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Report of: *Laraine Manley*

Report to: *Cabinet*

Date of Decision: *20/09/2017*

Subject: *SCC to act as Accountable Body for grant for the connection of the E.ON district energy network to the SCC district energy network, with associated funding agreements and heat purchase agreement.*

Is this a Key Decision? If Yes, reason Key Decision:-	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
- Expenditure and/or savings over £500,000	<input checked="" type="checkbox"/>	
- Affects 2 or more Wards	<input checked="" type="checkbox"/>	
Which Cabinet Member Portfolio does this relate to? <i>Environment</i>		
Which Scrutiny and Policy Development Committee does this relate to? <i>Economic and Environment Wellbeing.</i>		
Has an Equality Impact Assessment (EIA) been undertaken?	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
If YES, what EIA reference number has it been given? <i>1250</i>		
Does the report contain confidential or exempt information?	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
If YES, give details as to whether the exemption applies to the full report / part of the report and/or appendices and complete below:-		
Appendix One is not for publication by virtue of Regulation 20(2) Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 because, in the opinion of the proper officer, it contains exempt information under Paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.		

Purpose of Report:

1. To allow the Council to enter into funding agreements with E.ON and draw down grant funding of up to £2,231,250 from Government (Business Energy and Industrial Strategy) as part of the Heat Networks Investment Project. The grant will be used to support the cost of connecting the heat network from the E.ON biomass plant at Blackburn Meadows to the SCC District Energy Network (DEN) providing an additional source of low cost, low carbon heat and facilitating the development of the SCC DEN. Through the funding agreements SCC will act as the Accountable Body, passing the grant funding and related obligations to E.ON who will construct the connection.
2. To allow the Council to enter into a related Heat Purchase Agreement with E.ON to buy a minimum of 7.5GWh per annum of heat to replace heat currently supplied by gas and oil boilers as back-up and top-up to the Energy Recovery Facility plant (the primary source of heat for the SCC DEN). The agreement also provides for the purchase of additional heat if required by the network (for example to supply the Sheffield Retail Quarter) and for the sale of heat from the SCC network when required to provide backup to the E.ON network.

An Outline Business Case (OBC) for the project is attached as Appendix One (not for publication).

Recommendations:

That Cabinet:

1. Approves the drawdown of the grant funding, totalling £2,231,250 (via a commercialisation grant for £417,500 and a construction grant for £1,813,750) from the Department for Business, Energy and Industrial Strategy (BEIS), via Salix (its agent), for commercialisation and construction of the connection between the E.ON Lower Don Valley (LDV) Heat Network and the SCC DEN.
2. Delegates authority to the Executive Director of Place, in consultation with the Director of Finance and Commercial Services and Director of Legal and Governance, to negotiate final terms and approve entry into:
 - a. back to back funding agreements for the commercialisation grant for £417,500 and for the construction grant for £1,813,750 with E.ON, with SCC acting as the Accountable Body for the funding; and
 - b. a Heat Supply Agreement with E.ON for the purchase of a minimum of 7.5GWh of heat from E.ON's LDV Heat Network with the possibility for both the purchase of further heat beyond the initial 7.5GWh and the sale of heat from the Sheffield DEN to the E.ON LDV Heat Network.
3. Subject to the terms of any agreements with E.ON being approved by the Executive Director of Place in accordance with the delegation above, authorises the Head of Waste Management, to administer the grant agreements with BEIS and the agreements with E.ON in accordance with their terms.

Background Papers:

31st March 2017: Individual Executive Decision Record

Acceptance of grant for Phase 1 for the connection of the E.ON biomass plant to the SCC District Energy Network.

