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COMMUNITY HEAT DEVELOPMENT PROGRAMME

LEGAL STRUCTURES AND GOVERNANCE CONSIDERATIONS IN COMMUNITY HEATING

(Prepared June 2024)

PLEASE NOTE: A document of this kind can provide high-level guidance only. This is a changing area and there may be more detailed points arising from the legislation or factors specific to a particular organisation or project which could point to a different solution from that indicated in this guidance. Specialist legal advice – as well as input from tax and VAT advisers, where appropriate – should be obtained before any final decision on legal structure is taken.

This guidance is written by Burness Paull and commissioned by Local Energy Scotland.

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1 INTRODUCTION TO THIS GUIDANCE

This guidance note is intended as a starting point for householders and community groups considering embarking upon a community heating project. This guidance will cover why a community may look to engage with community heating and consider how that project ought to be structured, having particular regard to legal structure, issues around operation and liability and finance and funding considerations.

2 INTRODUCTION TO COMMUNITY HEATING

Community heating is very much in the early stages of development. At present there are no accepted or standardised models for projects of this kind. This is in contrast to certain other renewable energy projects, for example electricity generated by windfarms, which boast a well trodden path in terms of community involvement and ultimately community benefit. However, it is clear that a shift is needed towards more sustainable methods of producing heat. Community heating offers a means to share the burden and cost along with the benefits with others in your area.

For the purposes of this guidance, references to community heating are intended to be in a broad sense which will encompass groups and projects of difference sizes. At the smaller end of the scale community heating might be a group of individuals who have come together with the goal of co-ordinating a group purchase of equipment with the intention of switching from their existing gas heating system. At the larger end of the scale, community heating could be a district heat network where a large, centralised heat source provides heat to multiple homes and other buildings and could ultimately allow a village or part of a town to switch from the gas network.

Implementing community heating will require diligent planning and engagement from the community group. Each group and project will have specific needs and goals and this guidance aims to set out some of the key considerations for a group starting out on their journey towards community heating. This guidance contains high-level guidance on how a community group can engage with community heating, the key considerations to be taken into account when determining whether a formal legal structure is required and the options available.

3 WHY AND HOW COULD A COMMUNITY ENGAGE WITH COMMUNITY HEATING?

For some community groups, engaging with community heating will be an obvious next step – for example, your community might have an existing successful community development trust which is looking for a new project. The drive may also have started with one individual who wants to share with their neighbours the results of their research on finding a suitable alternative to their existing boiler. As this is a novel topic, groups have the opportunity to engage in a way that is appropriate to them and their circumstances.

Ultimately, there are targets in place in Scotland which mean that everyone will need to consider a change to their source of heat in the near future. Community heating offers a way to explore this with others and the possibility of sharing information, experience and costs.

3.1 Getting started with your project (including live examples)

As indicated in the introductory section, community heating is a wide term. To assist groups to see where this guidance is most relevant to them, we have split this guide into three sections:

Collective action	Describes a group of individuals residing in the same area – maybe neighbours but this is not a requirement – who are interested in sourcing equipment for the purpose of generating renewable heat. For example, this could be a ground source heat pump. Ultimately the group does not intend to take responsibility for the provision of heat to individual homes/properties but rather the group is looking to take advantage of a shared experience and explore any cost benefits offered by a third party on a bulk purchase.
Communal heating[1]	Describes a group intending to establish and operate a heat network which provides heat to multiple dwellings within the same building – for example a block of flats.

[1] From the Heat Network (Scotland) Act 2021 – "A communal heating system is a system by which thermal energy is distributed from one or more sources of production to one building comprising more than one building unit."

District heating[2]	Describes a group intending to establish and operate a heat network which provides heat to multiple dwellings/properties.

The case studies below should not be taken as rigid models for how groups ought to structure themselves, these are illustrative examples designed to highlight the key considerations for groups when engaging with community heating projects. Depending on the size of a communal heating project – if it is particularly large - the detail contained within the district heating case study may be useful. It is worth noting that district heating is a fairly broad description and whilst this might be larger in scale and cover a wide geographical area with both residential and commercial properties, it may also be smaller and more contained. The larger district heating projects may have additional complexities as these projects are more likely to attract input from a third party such as an energy company or a local authority.

The following examples have been anonymised but draw on the real experience of groups who are pursuing community heating options.

[2] From the Heat Network (Scotland) Act 2021 – "A district heat network is a network by which thermal energy is distributed from one or more sources of production to more than one building."

3.2 **Collective Action**

'Collective Action SCIO' is made up of 10 active members and a wider group of 35 members. The individuals leading the project have significant experience and expertise directly relevant to the project and they are retired and have time to commit to the project. Amongst the wider group they have volunteers who are willing to participate in project delivery activities such as community engagement.

As a registered charity, Collective Action SCIO has the following charitable purpose:

- the advancement of environmental protection and improvement

and the organisation is therefore restricted to carrying on activities which are in furtherance of this particular purpose. In addition to being limited to the stipulated charitable purpose, a charity must also provide a public benefit.

Collective Action SCIO's proposal is to develop a project which supports residents to improve the energy efficiency of their homes and install renewable energy equipment. Collective Action SCIO's intention is that it would help residents fully understand the potential to reduce the carbon emissions related to heating their homes, identify which measures are appropriate and provide a pathway to help them overcome the barriers to installation. In order to do so, Collective Action SCIO intends to:

• develop and promote the refurbishment specifications for housing archetypes;

• identify a suitable contractor;

• assist with the bulk/collective purchasing of air source heat pumps; and

• facilitate the appointment of a project manager to oversee the installation and quality control of renewable heating equipment in the community.

