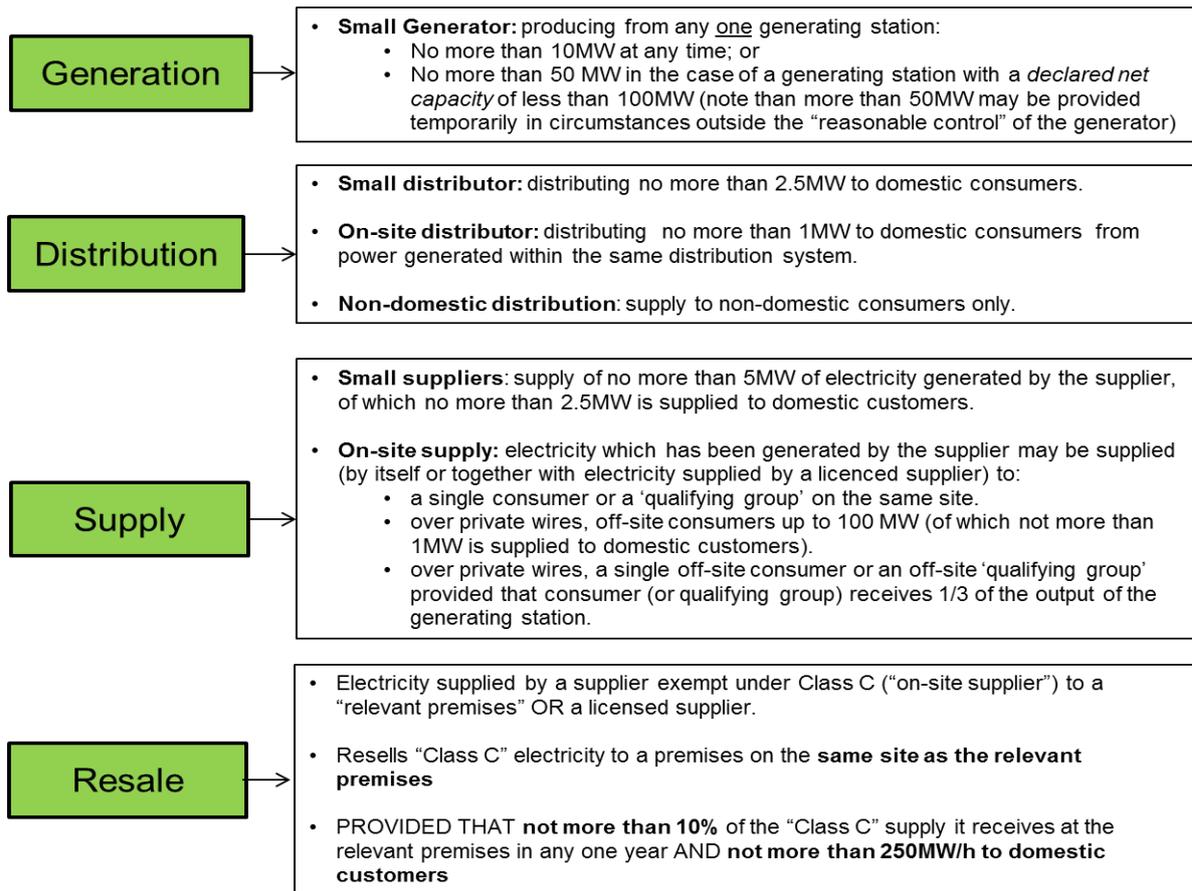


Figure 7: Key class exemptions to the general requirement for a licence.

5.3 **Generation:** As Figure 7 indicates, provided a local authority does not have any one generating station which either:

5.3.1 provides more than 10MW (at any time); or

5.3.2 provides more than 50MW (other than temporarily, in circumstances beyond the reasonable control of the generator) and has a declared net capacity of less than 100MW,

it will fall within the Class A (small generator) exemption and will not require a generation licence. The declared net capacity of a generating station is determined by the formula in Schedule 1 of the Order. Electricity that is (i) wholly consumed by a single consumer or a 'qualifying group' that (in each case) occupies premises that are on the same site as the generating station, or (ii) consumed in part by a single consumer or a 'qualifying group' on the same site as the generating station and the remainder is resold by that consumer (or qualifying group) under Class B of Schedule 4 of the Order does not count towards these thresholds.