Lead Officer to complete:-		
1	I have consulted the relevant departments in respect of any relevant implications indicated on the Statutory and Council Policy Checklist, and comments have been incorporated / additional forms completed / EIA completed, where required.	Finance J Wilby & M Wassell
		Legal: Tim Hoskin
		Equalities: Annemarie Johnson
<i>Legal, financial/commercial and equalities implications must be included within the report and the name of the officer consulted must be included above.</i>		
2	EMT member who approved submission:	Lorraine Manley
3	Cabinet Member consulted:	Cllr Bryan Lodge
4	I confirm that all necessary approval has been obtained in respect of the implications indicated on the Statutory and Council Policy Checklist and that the report has been approved for submission to the Decision Maker by the EMT member indicated at 2. In addition, any additional forms have been completed and signed off as required at 1.	
	Lead Officer Name: Gillian Charters	Job Title: Head of Waste Management
	Date: 31/07/2017	

1. PROPOSAL

- 1.1 The Sheffield District Energy Network (DEN) currently has two major concerns. Firstly, lack of heat during times of particularly high demand and reliance on carbon intensive sources of heat to provide top-up to heat from the Energy Recovery Facility (ERF) and resilience for the entire DEN. This backup and resilience of approximately 7.5 GWh of heat is currently provided by oil and gas boilers. Secondly, due to this restriction there is little opportunity for expansion of the DEN or connection of new customers unless an existing customer comes off the DEN.
- 1.2 To overcome these problems, a new low carbon heat source is required to feed in to the city centre DEN.
- 1.3 In 2014 E.ON began providing heat from its Blackburn Meadows biomass Power Station along their LDV heat network (LDV). This power station has the capacity to deliver up to 96GWh of heat locally.
- 1.4 The proposal is to develop a linking heat network to connect the LDV DEN to the SCC DEN at Bernard Road. This link will be developed by E.ON at their cost and risk, supported by a capital grant of £2,231,250 from the Department for Business, Energy and Industrial Strategy (BEIS) via the Council.
- 1.5 An ICM report in March 2017 gave approval to accept up to £2,231,250 of grant funding for phase 1 of the project from BEIS via the Heat Networks Investment Project (HNIP).

- 1.6 The HNIP funding is to support the expansion of the E.ON owned district energy network in the LDV to make a connection to the SCC DEN to supply heat to the Sheffield District Energy Network. This project will:
- Require minimal funding from SCC (costs of administration of the Accountable Body function and Veolia costs for connection to be met within the existing Waste Management budget). It will require SCC to be the recipient of grant funding and then pass on the funds to E.ON on reciprocal terms.
 - As phase 1: Deliver a connection between the E.ON district energy network and the SCC DEN, providing additional low cost, low carbon heat to the SCC DEN eliminating reliance on carbon intensive fuels (gas and oil), providing general resilience as well as supporting opportunities to expand the SCC DEN.
 - As phase 2: Deliver connections in the E.ON network to the Northern General Hospital and a BT datacentre.
 - Support the city's regional development growth plan to encourage new industry and investment in the region; assisting with low cost, low carbon heat, improving air quality, providing essential energy resilience and ensuring Sheffield's established and potential new investors are competitive in world markets.
- 1.7 A separate Business Case will be produced for phase 2 of this project during 2017/18. This Report and the associated Business Case focus on phase 1 only.
- 1.8 Whilst the Council is not legally required to expand district heating in the city, this linking heat network should lead to reduced carbon emissions, lower costs, improved resilience, improved air quality and less reliance on fossil fuels.

2. HOW DOES THIS DECISION CONTRIBUTE?

- 2.1 The development of this network and its connection to the SCC DEN, contributes to the city on many levels.
- 2.2 One of our five priorities in the Corporate Plan (2015 – 2018), is to develop a Strong Economy.
- 2.3 A key part of this priority is creating "Access to local, low carbon Energy". Within our Corporate plan we undertake to "Reducing dependency of Sheffield's businesses on imported fuel with decarbonised, locally generated energy sources will give Sheffield a competitive advantage over other locations and support future economic growth."
- 2.4 We also state that "Over the next three years we will work with partners to expand Sheffield's energy network, increasing access to business and residents in the Lower Don area."