<u>Commentary:</u>

The key features of this example are:

- a shared goal of working towards a change in source of heat, or reducing the carbon emissions produced by the generation of heat;
- a group of individuals united by community or geographical area;
- the group taking on an organisational or co-ordination role rather than an ownership or heat provider role; and
- there is a benefit to the wider community.

The above example highlights that a community heating project does not need to involve a community group taking on the role of a heat provider. In this instance the group is harnessing local expertise to make it easier for individuals to make a change to their own home. The group has taken steps to formally incorporate which is helpful when engaging with third parties from the perspective of ensuring separation between the individuals and the capacity in which they are acting – i.e. on behalf of the community, rather than in a personal capacity. However, ultimately the SCIO is taking on a facilitator type role and it is not anticipated that the SCIO will enter any agreements with the third parties, rather those contracts (e.g. for the purchase and maintenance of equipment) will be between the individuals who wish to purchase and the suppliers or manufacturers of the equipment.

This type of group will not:

- Take ownership of any equipment;
- Arrange for heat to be supplied to individual dwellings and/or businesses; or
- Take payment for the supply of heat or equipment.

It is not necessary for a Collective Action group to be incorporated and, depending on your goals and the number of individuals involved, it may be that an unincorporated association (in the context of managing common ground or buildings often also known as a residents' association) would provide a suitable and cost-effective option. It should be noted that an unincorporated association does not have its own separate legal personality, meaning that the members of the management committee could be personally liable for debts/liabilities of the unincorporated association. This should be carefully considered at the outset by the individuals involved in order to mitigate any risk to those individuals.

The above example notes that there is expertise and knowledge within the group. While this will, of course, be a driving factor and will certainly be of assistance, it is not a pre-requisite. It is worth considering the skills and expertise which is available to you from within your group before embarking on a collective action in your community. Although the group will not be taking on the delivery of a full scale heat network, you should assess whether you have the resources to commit to achieve your desired outcome. We would recommend undertaking initial research to understand the local appetite for changing heat source and feasibility of installation of the equipment at the outset. It might be that there is someone within the area who has already taken steps to make this change and you would benefit from them sharing their experience.

It is worth noting that there is nothing in this case study which requires that the entity is a registered charity. There are benefits to being a registered charity (e.g. public perception, access to funding and tax benefits) but some groups may find the regulatory requirements (e.g. acting only for the recognised charitable purposes, and with public benefit) to be too restrictive to achieve their desired aims.

3.3 **Communal Heating**

Case Study

The owners of a block of eight flats constructed in the 1960's ("Block A") have come together with the common goal of finding an appropriate renewable-based alternative means of heating their properties. The flats are all privately owned, and each owner is a member of Residents' Association which was set up with the purpose of managing the block ("Block A Residents' Association"). Block A Residents' Association has previously undertaken a project to enhance the insulation of the block for the benefit of the owners and now they wish to identify a sustainable, renewables-based alternative to the eight individual gas boilers that currently heat each of the individual flats. All of the flats are privately owned but not all of the flats are occupied full-time. The flats which are not occupied full-time by the property owners are a mix of holiday rentals and private rentals.

Commentary:

Key features of this example are:

- a shared goal of working towards a change in source of heat, or reducing the carbon emissions produced by the generation of heat;
- a group of individuals united by adjoining or even shared property – it's likely that most if not all of the residents will share an entrance to the building, there may be other common parts e.g. the roof or parts of the walls, or external common parts such as a garden; and
- ultimately there will be a purchase of equipment by the individual residents and potential for shared ownership of equipment depending on how Block A Residents' Association chooses to change their source of heat.

The above example highlights that a community heating project might be more localised to a specific group of people for their own private benefit. As there is an existing group this means that there is already an open forum to put forward the idea of community heating. However, a community heating project could also be the start of a new relationship and sense of community for a block of neighbours which don't already have anything in place. A residents' association is not a legal entity but it should have a constitution setting out the governing rules for how it will operate. The purpose of the residents' association is really to provide a mechanism for the proprietors of Block A to share ideas and take forward a project together. Ultimately the obligations in implementing the change to the heat source supplying the building, including the cost and ongoing maintenance, are likely to fall to the individual proprietors.

Option 1

One option is for Block A Residents' Association to explore the installation of a ground source heat pump, or an air source heat pump, that would supply heat to each of the individual flats in Block A. This will be a large project with a cost incurred by each of the owners. The residents' association is a mechanism for this to be explored among the residents. Undertaking this project for the full block may allow for a sharing of time and costs relating to any potential consents which may be required prior to commencing a project like this – this might include instructing feasibility surveys, seeking planning permission for what is proposed, and seeking legal advice on the owners' title deeds to understand if there are any restrictions attached to the titles and which might impact the installation of the necessary equipment. It is worth considering the implications for the lower-level flats – it is likely that any equipment required to connect the upper-level flats may require to be affixed to those located on the lower levels. These factors would need to be explored in advance of taking any steps to install any equipment. If there are restrictions on the title and these are not properly adhered to, this could be problematic for the owners in future.

Block A Residents' Association could elect one of the members to act in a project manager role and reach out to manufacturers and contractors to understand the likely costs. In order to ensure this process is carried out fairly it would be recommended that various quotes are put to the rest of the members and voted on.

