



A-Z of issues in renewable energy projects: Q-S

In this series of articles, Burges Salmon's Energy team provides an "A-Z" of key legal and practical issues in renewable energy projects. This fifth instalment covers "Q to S" and sets out a number of issues that our construction, energy, corporate and finance teams regularly encounter.

Question: Where are we on the community ownership of renewable energy projects?

On 27 February 2015, the Government published its response to the report prepared by the Shared Ownership Taskforce, a group established following the Secretary of State's call for a voluntary approach to community shared ownership of onshore commercial renewable energy projects.

The report confirms that the Government supports the Taskforce's November 2014 proposals on how to achieve and develop a voluntary approach to shared ownership (the "Framework"). The Government now expects the Framework to be applied by all commercial renewable energy projects submitted into planning from November 2014, where project costs exceed £2.5m and where the primary purpose is to export at least 75% of energy production for supply via an electricity or gas public distribution network. Commercial developers are expected to offer a stake of between 5% and 25% of a qualifying project, depending on the context.

Background

When the Department of Energy & Climate Change (the "DECC") published its Community Energy Strategy in January 2014 it stated that it would consider requiring all developers to offer the opportunity of a shared ownership element to communities if significant progress on a voluntary approach to shared ownership of commercial renewable projects was not made by 2015.

The Community Energy Strategy outlines the Government's expectation that "by 2015 it will be the norm for communities to be offered the opportunity of some level of ownership of new, commercially developed onshore renewables projects".

In isolation, this expectation could be seen as being a relatively extreme or prescriptive measure. However, and compared with other schemes already implemented in Europe, it is clear that the UK has fallen behind and that the Community



Energy Strategy, together with the threat of legislation in the background, demonstrates the Government's desire to catch up with these European schemes.

For example, by the end of 2010 community-owned assets made up 40% of Germany's total renewable energy capacity, with a further 11% owned by farmers and 14% by project developers. The "big four" utility companies - E.ON, RWE, EnBW and Vattenfall - controlled only a 13.5% share of the market.

In Denmark, the majority of wind turbines are wholly owned or jointly owned by citizens, communities, landowners and farmers and, according to Government statistics, 150,000 households in Denmark owned or held shares in wind farm projects as far back as 2001.

The Framework

The Framework sets out various principles to guide the shared ownership process and suggests potential models for shared ownership. These include:

- 1 **Split ownership**, where a community enterprise buys a proportion of the development's physical assets (for example, one wind turbine or a cluster of solar panels).
- 2 **Shared revenue**, where a community enterprise buys the rights to receive a future 'virtual' revenue stream (to be calculated as if the community had acquired a proportion of the underlying infrastructure).
- 3 **Joint ventures**, where a commercial operator and a community enterprise create a joint venture vehicle, in which they each hold equity, to develop, own and manage a project.
- 4 Individual investment by way of **debt-based debentures or bonds**.

Infrastructure Act 2015

As an alternative approach to the voluntary protocol for shared ownership, the Infrastructure Act 2015 (which became law in February 2015) gives the Secretary of State powers to make regulations giving individuals and/or community groups the right to purchase a stake in renewable electricity projects in their local area (the "**Community Electricity Right**").

At the time of writing this is very much viewed as being a 'backstop power', and the Government has indicated that its strong preference is for the successful application of the voluntary approach set out in the Framework, and that Community Electricity Right regulations will only be made if the voluntary approach is not successful.

Interestingly, commercial developers should note that, if implemented, the Community Electricity Right would apply to both onshore and offshore projects generating (or expected to generate) at least 5MW.

Impact on the UK in 2015 (and beyond)

Whether through successful implementation of the voluntary protocol or through mandatory legislation, there is no doubt that community shared ownership will remain on the agenda throughout 2015 and beyond, especially given the recent General Election and the return of a Conservative majority government.

Anecdotally, we understand that take up of the Framework is not currently widespread. Commercial renewable energy developers must now consider how to implement the voluntary protocol. In doing so it is important to consider the implications of structuring and running (and, if applicable, exiting) a renewable energy project in the context of community shared ownership.

Organised and existing community groups should also be seeking to engage proactively with commercial developers to take forward projects in compliance with the voluntary protocol.

The Government intends to undertake a progress review at the end of 2015 to evaluate the initial success of the voluntary protocol. If progress is limited, the Government will consider whether there is a need to consult on exercising the Community Electricity Right backstop powers. Commercial developers and investors therefore need to address offering shared community ownership now, as there are now only seven months in which to convince the Government that the legislative 'stick' is not required.

