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Department for
Business, Energy
& Industrial Strategy

DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY
HEAT NETWORKS DELIVERY UNIT
DISTRICT HEATING GUIDANCE

Guidance on Powers, Public Procurement and State Aid

September 2016

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CONTENTS

GLOSSARY OF FREQUENTLY USED TERMS

BEIS – Department for Business, Energy and Industrial Strategy
Commission – the EU Commission
Concession – as used in the Concession Regulations and meaning the grant of a right to exploit works or services (as further explained in Part B)
Concessions Regulations – the Concession Contracts Regulations 2016
Contracting Authority - the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes the Crown/central government authorities, but does not include Her Majesty in her private capacity
De Minimis – the threshold below which state aid may be permissible (as further explained in Part C)
ESCo - Energy services company
GBER – General block exemption regulations
General power (of competence) – the statutory power for a local authority to do anything an individual may do (as further explained in Part A)
Joint venture – an arrangement between a local authority and a chosen private sector partner which may or may not, depending on context, involve the setting up of a new legal entity
MEOP – Market economy operator principle
Mixed contract/mixed procurement – where a procurement may cover outcomes that may be a combination or works/services/supplies and/or possibly falling under more than one of the regulations
OJEU – the Official Journal of the European Union (and because it is used for tender notices, generally adopted as an umbrella term for all EU procurement laws)
PCR – Public Contracts Regulations 2015
Procurement – the acquisition by means of a public contract of works, supplies or services (where "public contract" means a contract for pecuniary interest in writing)
SGEI – services of general economic interest (as further explained in Part C)
SPV – special purpose vehicle
Threshold – the relevant financial threshold above which a prospective procurement may be caught by procurement regulations
Treaty/TFEU – the Treaty on European Union and Treaty on the Functioning of the European Union
Utilities Regulations - the Utilities Contracts Regulations 2016
Utility – the general term used in the Utilities Regulations (being either a contracting authority or public undertaking)

INTRODUCTION

Purpose of this guidance

Lux Nova Partners Limited, working in collaboration with Browne Jacobson LLP, were appointed to produce guidance to assist local authority readers, familiar with local authority procurement issues generally, to better understand:

- the powers a local authority has to generate and supply heat;
- the application of public procurement rules to likely activity;
- where State aid may arise, how to quantify it and how to remain compliant.

What this guidance covers

The issues highlighted in this guidance are legal issues, which are not always straightforward in the context of a particular scheme. The need to consider the legal issues is important in order to –

- Ensure that the scheme, and its means of delivery, are lawful;
- To thereby ensure that risk of legal challenge is avoided;
- To facilitate and enable investment (by private sector and grant providers);
- To remove the difficulty of having to retro-fit the delivery structure (where legal considerations are overlooked at the start).

Failure to consider these factors can result in delay and extra expense. It should be noted, for example, that whilst (as explained in this note) the risk of procurement challenges will eventually be time barred, the limitation period for state aid risks is much longer: namely, 10 years from the provision of aid (which could be 10 years from the end of the project, depending on the aid provided).

The legal issues covered by this guidance overlap in many ways. For example, the assumptions made in the business case may drive whether the scheme is being promoted for a commercial purpose, and/or may require a joint venture with a private sector partner. This, in turn, will impact on the statutory powers being relied on, the application of procurement law and choice of procurement route, as well as on state aid analysis. Accordingly, none of these issues may safely be considered in isolation.

It is not possible to give definitive guidance that can be applied across the broad range of district heating scheme delivery models discussed in the other guidance produced in parallel to this guidance. As such, this guidance summarises particular legal issues involved but is no substitute for taking full advice – and, in preparing this guidance note, we have assumed that local authorities will take advice specific to the particular district heating project(s) for which they are developing their business case.

TIP: Alongside the business case, assess the powers, procurement, and state aid position in detail - and with an eye on what may change over time.

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In relation to procurement law and state aid, the legal position in the UK is founded on EU Treaty principles and/or EU Directives; accordingly any district heating scheme in an EU member state would have been established against predominantly identical legal considerations.

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PART A – LOCAL AUTHORITY POWERS

1. Powers to generate and sell heat

Section 11 of the Local Government (Miscellaneous Provisions) Act 1976 (as amended by the Electricity Act 1989) provides that a local authority may generate and sell heat and electricity, and may also purchase and supply heat.

Local authorities which are housing authorities, and which operate a heating installation and supply premises with heat produced at that installation, may also charge for that heat under the Housing Act 1985.

Although this guidance is focused on heat, it is worthy of note that, in relation to electricity:

- the broad power under section 11 was limited by section 11(3) which provides that:

  "*Except in such cases as may be prescribed, a local authority shall not be entitled to sell electricity which is produced otherwise than in association with heat*."

- since 2010, local authorities wishing to sell electricity generated from renewable sources have been permitted to do so;

- local authorities wishing to supply electricity (making physical delivery to premises as opposed to merely selling ownership to a licensed supplier) may only do so lawfully in accordance with a licence granted under section 6 of the Electricity Act 1989 or in circumstances where there is an exemption from the requirement to obtain a licence – which is effected by an exemption order made under section 5 of the 1989 Act.

"Renewable sources" is defined in the Electricity Act 1989 as "sources of energy other than fossil fuel or nuclear fuel, but includes waste of which not more than a specified proportion is waste which is, or is derived from, fossil fuel". In the Sale of Electricity by Local Authorities (England and Wales) Regulations 2010 (2010 No 1910), the following are cited: wind, solar, aerothermal, geothermal, hydrothermal and ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas, and biogases.

EU Directive 2009/28/EC, on the promotion of the use of energy from renewable sources, defines energy from renewable sources as:

> *"...energy from renewable non-fossil sources, namely wind, solar, aerothermal, geothermal, hydrothermal and ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas and biogases;"*

Exemptions can be found in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001 (amended in 2007), and covers (broadly) small scale generation, offshore generation, on-site distribution, and distribution solely to non-domestic consumers. Further legal advice would be required to rely on an exemption. See also - https://www.gov.uk/guidance/electricity-licence-exemptions

2. General power of competence – Localism Act 2011

More broadly, Section 1 (1) of the Localism Act 2011 provides that "*a local authority has power to do anything that individuals generally may do*". This *general power of competence* does not allow local authorities to do anything that is specifically prohibited in legislation (a '*pre-commencement limitation*'). Under section 3 of the Act, commercial activities may be undertaken - following on from the powers under sections 93 and 95 of the Local Government Act 2003 - but this must be done through a company and local authorities cannot trade in services that they already have a statutory requirement to provide.

Because earlier statutory powers to supply and sell heat and qualifying electricity exist (under Section 11 of the Local Government (Miscellaneous Provisions) Act 1976), it may be possible not to rely on the general power, and thereby not necessarily be obliged to set up a company.

This means that local authorities:

- can supply and sell heat (and/or electricity generated with heat or from renewables) either directly or through a company they control; and
- can operate on the basis of cost-recovery or on a for-profit basis, when selling heat (and/or electricity generated with heat or from renewables).

3. Planning

Local authorities can promote district heating in a number of ways, exercising their planning powers. This can include, amongst other things:

- pro-district heating planning policy – for example:
    - many local authorities already have policies that require district heating to be incorporated into developments of sufficient scale and adequate justification to be given if it is not;
    - where district heating networks already exist, some authorities require consideration to be given to connect to that network, subject to technical and commercial feasibility, and/or for new district heating schemes being installed to be "ready" for connection to neighbouring schemes;
    - the promotion of specifications for buildings and internal networks that make their design and construction better suited to connection to a district heating scheme – if done well, this can help raise standards for buildings and help district heating schemes significantly reduce heat loss across the network;
- imposing conditions on the grant of planning permission and ongoing obligations in a s.106 agreement;
- simplifying the construction of district heating networks and connections through, for example:
    - Local Planning Authorities have been able to produce a Local Development Order (LDO) since the introduction of the 1990 Town and Country Planning Act. LDOs grant automatic planning permission for specified development in defined areas. They are flexible and can be used for different uses and developments in different areas and streamline the planning process (What types of area-wide local planning permission are there? | Planning Practice Guidance)
    - The scheme may involve elements that are permitted under the Town and Country Planning (General Permitted Development) (England) Order 2015 – see http://www.legislation.gov.uk/uksi/2015/596/pdfs/uksi_20150596_en.pdf.

4. Other powers

Looking more broadly at local authority powers in relation to district heating schemes, relevant powers include:

- planning powers and associated obligations;

- powers of local authorities as the highways authority (and, for example, the Gas Act 1986 allows certain apparatus to be installed in the highway);

- powers to dispose of land at an undervalue (section 123 of the Local Government Act 1972) but State aid rules must still be complied with; and

- specific local powers enable local authorities to engage in district heating activities, e.g. The LCC General Powers Act 1949 (which also allows apparatus to be installed in the highway).

5. Landlord and Tenant

There is no general, statutory obligation imposed on landlords to provide heat. It is a common misconception that there is.

However, in certain circumstances, landlords do have specific statutory obligations directly relevant to district heating. Essentially, these can be characterised either as obligations:

- to provide or maintain certain infrastructure or services; or

- not to pass through to tenants unreasonable costs incurred.

Under section 11 of the Landlord and Tenant Act 1985, landlords must keep in repair and in proper working order the installations in a dwelling-house for space heating and for heating water. This obligation only applies to domestic lettings, under a *short lease*. A *short lease* is a lease of a dwelling house for less than 7 years.[1] There are various exemptions from this obligation, including: registered social landlords, lettings by local authorities and lettings to students by educational institutions. Even where section 11 does apply, it is a defence for a landlord to show that, using reasonable endeavours, he cannot gain access to parts of a district heating system outside the dwelling-house itself. In respect of those *short leases* where section 11 does apply, a tenant-heat customer will have grounds to object if, for example, he is charged by his landlord for maintenance of pipework in the dwelling house.

Under sections 18 and 19 of the Landlord and Tenant Act 1985, landlords can only pass through to tenants *reasonable* costs of maintenance (for example, of networks and apparatus within the building) if they are charging in advance of incurring the costs. And, under section 20 of the Landlord and Tenant Act 1985, landlord's rights to pass through to tenants costs they incur under *Qualifying Long Term Agreements* are severely limited unless they have undertaken a statutory consultation. Qualifying Long Term Agreements are agreements entered into by the landlord, which are at least 12 months in length and are charged at over £100 per year or require more than a £250 contribution towards the cost of covered works. Where tenants are already occupying, certain consultation requirements must be followed. These are set out in the Service Charges (Consultation Requirements)(England) Regulations 2003. The intention of the legislation is to give existing tenants the right to challenge landlords who appear to be passing through to them unduly high charges. But where, for example, no tenants have yet entered into a lease of a building served by district-heating at the time the contract is placed, case law would suggest that consultation is not legally required and no dispensation needed[2]. Instead, it is to be expected that the tenants will discover about the contract before they enter into their lease. Consequently, best practice suggests that landlords should still bring any such contracts to the attention of potential tenants before they sign.

Section 108 of the Housing Act 1985 limits to what is *reasonable* what local authorities can charge secure tenants for heat. However, this does not apply to charges made by a third party if they, rather than the authority, operate a district heating scheme and supply the heat.

[1] Section 13 and 14 of the Landlord and Tenant Act 1985
[2] Legal advice should be sought where, for example, an agreement for lease or investment lease has been granted as the legal position is ambiguous and a view may be needed whether or not consultation or dispensation is possible or advisable.

6. Conclusion

Accordingly, there is a statutory basis for pursuing district heating schemes lawfully (i.e. intra vires). Of course, in making decisions, a public body would also need to ensure it complied with general non-statutory duties to act reasonably, to take account of relevant factors (and disregard irrelevant ones), and to act rationally. It may, depending on the situation, need to undertake general or specific consultations.

TIP: Address statutory powers upfront as part of the business case. Recognise that there are "traps", e.g. the requirement to set up a company under the Localism Act 2011 (Section 4) if "commercial" activity is intended.

Moreover, whilst it may be clear-cut that sufficient statutory powers exist, the authority should nonetheless take account of its fiduciary duties and the degree to which it may be exposed to project risks (especially any financial risks). The existence of powers does not absolve an authority from acting prudently. The Section 151 officer[3] of a local authority, in particular, will take this into account.

This will be especially important where the authority may be required to give guarantees of some sort in relation to off-take agreements, supply agreements, or the like.

Depending on the scheme, there may be a range of other legal powers to consider and matters ancillary to that. For example, if the scheme is to be delivered via an arms-length company, there will be a need to consider directors' duties, indemnification/insurance of directors, conflicts of interest generally, plus company audit and secretarial functions.

[3] An officer appointed by a local authority under section 151 of the Local Government Act 1972 to ensure the proper administration of their financial affairs.

PART B – PUBLIC PROCUREMENT

This guidance assumes some familiarity on the part of the reader with procurement issues generally.

1. Identifying a "contracting authority" under the Public Contracts Regulations 2015, the Utilities Contracts Regulations 2016 and the Concessions Contracts Regulations 2016

"*Contracting authorities*" are defined consistently across the Regulations (Regulation 2 of the PCR, Regulation 4 of the Utilities Regulations and Regulation 4 of the Concessions Regulations) as being the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes the Crown/central government authorities, but does not include Her Majesty in her private capacity.

