

## A Guide to the Statistical Treatment of Energy Performance Contracts

May 2018



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Eurostat and the European Investment Bank (through the European Investment Advisory Hub) have worked together to produce this publication on the statistical treatment of energy performance contracts (EPCs).<sup>1</sup>

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## FOREWORD

In September last year, Eurostat published a guidance note<sup>2</sup> on the revised treatment of Energy Performance Contracts (EPCs) in government accounts. This guidance explains how the rules of the European System of National and Regional Accounts (ESA 2010) apply to EPCs. The revised treatment offers public authorities an opportunity to expand energy efficiency investments using private sector technology, know-how and finance and we are now pleased to introduce an accompanying practitioners' guide to help the market make the most of the possibilities now available.

This clearer approach to EPCs is designed to contribute to mobilise investment in energy efficiency in public sector buildings. The public sector's annual energy bill of €47 billion represents a large, untapped savings potential in energy efficiency. Improving the energy efficiency of this sector provides an opportunity to save public money, boost growth and job creation, improve the health of EU citizens, combat energy poverty and reduce our energy dependence. Despite these benefits, the public sector is not taking advantage of the huge potential savings in costs and energy use. One reason for this is the debt and deficit limitations.

An increase in investment using energy performance contracting should help public authorities lead by example and contribute to EU climate and energy targets for 2020 and beyond. EPCs offer a number of advantages for public entities:

- energy efficiency improvement investments are financed directly from cost savings
- the private sector takes on the performance risks of the works and technology used
- energy and cost savings are guaranteed by the private sector
- the private sector contractor brings its expertise to help the long-term use of improved energy management solutions
- the private sector contractor supports the public sector building owner in finding the most suitable technical and financing solution.

The value of EPCs in unlocking energy savings is highlighted in the Energy Efficiency Directive (2012/27/EU). According to the EED, EU countries are required to renovate at least 3% of the total floor area of buildings owned and occupied by the central government. More recently, the role of EPCs in helping to renovate public buildings was outlined in the "Clean Energy for All Europeans" package, which was adopted in November 2016.

The EPC market in the European Union has a long way to go before reaching its full potential, but the public sector can play a key role in accelerating energy efficiency

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<sup>2</sup> See <http://ec.europa.eu/eurostat/documents/1015035/7959867/Eurostat-Guidance-Note-Recording-Energy-Perform-Contracts-Gov-Accounts.pdf/>

investments in buildings. The Eurostat guidance, and this practitioners' guide, combined with technical assistance and financing solutions, contribute to the Investment Plan for Europe (IPE), launched by the European Commission and the European Investment Bank to support economic growth by stimulating additional investment.

On behalf of the European Commission and the EIB, we are therefore pleased to introduce this guide as a key contribution to the IPE's goals. The guide will help Member States and other stakeholders better understand the impact of EPCs on government balance sheets, assist public authorities in making good decisions when using EPC arrangements to improve the energy efficiency of their buildings and ultimately accelerate energy efficiency investments. Perhaps most importantly, this Guide will allow public authorities to plan with greater confidence, so that there will be more investment derived from the private sector using the opportunities offered by sound EPCs. It will be instrumental in developing a sound EPC market in Europe and in unlocking the potential for energy efficiency investments in the public sector.

This guide has been jointly prepared by Eurostat and the EIB. By clarifying the statistical treatment, it deals with one of the many practical issues that public authorities should consider if they are implementing and financing energy efficiency improvements using energy performance contracting. Along with the technical assistance and advisory support that the Commission and EIB will continue to offer through programmes such as Horizon 2020, ELENA, JASPERS and the European Investment Advisory Hub, we strongly believe that this new guide will help to create a sound basis for a growing market in energy efficiency investment.



A handwritten signature in black ink, appearing to read 'M. Thyssen'.

**Marianne Thyssen**

Commissioner for  
Employment, Social Affairs,  
Skills and Labour Mobility,  
European Commission



A handwritten signature in black ink, appearing to read 'Andrew McDowell'.