5.4 **Distribution:** For the purposes of section 4 of the Act, "distribute" means "distribute by means of a distribution system, that is to say, a system which consists (wholly or mainly) of low voltage lines and electrical plant and is used for conveying electricity to any premises or to any other distribution system".

5.4.1 The class exemptions to the requirement to obtain a distribution licence are summarised in Figure 7.

5.5 **Supply:** For the purposes of section 4 of the Act, "supply" means "supply of electricity conveyed by a distribution system to premises other than premises occupied by a licence holder for the purpose of carrying on the activities which he is authorised by his licence to carry on".

5.5.1 The class exemptions to the requirement to obtain a supply licence are summarised in Figure 7.

5.5.2 The supply exemptions are narrow - particularly in relation to the supply of electricity to domestic consumers. As such we recommend that these are taken into consideration in the initial project planning stage to ensure that an electricity supply licence is not required at the outset.

5.6 **Resale:** Under Class B of the Act, an entity may resell electricity that has been sold to them at a "relevant premises" by a licenced supplier or a supplier that is exempt under Class C ('on-site' supply) along with electricity that they have generated themselves, provided they adhere to certain conditions, including the following:

5.6.1 the electricity must be resold to premises on the same site as the relevant premises;

5.6.2 no more than 10% of "Class C" electricity is resold; and

5.6.3 no more than 250 MWh of "Class C" electricity is resold to domestic customers.

By way of example, this exemption may enable tenants to purchase resold electricity from landlords on a licence-exempt basis.

6. APPENDIX: ANALYSIS OF POTENTIAL CORPORATE STRUCTURES

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
<p>Company Limited by Shares ("CLS")</p>	<p>CLS exists as an entity/corporate body in its own right, has own legal identity</p> <p>2-tier ownership/management structure:</p> <ul style="list-style-type: none"> - shareholders (also referred to as "members") own CLS and can exercise certain decision making powers - directors of the Board are responsible for managing the business of the CLS on a day to day basis 	<p>Ownership of assets CLS can hold assets in its own right</p> <p>Liability of shareholders Liability of shareholders is limited to their investment</p> <p>Familiarity Public sector will be familiar with CLS as a vehicle/concept (e.g. Hub initiatives use CLS). In addition the private sector will be very familiar with CLS as a vehicle/concept.</p> <p>New financing Shareholders (existing or new) can inject funds into the CLS by way of subscriptions for new shares; in addition/in the alternative a CLS can borrow from external sources (e.g. banks) and grant security in favour of such lenders over its own assets. Flexible financing options.</p> <p>Returning funds to shareholders CLS can pay dividends to shareholders, subject to legal/accounting requirements</p> <p>Flexible control structure/constitution CLS structure lends itself well to providing for "reserved matters" (set out in a shareholders' agreement) which are certain decisions requiring unanimous consent of the shareholders, which therefore protects</p>	<p>Profit-making purpose CLSs are designed for profit-making enterprises</p> <p>Conflicts Potential conflict of interests for public sector directors.</p> <p>Double taxation CLS pays corporation tax on profits, therefore reducing amounts capable of return to shareholders as dividends, with no credit for non-tax paying shareholders.</p> <p>Statutory regulation of CLSs This is relatively heavy though the regime for CLSs has been simplified in recent years in many respects</p> <p>Exits Ownership interest in CLS (its shares) can be transferred by shareholders however given the "private" nature of the company there is no ready market for the shares unless there is already an interested party.</p> <p>Stamp duty on exit Incoming shareholders who acquire outgoing shareholder's interest will have to pay stamp duty (at 0.5% of price being</p>