A key part of this definition is what are "*bodies governed by public law*" – or for the purposes of the Utilities Regulations, "*public undertakings*" (see Regulation 5[4]). They are defined as bodies that have all of the following characteristics:

They are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; and

↓

They have legal personality (e.g. they are a company or partnership or similar); and

↓

They have any of the following characteristics:

- ***they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law***
- ***they are subject to management supervision by those authorities or bodies***
- ***they have an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law***

And for these purposes a "public undertaking" is any undertaking over which contracting authorities may exercise directly or indirectly a dominant influence by virtue of:—

a) their ownership of that undertaking;

b) their financial participation in that undertaking; or

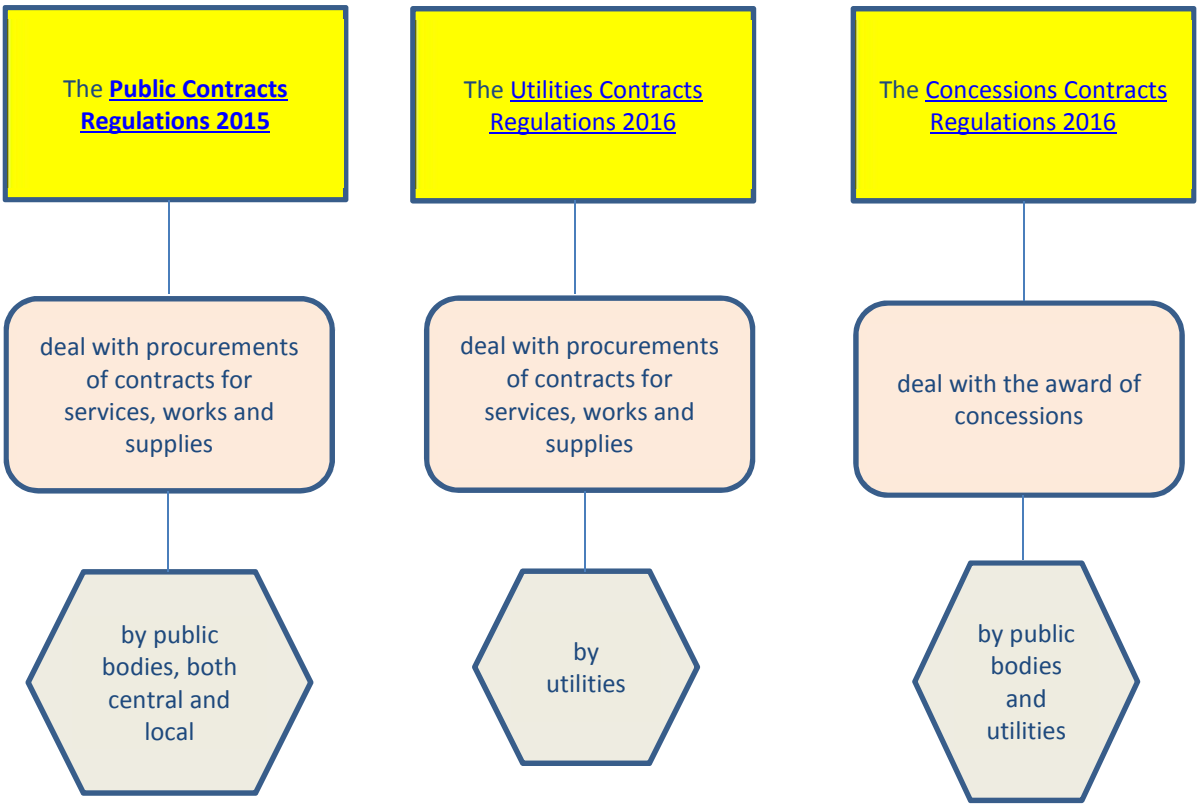
c) the rules which govern that undertaking.

[4] Regulation 5 introduces a stand-alone concept of "public undertaking" alongside "contracting authority".

Most obviously this will be the case where the contracting authority has a "dominant interest" by virtue of its share ownership, financial stake, or voting rights.

2. Determining which Public Procurement rules apply

From 18th April 2016, depending on the structure of the scheme, what scheme is being procured, and who is carrying out the procurement, any of the following Regulations could be relevant to district heating scheme procurement. A local authority may be a "utility" for the purposes of the Utilities Contracts Regulations 2016 (see below).



Each of these terms and the Regulations are explored further below. Annex A further describes the likely basis for deciding which of the Regulations applies.

Contracts to which the relevant Regulations do not apply in full or at all (e.g. because they are exempt) must still be let in accordance with Treaty Principles i.e. non-discrimination, level playing field, transparent tender process where there is likely to be cross border interest.

2.1 The Public Contracts Regulations 2015 (PCR)

Here is a link to the PCR:

http://www.legislation.gov.uk/uksi/2015/102/contents/made

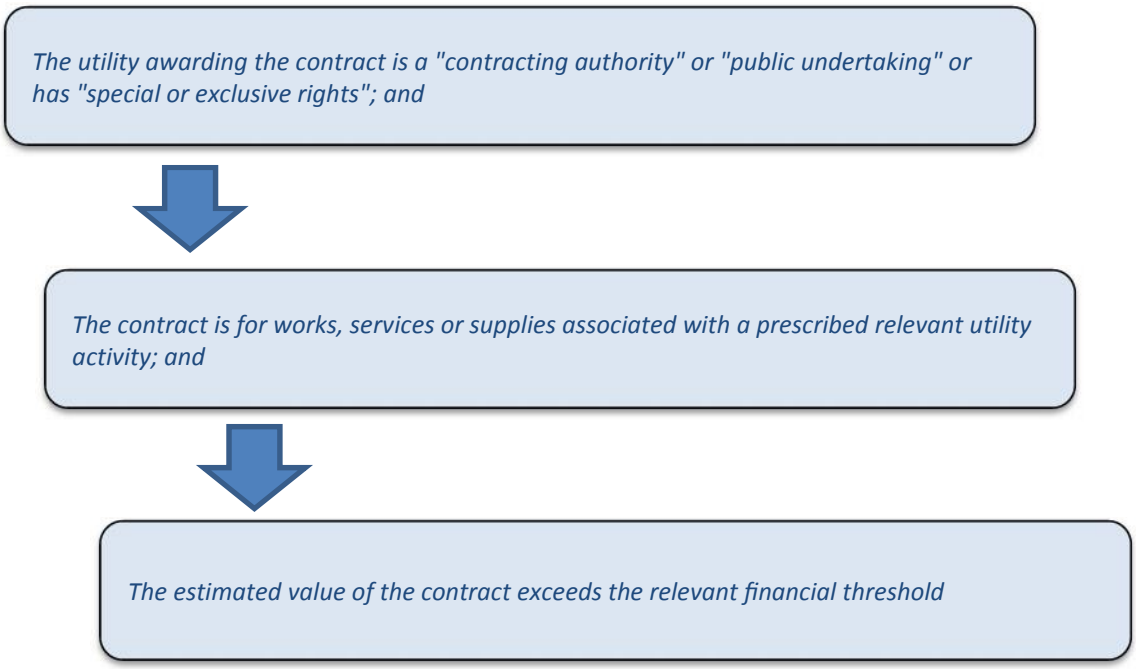
This guidance assumes that the reader is familiar with the PCR, as this has day-to-day relevance for so much local authority procurement activity, so we are not providing specific commentary on the PCR.

2.2 The Utilities Contracts Regulations 2016 (Utilities Regulations)

Here is a link to the Utilities Regulations:

http://www.legislation.gov.uk/uksi/2016/274/contents/made

2.2.1 Broadly speaking, the Utilities Regulations apply to the award of a contract where these three conditions are satisfied:



2.2.2 In more detail, the Utilities Regulations apply to:

- "*contracting authorities*" and "*public undertakings*" which carry out an activity referred to in Regulations 9 to 15 - this includes (Regulation 9):
  - the provision or operation of fixed networks intended to provide a service to the public in connection with the production, transport or distribution of heat; and
  - the supply of heat to such networks;
- entities which are not contracting authorities or public undertakings but carry out such activities on the basis of "special or exclusive rights" granted by a competent authority.

This last category might apply to (for example) an ESCo which has been granted exclusive rights to supply heat under a concession granted by a local authority, where this has not followed a competitive procurement procedure. The Utilities Regulations make it clear that the grant of special or exclusive rights in this context does not apply where the rights were granted following a procedure where "*adequate publicity has been ensured*" and "*where the granting of those rights was based on objective criteria*".

EXAMPLE: Where there is an advertised, competitive procedure which leads to the grant of the concession to the ESCo. Bear in mind, though, that the grant of the concession may itself be subject to the Concessions Regulations (discussed further below). In other words, the grant of the concession (the special or exclusive rights) will have been undertaken by way of a competitive process under the Concession Regulations, thereby taking the ESCo outside the application of the Utilities Regulations.

2.2.3 Exemptions exist for licensed electricity generation, supply of electricity and gas, and the exploration of oil and gas in England, Scotland and Wales; however, there are no such exemptions applying to the supply of heat. However, in principle, a utility which is above the threshold triggering the requirement to hold an electricity generation licence (broadly, 50MWe) and which, incidentally, produces heat in the course of this activity (e.g. an electricity led CHP scheme) could benefit from this exemption – but it is unlikely that many local authority schemes would be sufficiently large to require a licence.

2.2.4 Procurements carried out by these bodies will be subject to the full requirement to procure in accordance with the Utilities Regulations if the works, services or supplies being procured are intended for the pursuit of one of the activities in Regulations 9 to 15 and are above threshold (and see below for these).

2.2.5 Regulation 23 of the Utilities Regulations provides that the Utilities Regulations do not apply to contracts awarded by utilities which are active in the energy sector by engaging in an activity referred to in Regulation 9(1) (so including the provision or operation of heat networks) for the supply of (i) energy or (ii) fuels for the production of energy. This means that the procurement by an authority operating a district heating system of gas, other fuels or electricity or forms of energy (including heat going into the network), will not be subject to the requirements of the Utilities Regulations. For completeness, the PCR (by virtue of Regulation 7) will not apply.

2.2.6 Thresholds for the Utilities Regulations are cross-referenced in Regulation 16 to Article 15 of the Utilities Directive and are updated from time to time by the Commission – further details and the sterling equivalents are set out at the end of this section.

2.2.7 Additionally, the Utilities Regulations include provisions similar to those in the PCR on contracts with controlled persons and mutual co-operation. There are additional exemptions for contracts awarded to affiliated undertakings and joint ventures - see below.

2.3 The Concessions Contracts Regulations 2016 (Concessions Regulations)

Here is a link to the Concessions Regulations:

http://www.legislation.gov.uk/uksi/2016/273/contents/made

2.3.1 The Concessions Regulations apply where:

a contracting authority or a utility lets a public works or public services contract; and

↓

the value of that contract is (calculated on the basis of the estimated turnover, net of VAT, of the concessionaire during the concession life) over €5,186,000 (Regulation 9, cross referencing Article 8(1) of the Utilities Directive); and

↓

the concessionaire is permitted to exploit the works or services which are the subject of the contract (together with payment if required) and the award of the contract transfers the operating risk to the concessionaire, which has no guarantee that it will recoup its investment.

2.3.2 In calculating the estimated value of the concession contract, authorities and utilities must take into account, in particular:

- the value of any option and extension of duration;
- revenue from the payment of fees and fines by the users of the works or services (other than those collected on behalf of the contracting authority or utility);
- payments or any other financial advantages from the utility/public sector to the concessionaire;
- the value of grants or any other financial advantage from third parties for the performance of the concession contract;
- revenue from sales of any assets which are part of the concession contract;
- the value of all the supplies and services that are made available to the concessionaire by the contracting authorities or utilities, if necessary, for executing the works/services; and
- any prizes or payments to bidders.

2.3.3 Save where otherwise permitted, the maximum term for a concession contract is 5 years. A period longer than 5 years may be permitted if it is justified in order to allow the concessionaire to recoup its investment and realise a return. In the context of heat networks, which have high capital costs and long asset lifespans (of heat network assets in particular), concession contracts are typically 25 years and upwards and the justification for longer concessions is very likely to be present.

EXAMPLE: If the concessionaire is, for example, paying for the construction of the heat network itself, it should be a fairly simple exercise to demonstrate that the concessionaire will require longer than 5 years to recover its investment and make a profit. A robust financial appraisal and/or business plan will establish this.

2.3.4 Just as there are a range of types of contracts excluded from the scope of the PCR, these are also excluded from the scope of the Concessions Regulations – e.g. pure land transactions and loan agreements. Additionally, the Concessions Regulations include provisions similar to those in the PCR on controlled persons contracts and mutual co-operation – see below. There are additional exemptions for contracts awarded to affiliated undertakings and joint ventures - see below.

2.3.5 One of the key components of a concession contract to which the Concessions Regulations apply is that there must be a transfer of operating risk to the concessionaire, which has no guarantee that it will recoup its investment and/or the costs it incurs in operating the works and services to which the contract applies (depending on the type of concession) i.e. no guarantee that it will break even. The risk must not be nominal or negligible. It must also arise from factors which are outside the control of the parties (and can be demand risk or supply risk).

So, if a local authority offers a heat demand guarantee/take or pay heat contract to the concessionaire which effectively means that (assuming the concessionaire does not default or carry out its operations negligently, for example) the concessionaire is guaranteed a level of heat purchase that will largely or wholly cover its capital costs in constructing the network and/or (if it simply operating/maintaining the network) cover its operating/maintenance costs, then the contract will not amount to a concession contract but is very likely to be a works or services contract and its procurement will therefore governed by the PCR.

2.4 Mixed contracts but covering the same activity

2.4.1 A *mixed contract* is a contract where a particular activity is taking place e.g. building a heat network, but the contracts being procured fall under each of services and/or supplies and/or works.

2.4.2 Under the Utilities Regulations, Regulation 6 says where there are mixed contracts which have as their subject matter different types of procurement covered by the Utilities Regulations—

- contracts which have as their subject matter two or more types of works, services or supplies, the relevant procurement procedure is the one applicable to the type of procurement that characterises the main subject of the contract in question; and
- in the case of mixed contracts consisting partly of "light touch" services and partly of other services, or mixed contracts consisting partly of services and partly of supplies, the main subject matter is determined by which estimated value is the highest.

2.4.3 Regulation 6 goes on to say that in the case of mixed contracts which have as their subject matter procurement covered by the Utilities Regulations and procurement not covered by them:

- where the different parts of a contract are objectively separable, utilities may award separate contracts for the separate parts or award a single contract:
  - where they choose to award separate contracts for the separate parts, the decision as to which legal regime applies to any one of such separate contracts is taken on the basis of the *characteristics of the separate part concerned*; and
  - where they choose to award a single contract, the Utilities Regulations apply to the ensuing mixed contract, irrespective of the value of the parts that would otherwise fall under a different legal regime and which legal regime those parts would otherwise have been subject to;
- where the different parts of a contract are objectively not separable, the applicable legal regime is determined on the basis of the main subject matter of that contract;
- where the decision is taken to award a single contract then that mixed contract will, where it contains elements of supply, works and service contracts and, of concessions, be awarded in accordance with the Utilities Regulations, provided that the estimated value of the part of the contract covered by the Utilities Regulations is equal to or greater than the threshold prescribed by the Utilities Regulations (see thresholds table below).

2.5 Procurement covering several activities

2.5.1 Broadly speaking, this applies where a contract covers works, supplies or services benefiting both utility operations and non-utility (but still contracting authority) operations.

EXAMPLE: A possible example of this would be the procurement of an Operation and Maintenance contract applicable to a heat network, but principally to that part of the network within a local authority's operational buildings. This would be let using the PCR rules.

Regulation 7 of the Utilities Regulations says:

- Where contracts are intended to cover several activities, utilities may choose to award separate contracts for the

TIP: There is simply no easy test for determining the main subject matter, but the contract value is a good place to start.

purposes of each separate activity or to award a single contract.

- Where utilities choose to award separate contracts, which rules apply to each is taken on the basis of the characteristics of the separate activity concerned.

