GOVERNANCE AND BUSINESS MODELS FOR DISTRICT HEATING

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Introduction

- ESCOs – an introduction
- Drivers for choosing structure and governance
- Structure options
- Governance issues
What is an ESCO?

- An ESCO is not a business model
- An ESCO is not a project
- An ESCO does not answer questions of governance
- An ESCO is JAA
- It is a tool which can be used to address project issues – but not an answer in itself.
- A convenient term - a myriad variants
ESCO functions

Outputs
• energy supplies
• design, build, operation and maintenance of assets
• energy services

Project functions
• risk allocation
• governance tool
• funding vehicle
Sectoral fit

Third Sector

Public Sector

ALEO

Private Sector
Drivers for choosing a structure

- Technical expertise
- Commercial expertise
- Appetite for risk
- Availability and cost of finance
- Project goals – social vs economic
- Profit making / distributing

- Structure must follow the project – not vice versa
PPP ESCO

• Public authority / RSL driven, e.g. for large scale district heating:
  ▪ Public sector contributes land, planning and other influence
  ▪ Private sector contributes its ESCO expertise and know-how
  ▪ Funding can be shared or all private sector

• Examples:
  ▪ Southampton geothermal/district heating
  ▪ Birmingham district heating
  ▪ Glasgow (planned)
Public/third sector ESCOs

• Public sector created arms’ length external organisation (ALEO)

• Move from public sector sponsorship to third sector (Aberdeen Heat and Power, for example)

• Community driven (Example: Nottingham Ozone)
Legal structures

- Limited companies – the default option?
- Guarantee companies – “asset lock”
- Limited liability partnerships – tax transparency
- IPS / COPIC

- But – the key issues are:
  - What is the ESCO for?
  - Who are the stakeholders?
  - How will the project be paid for?
  - What are the income streams?
  - What is the exit strategy?
  - Control vs risk
Risk assessment

• Consideration of risk is critical to the choice of business model

• The various risks inherent in any project should be separately assessed: this should be done as early as possible in the project

• That assessment significantly informs where the project will lie in a spectrum ranging from public sector owned, operated and controlled to private sector owned, operated and controlled
Governance

• A day 1 issue – and continually monitored
• Not just a public sector issue
• Additional issues where a charity is involved
• Local authority rules on powers, accounting and trading
Tiers of governance

- Economic control – the owners
- Management control – the directors

- Built in to company structures
- Partnership structures start with “flatter” governance

- Special rights for particular stakeholders

- Think about conflicts before they arise

- Consultation obligations – contractual and statutory
Champions and key people

- Governance is just a structure
- What matters for success are the people in the structure
- A limited pool of people with the right skills mix, the interest and the time

- Where possible, a broad range of skills should be represented at director level, or at least the directors should have easy access to such skills

- Consider also Community involvement – at member level and/or director level?
Governance – external issues

- Public procurement regulations operating as a governance control
- A change to the status of the heat market as unregulated
- Contractual regulation – the local authority or RSL in the role of quasi-regulator
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