In addition to the planning and organisation phase, the Block A Residents' Association could be used to set out a framework for how the residents will regulate the ongoing sharing of any equipment which requires to be owned in common or that is installed on an area of common property (i.e. in the garden which each resident owns an equal share). As a starting point, the framework should include reference to:

- the likely cost to the individual residents in running the equipment and how this will be split and charged;
- a plan for the ongoing maintenance of the equipment including how any costs will be split between the owners, how access will be obtained if any part of the equipment is located on an individual owner's property; and
- a process which can be followed in the event of a change of ownership of any of the properties (it may also be necessary to consider whether changes are needed to the Title to ensure rights and responsibilities are binding on future owners).

As previously indicated within this guidance, this is a novel area and therefore there will be a level of trial and error for the groups. Residents' associations are utilised as a mechanism to manage common areas such as gardens and manage maintenance of roofs and stairwells, and therefore could certainly be used in a community heating scenario. Currently individual homeowners are not obliged to change their source of heat or become involved in a project of this nature so the project will rely on a certain level

of willingness from those involved. It may be possible to pursue a project of this kind even if all residents in a block were not on board, this depends on the title deeds. Consent, access, and ongoing relationships with your neighbours will all need to be accommodated.

Option 2

Another option for the owners of Block A could be to move away from the existing unincorporated association and to establish an incorporated entity in order to take forward the installation and maintenance of an alternative heat source for the properties of Block A. There are various options that could accommodate this and one such option that the residents of Block A might consider is forming a co-operative society ("Block A Co-op"). A co-operative is registered with and regulated by the Financial Conduct Authority (the "FCA") and as such there are costs associated with applying for registration and ongoing administrative requirements once registered. A co-operative society would be a feasible option where the residents of Block A intend to create a business in connection with the installation and maintenance of the alternative heat source. The key difference between a co-operative society and a regular business is that the profits are shared among the members, who are the same people who have a say in how the entity is run.

Establishing and operating a co-operative society would be an additional layer to Block A's community heating project and, with the ongoing regulation by the FCA, would be more involved than continuing with the existing Block A Resident's Association. Block A Co-op, with its separate legal personality, could take ownership of the new heat network equipment, but there would still be an exercise in seeking legal advice to undertake a review of the title deeds of each property to understand the position regarding any restrictions which may be attached to the titles and therefore the properties. There would also be a need to consider any feasibility surveys, and understanding whether planning permission is required to install the required equipment.

3.4 **District Heating**

Case Study

The people of Greentown are progressing to the point of carrying out a feasibility study in their town to understand how a district heating project could be executed. It was started by one individual who contacted each of their neighbours to generate interest. The current project lead has made successful attempts to engage with a number of potential stakeholders. This included a letter drop to 43 houses in Greentown and contacting the Climate Change Officer at their local authority to gauge their interest in decarbonising the council owned facilities in the town.

Initial engagement with residents and businesses has been positive with a high level of interest from people keen to reduce their carbon footprint and energy costs in all possible ways. The proposed district heating network area contains approximately 50 domestic properties but could be extended to include neighbouring areas and buildings. It is presently envisaged that the district heat network will be linked up to multiple public and commercial buildings including recreational facilities, schools and retail units.

The domestic properties, which are the focus of the original proposal, are primarily owner-occupied houses. They are a mixture of detached and semi-detached stone-built buildings, mainly from the 19th and 20th centuries. Based on the initial assessments undertaken there are no obvious issues arising from the buildings themselves or the site layout to suggest that a community heat network would not be technically viable.

Commentary:

Key features of this example are:

- a shared goal of working towards a change in source of heat, or reducing the carbon emissions produced by the generation of heat with motivation coming from benefit to individuals as well as the wider community;
- individuals united by living in the same geographical area;
- given the size of the project and the number of beneficiaries, establishing a formal legal entity will be required further down the line.

The above example is perhaps the easiest to match up with the idea of a ‘community heating project’. There is a clear community element and a big shift in heat production which will supply a specific geographical area. In this instance the group is actively engaged in the preliminary investigations and all being well should soon move to consider the most suitable vehicle to continue the project. The key reason for establishing a legal vehicle is to protect the individuals behind the project from the risk associated with implementing the project. In taking steps to establish a legal entity, this will also help to bring the community together.

Given that there has been community "buy-in" in terms of initial interest and a real sense of desire to make a change to the wider carbon footprint of Greentown, the next step might be to explore establishing a co-operative (co-op). The output of this would be two-fold, firstly this establishes a legal entity to take the project forward, and secondly the co-op could be used to raise funding by way of a community share issue. Unlike if a company is raising finance through a share issue, a co-op may raise finance through a community share issue without the need to follow detailed financial services regulation requirements by offering shares to both individuals and businesses. Typically, community shares will provide only a relatively low rate of return - lower than the financial returns which a conventional investor would want. The key message for those investing in community shares is that this is about giving support to a project that will benefit the local community, rather than maximising the return on their money.

The money raised by a community share issue can be supplemented by grant funding and/or a commercial loan. The rate of interest on a commercial loan will likely be higher than the return payable to holders of community shares, so generally the intention will be to raise as much as possible via grants and the community share issue. Having an established legal entity will be particularly important if finance is being sought from third parties – it would be very risky for an individual to take on responsibility for a commercial loan for the benefit of the wider community heating project.

Another aspect of the above example to explore is the involvement of the local authority. Climate change is high up on many agendas at the moment, therefore the local authority might be able to offer assistance by way of a grant or engaging with a group by way of shared ownership of equipment. With a shared ownership scenario, careful consideration should be given by the community group to the terms of the ownership, including:

- the location of any equipment (will this be on local authority land or community land and what title conditions are there existing?);
- any consent requirements and/or permissions;
- the ongoing operational obligations of each party (are there maintenance obligations on each party and is that an even split?); and
- the ongoing financial obligations of each party (are there financial obligations on each party and, as above, is that an equal split?).