- Where utilities choose to award a single contract, the following paragraphs will apply (and will override Regulation 6):

  - the choice between awarding a single contract or separate contracts must not be made with the objective of avoiding the application of the Utilities Regulations, the PCR or Concessions Regulations;

  - a contract intended to cover several activities is subject to the rules applicable to the activity for which it is *principally* intended.

2.5.2 Where it is objectively impossible to determine for which activity the contract is principally intended, the rules are determined as follows:

- The contract is awarded under the PCR if one of the activities for which the contract is intended is subject to the Utilities Regulations and the other to the PCR;

- The contract is awarded under the Utilities Regulations, if one of the activities for which the contract is intended is subject to the Utilities Regulations and the other to the Concessions Regulations;

- The contract is awarded under the Utilities Regulations, if one of the activities for which the contract is intended is subject to the Utilities Regulations and the other is not subject to any of the 3 sets of Regulations.

2.5.3 The rules on mixed procurement under the Public Contracts Regulations 2015 (Regulation 4) and the Concessions Regulations (Regulation 21) broadly follow the Utilities Regulations, to the extent that they deal with the same subject matter. See above for a brief explanation of the differences between the Regulations.

2.6 Thresholds above which the three sets of Regulations will apply

2.6.1 The Crown Commercial Service Procurement Policy Note: New Threshold Levels 2016 sets out the current thresholds that will apply for the PCR and the Utilities Regulations. The Commission publishes revised thresholds (usually every two years, commencing from 1st January).

The current thresholds, in sterling, are:

PCR:

	Supplies	Services	Works
Central Government bodies	**£106,047**	**£106,047**	**£4,104,394**
Other contracting authorities	**£164,176**	**£164,176**	**£4,104,394**

Utilities Regulations:

	Supplies	Services	Works
All utilities	**£328,352**	**£328,352**	**£4,104,394**

Concessions Regulations:

	All concessions
All contracting authorities and utilities	**£4,104,394**

3. When and how Public Procurement rules apply in relation to District Heating Schemes

There are numerous combinations of possible delivery structures for district heating schemes where local authorities are involved.

Here are some of the most common arrangements, together with a brief commentary on how the public procurement rules may apply in relation to the different elements of the scheme:

3.1 Public sector led, funded, developed, owned and operated

EXAMPLE: The local authority funds the entire scheme (either internally or via Government/EU funding). It constructs, operates and maintains the scheme itself. The only aspect of the scheme which it outsources is the purchase of equipment. This may also include the procurement of specialist maintenance.

In this case, the local authority is acting as a utility, and not granting a concession. Consideration could be given to the application of the Public Contracts Regulations 2015 ("PCR"), but in either event, there would need to be a public procurement. Accordingly, the purchase of equipment (and/or maintenance) will likely be subject to the full rules under the Utilities Regulations where the procurement is above the threshold (see above for thresholds). Compliance with public procurement rules, together with additional competitive tendering requirements for below threshold procurement, is likely to be required under external funding arrangements from public funds (and will certainly be required for EU derived funding). In any event, where there is cross-border interest, Treaty principles of transparency etc. may still apply. Local authorities should also comply with their own internal financial regulations and requirements to obtain value for money. See above section and table for more detail about thresholds.

3.2 Public sector led and funded, private sector contractors

EXAMPLE: The local authority manages and funds the scheme. It procures the construction of the scheme (on a turnkey basis – Design & Build), and its operation and maintenance (Operate & Maintain). Or it procures a single Design, Build, Operate & Maintain.

The appointment of the contractor and any operator and maintenance provider will be subject to the Utilities Regulations – it is likely that each element will be above threshold. See above for more detail about thresholds. For below threshold procurements, similar requirements apply as set out above in relation to central Government and EU derived funding.

3.3 Public sector led/private sector ownership

EXAMPLE: Here, the public sector initially drives the project and may provide assets (e.g. land); the private sector investor provides investment and (in particular) accepts risk for part of the project in exchange for the right to exploit the scheme.

If the structure of the scheme involves the award of a concession and if the value is above threshold, then the Concessions Regulations will apply. See above for more detail about thresholds. See above for the application of the rules where mixed contracts are involved.

3.4 Public/public joint venture

EXAMPLE: This might involve two or more local authorities jointly delivering a district heating scheme either by building and operating it or simply by operating it.

In the case of local authorities (and, indeed, other public bodies) jointly delivering a scheme, the mutual co-operation exemptions under Regulation 12 of the PCR or (more likely) Regulation 28 of the Utilities Regulations should apply to the co-operation (but not to subsequent procurement of works/services).

3.5 Use of a publicly owned company

EXAMPLE: This might involve a local authority setting up a wholly owned company to deliver the district heating scheme either by building and operating it or simply by operating it e.g. through an Energy Services Company (ESCo).

Where a local authority owned company is providing services or carrying out works, if the PCR applies, then the Regulation 12 controlled persons test may apply (see below); if the local authority is procuring these services or works in the course of its activities as a utility, Regulation 29 of the Utilities Regulations (contracts awarded to an affiliated undertaking) is likely to apply; if a concession is being granted to the wholly owned company, Regulation 13 of the Concessions Regulations (contracts awarded to an affiliated undertaking) is likely to apply

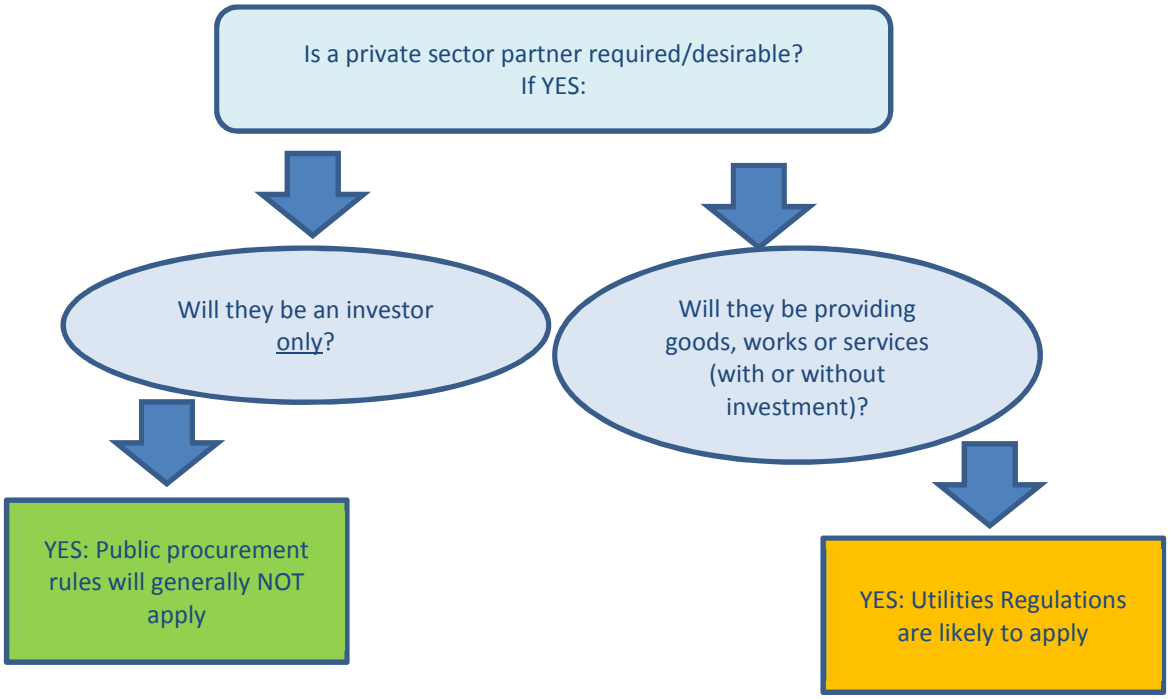
3.6 Public/private joint venture

EXAMPLE: Typically, the local authority and one or more private sector partners own equity stakes in a special purpose vehicle (SPV) – both public and private sector partners invest assets and/or funding.

There are two aspects to this. The first is the procurement of the private sector partner. Whether the public procurement rules apply will depend on whether the private sector partner is simply investing or it (or an associated company) is or is likely to be providing works, supplies or services. If the latter (i.e. the JV partner is required to carry out works/services), then the public procurement rules (most likely the Utilities Regulations) will apply (subject to the thresholds being met). See above for more detail about thresholds.

If the former (i.e. the JV partner will be providing money only), then the public procurement rules will generally not apply.

However, procuring a JV partner through a competitive route is likely to assist in demonstrating the partner is not being provided with illegal State aid. It should also be borne in mind that where there is cross-border interest, Treaty principles of transparency, etc. may still apply. Local authorities should also comply with their own internal financial regulations and requirements to obtain value for money. So (and subject to detailed legal advice): SEE OVERLEAF



The second issue to consider is the actual award of contracts (be they works/service contracts or concessions) by the local authority to the joint venture entity (a company limited by shares most likely). In the case of works and services, the exemption for affiliated companies may apply – see para 5.3 below for further details – which would mean no procurement is required.

In all cases where a joint venture is formed (meaning a legal entity), the basic test of "bodies governed by public law" will apply to whether the JV entity is a contracting authority, or not (see paragraph 5 below). The test is not simply about the size or percentage of the public sector shareholding. In no circumstances can it be assumed that none of the Regulations apply – either to the award of contracts to the JV or to the award of contracts by the JV.

3.7 Private sector led, public sector (part) funded

EXAMPLE: Here, the private sector body owns and leads the development of the scheme and accepts the risk in it. The public sector body makes a financial contribution to incentivise the private sector activity and, possibly, subsidises economically unviable parts of it.

This may amount to a concession, depending on the level of transfer of risk and rights of exploitation. If so, a procurement should, therefore, be dealt with under the Concessions Regulations. Compliance with public procurement rules together with additional competitive tendering requirements for below threshold procurement is likely to be required where the funding derives from central Government (grant) funding arrangements (and will certainly be required for EU derived funding). Also bear in mind that where there is cross-border interest, Treaty principles of transparency, etc. may still apply.

Alternatively, it may be prudent to procure the private sector partner via a competitive tender in order to minimise or eliminate any risk of State aid to the private sector body – see the State aid section of this guidance in relation to this – especially where there is grant funding to the private sector body.

4. Which Public Procurement procedures may be used

Under each of the Regulations, different types of procurement route are available, subject always to whether they can be justified under the relevant provision in the Regulation concerned. The procedures available are –

- ✓ **Open (under the PCR and Utilities Regulations)** – *this involves single stage procurement with no scope for negotiation. It would generally be used only where the subject matter is a commodity and commercial terms and pricing not likely to need negotiation.*

- ✓ **Restricted (under the PCR and Utilities Regulations)** – *this involves a two-stage procurement; pre-qualification and shortlisting, followed by the tender stage. However this route does not allow for negotiation and will generally be used where the subject matter is capable of being specified and priced in a straight-forward way.*

- ✓ **Competitive Procedure with negotiation (under the PCR)** – *again, a two-stage approach but with an element of focussed negotiation if necessary.*

- ✓ **Competitive dialogue (under the PCR and Utilities Regulations)** – *also a two-stage process, but in this case with a dialogue about the overall solution (including price). This approach is usually taken where the subject-matter is complex.*

- ✓ **Negotiated procedure with prior publication (under the Utilities Regulations)** – *available in limited circumstances only and if justified under the Regulations. Will be a two-stage process, but the tender stage being an open negotiation.*

- ✓ **Innovation partnerships procedure (under the PCR and Utilities Regulations)** – *used where the procurement is aimed at the development of a new "product/service/work" not available in the market.*

- ✓ **Procedure ensuring Treaty Principles of equal treatment, transparency and proportionality (under the Concessions Regulations)** - *meaning that the procurement route for a concession is not prescribed other than by reference to these general principles.*

- ✓ **Existing framework agreement (under the PCR and Utilities Regulations)** – *being the use of a framework (for works, services, or supplies) in existence. This route will work where the subject matter, is capable of being "standardised" in some way so that the procuring authority makes a "call-off" from the framework; there will be no negotiation/dialogue.*

Broadly speaking, the procedures and associated requirements under the Utilities Regulations will be familiar to anyone who regularly applies the PCR, but the Utilities Regulations are less onerous than the PCR. For example, it is possible to apply the negotiated procedure without having to justify doing so, and the Utilities Regulations rules on negotiated procedure are less prescriptive than the competitive procedure with negotiation under the PCR. The Concessions Regulations, by comparison, do not require the same prescriptive procedures.

5. Controlled persons, mutual co-operation, affiliated undertakings and joint ventures

5.1 Controlled persons

Each of the PCR, Utilities Regulations and Concessions Regulations provide exemptions for various types of public sector/utility administrative arrangements (where there is a "*controlled person*") rather than treating them as a procurement under the respective Regulations.

Under the PCR, Regulation 12, a procurement will comprise a *controlled persons administrative arrangement* if all the following circumstances apply (and this will also apply where there is joint local authority control). These tests would need to be met on an ongoing basis, not just at day one:

The control which the contracting authority exercises over the entity that has been awarded the procurement is "similar to that which it exercises over its own departments"; and

More than 80% of the activities of the controlled entity are performed for the contracting authority or other legal persons controlled by that contracting authority; and

There is no direct private capital participation in the controlled entity (subject to narrow exemptions - see below)

The rule on "no direct private capital participation" in the controlled entity, excludes non-controlling and non-blocking forms of private capital participation required by national legislative provisions, in conformity with the TFEU and the Treaty on the European Union, which do not exercise a decisive influence on the controlled entity.

EXAMPLE: In context, where a local authority sets up a wholly owned company to provide heat solely to its own buildings (i.e. not to third party customers) then the award of a contract by the public authority to the company would not require a procurement.
By contrast, if the company is to provide heat mainly to third parties (customers), then the second test will not be met. Equally, if the company involves a joint venture partner, the third test will not be satisfied.

A procurement will also constitute a *controlled persons administrative arrangement* if a controlled legal entity awards a contract to its parent or to any other entity controlled by the same parent, provided that there is no direct private capital participation in the legal person being awarded the contract.

To amplify, where a local authority decides to carry out an energy services requirement through an ESCo which is wholly owned and controlled by the local authority, then as between the local authority and the ESCo, there is no procurement requirement arising out of the use of the ESCo to provide energy services to, or for the benefit of, the local authority.

Similar provisions apply under Regulation 13 of the Concessions Regulations and Regulation 29 of the Utilities Regulations.

However, it must be borne in mind that the ESCo is a contracting authority itself (as a body governed by public law and a utility) and is required to comply with public procurement rules in relation to any contracts it procures.

5.2 Mutual co-operation

Regulation 12(7) of the PCR, Regulation 28(7) of the Utilities Regulations and Regulation 17(7) of the Concessions Regulations deal with mutual co-operation between public bodies – including public-to-public contracts/joint ventures.