Scotland extends the proposals?

In March 2015 the Scottish Government published a consultation entitled '*Good Practice Principles for Shared Ownership of Onshore Renewable Energy Developments*' which states the desire of the Scottish Government to push the boundaries of shared ownership further than the proposals outlined by DECC, to cover all onshore renewable projects over 500KW. The consultation is open for responses until 9 June 2015.

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Renewables Obligation grace periods



With the opening of the Contracts for Difference (“CfD”) scheme on 16 October 2014 (for more on CfDs, see the A-D edition of the *A-Z of issues in renewable energy projects*), the Renewables Obligation (“RO”) scheme entered a transition period leading up to the general closure of the RO scheme to new applicants on 31 March 2017. As part of this process, the Renewables Obligation Closure Order 2014 (the “Closure Order”) provides for a number of grace periods allowing continued RO accreditation of projects after 31 March 2017 up to a longstop date (varying according to the technology in question), assuming that certain requirements can be met.

Specific provisions affect large-scale solar photovoltaic (“PV”) generating stations, and these are dealt with below.

Types of grace period – other than large-scale solar PV

The Closure Order provides for a number of different grace periods extending the longstop date for accreditation under the RO beyond 31 March 2017. These are summarised below. Only the “enabling financial decisions” grace period provides confirmation of grace period entitlement pre-construction of the generating station. The other grace periods are applied for at the point of accreditation (post-construction) along with specific supporting evidence:

- **“Enabling financial decisions” grace period:** this is a 12-month (or 18-month for biomass with CHP) grace period for generating stations using gasification/pyrolysis (“ACT”), offshore wind or dedicated biomass with CHP, where the operator has successfully submitted a notice of intent on or before 9 November 2014;

- **“Radar or grid connection delay” grace period:** this is a 12-month grace period for generating stations where radar or grid connection delays prevent commissioning on or before 31 March 2017. When applying for accreditation, the following supporting documents must be provided:

- 1 a grid / radar works agreement;
- 2 a copy of a document from the works provider estimating or setting a date for the completion of the works at no later than 31 March 2017;
- 3 a letter from the works provider confirming that the relevant grid / radar works were completed after the 31 March 2017 and that the delay was not due to a breach of any of the terms of the grid / radar works agreement by the station’s developer; and
- 4 a declaration by the operator that the station would have been commissioned on or before 31 March 2017 had the relevant grid / radar works been completed to schedule;

- **“Signed investment contracts” grace period:** this is a 12-month grace period for projects which have secured an investment contract (an instrument broadly similar to CfD, but issued before the formal establishment of the CfD regime) which is then terminated or otherwise ceases to have effect for one of a limited number of permitted reasons. A letter from the Secretary of State is required to evidence this;

- **“Dedicated biomass cap” grace period:** this is an 18-month grace period for projects falling within the Government’s 400MW dedicated biomass cap. Qualification requirements include: at the point of accreditation, the developer must submit a letter to Ofgem from the Secretary of State dated on or before 31 March 2017 confirming the allocation of a place under the cap along with a declaration that the place under the cap has neither lapsed nor been revoked; and

- **“Scottish offshore wind” grace period:** in relation to Scotland, an 18-month grace period is available for offshore generating stations using test and demonstration wind turbines or floating wind turbines.

Types of Grace Period – large-scale solar PV

Unlike for other technologies, the RO scheme closed to solar PV generating stations with generating capacity greater than 5MW on 1 April 2015. Three large-scale solar PV-specific grace periods do, however, allow eligible operators to apply for RO accreditation until 31 March 2016. These grace periods are:

■ **“Significant investment” grace period:** in order to be eligible for this grace period, the operator will need to supply:

- 1 documents demonstrating that an application for planning permission for the station was made (or granted) on or before 13 May 2014 (or a declaration that planning permission was not required);
- 2 a copy of an offer from a licensed network operator made on or before 13 May 2014 to carry out grid works in relation to the station and documents evidencing acceptance of the grid works on or before 13 May 2014 (or a declaration from the operator that no grid works were required); and
- 3 a declaration by the operator that the developer (or connected person) was, in relation to the land on which the station is situated, as at 13 May 2014: an owner or lessee; had entered into an agreement for a lease; had an option to purchase or lease; or, was a party to an exclusivity agreement;

■ **“Grid delay” grace period:** this operates similarly to the grid delay grace period for non-large solar PV generating stations, except that the date 31 March 2015 is substituted for 31 March 2017; and

■ **“Preliminary accreditation” grace period:** here, it must be demonstrated that the preliminary accreditation of the generating station was effective on or before 13 May 2014 and that, since that time, it has not been invalidated.