- 2.5 A number of other documents on sustainable local growth and development further set the context for this project; these include Sheffield's Economic Masterplan, Sheffield's Development Framework, the City Centre Masterplan 2008, Sheffield – The Decentralised Energy City and specific Sheffield City Council (SCC) spatial planning policies.
- 2.6 The sustainability policy "Growing Sustainably: a bold plan for a sustainable Sheffield", was approved at Cabinet recently, and makes several references to the importance of district heating and decentralised energy to delivering sustainability in Sheffield. A more extensive decentralised energy infrastructure would assist with flexibility, resilience and future-proofing of energy provision for Sheffield, together with carbon dioxide emissions reductions and a decrease in local atmospheric pollutants.

Overall the project will have a positive contribution to the city in many ways including:

- Climate change - through a significant reduction in carbon emissions;
- Air quality – through the reduction of fossil fuels being burnt in the city centre;
- Economic impact – through the potential extension of the heat network to new and existing properties, offering more environmentally friendly heat at no additional cost and creating an attractive low carbon offer to business';
- Future city – Sheffield will regain its mantle of the UK's leader in district heating. Boasting not just the largest UK heat network but the also the largest low carbon network.

3. HAS THERE BEEN ANY CONSULTATION?

- 3.1 Due to the tight deadlines of submitting the funding application the Council did not undertake a prior consultation about the proposed project.

4. RISK ANALYSIS AND IMPLICATIONS OF THE DECISION

4.1 Equality of Opportunity Implications

- 4.1.1 This project should lead to positive impacts for the whole city but in particular the city centre. Any improvement to air quality will lead to a positive impact for all Sheffield residents. For current and new customers of the DEN this will lead to more reliability, better choice, lower carbon emissions and better energy security.

- 4.1.2 Expansion and development of the SCC DEN, which this project will facilitate, will support the attraction of industry and commerce to

Sheffield, with resultant employment opportunities.

4.2 Financial and Commercial Implications

4.2.1 SCC will be the Accountable Body for the funding and will pay it over to the applicant when the terms and conditions have been met. Key features (not exclusive) of the two back to back Funding Agreements /MoUs are summarised as follows:

- Grant will only be paid in respect of Eligible Costs incurred after the Application Date.
- The grant recipient must submit a Grant Claim Form no later than 3rd January 2018.
- Any part of the grant not drawn down during the Availability Period will automatically be cancelled at the end of the Availability Period.
- The Recipient must comply with all requirements of the MoU, including the monitoring and reporting requirements.
- The Recipient will immediately repay Grant monies to SCC if the Grant becomes repayable under the terms of the Agreement or the MoU.
- If any funding under the MoU is recovered, withdrawn, reclaimed by BEIS under the terms of the MoU due to the Recipient, this amount will be repayable by the Recipient to the Funder.
- The grant maybe withheld or suspended if the delivery of the Project does not start within 6 months of the Commencement Date
- Must comply with both EU Public Procurement Law and EU State Aid law requirements

The SCC Sustainable Energy Project Officer will need to read and understand and ensure that EoN comply with all of the terms and conditions of the two back to back Funding Agreements/ MoUs (totalling £2,231,250) when submitting their returns and evidence.

The main risks identified are:

- 4.2.2 Around the funding agreements with BEIS and the timescales related to the drawdown deadlines. The Council has entered into two grant Memorandums of Understanding - one for commercialisation (grant amount £417,500) and one for construction (grant amount £1,813,750) totalling £2,231,250, however the availability period for the grant is the end of March 2018.
- 4.2.3 SCC is expecting to pass on all liabilities to E.ON. However E.ON are not willing to accept uncapped liability and the project team are currently negotiating a cap of £20m against the Funding Agreements and a further £20m against the Heat Supply Agreement (the full amount in relation to a

default termination, and a £5m annual cap in relation to other liabilities). In the event of the liability being above the cap the Council would have to find this money. Currently there are no funds identified should a cost of this nature arise. This is anticipated to be a low risk as the overall value of the grant is under £3m and the value of the contract is low at approximately £6m over 40 years.