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
		<p>minority/non-controlling shareholders' interests</p> <p>Governance Directors have statutory duties to act in best interests of a CLS and to promote the success of its shareholders</p> <p>Assets remain with JV on exit If a shareholder exits the assets remain with the CLS</p> <p>Continuity CLS exists in own right independently of its members so will continue to exist as a business enterprise going forward despite any changes in members</p>	<p>paid for shares acquired).</p> <p>Administrative burden Filings/returns need to made at Companies House</p> <p>Less privacy Part of the constitution of the CLS (the articles of association) need to be filed at Companies House and so are in the public domain. However, the Shareholders Agreement can remain a private document and does not need to be publicly filed.</p> <p>Personal liability of directors Directors' duties can be onerous and may result in personal (and even criminal) liability for directors if certain duties are breached</p> <p>Returns of capital More difficult compared to LLPs (but has become easier/more streamlined process following recent company law changes)</p> <p>More complex control structure The decision-making process at shareholder level is set out in statute (Companies Act 2006) – some decisions require 50.1% of the vote and others require 75% of the vote (however see</p>

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
<p>Community Interest Company ("CIC")</p> <p><i>NB Please note that as a CIC is either a CLS or a CLG, all of the pros and cons listed for each of those entities are also relevant for CICs.</i></p>	<p>A CIC is a limited liability company, designed for social enterprises that want to use their profits and assets for the public good. A CIC has the specific aim of providing a benefit to a community and must use its income, assets and profits for the community it is formed to serve.</p> <p>CIC exists as an entity/corporate body in its own right, has own legal identity</p> <p>2-tier ownership/management structure:</p> <ul style="list-style-type: none"> - members own CIC and can exercise certain decision making powers - directors of the board are responsible for managing the business of the CIC on a day to day basis <p>A CIC must be a "not for profit" organisation and is typically a business with social objectives, the surplus funds of which are to be reinvested to achieve those social objectives or within the community.</p>	<p>Transparency A CIC has to deliver to the Registrar of Companies an annual community interest company report with its annual accounts. This report records the CIC's activities for that year including any details on assets transferred for less than market value, dividends paid and the remuneration of directors</p> <p>Limited liability A CIC must be a limited company whether by shares or by guarantee.</p> <p>Separate Legal Identity As a CIC is either a CLG or a CLS it has separate legal identity and can therefore hold property, enter into leases and employ people. In addition, the liability of its members is limited (to what extent depends on whether the CIC is set up as a CLG or a CLS).</p> <p>Simple to set up CICs are formed under the Companies Act 2006 like any other limited company. The Regulator has produced various forms of model memoranda and articles of association for CICs.</p>	<p>"Flexible control structure/constitution" in "Pros" column).</p> <p>Administrative Requirements Must comply with company law. In addition, they must comply with the legislation governing CICs.</p> <p>Supervision and Regulation Regulated by the Regulator of Community Interest Companies who ensures that the CIC satisfies the community interest test and pursues its community interest objects.</p> <p>A CIC has to deliver to the Registrar of Companies an annual community interest company report with its annual accounts. This report records the CIC's activities for that year including any details on assets transferred for less than market value, dividends paid and the remuneration of directors.</p> <p>Performance Interest Caps There are caps contained in the regulations where interest is payable on debts or debentures and the interest is linked to the performance of the CIC.</p>

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
	<p>A CIC must satisfy the community interest test at formation and continue to do so for as long as it remains a CIC. A CIC will satisfy the community interest test if it can show that a reasonable person might consider that its activities are being carried on for the benefit of the community. A company will not satisfy the test if its activities only benefit members of a particular body or its activities are political. Not all of the activities carried on by a CIC need to have a direct benefit to the community to which it serves but everything a CIC does should somehow contribute to benefiting the community it is set up to serve. For example, a sports club for employees of a business will only satisfy the community interest test if it provides a wider community benefit by making its facilities available to the local community.</p>	<p>Asset lock <i>The Regulations</i> governing CICs specify that the CIC cannot transfer its assets (including any profits or other surpluses generated by its activities) for less than market value unless transferring them to another CIC or charity (that is either specified in its or articles or consented to by the Regulator) or if the transfer is for the benefit of the community it was set up to serve (known as the asset lock). This asset lock is set out in the articles of association of the CIC. CICs must consider the asset-lock when entering into commercial relationships and when deciding remuneration for its employees and directors. The asset lock protects the assets of the CIC and ensures that the assets and profits of the CIC will be devoted to the benefit of the community and not for rewarding shareholders and directors.</p> <p>Flexibility A CIC can take the form of a number of different corporate structures so long as all its activities contribute to providing benefit to the community. If the CIC is a not for profit organisation, it can be formed using a company limited by guarantee. If however, it wishes to make profits and distribute the profits to its members, it may be formed using a company limited by shares. As CICs cannot be charities, their objects do not have to be exclusively charitable and it is not subject to regulation by the Office of the Scottish Charity Regulator. A CIC may also declare dividends</p>	

