

Executive Board – 22nd June 2021

Subject:	Enviroenergy Ltd – Options for continuation of the legal entity.
Corporate Director(s)/Director(s):	Wayne Bexton, Interim Corporate Director Growth and City Development Clive Heaphy, Strategic Director of Finance
Portfolio Holder(s):	Councillor Sally Longford Portfolio Holder for Energy, Environment and Waste Services
Report author and contact details:	Ian Edward, advisor on Companies ian.edward@nottinghamcity.gov.uk
Subject to call-in:	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Key Decision:	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Criteria for Key Decision:	
(a) <input type="checkbox"/> Expenditure <input type="checkbox"/> Income <input type="checkbox"/> Savings of £1,000,000 or more taking account of the overall impact of the decision	
and/or	
(b) Significant impact on communities living or working in two or more wards in the City	
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
Type of expenditure:	<input checked="" type="checkbox"/> Revenue <input type="checkbox"/> Capital
Total value of the decision:	See Finance Comments
Wards affected:	City Wide
Date of consultation with Portfolio Holder(s):	4th June 2021
Relevant Council Plan Key Theme:	
Nottingham People	<input type="checkbox"/>
Living in Nottingham	<input checked="" type="checkbox"/>
Growing Nottingham	<input type="checkbox"/>
Respect for Nottingham	<input type="checkbox"/>
Serving Nottingham Better	<input type="checkbox"/>
Summary of issues (including benefits to citizens/service users):	
The Council has considered the options for the long term future of the legal entity that facilitates district heating provision in the City. Enviroenergy Ltd is the commercial vehicle through which District Heating and Electricity has been supplied by the Council to customers since 2001. The report recommends the transfer of company's assets and liabilities to the council and a managed wind down and closure of the commercial entity, bringing the trading operation in-house.	
Exempt information:	
Appendix 1 of this report is exempt from publication under paragraph 3 of Schedule 12A to the Local Government Act 1972 because it because to disclose the information contained in the report would adversely prejudice EE's ability to trade in a competitive marketplace	
Appendix 2 of this report is exempt from publication under paragraph 5 of Schedule 12A to the Local Government Act 1972 because it contains information which is subject to legal professional, and having regard to all the circumstances the public interest in maintaining the exemption outweighs the public interest in disclosing the information, because it permits the decision maker to receive full and frank advice about legal issues without adversely prejudicing the City Council's ability to consider and manage those	

issues.

Recommendation(s):

- 1 To approve the transfer of all property, rights and liabilities in the Enviroenergy business to the City Council subject to the following conditions being met –
 - a. A satisfactory outcome of the legal and financial due diligence which confirms that the business formerly operated by Enviroenergy can be operated by the City Council within the constraints of the MTFP
 - b. Confirmation that the City Council is able to operate the business formerly operated by Enviroenergy, and
 - c. Confirmation that following the transfer of assets and liabilities to the Council, that the company can be solvently liquidated.
- 2 To delegate authority to the Chief Executive in consultation with the Corporate Director for Finance and Resources and the Director for Legal and Governance to agree the contract to transfer the business of Enviroenergy to the City Council subject to the conditions above being met to their satisfaction.
- 3 Subject to a successful transfer as described above to delegate authority to the Corporate Director for Finance and Resources to undertake a solvent liquidation of the Enviroenergy Company in consultation with the Portfolio Holder for Finance and Resources.
- 4 To approve the cost of £0.5m from funds earmarked for Transformation for the appointment of additional resources as set out in the report to undertake the due diligence and successfully transfer the business to the City Council.

1 Reasons for recommendations

- 1.1 The Council's Recovery and Improvement Plan, published in January 2021 identifies that the position of Enviroenergy (a wholly owned subsidiary of NCC) is an early priority for the Council to consider and that a Strategic Review of the company's future is should be undertaken.
- 1.2 Enviroenergy Ltd was taken over by Nottingham City Council in 2001 as operator of last resort following the departure of Dalkia who previously operated the system under a joint ownership arrangement with the Council.
- 1.3 The Company provides heating to approximately 5,000 homes and 70 commercial premises and underpins the Councils strategic aspirations for Carbon Neutral 2028, Fuel Poverty Strategy, Clean Industrial Growth Strategy and Energy self-sufficiency and security. The company has consistently provided good service to customers, equally as one of the largest district heating schemes in the United Kingdom and a provider of renewable energy; the service is also valued by central Government. The Council is committed to achieve a resilient and carbon neutral Nottingham by 2028 through Carbon reduction measures, Carbon removal, Resilience and Adaption, Ecology and Biodiversity.
- 1.4 The use of waste to generate steam also supports the Council waste disposal obligations, the process of incinerating non-recyclable waste, avoids the

requirement to landfill this waste which benefits the Council by approximately £5m annually. This is in addition to the benefits identified at paragraph 1.3.