Conclusion:

The grace period regime provides a valuable additional timeframe during which accreditation under the RO can be obtained. Applicants will need to be careful to ensure that they can provide the necessary evidence to support their case for grace period eligibility and comply with the prescribed timescales, including ensuring that RO accreditation takes place before the relevant longstop date.

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Security on renewable energy projects

For any renewables project where third party financing is provided, the third party funder (the “Lender”) will require security. Project financing of renewable energy projects is provided on a cash-flow basis and a Lender is concerned with the project’s ability to service the debt. A Lender usually requires security over all the assets of the project to ensure that the Lender is able to control and enforce against the whole of the project, should problems arise, and to ensure that the Lender has priority over the assets of the project against other creditors.

Debenture and share security

Usually a special purpose vehicle is set up so that the assets of the project are ring-fenced in a single project company. All assets required to construct and operate the project (including lease, project agreements, accounts and insurances) should be owned by the project company and the Lender will take



security over all those assets. Security is usually taken by way of a debenture, which will include:

- fixed charges over the lease, equipment and accounts;
- fixed charges / security assignments of all relevant project agreements and insurances; and
- a floating charge over all of the project company's assets.

A Lender would usually also require security over the shares in the project company. Share security would generally be given on a limited recourse basis, i.e. limited to the value of the shares so as to avoid further recourse to the shareholder(s). Where share security is required over the shares in the project company, it is more straightforward if a single holding company owns and grants security over the shares in the project company. Amongst other things this will avoid multiple corporate or natural persons being party to the security and other finance documents as shareholders.

A common misunderstanding is that security gives the Lender a right to step-in on a potential enforcement. In fact, security gives the Lender a right to realise the value of the secured assets to cover the debt owed to the Lender.

Direct agreements

In addition to the debenture and share charge, a Lender would usually require direct agreements in relation to material project agreements. A direct agreement is a tripartite agreement between the Lender, the project company and the counterparty to a project agreement. It gives the Lender the right to appoint a representative to step in and perform the rights and

obligations of the project company under the project agreement in order to keep a project running (and thereby preserve cash flow) if the project agreement would otherwise be terminable.

The difference between security assignments and direct agreements is that a security assignment assigns the rights of the project company under a project agreement to the Lender (e.g. payments), whereas under a direct agreement, the Lender has the right to appoint a representative to step in to the shoes of the borrower and perform the contract and carry on the project. The direct agreement prevents the counterparty from terminating the relevant project agreement for a specified period. During that period, the Lender can decide whether to appoint a representative to step in and/or to novate the project company's role under the project agreement to a suitable substitute.

Subordination

Any funding provided by investors, and security granted by the project company in respect of such funding, will need to be fully subordinated to the Lender. If a holding company has lent to the project company, the Lender may also seek to take security over that loan agreement by way of security assignment.

Final thoughts

Security is a key part of project finance and should be carefully considered when agreeing terms with the Lender. Burges Salmon are happy to get involved at an early stage of the project development and/or financing and to provide advice on the security and corporate structure.

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Shared grid connections: do they work?



The prospect of shared grid connections for energy generating facilities, has become a hot topic in recent months with increasing pressure on Grid and increasing numbers of renewable (particularly solar) projects wanting to connect.

The typical route for connection has been for a developer to obtain and accept an offer from a Distribution Network Operator (DNO) to connect its generating plant capacity onto the network, ideally at a specified date. Developers have had to juggle a variety of issues including the availability of the capacity; the cost of the connection (which increasingly has become a significant barrier to deployment) and increased competition in obtaining the grid connection.

With the growing pressure on DNOs to connect projects, many DNOs are devising innovative ways of providing alternative “non-firm” connections (allowing customers willing to have their capacity temporarily reduced to connect ahead of grid reinforcements) and we are likely to see more of this in years to come. However, the energy industry itself has looked to another solution, that of sharing an existing or proposed grid connection. The question is “*do these arrangements work?*”

Sharing a grid connection may sound easy at the outset, but it is not. Shared grid is at its most simple when neither of the sharing projects requires external funding. The moment that is not the case, the issue of security over the grid connection arrangements and assets comes into sharp focus.