**Andrew McDowell**

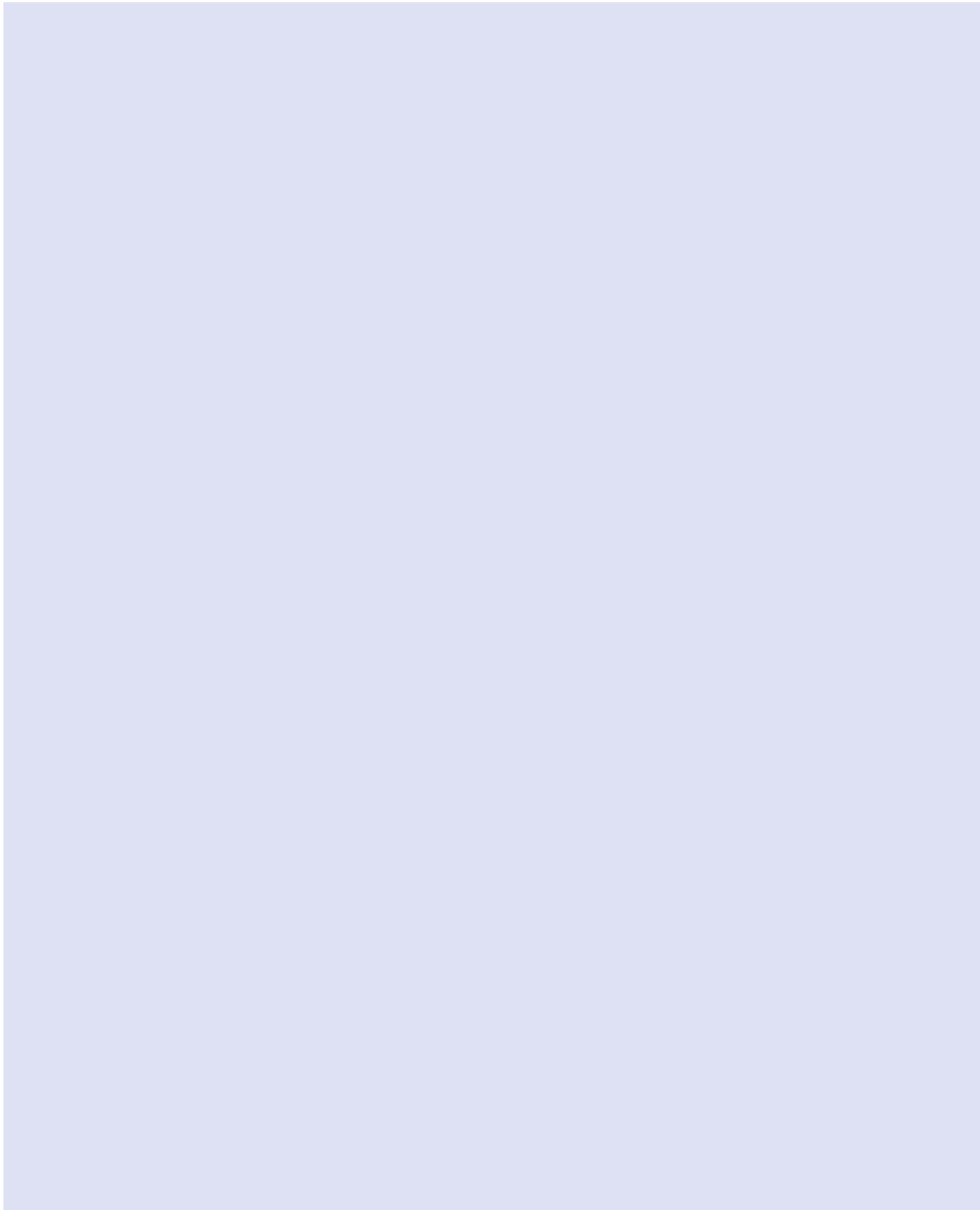
Vice President,  
European Investment Bank



A handwritten signature in black ink, appearing to read 'M. Arias Cañete'.