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
		<p>on its shares to investors who are not asset-locked bodies (subject to its constitution). Directors may also receive reasonable remuneration.</p>	
<p>LLP</p>	<p>LLP exists as an entity/corporate body in its own right, has own legal identity</p> <p>1-tier ownership/management structure - members are both owners of and responsible for management of LLP on a day to day basis</p> <p>Structure commonly used by Scottish Local Authorities for ALEOs.</p>	<p>Ownership of assets LLP can hold assets in its own name</p> <p>Liability of members Liability of members is limited to their investment</p> <p>New financing Members (existing or new) can inject funds into the LLP by way of capital contributions or loans to the LLP; in addition/in the alternative a LLP can borrow from external sources (e.g. banks) and grant security in favour of such lenders over its own assets</p> <p>Introduction of new members New members can easily be introduced to an existing LLP</p> <p>Returns of capital Easier compared to CLS model</p>	<p>Profit-making purpose LLPs are designed for profit-making enterprises however the LLP can be adapted by having protections for the social mission set out in the LLP Agreement.</p> <p>Sale of a member's interest Less familiarity in market as to how to sell/transfer an interest in an LLP compared to CLSs.</p> <p>Administrative requirements A degree of administrative burden exists (e.g. Companies House filings) though less than CLSs. Notably the names of the members (both original and subsequent changes) need to be recorded at Companies House, and annual accounts filed within the statutory timeframes.</p>

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
		<p>Tax transparency LLP does not pay tax on its profits but rather its members are subject to corporation tax (corporate members) or income tax (individual members).</p> <p>Flexible control structure/constitution More flexible control structure compared to CLS model</p> <p>VAT VAT registration is possible</p> <p>Profit distribution Flexible basis for profit distributions (e.g. not necessarily in proportion to invested capital) if considered a requirement.</p> <p>Privacy of LLP documentation The key constitutional document (the Members Agreement) will not need to be filed at Companies House and therefore is not in the public domain</p> <p>Continuity LLP exists in own right independently of its members so will continue to exist as a business enterprise going forward despite any changes in members</p>	

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
<p>Co-operative and Community Benefit Societies ("Societies") (formerly known as Industrial and Provident Societies ("IPS"))</p>	<p>Last year the old IPS legal form was replaced with two new legal forms:-</p> <ul style="list-style-type: none"> - the co-operative society; and - the community benefit society. <p>Societies are similar to a company limited by shares in that they have directors and members but the business must be conducted for the mutual benefit of the Society members or the community.</p> <p>To qualify for registration as Society a body must either be a co-operative society for the mutual benefit of members, or for the benefit of the community.</p>	<p>Not for Profit A Society is suitable for non-profit-making enterprises.</p> <p>Community Benefit Societies must not allow profits or its assets to be distributed to its members. Co-operative Societies can allow for profits to be distributed amongst its members in line with the rules of the society.</p> <p>Societies are registered with the Financial Conduct Authority and are regulated by the FCA under a regime which is similar to that for registered companies.</p> <p>Society Rules The society must have rules which are submitted with its application for registration.</p> <p>The powers of the society are determined by its rules and the statutes.</p> <p>Ownership of assets As it has a separate legal personality it can hold or purchase land, hold contracts and employ staff.</p> <p>Membership Control Members have ultimate control over the society and the appointment and removal of directors.</p> <p>Directors Directors have a range of duties based on the</p>	<p>Membership criteria Requires three members from the outset.</p> <p>Are a form of constitution less frequently used than others.</p> <p>The incorporation procedure can be expensive and time-consuming.</p>

LEGAL STRUCTURE	KEY CHARACTERISTICS	ADVANTAGES	DISADVANTAGES
		<p>same underlying principles as those of company directors.</p> <p>Limited Liability The liability of the members is limited to the share capital they hold in the Society and the amount of any unpaid capital.</p>	

Should you have any queries about any aspect of our report, please do not hesitate to get in touch.



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