In the above example, the construction required to link up all of the various commercial and domestic premises to the heat network will be substantial. As with the communal heating example, the titles of the individual properties will need to be examined to understand if there are any restrictions which might impact the installation of such equipment. This examination will need to consider the implications for the equipment which will supply the property but also the installation of equipment which might pass over one property in order to supply a neighbouring property. At this point consideration should also be given to the lifetime of the heat network and the impact which a sale of property might have on

the wider network – a conveyancing professional will be able to explore the options available to protect the equipment which has been installed.

4 OPERATION AND LIABILITY

There is no one size fits all approach when considering the operating of a community heating project and any potential liabilities which might flow from that project. It will be for the group to consider and assess this. Key considerations might include:

- Is there sufficient demand for a project of this type – this could involve undertaking an assessment of the appetite in the community, reviewing the work of other local groups in the renewable energy sector (ultimately this could be an opportunity for collaboration and sharing the workload), and consideration of any gaps;
- Have suitable avenues of funding been identified and will these be adequate to fully fund the community heating project (funding and finance will be covered in more detail below);
- Who will 'own' the project – at the outset and also on a longer term basis – this would include considering who will own any equipment; and
- Considerations relating to property and planning.

Other considerations around operation and liability will be linked to the make up of the group (whether an existing entity or a group of individuals) driving the community heating project. For example:

- If the community heating project will form part of the work of an existing organisation – consideration will be required as to how the community heating project will interact with the existing work which that organisation carries out – this might include whether the organisation has sufficient expertise and capacity to undertake a new project and how this fits in to any existing longer term plans;
- If the existing organisation has charitable status – the group should consider how the project will interact with the charitable purposes of the organisation and ultimately if the project is permitted within the remit of the charitable purposes;
- If there is no existing organisation – the group will need to consider whether, based on the scale of the project, a formal legal structure should be incorporated to take the project forward. In most cases, one of the principal goals will be to mitigate any risk to the individuals involved in taking the project forward;
- If the group intends to work with an industry partner – consideration as to the best way to formalise the relationship between the parties will be required and also to set out a framework for how funding and any ownership will operate.

5 FINANCE AND FUNDING

In larger community heating projects, securing finance (i.e. obtaining the means to fund a particular project) will be crucial to the success of the project. Finance can take a number of different forms and the most appropriate means of financing one community heating project will not apply to every community heating project. Securing finance is likely to be more geared towards those projects which fall into the communal heating or district heating categories, the reason being that these projects are more likely to incur costs in relation to construction of the heat networks. With a collective action project, it is more likely that the costs will remain with the end users.

Funding typically means a sum of money given as a grant by an organisation (or person) for a specific project or purpose and which is not paid back. There will likely be conditions attached to the grant and these conditions might be directly linked to the implementation of the project, or they might relate to the entity which is carrying out the project. For example, a grant may have a condition tied to it that certain reports should be provided to the funder over the course of the implementation of the project, or the funder may require that the project is completed within a certain period of time from the date of the grant. Any conditions associated with the grant will require to be met in order to receive the funds and will continue to apply once the funds are received. As an example, a funder may require that their consent is sought in advance of any changes that the community wishes to make to the project. It is important to explore in advance how involved the funder intends to be during the lifetime of the project and the period of their funding. Non-compliance with the conditions may result in recovery of some or all of the grant funding.

An alternative to grant funding might be finance by way of a commercial loan. With a commercial loan there would of course be repayment obligations and depending on the amount, the lender might require a security over the loan. Depending on the size and scale of the project this might be an additional pressure to ensure sufficient income to repay the loan as well as covering other costs. If a group were to go down this avenue, a legal structure would definitely be desirable to protect the individuals involved – even if there were an existing organisation, a separate entity might assist in terms of providing a layer of protection to any existing assets.

Securing funding can be challenging and often takes time and effort. Funders will have certain expectations regarding the level of detail to be provided during the application stage. Along with the ultimate feasibility of a proposed project, funding options should be explored as early as possible, to ensure that the group understands what will be available and the information which will be required as part of this process.

6 OTHER CONSIDERATIONS IN COMMUNITY HEATING

Each project will have its own unique challenges and considerations on account of the size, the needs of the community group, the location, and the types of buildings involved. However, the following areas are highlighted as a summary of expected considerations likely to need to be thought about in taking forward a community heating project.

Cost Despite the projected financial benefit (including both lower bills and resilience to volatility in pricing) resultant from changing heat source, the recent cost of living crisis has been far reaching and individuals have been hit with rising bills causing them to re-evaluate their spending. If your project is reliant on individuals spending (like in the communal heating example above), it might be that this is simply not an option for some households at this time. The other side to cost considerations is that energy bills have gone up substantially and consequently people are exploring other options to understand what they can do to make their bills more affordable and more stable against volatility in energy prices.	**Time** From the point of idea to implementation, it's likely that any community heating project will take time. There will be different phases – from the feasibility exploration, to construction, to ongoing operation. Many of the individuals involved will be doing so in their spare time and on a voluntary basis, consideration should be given to how much time is likely to be required from those involved. In larger scale projects there may be scope to employ staff to assist with planning and overall co-ordination. This would be suited to projects which are in receipt of funding.
Rental and holiday let properties It is anticipated that it may be more difficult to engage with owners of rental properties, given that there is no immediate benefit to them. It is also more likely that they will not be based locally to the community. However, many landlords are influenced by changes to policy and legislation and availability of funds. Of course, this will depend on the individual landlord/proprietor but it is worth considering at	**Ongoing management** If your project will ultimately supply heat to others, careful consideration will need to be given to how this will operate in practice. If it is a district heat network, a system for invoicing will need to be established and managed. Involving a third party partner such as an Energy Services Company (ESCo)[3] might be an effective