**Miguel Arias Cañete**

Commissioner for Climate  
Action and Energy,  
European Commission



## TABLE OF CONTENTS

6	Main Terms Used in the Guide
9	Introduction
15	Chapter 1 – Background to the Rules
19	Chapter 2 – The Features of an EPC
31	Chapter 3 – The EPC
34	Theme 1 – Legal ownership and access rights
36	Theme 2 – Specification, design, construction and installation of the EPC assets
42	Theme 3 – Maintenance and operation of the EPC assets
48	Theme 4 – The Guaranteed Savings
60	Theme 5 – The payment mechanism
76	Theme 6 – Compensation, relief and force majeure events
84	Theme 7 – Changes to the EPC
88	Theme 8 – Changes in law
90	Theme 9 – Insurance
96	Theme 10 – Warranties and indemnities
100	Theme 11 – Early termination of the EPC
106	Theme 12 – Compensation on early termination of the EPC
116	Theme 13 – Expiry of the EPC
120	Theme 14 – Financing arrangements
134	Theme 15 – Government influence
140	Theme 16 – Miscellaneous provisions
143	Chapter 4 – Concluding the Statistical Treatment Assessment
149	Annex 1: Table of Typical EPC Provisions that Influence the Statistical Treatment
161	Annex 2: Government and EU financing in EPCs (worked examples)

## MAIN TERMS USED IN THE GUIDE

<b>2017 Guidance Note</b>	The guidance on EPCs issued by Eurostat in September 2017 <sup>3</sup>
<b>Authority</b>	The public authority that enters into the EPC for itself and/or on behalf of other public authorities
<b>CHP</b>	Combined heat and power
<b>Construction Phase</b>	The period during which the EPC assets are installed
<b>Energy consumption saving</b>	A reduction in volume of energy consumption
<b>EPC</b>	An energy performance contract, meaning a contract to provide measures to improve the energy efficiency of existing infrastructure in return for payments conditional on the performance of those measures in achieving agreed energy consumption and/or cost savings
<b>EPC assets</b>	The measures comprising capital expenditure (e.g. construction works and/or provision of equipment) that are implemented under the EPC
<b>ESA 2010</b>	The European system of accounts in force at the date of the Guide <sup>4</sup>
<b>ESIF</b>	The European Structural and Investment Fund
<b>EU</b>	The European Union
<b>FI</b>	A financial instrument
<b>Financial close</b>	The date that the financing agreements for an EPC arrangement become unconditional and the financing becomes available (for an EPC undertaken on a project finance basis) or the date that the contractual obligations under an EPC become unconditional (for an EPC undertaken on a corporate finance basis)
<b>Government</b>	The general government sector, as defined in the Rules <sup>5</sup>
<b>Guaranteed savings</b>	The amount of energy consumption savings, energy-related cost savings and/or revenues guaranteed under an EPC

<sup>3</sup> See [ec.europa.eu/eurostat/documents/1015035/7959867/Eurostat-Guidance-Note-Recording-Energy-Perform-Contracts-Gov-Accounts.pdf/](http://ec.europa.eu/eurostat/documents/1015035/7959867/Eurostat-Guidance-Note-Recording-Energy-Perform-Contracts-Gov-Accounts.pdf/)

<sup>4</sup> Council Regulation (EC) 549/13 of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174/1, 26.06.2013, p.1). [ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-02-13-269](http://ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-02-13-269)

<sup>5</sup> See ESA 2010, paragraphs 2.111 to 2.112 and 20.5 to 20.6

<b>Guide</b>	This guide
<b>HVAC</b>	Heating, ventilation and air conditioning
<b>MGDD 2016</b>	The latest version of the Eurostat Manual on Government Deficit and Debt – Implementation of ESA 2010, published in March 2016 <sup>6</sup>
<b>LED</b>	Light-emitting diode
<b>Operational Payments</b>	The routine payments made by the Authority to the Partner during the Operational Phase, linked to the performance of the EPC assets and/or the delivery of related services (e.g. maintenance of the EPC assets, monitoring energy consumption) <sup>7</sup>
<b>Operational Phase</b>	The period during which the EPC assets are maintained or maintained and operated by the Partner
<b>Partner</b>	The entity that enters into the EPC with the Authority
<b>PPP</b>	A public private partnership
<b>Rules</b>	The rules used by Eurostat for assessing the statistical treatment of EPC arrangements
<b>Savings excess</b>	The difference between the guaranteed savings and actual savings (where actual savings are higher than the guaranteed savings)
<b>Savings shortfall</b>	The difference between the guaranteed savings and actual savings (where actual savings are lower than the guaranteed savings)
<b>SPV</b>	A special purpose vehicle
<b>Statistical treatment</b>	The recording of an EPC arrangement on or off the balance sheet of the relevant government according to ESA 2010
<b>Themes</b>	The main features of a typical EPC arrangement as set out in Chapter 3 of the Guide