A contract concluded/concession awarded exclusively between two or more contracting authorities is exempt where all of the following conditions are fulfilled:

The contract/concession establishes or implements a co-operation between the participating contracting authorities with the aim of ensuring that public services they have to perform are provided with a view to achieving objectives they have in common; and

The implementation of that co-operation is governed solely by considerations relating to the public interest; and

the participating contracting authorities perform on the open market less than 20% of the activities concerned by the cooperation.

EXAMPLE: A practical example is where a local authority has a duty to provide education – and must provide facilities in order to do so. So, a district heating network providing heating to a school could be a discretionary element in meeting that public function and it could collaborate (for example) with an adjoining local authority and/or an NHS Trust with similar public service obligations).

A key requirement is that any heat provided to third parties (i.e. on the "open market") amounts to less than 20% of the average total turnover or other appropriate measure relative to the total heat supplied (i.e. the third test). Co-operation involving the joint delivery of the district heating scheme would be a robust form of co-operation.

In this context, the supply of heat solely to residents of the local authority is likely to be treated as "open market" activity for these purposes. Also, it should be noted that as soon as any commercial aims are taken into the business case (e.g. profits recycled into other services), the second test will most likely not be met.

5.3 Contracts awarded to affiliated undertakings by utilities

EXAMPLE: A practical example is where a utility (under the Utilities Regulations) sets up an affiliated company to provide maintenance and other services in relation to a heat network. It may award the contract to do so to that company and the company may carry out services for other utilities provided that no more than 20% of its turnover derives from those other services. In other words, provided 80% of its turnover derives from the service provided to its "parent" (the Utility); the affiliated undertaking can be awarded a contract directly without a procurement.

Regulation 29 of the Utilities Regulations and Regulation 13 of the Concessions Regulations provide for additional exemptions. These apply where:

A contract/concession is awarded: and

The award is by a utility to an affiliated undertaking or by a joint venture formed by utilities solely to carry out activities under Regulations 9-15 (in the case of the Utilities Regulations) or Schedule 2 (which is similar to Regulations 9-15) of the Concessions Regulations to one of its members or an affiliated undertaking of those members; and

For each of service, supply and works contracts (in the case of the Utilities Regulations) and for each of services concession contracts and works concession contracts (in the case of the Concessions Contracts), at least 80% of the average total turnover of the affiliated undertaking over the preceding 3 years, taking into account all services provided by that undertaking, derives from the provision of services to the utility or one or more of its affiliated undertakings; and

Where, because the affiliated undertaking is a new company, the turnover is not available for the preceding 3 years, it is enough for that undertaking to show that the turnover is credible, in particular by means of business projections; and

Where more than one affiliated undertaking provides the same or similar services, supplies or works to the utility with which they form an economic group, the 80% is calculated taking into account the total turnover deriving respectively from the provision of services, supplies or works by those affiliated undertakings.

The test in the third box above, means in simplest terms that on a three year averaged basis, the affiliated undertaking is doing 80% or more of its business with and for the parent Utility; in essence the works or services are within a group structure.

5.4 Contracts awarded to a joint venture or to a utility forming part of a joint venture

Regulation 30 of the Utilities Regulations and Regulation 14 of the Concessions Regulations provide for additional exemptions where:

A contract/concession is awarded….

by a joint venture, formed exclusively by a number of utilities for the purpose of carrying out activities under Regulations 9 to 15/Schedule 2, to one of those utilities or by a utility to such a joint venture of which it forms part; and

the joint venture has been set up to carry out the activity concerned over a period of at least 3 years; and

the instrument setting up the joint venture stipulates that the utilities which form it will be part of the joint venture for at least the same period.

6. Typical activities for local authorities to engage in during the course of a procurement

In the course of conducting procurement, the authority is likely to engage in the following activities (in sequence). Some, but not all, will be governed by the applicable Regulations – the ones which are marked *.

- ✓ Early Market Engagement* – *to establish market interest, barriers to doing business, appetite for the specific opportunity, and so on. This must not be done in a way which distorts the market.*
- ✓ Business case – *to establish commercial and technical viability of the proposed investment*
- ✓ Approval of procurement strategy (including Cabinet approvals and delegations)
- ✓ Consultations with stakeholders (commercial, residential, highways, etc.)
- ✓ Establish selection and evaluation criteria – *and scoring system**
- ✓ Drafting Tender Specifications*
- ✓ Defining performance management standards
- ✓ Legal review and drafting of contract conditions
- ✓ Issue contract notice (if required) and Contract Finder notice*
- ✓ Issue Pre-Qualification Questionnaire (if required)*
- ✓ Selection stage – *of bidders in two-stage process (open procedure is single stage)**

- ✓ Send notifications to unsuccessful candidates – *with reasons**
- ✓ Issue Invitation to Tender ITT (or its equivalent under each procedure)*
- ✓ Evaluate tenders – *using the published criteria**
- ✓ Inform tenderers of outcome – *with reasons**
- ✓ Execute contract
- ✓ Issue Contract award notice*
- ✓ Issue Contract Finder award notice*
- ✓ AND possibly at a later date vary the contract awarded in response to a change in circumstances, or need for additional (or less) works/services*.

7. Procurement in practice

7.1 Timing and strategy

For any scheme, a procurement strategy and programme is essential. This would address:

- ✓ what elements of the project are subject to procurement law;
- ✓ how other strategies of the council may need to be linked (e.g. the appointment of developers), so that all relevant procurement activity is harmonised;
- ✓ what procurement routes will be used;
- ✓ overall timescales for each relevant procurement and ensuring these are correctly prioritised and sequenced (including where carried out in parallel) ;
- ✓ how and when soft market testing (as permitted by the OJEU rules) will be carried out – which may be beneficial;
- ✓ the possible use of any pre-existing frameworks for delivery of the scheme or certain parts of the scheme;
- ✓ whether stand-alone frameworks might be used (and which would be set up by the procuring authority).

TIP: Timing is usually little to do with what the Regulations say about minimum periods, and more to do with how much time (usually longer) the procuring authority and the market needs.

7.2 Evaluation criteria

It is always critical to get this right – especially for evaluation of tenders. That is because the Regulations require criteria to be transparent (i.e. disclosed to bidders and farmed in a way which makes clear to bidders what will be evaluated and how). Lack of transparency is often one of the ways in which a procurement is successfully challenged by a losing bidder for example. As a rule, the criteria, published at the start of the procurement, cannot be changed later on.

TIP: Justifying a concession period of more than 5 years is very unlikely to be difficult where significant upfront capital investment is required for a district heating scheme.

It is noteworthy, in context, that under the Regulations, social and economic criteria may be taken into account.

7.3 Future proofing

Under procurement law, variations to contracts are subject to rules that may mean a variation requires a fresh procurement. This may include additional works, change of scope or specification, and change of parties, for example. Depending on the type of contract being awarded, the authority should consider at the start of any procurement programme and subject to the relevant Regulations, including detailed provisions which allow for flexibility by way of variations. Also, when relying on the "controlled person" exemption, be aware of possible loss of status over time (e.g. where the 80% rule is broken, or private capital introduced); this may trigger a need for procurement.

TIP: Future-proofing should be built into the OJEU, procurement documents, and (crucially), the actual contracts entered into.

7.4 Market appetite

For any scheme there may be a limited pool of suitably qualified providers. And in some situations, there may be a marked reluctance by potential contractors to engage in time-consuming and costly tendering. This should be taken into account in framing the procurement strategy (including the matters that may need dialogue/negotiation). This is also a reason to carry out soft market testing.

8. Deciding whether to procure a framework agreement, works/services contract or a concession

It is not always straightforward to distinguish a concession contract from a public services or works contract. The key distinguishing feature of concessions is that they involve the transfer to the concessionaire of an operating risk of economic nature – this means that there is a possibility that the concessionaire will not recoup its investments and costs incurred in operating the works/services awarded under normal operating conditions, even if some of the risk remains with the contracting authority.

TIP: The most difficult task in practice can be the framing of evaluation criteria – and is the most likely to cause later difficulty if not worked out carefully.

A principal benefit in awarding a concession rather than a services/works contract is the ability to carry out a flexible procurement, based primarily on Treaty principles. Although the maximum term for a concession contract is 5 years, district heating schemes are unlikely to have difficulty making out the justification for a longer contract period. But that justification will need to be written up and included in the business case (or elsewhere).

There are several advantages to using an existing framework to procure services, work or even funding. The principal advantages are, arguably, speed, coupled with cost savings and efficiencies associated with only having to put in place, at most, a mini-competition rather than a full procurement procedure. The disadvantages are, arguably, restrictions on competition, coupled with restricted flexibility of specification/award criteria. There are a number of frameworks which have been or are proposed to be established to assist renewables and other energy efficient schemes, for example, by The Carbon Energy Fund and the forthcoming District Energy Procurement Agency framework.

9. Challenge periods

It is not the purpose of this guidance to go into lengthy description of the various challenge periods available under the Regulations. Suffice to say that there are time limits and that, as a rule, these will mean that after a period a challenge would be timed barred.

Time periods are generally applied strictly but equally it is open to a court to exercise discretion. In any event, it is the consequences of there being a challenge at all that should be uppermost in the mind of an

authority and of course the over-riding view that the scheme should be established in accordance with the law.

10. Case studies

Practical scenarios involving some of the structures listed in Section 1:

Case Study 1: wholly owned Council company

A Council establishes a wholly owned company to deliver affordable heating via a district heating scheme. Council proposes to fund the company and decides to appoint it to procure, construct, operate and maintain a new district heating scheme. The Council is able to appoint the company to act as the developer of the scheme using Regulation 28 of the Utilities Regulations. The company is a "*public undertaking*" under the Utilities Regulations and must procure above threshold (see above table on thresholds) construction, and O & M services as regulated procurements.

Case Study 2: Concession to private sector partner

A Council wishes to establish a district heating scheme. It considers developing and financing the scheme itself, but then decides that it wants a private sector partner to provide significant levels of capital and take on construction and O & M risk. The Council is able to provide land and also a guaranteed minimum level of connections for the scheme, via its city centre tenants and also in respect of some of its own buildings. This is likely to represent about 20% of the volume take-up needed by the successful bidder to break even on the assumption that there is a 30-year concession. The Council considers whether it can justify offering a 30-year concession to a private sector developer under the Concessions Regulations. It runs a procurement which is compliant with the Concessions Regulations via a procedure which is analogous to competitive dialogue. Most of the risk capital is provided by the successful bidder. Its SPV, which enters into the concession, also agrees a heat supply agreement with the Council and its tenants.

Case Study 3: joint venture with private sector partner

A Council wishes to establish a district heating scheme. It decides to work with a private sector partner, but wishes to retain some degree of control. It decides to set up an ESCo and to procure a private sector partner to be the majority shareholder in the ESCo, with the private sector partner having a 90% shareholding and the Council having a 10% shareholding. The Council will then award a 20-year concession to the ESCo to build, maintain and operate the scheme. The Council considers whether it can justify offering a 20-year concession to a private sector developer under the Concessions Regulations. It runs a procurement which is compliant with the Concessions Regulations via a procedure which is analogous to competitive dialogue. The private sector partner will provide 90% of the funding. The ESCo, being a private sector entity appointed by way of a competitive procurement procedure is not bound by the public procurement rules.

11. Unbundling

We cannot address unbundling in detail, but highlight a few early considerations. For these purposes please see other parts of the overall Guidance for an explanation of the unbundling concept.

First, if a scheme is to be unbundled at the outset (i.e. individual elements of heat production, supply, etc., are separated out), then each component will be subject to procurement law considerations. Unbundling will not, of itself alter the need to consider procurement law.

Second, if unbundling is to be considered at a later stage (i.e. after the scheme has been operation for a number of years) then the way in which the various contracts are initially procured and structured will be highly important. For example, the procurement Regulations will govern variations to contracts, and therefore it will greatly assist if the initial procurement and contracts expressly cater for later unbundling.

PART C – STATE AID

1. When and why State aid might arise in district heating schemes

State aid can occur whenever state resources are used to give selective assistance to an undertaking. Article 107(1) of the Treaty on the Functioning of the European Union sets out the conditions which must apply for a measure to represent State aid:

"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"

An 'undertaking' is any organisation engaged in economic activity and can include non-profit organisations, charities and even public bodies. An entity providing energy (including heat) under discretionary powers will virtually always be an undertaking for State aid purposes.

BEIS has prepared clear and useful guidance on the basics of State aid which is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443686/BIS-15-417-state-aid-the-basics-guide.pdf

State aid will be relevant to all district heating network projects involving public authorities or the use of public funds (including European funding) as any agreement involving state resources and an undertaking – even a simple contract for services - can attract State aid considerations. Different considerations will apply depending on the structure used and the parties involved.

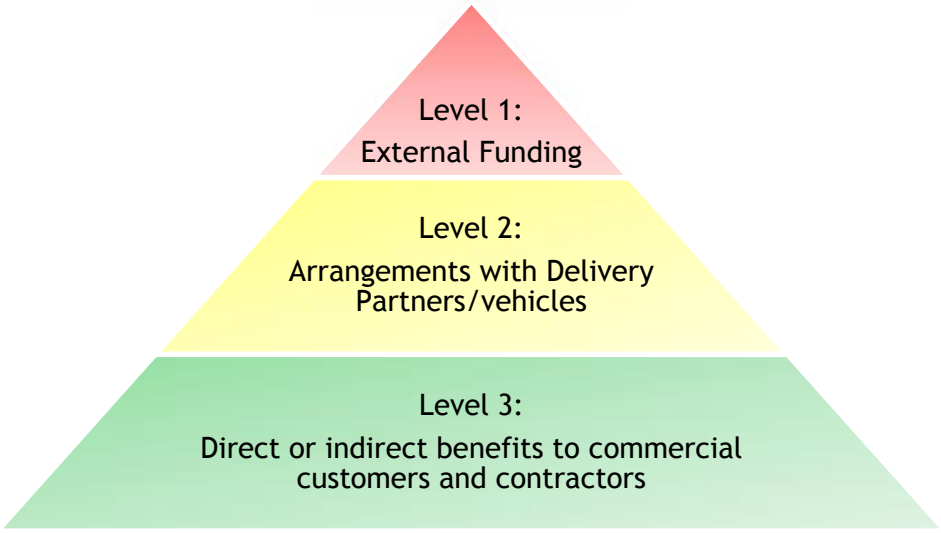
TIP: Where a local authority is engaged in an economic activity (rather than simply carrying out statutory functions), the authority can be considered to be an "undertaking".

What does MEOP mean: Key to an understanding of State aid is the principle of MEOP (Market Economy Operator Principle). This is explained in Section C below.