Ultimately the connection agreement from the DNO will be held by one party. If that party wishes to allow someone else to share that grid connection, a robust contractual arrangement will need to be put in place, if the second party is to have meaningful rights to export their electricity. Even if the contractual arrangements can be put in place and are palatable

to the holder of the connection agreement or offer, they may still not be satisfactory to, for example, a bank funding the second project. External funders will be concerned that if the person holding the grid connection defaults, the DNO will have a right to terminate the connection agreement notwithstanding the contractual arrangement sitting behind it between the developers. We have advised on a number of situations where shared grid connection arrangements between commercial projects have worked, but where external funding is required by both projects, it is achievable but not at all easy and can involve complex mechanisms to provide legal protection for both parties with an element of security over the connection. The key is persuading the holder of the connection that it is worth the effort.

The need for shared connection arrangements will only increase with the announcement of the Government’s Community Ownership Strategy and the adaptation of the rules governing the Feed-in Tariff (FiT) to allow larger solar projects which can no longer benefit from the Renewables Obligation, to be split into two. In January 2015 DECC announced that it would relax the rule that two sites must have separate grid and meter connections (MPAN’s) for each to qualify for the FiT, providing one of the projects is community owned. This was welcome news. Many existing developers are now looking at the connection arrangements they have for 10MW sites thinking that they can share a grid connection with a 5MW community site. This still brings us back to the problem of how the grid connection arrangement itself is shared. A single MPAN arrangement also needs careful consideration when it comes to the power offtake (PPA) arrangements. It is unlikely that separate offtakes can be easily negotiated which has led to the idea of “pseudo MPANs”.

For these form of community projects to piggy back off a single connection, the community project will need to be clear on how it intends to obtain funding and how it can rely on the availability of the grid connection notwithstanding the connection offer and agreement is likely to be in the name of the original commercial developer. Burges Salmon has been at the forefront of developing a number of potential alternative structures which could be used. Ultimately, however, there will be an important role for the DNOs going forward to show a commitment to the Government's Community Energy Strategy and adapt their connection offers, agreements and arrangements to give all

parties the necessary protection and assurances to enable these projects to go ahead.

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Safety: CDM Regulations update

The new CDM Regulations came into force on 6 April 2015. From that date, a new CDM regime applies to virtually everyone in the UK who procures or provides construction works and services of any significance. There is already plenty of information freely available online (including in the HSE's own [guidance](#)) which explains the key changes – the demise of the CDM Coordinator, the new role of principal designer, domestic work now covered by CDM, the enhanced role of the client, etc.

So, rather than repeat what is already available, this article focuses on a number of issues raised by the new Regulations which are less clear cut.

How much of the design is the principal designer responsible for?

The decision to call the new duty holder principal designer has raised concerns in some quarters. To construction people involved in complex projects where there is likely to be a team of consultants all contributing to an overall design (architects, structural engineers, M&E engineers, etc.) the phrase suggests someone who will check each element of that design and then be responsible for the overall technical performance of the completed works. However, while the new role undoubtedly has more design responsibility than that of the CDM Coordinator under the old rules, it does not go as far as many in the industry seem to think.

Although the principal designer must be a "designer" for the purpose of the Regulations, the role is largely one of management and coordination. The principal designer is not necessarily required to do any original design itself but, rather, must *"coordinate matters relating to health and safety...to ensure that, as far as reasonably practicable, the project is carried out without risks to health and safety"*.

The principal designer is helped in this task by the fact that each of the other designers have positive obligations to *"take into account the general principles of prevention...to*

eliminate, so far as is reasonably practicable, foreseeable risks" when carrying out their element of the design. The principal designer must ensure that this is being done. In practice this will mean that the principal designer puts in place appropriate arrangements for the monitoring, sharing and coordination of design information between the designers (and client). This is most likely to occur through regular design review meetings. During those meetings the principal designer must work with the other designers to check how risks are being identified and how the designs eliminate, reduce or control them. The principal designer will also act as a conduit between the designers and the principal contractor to explain risks that cannot be eliminated at the design stage.

In reality, the role of principal designer is unlikely to be standalone. It will make practical sense for the "lead" consultant for any given project to take on the role of principal designer alongside its other responsibilities (an architect on a building project perhaps or a process engineer on a piece of process plant).

Any principal designer who continues to be concerned about the extent of its design responsibility should make it clear in its terms of appointment that it agrees to carry out the duties of principal designer under the CDM Regulations but, subject to that, not to be on the hook for the technical performance of the works as a whole.

How long is the "construction phase" and when do projects "come to an end"?

Many of the duties under the new Regulations last until completion of the *"construction phase"* of a project. *"Construction phase"* is defined as *"the period of time...ending when construction work in that project is completed"*.