<sup>6</sup> See [ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-GQ-16-001](http://ec.europa.eu/eurostat/en/web/products-manuals-and-guidelines/-/KS-GQ-16-001)

<sup>7</sup> See Themes 5.1 and 5.4



# Introduction

Public sector stakeholders are under increasing pressure to reduce their overall energy consumption and, in doing so, to look at ways of improving the energy efficiency of their buildings and other infrastructure. Decisions to undertake the up-front investments needed in order to deliver energy efficiency improvements are, however, sometimes influenced by expectations as to how they will impact governments' balance sheets according to the European system of accounts (the so-called "statistical treatment").

In September 2017, Eurostat issued revised guidance (the 2017 Guidance Note) on how a particular form of energy efficiency investment, commonly referred to as "energy performance contracting", impacts on government deficit and debt figures. The 2017 Guidance Note recognises that, in certain circumstances, energy performance contracts (EPCs) can be recorded "off balance sheet" for government.

In order to bring clarity on the practical application of the 2017 Guidance Note, Eurostat and the EIB have worked together to produce this guide (the Guide).

## Aim of the Guide

The Guide is aimed mainly at public sector stakeholders, and in particular authorities in charge of energy efficiency policy, decision-making and the preparation and procurement of EPCs. It is intended to improve their understanding of how the statistical treatment of EPCs should be assessed. It explains how the typical features of EPCs (i.e. those that reflect general market practice in the EU jurisdictions) influence the statistical treatment of an EPC arrangement as on or off the balance sheet of the relevant government. It will therefore assist EPC practitioners to develop, draft and negotiate EPCs with a better understanding of the likely statistical treatment implications.

The structure and drafting of EPCs varies widely across the EU. There is no one style or approach that can be identified as being particularly dominant. Therefore, rather than attempt to cover individual contract clauses, the Guide instead looks at common themes (the Themes) drawn from market practice observed across the EU.

In contrast to existing Eurostat publications, which look at the statistical treatment of EPCs from a statistical standpoint, the Guide looks at it from a contractual and commercial standpoint. The Guide has been approached with the intention of being:

- **user-friendly:** it is organised in a contract-like structure;
- **comprehensive:** it is thorough in its coverage of typical features of EPCs across the public sector EPC market; and
- **clear:** the Guide has been prepared with a view to being as definitive and unambiguous as possible.

## How the Guide was produced

The EIB (through the EIAH) managed the process to develop the Guide. Two main steps were taken:

- A stock-take of EPC provisions across the EU: the first step involved identifying the various approaches adopted across the EU to deal with key contractual aspects of EPC arrangements (including matters implied by relevant laws). This part of the work was led by the EIB with support from Pinsent Masons LLP, an international law firm with EPC experience across the EU;<sup>8</sup> and
- Applying the Rules to the typical EPC provisions: the second step involved the EIB asking Eurostat to explain how it would apply the Rules to the EPC provisions considered to represent typical EU practice.

## Structure of the Guide and how to use it

The Guide is structured around four Chapters:

- Chapter 1 provides users with the background required for understanding the statistical treatment of EPC arrangements. It gives a general overview of the development of the Rules and their key underlying principles. It also explains the stages at which the statistical treatment of an EPC should be assessed;
- Chapter 2 explains the general features of EPC arrangements that, according to Eurostat, distinguish EPCs from other types of arrangements for delivering energy efficiency improvements. If an arrangement is an EPC, as defined by Eurostat, the Rules (as explained in the later Chapters of the Guide) apply. If the arrangement is not an EPC, as defined by Eurostat, the Rules do not apply and the statistical treatment of the arrangement will be determined under separate Eurostat rules that are outside the scope of the Guide;
- Chapter 3, the main body of the Guide, deals with how the Rules apply, Theme by Theme, to arrangements that fall within Eurostat's definition of an EPC. It summarises the typical approaches taken in EPCs in the EU to deal with the main issues under each Theme and provides Eurostat's view on whether or not the approaches taken influence the statistical treatment. For ease of reference, Eurostat's comments are shown in *colour and italics*. Where an approach does influence the statistical treatment (meaning that it points to the EPC being on balance sheet for government), Chapter 3 indicates if the matter is of VERY HIGH, HIGH or MODERATE importance or is sufficient in itself to record the EPC ON BALANCE SHEET for government; and

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<sup>8</sup> EIB and Eurostat thank Pinsent Masons LLP for its contribution to the production of the Guide.