In short, it is necessary to show that an '*ordinary*' market operator, in the same position as the public authority, would enter into the proposed arrangements. It is vital that, when assessing this, only private considerations (which will primarily focus on financial considerations, but it is also possible to include long term strategic considerations) are taken into consideration.

'*Public*' considerations, such as social objectives (for example, eliminating fuel poverty) or the promotion of regeneration or economic growth, should be ignored for the purposes of this principle. If the Council owns land with development potential which the network will feed into, then the commercial benefits of linking to the network could be taken into account, depending on the contractual structure.

Broadly, State aid considerations arise at three levels in relation to district heating schemes:



External Funding

Firstly, any external funding (being from state resources) injected into the scheme could give rise to State aid considerations and the funding bodies will often seek assurances that the funding will be used in a State aid compliant manner. Local authorities will not only need to satisfy themselves that the project is State aid compliant, but also to satisfy their funding bodies. This will often involve obtaining legal opinions confirming the State aid position addressed to both the funding body and the local authority. Where external funding has been obtained this does not automatically preclude further external funding being utilised in the same scheme, although different funding sources may apply their own conditions restricting the use of separate external funding. All of these considerations will apply in relation to the deployment of the £300m allocated by the Government to district heating through BEIS, and will likely form part of the eligibility criteria and conditions of accessing these funds.

TIP: Undertaking a competitive exercise to award grant funding will not negate any state aid in the grant although it may mitigate the risk of a challenge arising.

Joint Ventures and Wholly Owned Companies

State aid issues will clearly be relevant where a private sector partner is brought on board to help deliver the project, but can also apply where a joint venture partner is another public authority. This is because the definition of an '*undertaking*' for State aid purposes is based upon the recipient's activities, not their status as a public or private body - see page 4 of this BEIS Guidance. This means that aid to public authorities offering goods or services on a market must be considered just as carefully as aid to private sector bodies.

Similarly, a company or other entity wholly owned by the local authority which undertakes any commercial elements of a project is likely to be an undertaking and so any funding or support provided to such an entity will also need to be considered for State aid purposes. See the next section for examples of potential aid.

Downstream aid to third parties

If State resources are used to generate energy which is then sold at below-market rates (i.e. below the rates the recipients would be able to obtain elsewhere on the available market), the sale of this energy to

undertakings has the potential to be illegal State aid to those undertakings. When developing a commercially attractive offer, for example including discounted rates on price, care will need to be taken to avoid illegal State aid. It is important to note that private individual consumers are not usually undertakings for State aid purposes and, so, below-market rates to these consumers will not be illegal State aid. However, this does not mean that the aid could be granted to an intermediary just because the end user would be a private resident. For example, if a social landlord which was an undertaking obtained below-market rates and obtained a commercial benefit as a result, the fact that the end user would be private residents would not eliminate any State aid to the social landlord. There may, however, be other routes to compliance, for example by passing through the benefit of the below market rates and ensuring no residual benefit is retained by the social landlord.

For analysis of what the concept of "*market*" means, see section C below.

Local authorities should carefully consider who else might benefit from the project, including developers, house builders and commercial landowners. It is possible that third parties may benefit from direct or indirect State aid so this will need to be considered on a project-by-project basis.

Finally, aid to any contractors or partners used in the delivery of the project must be considered carefully alongside any public procurement obligations.

Sub-economic schemes

The financial modelling of a scheme may show that a particular district heating scheme – or involvement in a particular heating scheme in a particular way – will deliver returns below thresholds that would be acceptable to the private sector. If that is the case, but the scheme or involvement is considered worthwhile for broader economic reasons or wider social or environmental reasons, then support, in the form of State aid is likely to be necessary for the scheme to progress. In that case, the exemptions or notification discussed in this guidance will need to be relied on.

Case Study 4: Identifying Aid in Joint Venture structures

A local authority is proposing to enter into a joint venture with Heat PLC to construct and operate a new district heating system. The local authority will invest £10M in funding and land worth £2M and Heat PLC will invest £10M in funding. The profits generated by the joint venture arrangement will be shared 60:40 in favour of Heat PLC. The local authority is comfortable investing slightly more for a lower return as the district heating system will support its social and economic regeneration objectives. In these circumstances, there is the potential for illegal state aid to Heat PLC as the investment is not made on '*market terms*' where (subject to any indications to the contrary) as a private investor would look for a proportionate sharing of risk and reward. This is because the local authority is forgoing financial return and instead attributing value to social and regeneration considerations, whereas a private investor would not.

If the investments and returns were equal or proportionate then this would give a strong argument that the MEOP (see below) would apply, meaning that the investment by the local authority would not be state aid. If the MEOP does not apply then another approach to state aid compliance would need to be identified.

In this example, the joint venture may be classed as a separate undertaking and so aid could accrue to the SPV as well as Heat PLC. This may be the case if the local authority provides loans or guarantees which benefit the SPV at below-market rates.

2. Quantifying aid:

In order to address or eliminate any aid, the amount of potential aid must first be quantified. The table below sets a simplified approach to quantifying aid for different measures:

Measure	Quantum of aid
Investment	Value of the investment. Where MEOP provides that a private investor would not make the investment in question, the quantum of aid will be the total investment value. If MEOP provides that a private investor would make an investment on different terms (in a manner which can be valued) the quantum of aid will be the difference between the two values.
Grant	Value of grant (i.e. the amount)
Disposal of assets or shares at undervalue	Difference between 'market' value and direct value obtained. See the Commission Guidance Paper on State aid compliant financing, restructuring and privatisation of state owned enterprises
Disposal of land	Difference between 'market' value of land and direct value obtained – see Commission Communication on sales of land
Loans at discounted interest rates but on otherwise 'market' terms	The difference between the total interest to be charged over the term of the loan and the total interest which would be charged over the term of the loan if an appropriate market rate of interest were to apply. The Commission Communication on establishing the reference rate sets out how to establish the market rate of interest. See also part 4.2.3.4 of the Commission Communication on sales of land
Guarantee	The market value of the guarantee or, in certain circumstance where the guarantee applies to reduce the interest payable under a loan, the total reduction in interest payments attributable to the provision of the guarantee. The Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees and the related Corrigendum provide further guidance on this.
Provision of services or access to resources (such as premises) at nil cost or at a discount	If provided free of charge, the market value of the services or access provided. If provided at a discount, the difference between the market value and the discounted price charged.

Care should be taken when calculating the quantum of any aid as the exact approach will vary depending on the nature of the aid, any exemption that may be used and the application of the Market Economy Operator Principle to the circumstances. The above provides a useful starting point only and expert advice should be obtained on a case-by-case basis.

3. Quantifying Risk

Granting illegal State aid can give rise to several significant risks, including:

- ✓ orders for the recovery of aid (regardless of the impact on the recipient);

- ✓ aid schemes being suspended;
- ✓ withdrawal of the right for a member state or public authority to use GBER (see below);
- ✓ claims for damages from competitors of aid recipients;
- ✓ judicial review proceedings against the granting authority; and
- ✓ fines from the Commission.

However, BEIS Guidance encourages public bodies to take a risk-based approach – see page 97 for more detail. These risks can also be mitigated by including appropriate contractual protection in key documents, such as provisions requiring the repayment of aid and interest and indemnities in the event of a finding of illegal State aid.

Case Study 5: Identifying aid in a discounted loan

A local authority intends to provide an unsecured loan to a company which will operate a district heating network (whether or not the company is wholly/partly owned by the local authority). The market rate for an unsecured loan to this company would be 8%. The local authority can borrow funding at 2% and proposes to on-lend at 3%. The value of the loan is £500,000 and the term is 10 years.

The aid in the loan is the difference between the total interest payable over the loan at market rates and the actual interest payable. Assuming simple interest and repayment in full at the end of the term, the market interest would be: 8% of £500,000 x 10 years = £400,000.

The actual interest will be: 3% of £500,000 x 10 years = £150,000.

The benefit to the company is the difference between the two and this will be the quantum of aid to be eliminated: £250,000

4. Avoiding or addressing State Aid:

Once the quantum of any aid has been established, it will be necessary to either identify an appropriate exemption or obtain approval from the European Commission by notifying it of the proposed scheme through the Department for Business, Innovation & Skills.

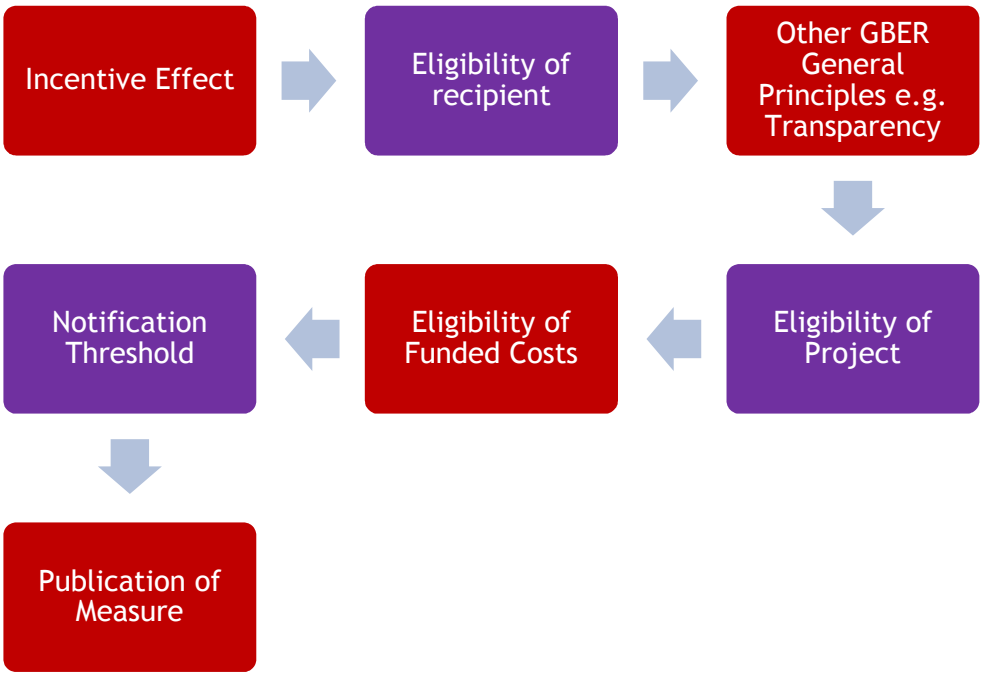
A: De Minimis Regulation

Where only a small quantum of aid is to be provided, it may be possible to rely on the De Minimis Regulation. Further guidance on the application of the De Minimis Regulation is available at paragraph 8 of this BEIS Guidance. Given the low threshold for the application of this exemption, it is only likely to be useful for low levels of aid to third parties rather than delivery partners.

B: General Block Exemption Regulation

The current General Block Exemption Regulation contains several exemptions permitting aid for specific projects. See page 8 of this BEIS Guidance. The second iteration of GBER, adopted in July 2014, added a new exemption expressly permitting investment aid for energy efficient district heating and cooling systems. This is set out at Article 46 of GBER. If aid falls within the scope of Article 46, it will be deemed to be aid which is compatible with Articles 107-109 Treaty on the Functioning of the European Union (TFEU) and, so, will be exempt from the requirement to give prior notification to the Commission.

Local authorities seeking to rely on Article 46 to ensure State aid compliance will need to address the different elements in the flowchart below. Each stage is explained in more detail below. The elements are split into two categories: (i) general requirements which apply to all or the majority of exemptions under GBER, and (ii) specific requirements which only apply to the Article 46 exemption.



GBER General Principles: GBER sets out a series of general principles which apply to the majority of exemptions. These are set out at Articles 1-12. We have summarised key general requirements below but care should be taken to review all the requirements in full.

Incentive Effect (Article 6): Prior to any '*aid instrument*' (i.e. the legal agreement under which the recipient becomes entitled to the aid) coming into effect, the recipient must formally request the aid in order to demonstrate that the project would not proceed at the same level, or at all, without the aid. The information to be contained in the application varies according to the size of the recipient. See Article 6 of GBER for further detail. In reality, the following stages will be considered prior to the request being made to ensure the exemption is available but the request will be the first 'formal' stage in the process.

Eligibility of Recipient (Article 1): the local authority must ensure that the recipient (even if itself) is eligible to receive funding through GBER. GBER contains a number of restrictions at Article 1 - for example, aid cannot generally be provided to recipients which are in financial difficulty or active in certain sectors.

Transparency (Article 5): it must be possible to calculate the precise amount of aid under GBER. Usually this means that funding cannot be provided which covers all of the costs of a project up to a certain date or completion if the amount of those costs are uncertain. Instead, the deployment of aid to such costs must be for a capped amount or fixed in advance. Similarly loan facilities and guarantees must be of a maximum or fixed duration.

GBER Specific Requirements: As well as the general requirements above, a number of specific requirements apply to Article 46. These are summarised below.

Eligibility of project: Article 46 only applies to funding for the production plant and/or distribution network (including related facilities) of energy efficient district heating and cooling systems. The system must satisfy the requirements of Article 2(41) and (42) of Directive 2012/27/EU on energy efficiency, set out in the boxes to the right and below.

Eligibility of costs to be funded:

Production Plant: Eligible costs will be "*extra costs needed for the construction, expansion and refurbishment of one or more generation units to operate as an energy efficient district heating and cooling system compared to a conventional* production *plant. The investment shall be an integral part of the energy efficient district heating and cooling system*." The value of the aid must be no more than 45% of these costs. This percentage can be increased for small and medium enterprises. The Commission has published a User Guide setting out how to establish whether an entity is an SME.

"efficient district heating and cooling" means a district heating or cooling system using at least 50% renewable energy, 50 % waste heat, 75 % cogenerated heat or 50 % of a combination of such energy and

"efficient heating and cooling" means a heating and cooling option that, compared to a baseline scenario reflecting a business-as-usual situation, measurably reduces the input of primary energy needed to supply one unit of delivered energy within a relevant system boundary in a cost-effective way, as assessed in the cost- benefit analysis referred to in this Directive, taking into account the energy required for extraction, conversion, transport and distribution

The financial modelling used to compare a district heating system with a counterfactual may prove useful in establishing the base costs for the purposes of establishing the '*extra costs*' referred to above.

Distribution Network: Eligible costs will be the total costs of the installation of the distribution network but not the operating costs. The value of the aid is limited to the difference between the investment costs of network installation and the operating profit (i.e. the *viability gap*). For the purposes of GBER, the operating profit is defined as:

"*the difference between the discounted* revenues *and the discounted operating costs over the relevant lifetime of the investment, where this difference is positive. The operating costs include costs such as personnel costs, materials, contracted services, communications, energy, maintenance, rent, administration, but exclude, for the purpose of this Regulation, depreciation charges and the costs of financing if these have been covered by investment aid*".