[3] An ESCo is a company that provides a broad range of energy solutions including designs and implementation of energy savings projects, retrofitting, energy conservation, energy infrastructure outsourcing, power generation, energy supply, and risk management.

the outset if there are lots of rental properties in your area and how this might impact your overall goal.	way to gain the relevant skills and expertise to implement an invoicing system.
Title considerations, planning and environmental consents Property ownership can often be complicated and it's not uncommon for land to be burdened by certain historic restrictions. This should always be explored with a conveyancing professional in order to comply with any restrictions and not inadvertently cause problems for property owners further down the line. It may be that new title conditions may be required or desirable. Similarly, certain types of equipment may require planning permission to be obtained – this should be explored as early as possible. Of course there may be requirements for other permissions too – these may arise pre-construction or during the construction process. A feasibility study should assist groups to establish a clearer picture about what is likely to be required.	**Policy and Legislation** Climate change and net zero targets are firmly on the agenda at the moment and particularly with the aim of bringing about long lasting and societal shift in attitude to the part they play in creating such a change. The prevalence of this topic might raise awareness and generate a communal desire to act and create change. It is worth keeping in mind that future legislation may be brought in which could oblige individuals to act to change their source of heat within a certain timeline. Getting ahead of the curve might be appealing to certain individuals.

7 FURTHER DETAIL ON LEGAL STRUCTURES

The case studies comment on some of the options available to groups in each of the three categories (collective action, communal heating, and district heating). However, these are not set in stone and ultimately the best option for you will depend on your circumstances and goals. Further detail is set out below on legal structure options for a community heating group. Another factor which will have a significant impact in choosing a legal structure is whether the community group will be taking ownership of equipment required as part of a heat network, additional detail is set out on this below under the headings 'shared ownership' and 'third party ownership'. This detail is not intended to be exhaustive but rather an indication of the different options which are available. Setting up a legal entity comes with certain legal duties, particularly for those individuals who become directors or trustees. A legal advisor will be able to give specific advice on the best option having regard to a group's unique needs and circumstances.

Collective action

This scenario will be relevant if there is drive within the community but possibly insufficient access to funding or alternatively the group will assist with co-ordination of installations when individuals left to themselves would struggle to complete an install. The rationale is that individuals could benefit from being part of a wider group – possibly financially by way of a group order discount and potentially multiple annual services if coordinated – and benefitting from being part of a shared experience with their neighbours. Ultimately the benefit will be to those individuals who choose to become involved.

Collective action may also take the form of a group forming an umbrella organisation to provide support to groups who have established communal heating or smaller scale district heating.

A co-ordination or support role might not warrant a formal legal structure, as such (and as mentioned above), an **unincorporated association** (also known as a residents' association in a housing context) would therefore be a good option. This would be particularly helpful if the community is looking to minimise cost, and retain flexibility, albeit that it does not come with the benefit of limited liability. However, if the community is looking to limit any liability of the individuals involved and is happy to take on the formal responsibilities which come with incorporation, either a **SCIO** or a **company limited by guarantee** would be a suitable structure. Ultimately it will depend on the intended activities as to whether or not an incorporated structure is necessary.

Communal heating

The most appropriate route for a communal heating project will be largely guided by the scale of the project – a communal heating project is somewhat limited given that it is likely to be characterised by the fact that it provides heat to separate dwellings within one building but this may be 2 dwellings or it could be 22 dwellings. At the smaller end of the scale e.g. a small block of flats it may be somewhat

easier for individuals to come together by way of an **unincorporated association** (also known as a **residents' association**) in order to engage with community heating. Where a building is larger and comprises more dwellings e.g. a large block of flats, it might be more suitable to have a corporate entity (a **company limited by guarantee** or a **co-operative society**) to take forward the project.

It will be crucial to understand what is required in terms of the rights of the individual dwellings within the building to understand any requirements in terms of consent to install equipment and continue to have equipment. This may have an impact on whether individuals own the equipment in common, or whether it could be owned by another entity which has a separate legal entity.

District heating

This is a substantial project which will rely on long term commitment from a group of individuals within the community. The group would need to work together to develop a heat network for the wider community. It is likely that this scale of project will only be suitable for a community which has experience of successfully working together on long term community projects. The responsibilities and potential liabilities will continue even after the heat network is set up and therefore careful consideration is needed regarding how the community will secure the ongoing operation of the project.

One of the driving factors in choosing a structure will be minimising risk for the individuals within the community working on the project. The most suitable options are legal structures which benefit from limited liability. In addition, it is more likely that a project of these types will need to engage with third parties, whether by way of a contractual arrangement or by engaging staff to relieve some of the work burden from those involved in a voluntary capacity.

Where there is an **existing community entity**, or even multiple community entities, the community may wish to consider use of a **subsidiary** company for the community heating project. This can be structured as a **company limited by shares**, with the existing entity, or entities, holding all the shares. This structure would provide a degree of insulation from risk for the parent entities in respect of losses or liabilities arising in respect of the project. This assumes that the parent entity does not enter any agreements directly or provide a guarantee for the debts or liabilities of its subsidiary.