- 4.2.4 That ongoing negotiation with E.ON fails to lead to an acceptable agreement between them and the Council. Failure to come to an agreement may lead to the project folding and the connection of the networks not going ahead. The agreement between the Council and BEIS for the funds would expire.
- 4.2.5 To mitigate against these risks:
All funding agreements between the Council and E.ON will seek to 'back off' and 'flow down' risks, obligations and liabilities to E.ON, where at all possible with all agreements made replicating the terms and conditions in the original funding Agreement issued to SCC by BEIS. . All funding agreements will be signed before any funding is drawn down and full evidence of spend and compliance with grant terms and conditions is provided.
- 4.2.6 SCC will only draw down funding from HNIP when requested by E.ON and once agreed milestones have been completed. The risk of any clawback is therefore anticipated to be minimal, but in any case that risk is also backed off to E.ON.
- 4.2.7 The Key Principles Paper attached to the OBC sets out the key principles that will be embodied in the funding agreements and the Heat Supply Agreement. This acts to mitigate all key risks. This paper has been agreed and signed off by E.ON. There will also be a procurement challenge risk mitigation clause in the agreement(s) with E.ON in the event of a procurement challenge with both sides able to walk away. The Council would have no liability for E.ON incurred costs and (subject to any caps) E.ON will be responsible for Council costs and losses.
- 4.2.7 There are also risks stemming from the MOU's with BEIS which should be noted: Repayment and claw-back obligations attached to the funding from BEIS. The Council seeks to pass these on to E.ON via the back to back funding agreements. The repayment obligations are only relevant if the project proceeds and if the Council makes a claim for funding on behalf of E.ON. Repayment of any unspent grant is also necessary, if the Eligible Costs of the Project are less than the Projected Costs.
- 4.2.8 There are a number of Repayment Events set out within the Memorandums between BEIS and SCC, including non-compliance with the obligations of the grant agreement, insolvency, material adverse change to the business or function which would have made a difference to the application being accepted, any event or circumstance which BEIS consider would have a material adverse effect and failure to proceed to construction. The consequences of which could be the grant is cancelled, BEIS declare all or part of the grant immediately due and payable or

payable on demand, with or without interest. In the case of a repayment event due to non-construction, only a portion of the Grant, which has not been spent, will be immediately due and payable or payable on demand.

- 4.2.9 The Council is providing indemnities against any cost, loss or liabilities incurred by BEIS, as a result of the Council's or any Investment Vehicles actions or omissions or in respect of the Project. These obligations will be passed on to E.ON via the further agreements proposed.
- 4.2.10 The grants may constitute a state aid and therefore the Council will also have to ensure it is state aid law compliant throughout the Project and has sought – and is working within the terms of - external legal advice in this regard from Bevan Brittan Solicitors. They have also provided the Council with advice in respect of complying with procurement obligations.
- 4.2.11 The BEIS Funding Agreements require the project to be in compliance with the European Procurement Rules. E.ON will be undertaking the procurement of all works and services and will be financially responsible for all procurement law risks (including third party claims) as detailed within the funding agreements.
- 4.3. Minimum Heat Supply
 - 4.3.1 SCC is to enter into a 40 year contract for a minimum heat supply of 7.5GWh. This is approximately the amount of heat generated by oil and gas on top of the heat generated by the ERF. Pricing details are contained in the Key Principles paper attached to Appendix 1.
 - 4.3.2 This risk is mitigated by the introduction of 10 year break clauses in the Heat Supply Agreement as well as the knowledge that the Council could use the 7.5 GWh instead of the ERF heat if required.
- 4.4. Reputational
 - 4.4.1 The key reputational risks are:
 - 4.4.2 Administering the grant correctly: to limit reputational risk, we will not attempt to drawdown any funding until E.ON have met key milestones and made a formal request to SCC to begin the drawdown process.
 - 4.4.3 The impact to the local environment during the construction. The project team will ensure there are timely and good communications with stakeholders including local businesses which may be disrupted by the digging up of the roads to lay the pipes.
 - 4.4.4 The project relies on a good working relationship among E.ON, the Council and Veolia, in order to develop and implement the technical, commercial and legal interface between the two heat networks. This relationship has now started and the Council will continue to support the flow of information between the parties. However, there remain significant challenges, particularly on the commercial and legal interface, that will need to be overcome as the project proceeds.