TIP: Local authority owned vehicles will usually not be classed as SMEs regardless of their size. The rules for establishing SME status are complex and involve assessing group structures as well as the recipient undertaking itself.

Since assessing the cost of installation and measuring the operating profit occur at very different times, and are subject to very different degrees of certainty, the value of the aid can be established in advance on the basis of projections or retroactively through a claw-back mechanism. It is vital to ensure that there is no double-counting, so the same eligible costs cannot be met by '*operating aid*' and '*investment aid*' or by funding through different exemptions.

The distribution network and the production plant should be considered and calculated separately, as confirmed in the Commission's General Block Exemption Regulation Frequently Asked Questions.

EXAMPLE: **Eligible Costs for production plant:**

	Energy Efficient District Heating and Cooling costs (£)	**Conventional Costs (£)**
Completion of retaining wall/ground preparation	2,900,000	2,900,000
Completion of Steel Erection	2,400,000	2,000,000
Completion of Steelwork and Cladding	1,900,000	1,500,000
Installation of plant and equipment	4,000,000	2,000,000
Completion of Building and landscaping	1,500,000	1,500,000
Total	**12,700,000**	**9,900,000**
Difference = £2.8m		

The above are all examples of the kinds of costs which could be eligible for GBER funding under Article 46. However, only 45% of the extra costs incurred due to using an efficient district heating production plant as opposed to a conventional production plan can be obtained. In the above example, 45% of £2.8M (i.e. £1.26M) could be funded under Article 46.

Notification threshold: The level of aid which can be provided under Article 46 is capped at €20,000,000 in respect of any one project. If the proposed aid exceeds this, prior approval will need to be obtained from the European Commission through BEIS.

TIP: The application of MEOP will usually require expert advice to be obtained on e.g. the interest rate to be applied to a loan, or the market value of land, or the "market" rate in the context of downstream aid.

GBER post-award publication (Articles 9 and 11)

Once the aid instrument has been entered into, the local authority must log certain details about the aid measure with the European Commission through BEIS. The information to be provided varies according to the total value of the aid and is set out at Articles 9 and 11 of GBER. This includes a summary of the aid measure in the form set out in Annex II of GBER, the full text of the aid measure, and where the aid award exceeds €500,000, the additional information set out in Annex III of GBER. The information must be logged within 20 working days of the aid measure coming into effect and the local authority must publish the aid measure on the internet.

C: Market Economy Operator Principle (MEOP)

Generally, loans, guarantees and contracts for goods, works or services entered into at market rates will comply with the MEOP.

If a local authority can demonstrate that a private operator operating under normal market economy conditions would act in the same way as the local authority, then the action taken will not result in illegal State aid. This is the Market Economy Operator Principle ("*MEOP*"). BEIS' detailed guidance on State aid deals with MEOP at page 16.

To rely on the MEOP, it is necessary to show that an '*ordinary*' market operator, in the same position as the local authority, would enter into the proposed arrangements. It is vital that, when assessing this, only private considerations (which will primarily focus on financial considerations, but it is also possible to include long term strategic considerations) are taken into consideration. '*Public*' considerations, such as social objectives (for example, eliminating fuel poverty) or the promotion of regeneration or economic

growth, should be ignored for the purposes of this principle. If the Council owns land with development potential which the network will feed into then the commercial benefits of linking to the network could be taken into account, depending on the contractual structure.

In practice, MEOP will only be useful where the proposed district heating scheme would be seen as sufficiently attractive to a private investor (i.e. would generate sufficient revenue) to warrant the investment the local authority is proposing to make. In order to demonstrate compliance with MEOP, a local authority would need to have prepared a business plan which demonstrated that revenue from the sale of heat, connection charges, sale of electricity or any other products and services would be sufficient to warrant the risks assumed on a commercial basis. Expert advice is often obtained from commercial advisers as to what a private investor would look for in a scheme and this would go a long way in defending the local authority's position in the event of a challenge or investigation.

EXAMPLE: **State aid and public procurement**

As noted above, one means of avoiding the award of State aid is to ensure that any financial arrangements – such as procuring services or works – are entered into on market terms – in other words, are compliant with the market economy operator principle. The most effective way of demonstrating this is to procure the services or works via a competitive tender. This will generally eliminate (or, at least, minimise) any risk of State aid to the private sector body. However, while procuring a private sector partner reduces the risk of illegal state aid, aid provided in the form of support to the joint venture will not be negated by simply carrying out a competitive exercise so this should be considered carefully on a case-by-case basis.

D: Services of General Economic Interest (SGEI)

SGEI are services which the market does not naturally provide to the extent or at the quality required by an individual Member State and which is in the general interest (i.e. open to the public). There is no prescribed list of SGEI and it is left open to each member state to determine which services will be SGEI. The provision of gas and electricity at a national level has the potential to qualify as an SGEI but the position is less certain in relation to local district heating systems.

Decision SA.31261 (2011/N) of the Commission suggests that, in limited circumstances (which included a statutory obligation on the body in question to provide affordable heat to residents), the provision of heat through a district heating system can qualify as an SGEI. However, care should be taken in relying on this decision and it may be prudent to obtain Commission approval before proceeding on this basis, as the German authority involved did.

If a service does qualify as an SGEI, then the funding of this service by the state can qualify as legal State aid if a number of criteria are met, including:

- the recipient undertaking must have public service obligations and the obligations must be clearly defined;
- the parameters for calculating the compensation must be objective, transparent and established in advance
- the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit;
- where the undertaking which is to discharge public service obligations is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of

providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs of a typical well-run company

These requirements are often referred to as the '*Altmark Criteria*'.

For further information on SGEI see Chapter 7 of this BEIS Guidance. The provisions governing the funding of SGEI are set out in the following documents:

Document	Applicability
Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest (2012/C 8/02)	Sets out the general requirements required for funding of SGEI to be legal State aid
Commission Decision on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (2012/21/EU)	Permits aid for funding SGEI up to €15M per annum without prior notification to the Commission
Communication from the Commission on the European Union framework for State aid in the form of public service compensation (2012/C 8/03)	Sets out criteria for assessment of larger SGEI funding arrangements requiring prior notification to the Commission
Commission Regulation 360/2012 on de minimis aid granted to undertakings providing services of general economic interest	Sets out an increased de minimis threshold for undertakings providing SGEI (€500,000)
Financial Transparency Directive 2006/111/EC	Sets out transparency requirements for certain recipients of SGEI funding (for example additional accounting requirements)

E: The interaction of the Community Infrastructure Levy, s.106 agreements and State aid

The Community Infrastructure Levy (CIL) was introduced in the Planning Act 2008 and the CIL Regulations 2010. Planning authorities in England and Wales may choose to charge the CIL on new developments, including district heating schemes. Charging the CIL supplements planning obligations agreed under s.106 agreements. The CIL is calculated as set out in the planning authority's charging schedule and based on the size and type of new development.

Funds raised by the CIL must be spent on "infrastructure necessary to support growth" and this includes district heating schemes. The CIL funding may only be spent on capital projects and on associated revenue spending to maintain those capital projects. This includes increasing the capacity of existing infrastructure or repairing failing infrastructure, if necessary to support development.

The CIL Regulations provide that an authority may grant relief from liability to pay CIL if it appears that there are exceptional circumstances which justify doing so and the authority considers it expedient to do

so. Discretionary relief for exceptional circumstances can only be granted if a s.106 agreement is in place and that any relief must not constitute State aid.

CIL reliefs/exemptions are likely to constitute State aid, in principle, unless in particular circumstances there is no selectivity or distortion of competition (in particular, if the cost of complying with a s.106 agreement is the same or greater than the CIL that would have been charged). Similarly, the deployment of funds raised through CIL or s.106 towards district heating infrastructure being operated on a commercial basis are capable of giving rise to illegal State aid and so should be considered alongside any other forms of funding.

If the reliefs/exemptions or deployment of funds do constitute State aid then it will be necessary to consider whether SGEI, GBER or the De Minimis Regulation will apply.

F: Notification to Commission: Process, timescales and principles

In the event that an appropriate exemption cannot be identified, the authority will need to either revisit its proposals or obtain Commission approval for the project. The process for notifying the Commission of the proposals is lengthy and must be conducted through BEIS as the process is conducted between the member state (the UK) and the Commission. The Commission will only approve projects which it considers to be compliant with the treaty principles and, in the case of district heating, the Commission will usually consider the proposals against the Environmental Aid Guidelines. Although there is some overlap (e.g. that a district heating scheme is to be energy efficient) between the Environmental Aid Guidelines and Article 46 of GBER, the requirements are different, so it is possible for projects which fall outside the scope of Article 46 to comply with the Environmental Aid Guidelines.

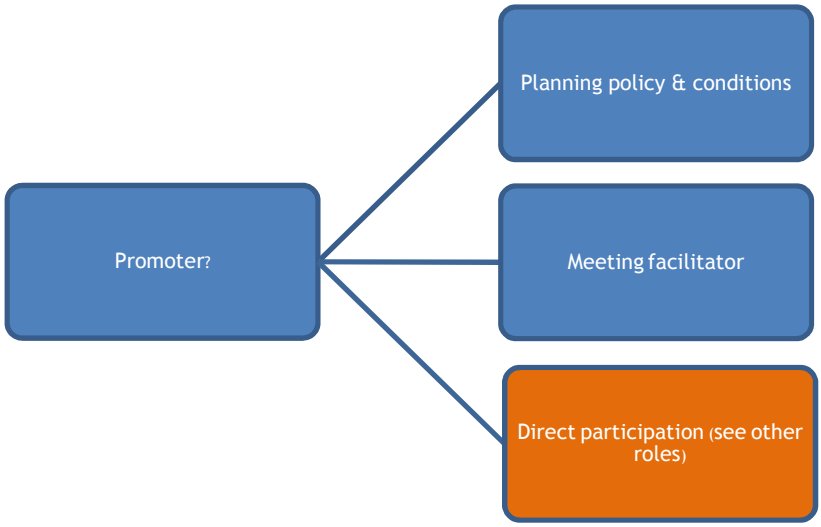
The process for notification is set out in this BEIS Guidance at page 59 and BEIS recommends allowing a period of at least 6-12 months for any notification process. This is a minimum as several factors, including third parties objecting, can lead to significant delays in the process. Notification will usually only be a last resort due to the timescales involved.

The following diagrams show how the State aid analysis might be made on a case by case basis, depending on how a scheme is being structured. The diagrams only identify the areas where there may be a risk of generating State aid and that an approach needs to be identified to deal with issues to ensure no unlawful aid is being provided.

Procurement and State aid – red flags

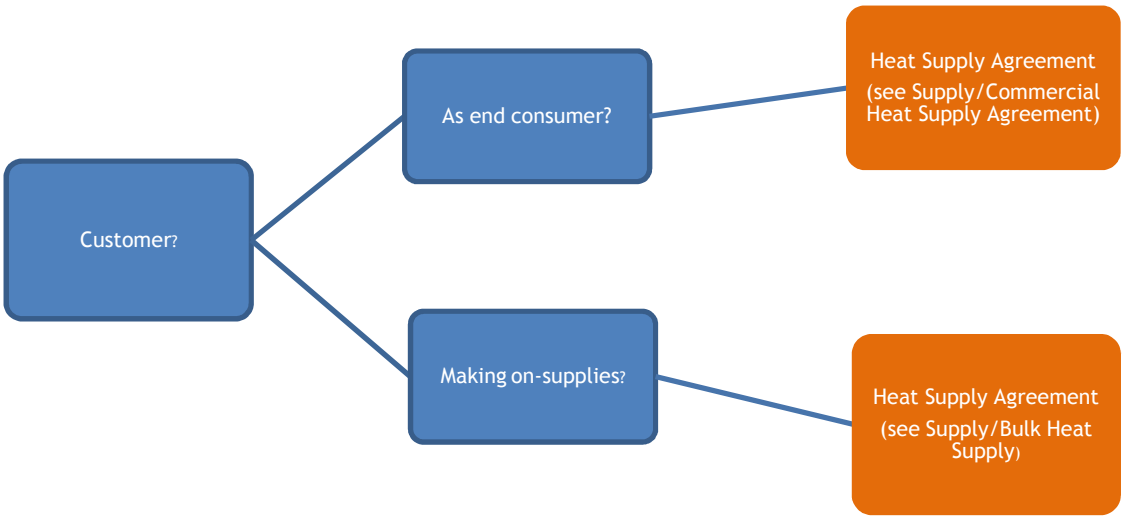
This final section is merely intended to highlight, graphically, where there is the greatest potential for State aid to arise because of non-market terms, and where procurement rules will be triggered, in the context of the **roles** and **decision trees** used, and explained, in the Commercial and Strategic Case Guidance.

1. **Promoter**



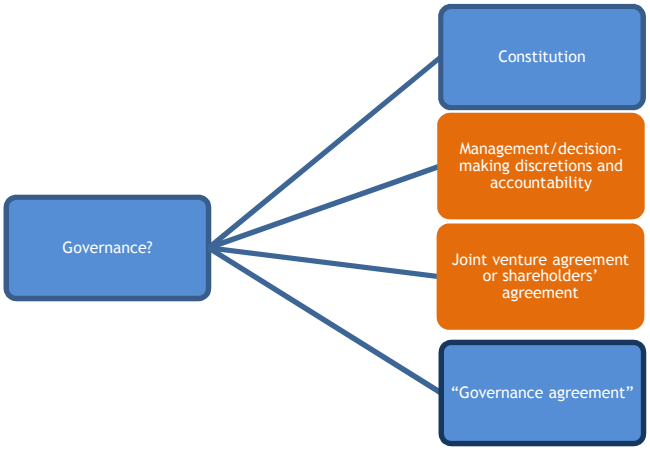
No procurement or State aid red flags unless direct participation (then see other roles).