If there is **no existing community entity**, the community should first consider whether they wish to raise capital by way of a **community share offer**. If there is no intention to issue shares (whether now or in the future) a **company limited by guarantee** could be used.

If the community wishes to raise funds by way of a community share offer, there are two options under this wider category – a **Community Benefit Society** (BenCom), or a **Co-operative** (Co-op). A BenCom is more restrictive than a Co-op in that it must provide benefit to a wider community, as well as providing mutual benefit to its members.

Shared ownership

One way to ease the burden on the community would be to involve a third party to assist with the project. The involvement of an **industry partner** could provide vital expertise, financial and organisational support to the community but the individuals within the community will still require to make a significant commitment to the project, albeit a little less than with the scenario without the industry support. It would be helpful for the community to have existing experience of developing and running long term community projects. With partial community ownership, the responsibilities and liabilities will continue even after the heat network is established and therefore careful consideration should be given to how the community intends to future proof the project. Careful consideration should also be given to the requirements of the industry partner – it is likely that they will have their own requirements in relation to the management and running of the project.

Where there is joint or shared ownership with a third party in a community heating project, the community should use a limited liability structure to protect the community. A limited liability structure could be a **company limited by shares** could be owned by two (or more) entities. Each entity would hold shares in the company limited by shares which would allow for sharing of control and profit, or a **limited liability partnership** (LLP) could be used where the community and the third party intend to distribute profits to themselves (as the partners).

Third Party Ownership

Third party ownership might be required where the community group does not have access to funds or expertise to move forward with the community heating project. A third party might have approached the community about this project. The community would need to consider how best to engage with the third party and any funders in a way which offers protection to the community. For the avoidance of doubt, third party ownership here envisages a heat network which is owned by a third party entity, the operation and maintenance may also be undertaken by the third party or this may be undertaken by the community. Alternatively, it may be that the community is just a user of the heat network.

Regardless of the specifics of the relationship, a **formal contractual relationship** with the third party will be required which will set out the obligations of each party and ensure that the parties agree on their respective rights and obligations under the project. Prior to entering into a contractual relationship with a third party, advice from a legal professional would be very desirable to ensure the community understands the obligations which it is signing up to.

The community may wish to explore reaching an agreement with the third party entity whereby one of the directors of the community entity (whether an existing entity or a new entity) is permitted to engage with the third party entity by way of a nominated representative on the board of the third party or by forming a governance committee made up of board members from both the third party entity and the community entity. This is a way to ensure that the voice of the community is represented.

For additional details on the various legal structures referred to above, please see appendix part 1.

APPENDIX

PART 1 – LEGAL STRUCTURES – ADDITIONAL INFORMATION

Appropriate legal structure	Might be appropriate legal structure	Unlikely to be an appropriate legal structure

LEGAL STRUCTURES AT A GLANCE This table is designed to give a high level overview of the key features of the different legal structures which are suitable for groups engaging with community heating.	Unincorporated Association	Company Limited by Guarantee	Scottish Charitable Incorporated Organisation	Co-operative Society	Community Benefit Society	Company Limited by Shares	Limited Liability Partnership
1. Assets							
Can hold assets to protect from risks associated with operations							
Could manage operations and maintenance of a project and sale of heat (note: these are likely to be higher risk activities)							
Could be used to take up opportunities from community right to buy &/or community asset transfer legislation							
2. Funding							
Could be used to easily access grant funding							
Issuing community shares to generate finance							
3. Tax implications							
Could obtain charitable status (minimising corporation tax liability)							

4. Maintenance and management responsibilities							
Flexibility in terms of structure - does not require to be formally incorporated or registered							
Provides a regulated structure which could easily be used to engage with an industry partner							
Would be able to participate in a shared ownership model							
Provides limited personal liability to individuals involved in terms of running costs and maintenance obligations							
5. Perception and engagement							
Maintaining positive relationship with community membership allowing for individuals to participate (including board election at AGMs)							
6. Managing finance							
Managing trading activities							

Unincorporated association

An unincorporated association is the simplest form of legal structure and is typically utilised by small-scale organisations which do not typically incur significant liabilities such as employing staff, entering contracts or leasing or owning property. The governing document is a constitution and, unless it is registering as a Scottish charity, there are no legislative rules governing what needs to be included.

Advantages

There are little or no set up costs and its legal structure is not governed by detailed statutory, ongoing requirements (unless the association is registered as a Scottish charity).

Disadvantages

An unincorporated association does not have its own 'separate legal personality'. This means that the members of the management committee could be personally liable for debts/liabilities of the unincorporated association. The office bearers are typically those who enter into contracts relating to the unincorporated association as it is not able to enter into contracts in its own name, given its lack of separate legal personality.

Given that the SCIO legal form (see below) has been available since 2011, for community bodies proposing to register as a Scottish charity, far fewer unincorporated associations are now being utilised for community organisations, given the liability exposure.

Application in community heating context

It is likely that an unincorporated association may have a use for smaller community heating projects which are not in receipt of funding. The principal benefit of an unincorporated association is that it allows for flexibility in terms of the way that it is run and there are not arduous requirements in terms of administration. Often this type of structure is used by groups of neighbouring residents to join together for the benefit or management of a shared area e.g. a common garden. This could certainly be an option for a group where individuals are willing to take on the bulk of the risk in a project (ownership and ongoing maintenance) and the group is required for co-ordination of a common goal.