4.5. Opportunities

- 4.5.1 The project as a whole offers some significant opportunities for SCC: The main opportunity is to lower carbon emissions directly related to the production of heat.
- 4.5.2 The connection to E.ON also offers the best opportunity in recent times to significantly expand the heat network, in effect offering the opportunity to almost double in size.
- 4.5.3 The connection also gives Sheffield City Council the opportunity to show its commitment to both district heating and also the lowering of emissions in the city.

4.6 Legal Implications

- 4.6.1 The Council has the power to proceed through the General Power of Competence in Part 1 of Localism Act 2011, together with s.111 of the Local Government Act 1972.
- 4.6.2 The Council has entered into two grant Memorandums of Understanding with BEIS for the funding for the project, one for commercialisation (£417,500) and one for construction (£1,813,750), totalling £2,231,250.
- 4.6.3 The Council will enter into back to back grant agreements with E.ON, passing on the obligations under the BEIS agreements to E.ON (apart from those relating to the administration of the BEIS funding), in order to minimise the risks to the Council.
- 4.6.4 The E.ON corporate structure for the delivery of the project has not yet been finalised, and the specific E.ON company that is to enter into each agreement has yet to be confirmed. As necessary, the E.ON obligations under each of the funding agreements and the Heat Supply Agreement will be supported by an appropriate parent company guarantee.
- 4.6.5 The commercial risks (and the mitigation and management steps associated with them) relating to the terms of the BEIS funding agreements are described in section 4.2 above.
- 4.6.6 It is considered that a competitive procurement process for this project is not required by the procurement regulations. The main justification under the regulations for this (for following a negotiated procurement procedure without prior publication of a contract notice) is that competition is absent for technical reasons and/or due to the protection of E.on's exclusive rights. This is because there are no alternative, accessible sources of heat and because E.ON's agreement is necessary for any connection to their network.
- 4.6.7 Notwithstanding the above, there is some procurement risk in entering into the Heat Supply Agreement without having conducted a procurement process. Steps will be taken to mitigate this risk: firstly, through the

publication of an advance transparency (VEAT) notice; and, secondly, through the terms of the agreements with E.ON.

4.7.1 Other Implications

4.7.2 The near elimination of fossil fuel backup and the potential expansion of the DEN will have positive health implications through the related improvement in air quality. As the DEN expands there will be less combustion of gas in the city centre with a related reduction in emissions especially NOx.

4.7.3 The resilience that this connection will give to the DEN as well as the lowering of related carbon emissions and the potential to expand the DEN within the city could lead to Sheffield City Centre being seen as an epicentre of environmentally friendly, quality, office and retail space; an offer other cities cannot offer.

5. ALTERNATIVE OPTIONS CONSIDERED

5.1 The attached Business Case show that the alternatives investigated involved either SCC funding the schemes gap or E.ON fully funding the scheme, neither being commercially viable.

5.2 In the situation that the project was not funded, the SCC DEN would continue to rely on gas and oil boilers to provide back-up and top-up heat into the network at times of peak demand and during the Energy Recovery Facility (ERF) shut-down periods.

5.3 The opportunities for carbon savings and air quality improvement would be lost and the SCC DEN would remain unable to achieve significant development and expansion.

6. REASONS FOR RECOMMENDATIONS

6.1 The grant funding through the HNIP pilot is the only means of attracting the funding necessary to make the connection between the E.ON LDV Heat Network and the SCC DEN viable at this time.

This is a unique opportunity to use the grant funding that SCC has applied for to deliver a project with significant opportunities for Sheffield, and at minimal risk and cost to the Council. All funding agreements with E.ON seek to 'back off' and 'flow down' most risks, obligations and liabilities to E.ON. SCC will only draw down funding from HNIP when requested by E.ON and base on agreed milestones. The risk of any clawback is therefore minimal, but in any case that risk is also backed off to E.ON. SCC's only costs will be in administering the 'Accountable Body' role to pass HNIP funding through to E.ON who will deliver the project, but these costs will be covered by E.ON through a direct annual payment.