- 1.5 The district heating infrastructure was created in 1972, although fully operational it is now aging and requires further investment to protect the supply of heating and electricity to customers. Maintenance and replacement works are planned for the next 5 years that will ensure continuity during that period. The key consideration for the Council is how to best undertake the planned work on the asset it owns to achieve value for money and maintain continuity. The use of an arms-length company to operate and manage the council owned district heating network has been reviewed and it is concluded that alternative structures will achieve better value for money, and can be achieved without impact to customers.
- 1.6 As a separate legal entity, the company is obliged to pay the Council the costs of the asset it uses to trade which results in a transaction between the company and the Council; a taxation issue arises which will adversely impact the level of Value Added Tax the Council can recover against its various VAT exempt activities, being: Theatre Royal, Leisure Services, and property lettings. Professional advice has been sought to identify the most tax efficient structure for the relationship between the Council and the company which has concluded that the Council may continue its recovery of VAT if the business activities of the company are delivered as an in house council service. Further, recent reviews of the arrangement have identified that as a core council service, these activities are best delivered and managed in house.
- 1.7 The scale of investment planned also creates an issue for the trading position of the company. The Council's budgeted investment must be charged back to the Company. Although budgeted by the Council, the company's revenues cannot accommodate the costs and to avoid financial pressure on the Company and without detriment to the Council financial position or experience of customers, a further benefit of delivering the service in house is the resolution of that challenge.
- 1.8 The issues identified at paragraphs 1.6 and 1.7 can be resolved through the legal transfer of the Company's assets and liabilities to the Council with a subsequent managed closure of the legal entity through a solvent liquidation process (known as a member's voluntary liquidation). This will ensure the Company avoids financial pressures and will remove the transactions between the Company and the Council that will adversely impact on levels of recoverable VAT across the Council's services. This is the single option that will achieve resolution of both issues.
- 1.9 The mechanism for achieving the legal transfer is through the use of a "hive up" agreement between the Company and Council. This agreement would transfer the assets and liabilities of the Company from Company to Council ownership. Thereafter, the Company can then be placed into a Members Voluntary Liquidation whilst it is still solvent. These two measures are recommended to be deployed before the next tax year.
- 1.10 In parallel a project to review the options to continue strategic waste and district heating is in progress, the recommendation to return the business to an in-house setting does not preclude the options under review.

2 Background (including outcomes of consultation)

- 2.1 To maintain value for money and manage the transfer process a transition team will be deployed. The estimated budget requirement of the transition activity is **£500k**. This has been informed by a due diligence process undertaken with Council teams over the past two months. Additional benefits to the Council will include the implementation of improved financial management systems that will support ongoing exploration of investment opportunities and underpin regulatory requirements for transparency in recovery of costs through charges.
- 2.2 The timescale for achieving the transfer is approximately 7 months. This informs a potential transfer date of end of January 2022. The transfer process will be subject to continual review and project and risk management.
- 2.3 As part of the Council's Recovery and Improvement Plan, the Council is undertaking a review of strategic waste and district heating options to ensure alignment with carbon neutral 2028 objectives and a sustainable long term future, including:
- A detailed appraisal of the range of options available to it for the long term supply of heat and power to domestic and commercial customers at lowest risk/cost commensurate with the appropriate security of supply.
 - An aligned strategic review of waste disposal and district heating activity, to include recognition of legislative changes and management of short and long term costs and risks.

3 Other options considered in making recommendations

- 3.1 Do nothing: continue with separate legal entity for both district heating and the sale of electricity to customers via the private wire network. Adverse VAT impacts across the Council are inevitable and financial pressures on a separate legal entity (which is in essence a core function of the Council) will occur. This option is not considered viable
- 3.2 Partial transfer – transfer the district heating activities to the Council, leaving the private wire network in the separate legal entity. This would alleviate the majority of the short term VAT impact however, it fragments the business and may therefore impact on the ability to gain future investment from government. It is not considered justifiable to maintain a separate legal entity and associated costs (additional year end accounting costs, year-end audit costs, duplicated systems and ways of working).

4 Finance colleague comments (including implications and value for money/VAT)

- 4.1 In recent years the Council has been operating close to its Partial Exemption limit, continuing to operate at this level leaves little headroom for generation of additional income from revenue activities, or capital expenditure for development or emergencies on assets used to generate VAT exempt income. The risk of a Partial Exemption breach will increase from 2022 onwards as the de-minimis limit will decrease as the Council reduces its Capital Programme in

accordance with its Recovery and Improvement Plan. The Council will need to closely monitor its partial exemption position and take steps to ensure that it does not breach its limit with the ensuing irrecoverable VAT costs.