Company limited by guarantee

A company limited by guarantee has "members" as opposed to shareholders – the difference being that the members have no ownership stake in the company, whereas the shareholders in a company limited by shares do. It is incorporated under the Companies Act and has separate legal personality from its membership. Many Scottish third sector organisations have traditionally adopted this model where the scale of operations is such that staff are to be employed, contracts are to be entered into and property owned – the "limited liability" afforded by a limited company model helps to protect those managing the organisation (the directors) from the risk of personal liability. The liability of members is limited to a nominal amount (usually £1), and the directors are similarly protected from personal liability provided they fulfil their statutory responsibilities.

A company limited by guarantee is regulated by Companies House and is subject to the Companies Acts – it is, additionally, subject to regulation by the Office of the Scottish Charity Regulator ("OSCR")

if registered as a Scottish charity. The governing document is called the articles of association. Each member has one vote.

Advantages

A company limited by guarantee offers the principal advantages of having a separate legal personality (as distinct from those involved in it) and limited liability to its members. The company structure is readily understood and recognised by funders and banks. The process of incorporating a company is relatively straightforward and inexpensive.

Disadvantages

A company structure can seem intimidating and the legislative framework which govern companies can also seem daunting to many. There are also a number of administrative requirements for companies limited by guarantee including the ongoing requirement to notify Companies House of changes of directors. Annual accounts and annual returns must also be filed with Companies House. For companies limited by guarantee with charitable status, there is in effect a dual regulator as charitable companies are governed by both Companies House and OSCR and have reporting requirements to each.

This continues to be a popular model for those organisations in respect of which a decision has taken the charitable status is not an option or is not desirable.

Application in community heating context

A company limited by guarantee could be used by larger groups – perhaps in instances where existing community groups are involved – and which are likely to be engaging with a third party, particularly if that third party is providing funding. This structure offers a separate legal personality from the individuals involved and can own property and enter into contracts and employ individuals.

Scottish charitable incorporated organisation ("SCIO")

A SCIO is a legal structure which has been purpose built for the charity sector in Scotland. It provides the key benefits of a limited liability company (such as limited liability and a separate legal personality) within a much simpler statutory framework. This means that even the smallest charity can access the benefits of incorporation – including limited liability and legal capacity.

SCIOs are incorporated and regulated by OSCR and are subject to Scottish charities legislation. They are governed by a constitution which sets out its purposes (which must be charitable) and details around how it will be governed. There is no set form of SCIO constitution although some basic elements are required including i) a SCIO should have two or more members and three trustees (in the case of a single tier SCIO the members can also be the trustees); ii) it should have the name, purposes, a registered office in Scotland, and include any restrictions on powers; iii) it should list meeting procedures (convening, recording, quorum, voting, resolution); iv) it should list membership rules (eligibility,

appointment, withdrawal) and trustee rules (appointment, withdrawal, remuneration restrictions, conflict of interest); and v) it should list the purposes for which surplus assets may be used on dissolution.

Advantages

A SCIO provides the same benefits associated with becoming a company but within a far "lighter" regulatory framework which is far less intimidating to many. SCIOs, unlike companies with charitable status, are only regulated by OSCR and the administrative requirements associated with a SCIO are also "lighter" than those associated with a company model.

Disadvantages

Theoretically, a SCIO ceases to exist if it loses its charitable status (given that its charitable status is intrinsic to its existence) – whereas a charitable company would remain as a legal entity, notwithstanding a loss of charitable status. But OSCR will work closely with any charity to do what it can to ensure that it continues to meet the charity test and would only revoke charitable status as a last resort.

There is also one small technical disadvantage, as compared with a company limited by guarantee – a SCIO cannot grant a floating charge (a type of security that can be used to support a loan or grant), but as a matter of practice it is extremely unlikely that this will present any great difficulty (a SCIO can still grant a fixed security – e.g. over a building owned or held on long lease; and a fixed security is always more valuable to a bank or other funder than a floating charge).

Application in community heating context

A SCIO offers similar benefits to a company limited by guarantee but the crucial difference is that this structure is inextricably linked to having charitable status. The production of heat in and of itself is unlikely to fit within the parameters of the charity test, accordingly it is unlikely this structure could be used for the 'hands on' requirements of running and maintaining a community heat network. This could be utilised by a community group which is looking to form part of a wider project which incorporates community heating and the generation of some form of financial benefit being returned to the community.

Company limited by shares

It is very unlikely that a community group on its own would opt for a company limited by shares, rather this structure might be relevant in the context of a joint ownership model where the shares in the company are owned between a community entity and a third party. This structure could also be utilised in the context of a community organisation (however formed) establishing wholly-owned trading subsidiaries.

Community benefit society (or BenCom)

BenComs are a type of registered society run primarily for the benefit of the community at large rather than just for the benefit of its members – to be a BenCom, an organisation must have an overarching community purpose which extends beyond its membership. Community benefit societies are owned and controlled by their members through shareholdings, but they cannot distribute surpluses to members in the form of dividends – they can, instead, pay interest on shares. Each member has one vote (irrespective of shareholding). BenComs are regulated by the Financial Conduct Authority. BenComs can register for charitable status.

BenComs can raise finance through a community shares issue without the need to follow the detailed financial services regulation requirements that would apply if a company was making a share issue. BenComs can therefore be utilised by community groups looking to raise finance from individuals or businesses.

Application in community heating

A BenCom could be a viable option for a larger scale project where community ownership and retention of control is very important to the group. The limited liability means that this structure could be used to manage a project on a long-term basis.

Co-operatives (Co-op)

A co-op is another type of registered society. The key difference between a BenCom and a Co-op is that is run primarily to benefit its members – meaning that a Co-op is slightly less restrictive than a BenCom which must also benefit the wider community. Co-ops are considered to be a half-way between an unincorporated association and a registered company. Like a BenCom, a Co-op does have the benefit of limited liability which provides a level of protection to the members and allows the Co-op to hold property, enter into contracts, and employ people.