2. **Customer**



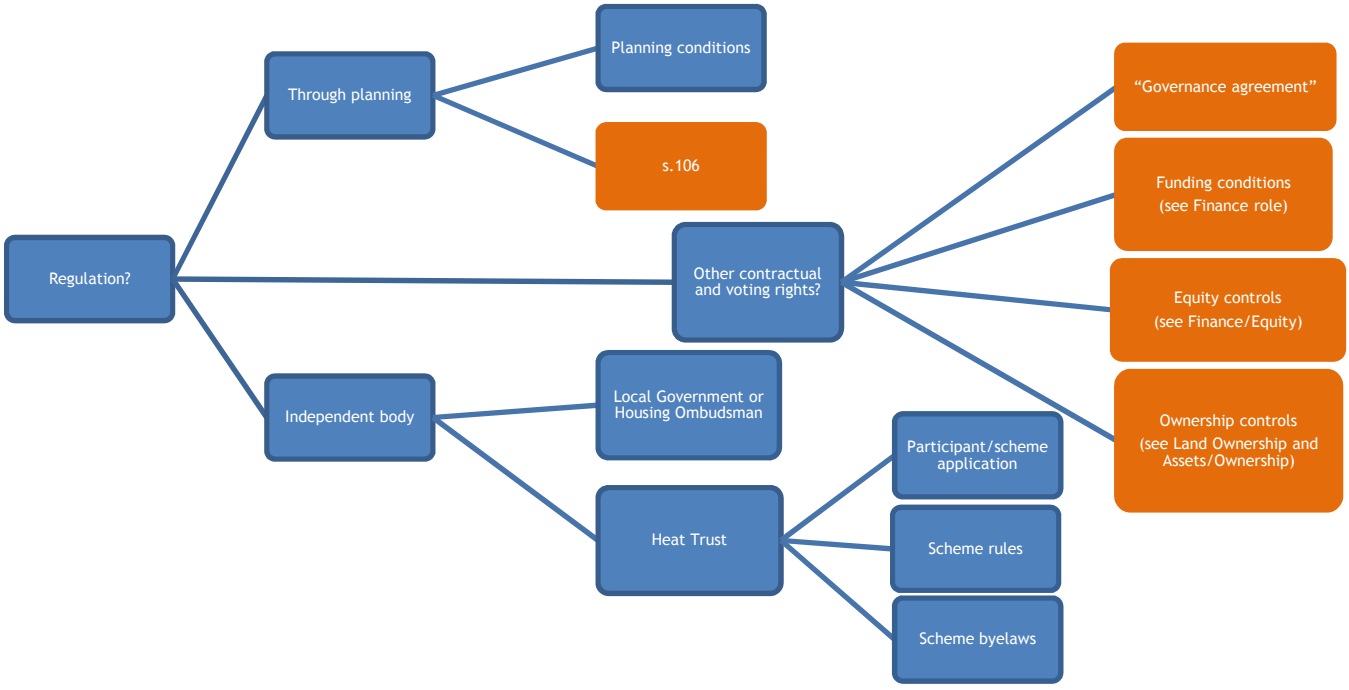
Potential for State aid if price being paid, as a Customer, is too high. Similarly, where buying heat but on-selling to tenants or others at too low a price, or where guarantees provided in the heat supply agreement.

3. Governance



If authority has a controlling interest in a delivery vehicle, tests under procurement Regulations should be applied. In a shareholding context, State aid could arise where, e.g. shares allocated to the authority are lower than the value of their investment, relative to the number granted to the co-investor.

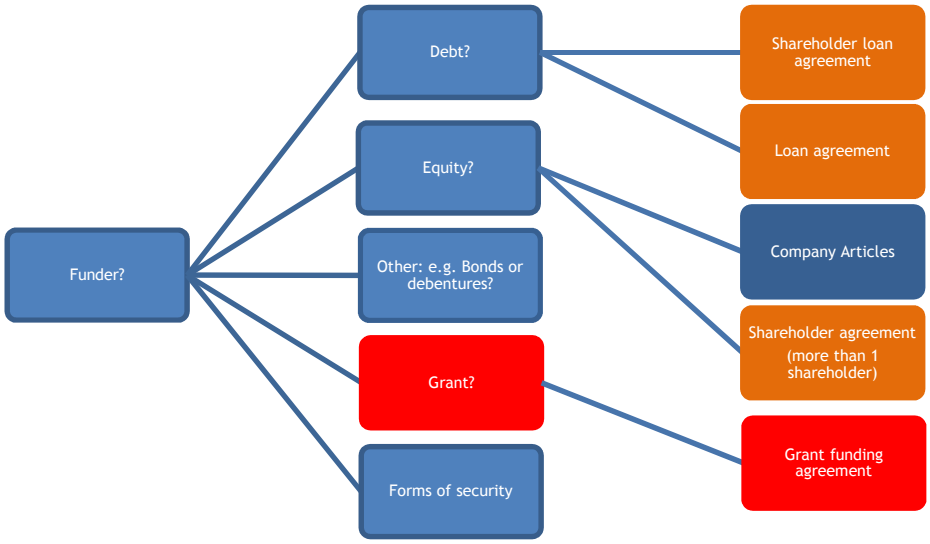
4. Regulation



Potential for the grant of State aid in any of the contract settings (described further below), if not on market terms.

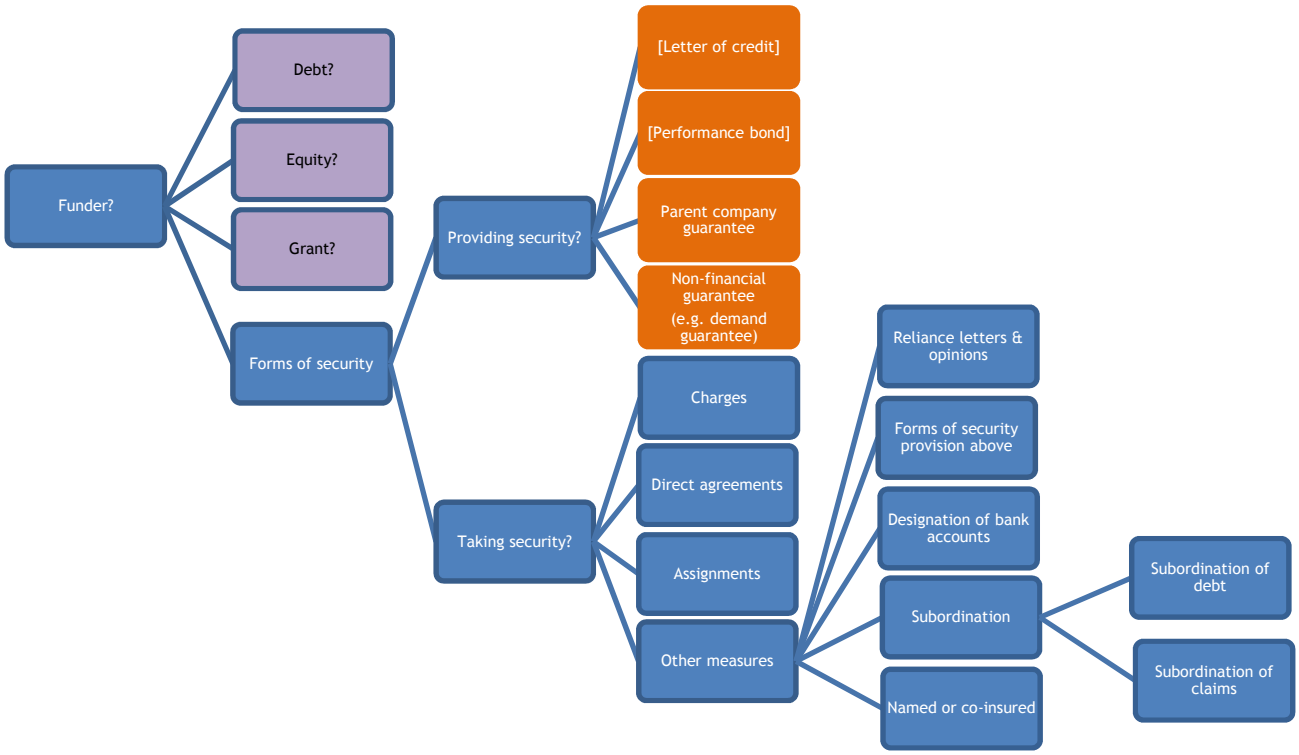
5. Funder

(a) primary provision of funding



Loans with below market interest rates or other terms suggest State aid. Grants are State aid.

(b) providing or taking security

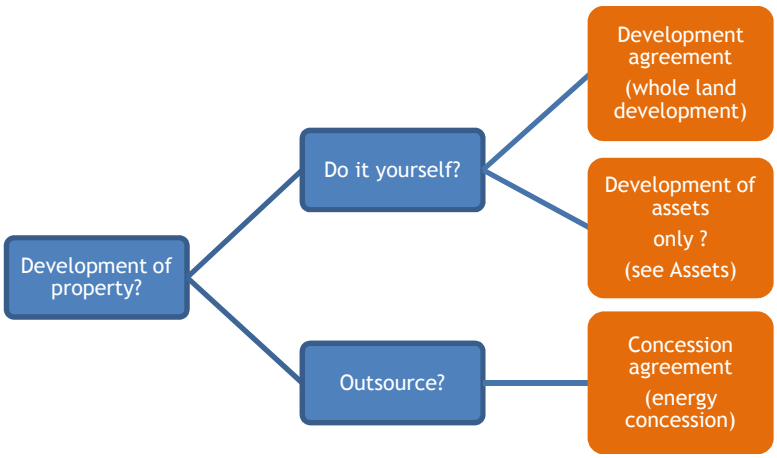


Granting security and giving guarantees, without receiving corresponding remuneration on market terms, suggests potential State aid (e.g. not charging a local authority controlled company for granting a parent company guarantee to one of the company's suppliers).

6. Asset ownership

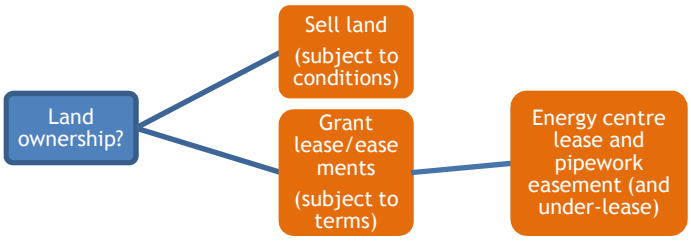
Assets transferred or other rights granted in assets, at undervalue, indicate State aid (and may require Secretary of State consent).

7. Development of property



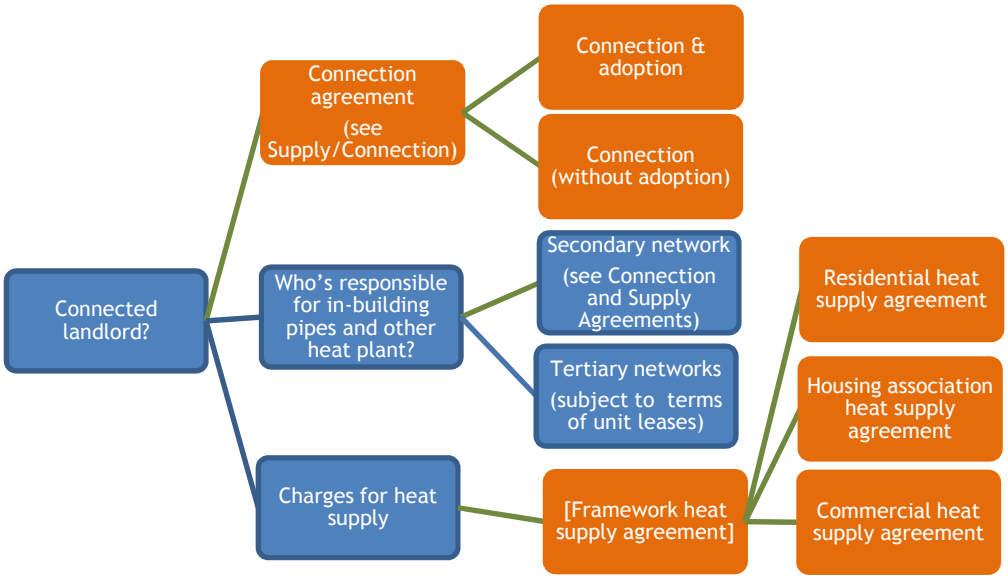
Disposals at undervalue, procuring works or services and paying too much, granting concessions on terms overly favourable to the concessionaire, all could give rise to State aid. Grant of concession and award of contracts for works or services all trigger procurement Regulations.

8. Land ownership



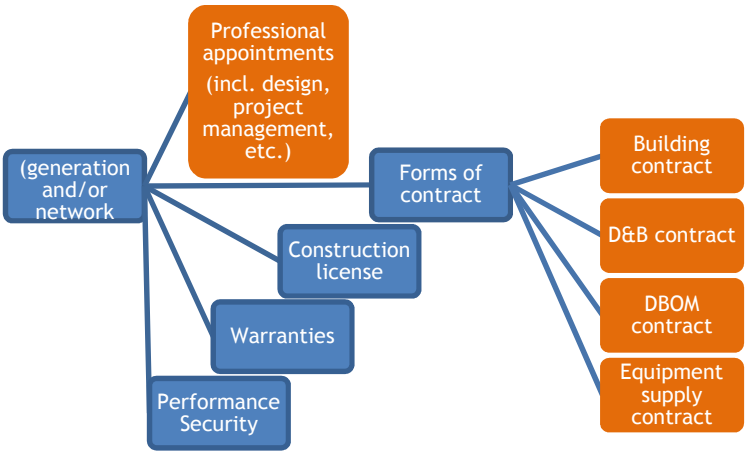
Local authority disposal of any land interest at undervalue is potentially State aid (and may require Secretary of State consent).

9. Landlord connected to a DH scheme



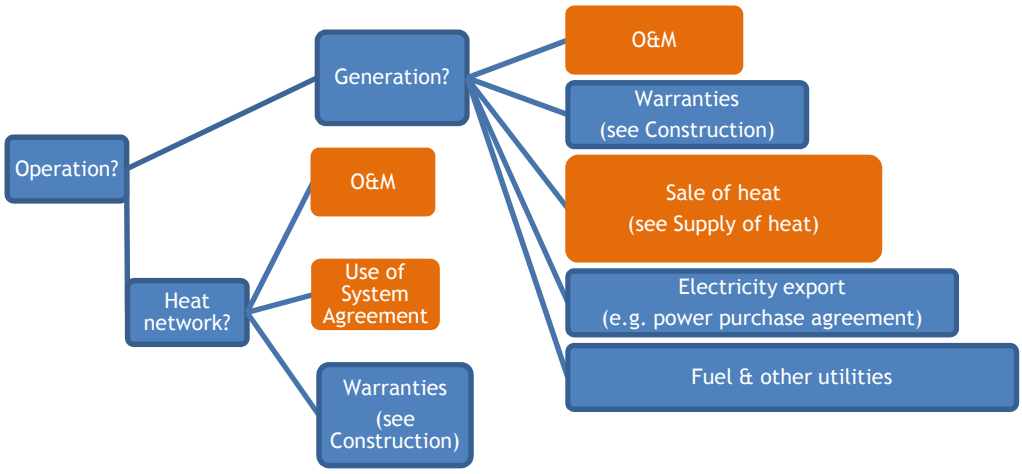
Potential for State aid through paying too high a connection charge or too high a heat price or standing charge. Market testing and benchmarking are important.