- 4.2 If Enviroenergy were to remain as a separate legal entity the VAT incurred on the capital works on London Road Heat Station (LRHS) and the District Heating Network would need to be included in the Councils Partial Exemption calculation for VAT. As a consequence, it is likely that the Council would exceed its exemption limit during every year of the works on LRHS and the Network resulting in additional cost pressures.
- 4.3 A partial transfer of the District Heating business would alleviate the majority of the VAT risk as the capital expenditure would be incurred on assets that were not leased to an external party and therefore not generating VAT exempt income for the Council or on assets that were generating both VATable and VAT exempt income for the Council. There would still be a risk of the Partial Exemption limit being exceeded due to the capital works on assets required for the generation and distribution of electricity, particularly in light of the reduced de-minimis limit. A partial insourcing arrangement would be a complex transaction from a tax perspective due to complications in valuing the assets to be transferred and ensuring that charges for the services that would continue to be provided to Enviroenergy were compliant with transfer pricing regulations. The transfer of assets would allow for some of the historic debt to be repaid the company but may not resolve the solvency issues of the company.
- 4.4 If Enviroenergy were fully insourced then the Council would no longer be using LRHS and the District Heating Network to generate VAT exempt income. Instead the assets would be used to make supplies of district heating and electricity to commercial and domestic customers which would be subject to VAT at standard or reduced rate; therefore all VAT incurred on the capital works would be fully recoverable and the Partial Exemption risk eliminated.
- 4.5 External tax advice has been sought and confirms that the transfer of the business and removal of the lease charge for LRHS will remove the risk of the Council exceeding its partial exemption threshold.
- 4.6 Resources required to undertake the transfer will require budget of up to £0.500m. This activity forms part of the Improvement Programme and will be funded from an earmarked budget allocated from reserves.

The repayment of the reserves will be captured in the Medium Term Financial Plan.

Advice provided by Gary Robbins Senior Tax Accountant 26th May 2021

5 Legal and Procurement colleague comments (including risk management issues, and legal, Crime and Disorder Act and procurement implications)

- 5.1 Legal comments are provided in Exempt Appendix 2.

Advice provided by Naomi Vass – Senior Solicitor – Commercial, Employment and Education 11 June 2021.

6 Strategic Assets & Property colleague comments (for decisions relating to all property assets and associated infrastructure)

- 6.1 There are two lease agreements in place between Nottingham City Council and Enviroenergy Ltd for the Heat Station on London Road, the associated pipe network and a number of sub-stations. The leases are for a period of 20 years from the 1st April 1995 and have currently expired. However, EE is currently holding over on the terms of those leases. Although the terms of the leases have expired, they continue to be adhered to by both parties.
- 6.2 All sites covered by the leases will need to be investigated to ensure they are still operational and valid.
- 6.3 EE is currently invoiced £100,000 per annum and the income is received by the General Fund. There are no rent arrears. The repairing liability sits wholly with EE as tenant.
- 6.4 Property Services will need to work with the Conveyancing Team in Legal Services to surrender the leases and any rights or interest EE has in the respective premises to leave the Council with clean ownership as part of the Hive Up. Repair responsibilities will need to sit with the new team and the budgets that sit with the Property Trading Account adjusted downwards.
- 6.5 Property Service has no objection to the decision being made in this Executive Board report.

Advice provided by Beverley Gouveia, Development & Disposals Manager & John West, Estates Surveyor, 27th May 2021

7 Social value considerations

- 7.1 Enviroenergy provides low carbon heating to some of the most deprived parts of the City. Its ability to operate effectively is a critical part of the City Council's Carbon Neutral Action Plan and other policies.

8 Regard to the NHS Constitution

- 8.1 N/A

9 Equality Impact Assessment (EIA)

- 9.1 Has the equality impact of the proposals in this report been assessed?

No
An EIA is not required because this does not represent a change of policy that will impact on equality.

Yes

10 List of background papers relied upon in writing this report (not including published documents or confidential or exempt information)

10.1 None

11 Published documents referred to in this report

11.1 Nottingham City Council Recovery and Improvement Plan

<https://committee.nottinghamcity.gov.uk/documents/s114407/Enc.%203%20for%20Nottingham%20City%20Council%20Recovery%20and%20Improvement%20Plan.pdf>

11.2 Nottingham City Council Carbon Neutral Action Plan

<https://www.nottinghamcity.gov.uk/media/2619917/2028-carbon-neutral-action-plan-v2-160620.pdf>