A co-op is not eligible to become a registered charity. Each member of the co-op is entitled to one vote. A Co-op is regulated by, and must be registered with, the Financial Conduct Authority. Co-ops are able to raise finance through a community share issue without the need to follow the detailed financial services regulation requirements that would apply if a company was making a share issue.

Application in community heating

A Co-op could be a viable option for a larger scale project where community ownership and retention of control is very important to the group – although there would not require to be a desire to generate benefit for the wider community. The limited liability means that this structure could be used to manage a project on a long-term basis.

Limited liability partnership (LLP)

An LLP can only be used where two or more parties wish to carry on a business "with a view to profit"; accordingly, it is not suitable for a project where there is no intention to distribute profits to the partner bodies participating in the project.

An LLP, unlike a general partnership, can hold title to land and buildings in its own name and the members of an LLP have the benefit of limited liability. Where the LLP goes into liquidation, they will generally not be liable for the debts of the LLP (although there is a special provision to the effect that if they have withdrawn capital from the LLP in the two years leading up to liquidation, they might in certain circumstances be ordered to repay some of that money to the LLP).

The advantages and disadvantages of an LLP as compared with a company limited by shares involve consideration of a number of quite technical issues (including in relation to tax) – and that is really outwith the scope of this guide. We would recommend that advice be obtained from a lawyer with specialist experience in forming LLPs.

PART 2 - OVERVIEW OF CURRENT SCOTTISH REGULATORY POSITION REGARDING HEAT NETWORKS

Forming part of the wider heat decarbonisation policy, the Scottish Government has noted that it is committed to facilitating access to heat networks. This is a somewhat unchartered territory, there is existing legislation in Scotland, the Heat Networks (Scotland) Act 2021 ("HN(S)A"), but this has not yet come into full force.

The Energy Act 2023 was passed by the UK Parliament in October 2023 and contained certain provisions which assist with the development of regulatory protections for heat network customers. At section 223 of the Energy Act 2023, the Secretary of State may regulate to designate the Gas and Electricity Markets Authority as the licensing authority for the purposes of the HN(S)A.

It is worth considering its contents as an indication of what is to come, and because it is likely that any existing heat networks will have to comply with the regulations. The HN(S)A will apply to "heat networks" which covers both district heat networks and communal heating systems. A district heat network being a network by which thermal energy is distributed from one or more sources of production to more than one building[4]. A communal heating being a system by which thermal energy is distributed from one or more sources of production to one building comprising more than one building unit[5]. Both options would be viable for community ownership. It is not clear when the HN(S)A will come into force in its entirety, but it is worth highlighting the key measures which are still to be phased in:

- permits – operators will require a permit to build and operate a network in a designated zone;
- licences – all operators (including existing operators) will require a licence to operate a heat network in Scotland, to ensure quality and provide certainty to investors;
- consents – a consent system will be introduced for heat network developments and consent will be required for each individual network; and
- assets schedule and transfer scheme – to ensure smooth transfer between operators, should this be required.

The HN(S)A also sets out key supply targets and delivery plans. Heat networks will form an important part of Scotland's overall heat decarbonisation programme. Scenarios broadly estimate emissions savings to be between 1.1 and 1.19 MtC02e per year in 2030[6]. The HN(S)A has already been supplemented by The Heat Networks (Heat Network Zones and Building Assessment Reports) (Scotland) Regulations 2023 which brought into force certain provisions within the HN(S)A on 30 May 2023, including:

[4] s1(2) Heat Networks (Scotland) Act 2021
[5] s1(3) Heat Networks (Scotland) Act 2021
[6] Heat networks delivery plan, Scottish Government, Minister for Zero Carbon Buildings, Active Travel and Tenants' Rights 31 March 2022

- heat network zones – local councils were to start identifying and consulting on potential heat network zones (an area which is particularly suitable for the construction of a heat network) within their areas; and
- building assessment reports – owners of non-domestic public sector buildings must produce a building assessment report for each of their buildings to check if they are suitable to connect to a heat network.

In addition to identifying heat network zones, local authorities have also been tasked with preparing a Local Heat and Energy Efficiencies Strategy (LHEES). The LHEES should set out the long-term plan for decarbonising heat in buildings and improving energy efficiency across the local authority area.

Currently the HN(S)A outlines the following criteria as being key in accessing an application for a heat network licence:

- the applicant's knowledge, expertise and experience,
- the applicant's ability to operate a heat network in a manner that—
    - minimises greenhouse gas emissions (within the meaning of the Climate Change (Scotland) Act 2009) from the heat network,
    - takes account of the just transition principles (within the meaning of section 35C of that Act), and
    - (contributes to meeting the fuel poverty targets, and
- such other matter as the Scottish Ministers may by regulations specify[7].

Further, a successful applicant will acquire certain powers including:

- compulsory acquisition of land (subject to authorisation by the Scottish Ministers), including the power to acquire any right or interest in or over land, or a servitude or other right in or over land by the creation of a new right;
- network wayleave rights – which would allow the licence holder to convey steam or liquids in land for a purpose connected with the supply of thermal energy by means of a heat network;
- permission to survey land to ascertain whether or not it is suitable for a heat network; and
- permission to access land for the installation and ongoing maintenance of a heat network and all associated apparatus.

[7] S5(4)(a) – (c) Heat Networks (Scotland) Act 2021