10. Installation



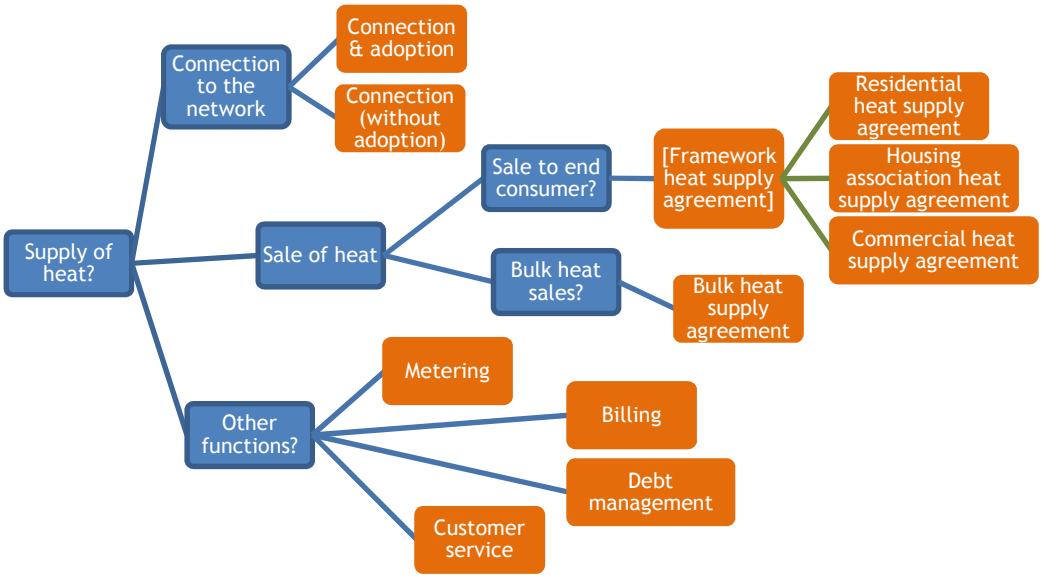
Potential for State aid if contracts granted on terms unduly favourable to the supplier. Procurement Regulations may be triggered by any of the procurements for works or services.

11. Operation



Procurement Regulations should be considered for O&M packages. State aid could arise if O&M price is artificially high or heat is sold too cheaply.

12. Supply of heat



Potential for State aid in overpaying for heat. All works and services contracts potentially subject to procurement Regulations.

13. Supplier of last resort

Holding a reversionary interest in land or assets is not in itself problematic. However, the arrangement under which the authority agrees to be the back-stop supplier could be seen as a form of guarantee, so circumstances in which the role is taken on should be considered carefully.

ANNEX A - Procurement route: Flow Chart

How to use the procurement decision tree

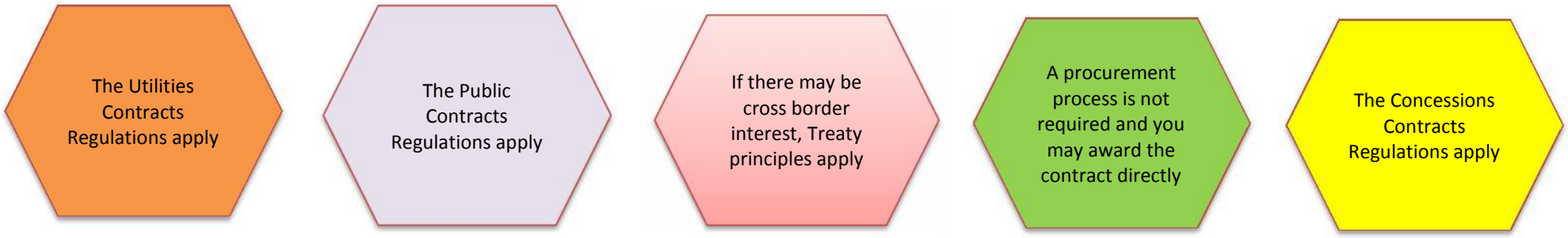
What type of procurement entity are you? Choose between:

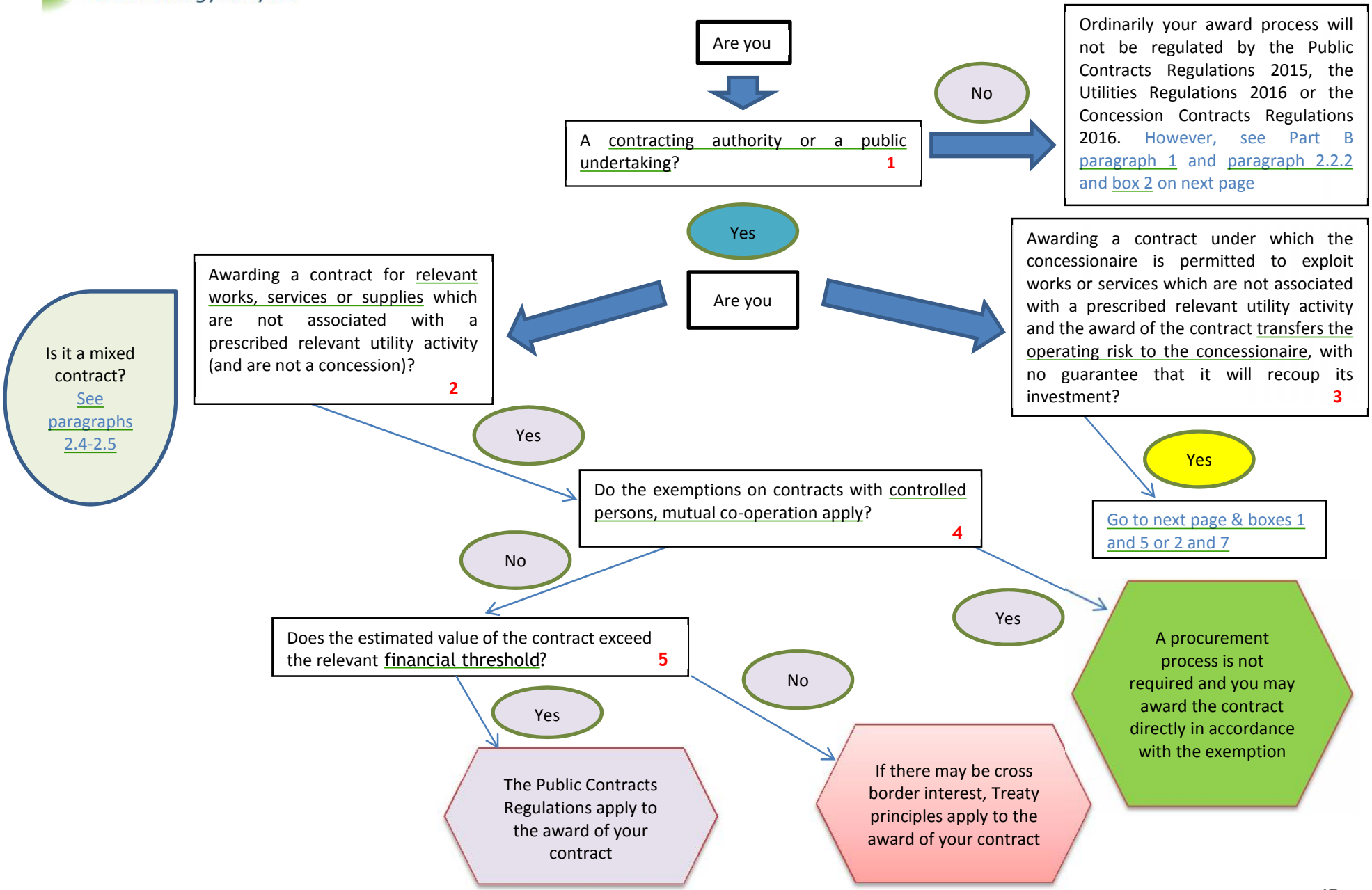
A contracting authority or a public undertaking

and

An entity which has special or exclusive rights

Choose the type of contract you are intending to award. The coloured ovals next to the decision arrows tell you what procurement options may still apply at that stage of the decision tree. The procurement routes and associated colours are:




Are you
A contracting authority or a public undertaking? 1
No
Ordinarily your award process will not be regulated by the Public Contracts Regulations 2015, the Utilities Regulations 2016 or the Concession Contracts Regulations 2016. However, see Part B paragraph 1 and paragraph 2.2.2 and box 2 on next page
Yes
Are you
Awarding a contract for relevant works, services or supplies which are not associated with a prescribed relevant utility activity (and are not a concession)? 2
Is it a mixed contract? See paragraphs 2.4-2.5
Awarding a contract under which the concessionaire is permitted to exploit works or services which are not associated with a prescribed relevant utility activity and the award of the contract transfers the operating risk to the concessionaire, with no guarantee that it will recoup its investment? 3
Yes
Yes
Go to next page & boxes 1 and 5 or 2 and 7
Do the exemptions on contracts with controlled persons, mutual co-operation apply? 4
No
Yes
A procurement process is not required and you may award the contract directly in accordance with the exemption
Does the estimated value of the contract exceed the relevant financial threshold? 5
No
Yes
The Public Contracts Regulations apply to the award of your contract
If there may be cross border interest, Treaty principles apply to the award of your contract

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clean energy lawyers

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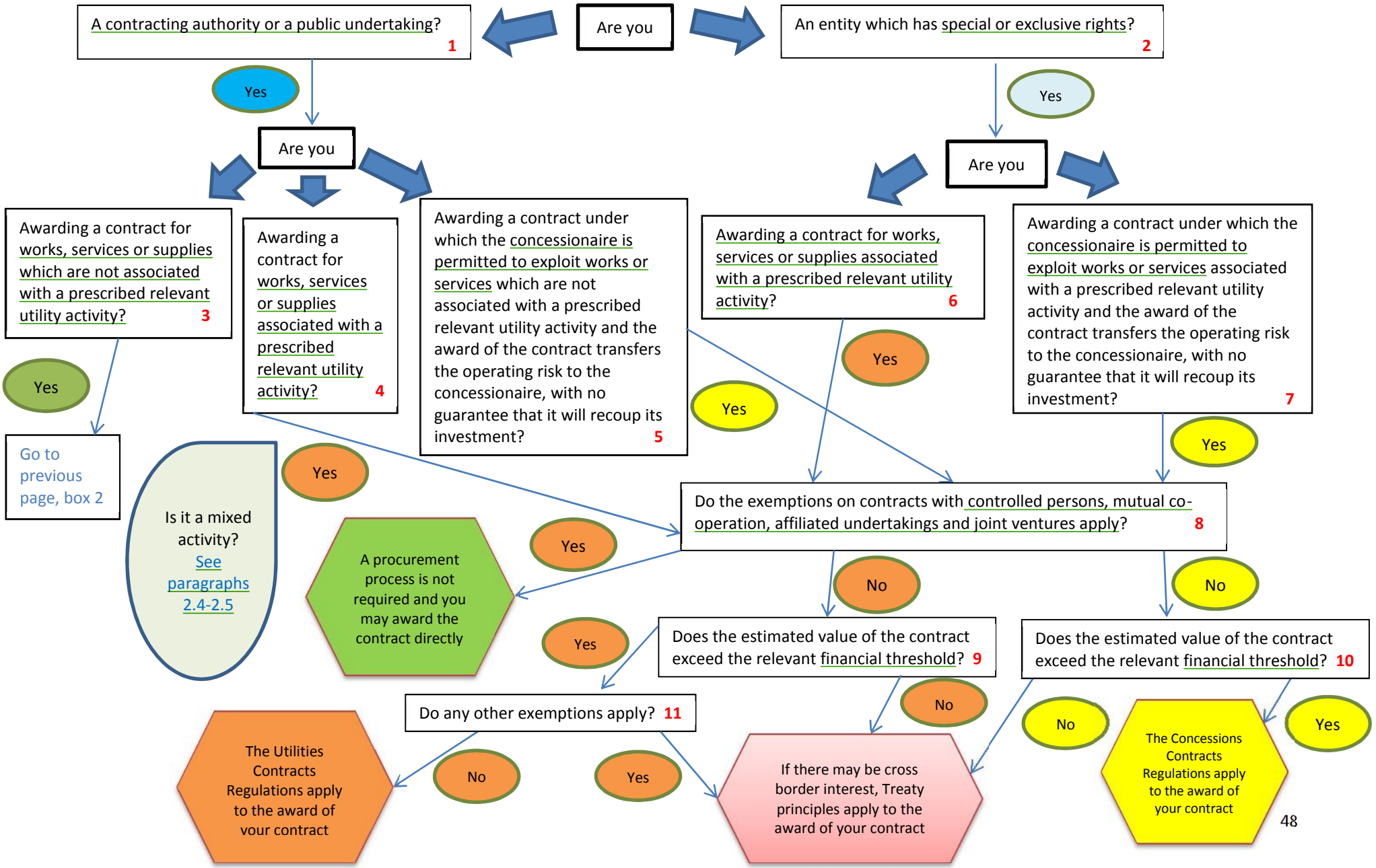

ABOUT LUX NOVA PARTNERS LIMITED

Lux Nova Partners Limited is a unique, specialist, clean energy law firm and a leader on district heating.

We have four core business areas:

- district heating and cooling
- renewables and low carbon projects
- clean energy M&A and finance
- alternative routes to market

We have worked on many award-winning projects from community to utility scale, in the UK and emerging markets, including numerous ground-breaking projects. We are recognised as market leaders for our work in district heating and cooling and alternative routes to market, where we are involved in the most innovative thinking about new business models, challenging how energy business is done.

Our own business model is flexible, enabling us to structure the support we provide and the teams that deliver that support to suit the project and client needs. We often work alongside Browne Jacobson LLP, who are providing us with procurement and State aid support on a number of projects.

ABOUT BROWNE JACOBSON LLP

Browne Jacobson is a national law firm offering a unique collection of specialisms and a genuinely dedicated public law practice. With over 800 staff, including over 400 lawyers and offices in Birmingham, Exeter, London, Manchester and Nottingham, we are committed to being a quality relationship-led business.

We act for a large number of government departments, NHS trusts and over 200 local authorities. As a result, we are well-versed in the issues that affect the sector on an on-going basis and we are fully up to speed with new and emerging issues.

Our specialist public sector practice is ranked nationally both by Chambers and Legal 500 and is led by "knowledgeable, very accessible, responsive and thorough" partners all of whom are nationally recognised as leaders in their fields.

CONTACT US

For further information about how we can help, please contact:

Tom Bainbridge
Partner
Lux Nova Partners Limited
Warnford Court
29 Throgmorton Street
London EC2N 2AT
tom.bainbridge@luxnovapartners.com
M: +44(0)7454 779 892

Peter Ware
Partner
Browne Jacobson LLP
15th Floor
6 Bevis Marks
London EC3 7BA
peter.ware@brownejacobson.com
T: +44(0)115 976 6242