The obvious assumption is that this means practical completion of the works. However, the definition of *"construction work"* is broadly defined and includes all the things you would expect it to cover but also *"commissioning"*, *"upkeep"*, *"demolition"* and

“maintenance, repair or removal of mechanical...services which are normally fixed within...a structure”.

It follows that the completion of the “*construction phase*” could mean:

- Practical completion of the works; or
- The end of the defects notification period (depending on the defects encountered, the work done during the DNP could range from fixing a dripping tap to major remedial works to repair inadequately designed foundations); or
- Some much later date (e.g. if the project anticipates the planned, periodic replacement of major items of plant in a power station).

To confuse things further, the transitional arrangements (which deal with projects that had already been started at the time the new Regulations came into force) says that the existing CDM Coordinator does not need to be replaced by a principal designer if “*the project comes to an end*” before 6 October 2015. Firstly, it is unclear why legislators chose to introduce this new phrase rather than making use of the defined term “*construction phase*”. It is possible, on one interpretation, to conclude that when “*the project comes to an end*” is a synonym for completion of the “*construction phase*”.

In any event, it has been suggested that the [guidance](#) to the new CDM Regulations published by HSE clarifies this point by saying that the Regulations “*apply to construction projects as a whole – that is, the whole construction process from concept to completion*”. Unfortunately, this takes us no further forward as neither the guidance nor the Regulations tell us what is meant by “*completion*”.

One view is that those drafting the Regulations and the HSE guidance deliberately made the terms flexible as they recognised that they would need to be sufficient versatile to cover projects ranging from a house extension to a nuclear power station. A possible solution for simple projects is that the principal contractor takes over the responsibilities from the principal designer from practical completion until the end of the DNP (which mainly involves completing and handing over the health and safety file). If major works are required during the DNP (e.g. the foundations need to be rebuilt) then a new principal designer is likely to be needed to coordinate the design of any new temporary and permanent works.

On more complex projects it is likely that both the principal designer and principal contractor will need to be retained until at least the end of the defects notification period. If, by that point, an operator of the project has been appointed with long term maintenance obligations (e.g. the periodic replacement of major pieces of plant) then the principal designer and principal contractor duties could be transferred to the operator at that point. On a practical level, it is likely that the HSE will look at



the “output” in terms of design and construction work being undertaken rather than contractual arrangements.

Alignment of CDM and contractual obligations

It is not possible to “contract out” of the CDM Regulations so, even if the contract does not mention them, the parties still have to comply with their duties under the Regulations. However, it is not unusual for contracts to include an obligation on consultants and contractors to comply with their CDM obligations so that any breaches are not only a breach of CDM (to be dealt with by the HSE) but also a breach of contract (giving the client potential rights against the wrongdoer).

The new Regulations throw up a couple of areas in which clients should consider what CDM compliance means from a contractual point of view.

Firstly, for projects that existed before the new Regulations came into force (on 6 April 2015) that will continue beyond 6 October 2015, the CDM Coordinator will need to be replaced by a principal designer. Under construction contracts and appointments the client usually retains the risk for changes in law so, even if the current CDM Coordinator has the skill and experience to take on the role of principal designer, this is likely to necessitate a significant variation to the appointment, with cost and extension of time implications for the client. Alternatively, the CDM Coordinator’s appointment may need to be terminated and a new principal designer appointed in its place. Again, this has time and cost implications for the client.

Less significantly, but something to be aware of, is the slight change in the role of the principal contractor. This is especially the case if the principal contractor takes on the role of principal designer after practical completion as suggested above. This won’t require the replacement of the principal contractor but may result in claims for additional cost to cover the enhanced health and safety obligations.

Secondly, the Regulations require duty holders to “ensure” that others behave in a certain way. For example, the principal designer must ensure that “all persons working in relation to the pre-construction phase cooperate with the client, the principal designer and each other”. However, the principal designer (in this example) will have no means of compelling such performance. He will not have a contract with any of those people (other than the client) so will be powerless to force them to act. One (drastic) solution is to put in place a multi-party interface agreement between each of the participants under

which they have contractual rights to compel performance against each other. However, this is unlikely to be feasible or attractive in anything other than the most complex projects. Instead, the client should ensure (as suggested above) that all professional appointments and construction contracts contain obligations on the consultants and contractors to comply with their CDM responsibilities. Then, if the principal designer meets with resistance from one of the delivery team, he can inform the client who will have the contractual muscle to compel performance of the recalcitrant party.

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