- Chapter 4 explains the methodology that Eurostat uses in practice to reach a conclusion on the statistical treatment of an EPC which has been assessed against the Themes in Chapter 3. Users can refer to this Chapter to help them understand whether a single issue (or a combination of issues) that they may have identified through Chapter 3 is likely to lead Eurostat to an off or on government balance sheet decision.

## Scope and limitations of the Guide

When using the Guide, the following points should be borne in mind:

- The Guide is based on the Rules as set out in the European system of accounts in force at the date of the Guide (ESA 2010), the most recent version of the *Manual on Government Deficit and Debt – Implementation of ESA 2010* published in March 2016 (the MGDD 2016) and the 2017 Guidance Note. Although substantive revision of the Rules is not expected in the near future, it is important to ensure, when using the Guide, that ESA 2010, the MGDD 2016 and the 2017 Guidance Note are still in force;
- The Guide is fully endorsed by Eurostat and it therefore constitutes official Eurostat guidance. Although the Guide is consistent with the 2017 Guidance Note, if a view expressed in the Guide is perceived to conflict with the 2017 Guidance Note, the view expressed in the Guide prevails as it reflects Eurostat’s latest thinking;
- The Guide can be applied both to assess the statistical treatment of arrangements that reach financial close on or after the date of its publication and to reassess the statistical treatment of EPC arrangements that reached financial close before that date. The latter is, however, a matter for the discretion of national statistical authorities. Chapter 1 provides more detail on the appropriate timing for carrying out the statistical treatment assessment;
- As noted above, the Guide is based on approaches to each Theme that are commonly observed in public sector EPC markets across the EU. Although considerable efforts have been made to be as extensive as possible, the Guide does not claim to cover all possible EPC provisions that may have an impact on the statistical treatment, or any provisions that may appear in the market in the future. The fact that a specific EPC arrangement contains features and/or provisions that are not covered by the Guide does not mean that those features or provisions should be disregarded in assessing the statistical treatment;
- In order to meet its intended purpose, the Guide is detailed and reflects a level of complexity that is typical of EPC arrangements. It is assumed, therefore, that users of the Guide have a good working knowledge of the structure and principal terms of EPC arrangements;

- The diversity of approaches to EPC structuring and drafting means that the EPC provisions described in the Guide may not directly correspond to individual EPC arrangements.<sup>9</sup> It is important to be aware, however, that the Rules are concerned with the economic substance and effect of the provisions that regulate EPC arrangements. Therefore, in using the Guide and interpreting how it applies to a specific EPC arrangement, users must consider the commercial impact of the typical EPC provisions described in the Guide and the principles referred to in Eurostat’s comments. They must also take account of all aspects of the EPC arrangement (including all documents relating to it);
- The statistical treatment of an EPC involves assessing many features of the arrangement, which are often interdependent. As a result, users need to consider the Guide as a whole and should refrain from looking at specific sections of it in isolation;
- The aim of the Guide is to provide assistance with the indicative statistical treatment of EPCs. As is the case with all statistical issues involving government, final decisions on the statistical treatment of EPCs remain with national statistical authorities and, ultimately, Eurostat. Early consultation with national statistical authorities is recommended if the statistical treatment is likely to be a determining factor in the public sector’s decision to procure or enter into an EPC or when certainty on the statistical treatment is required. This is particularly important if an arrangement includes novel provisions or structures for which no specific Eurostat guidance exists;
- If there is doubt as to whether or how the Rules or the Guide apply to a specific arrangement, the national statistical authorities of EU Member States are able to ask Eurostat for its assessment. Such requests can be made for contracts that have already been signed or for contracts that are under preparation. However, it must be noted that Eurostat only gives opinions on arrangements that are already structured. It does not issue guidance on hypothetical cases or different variants of the same arrangements and does not provide advice on how to structure arrangements in order to arrive at a particular conclusion on their statistical treatment;<sup>10</sup>

<sup>9</sup> For example: terminology or drafting mechanisms may be different from those assumed in the Guide, or an EPC may be influenced by provisions contained in national/local law rather than the contract document itself.

<sup>10</sup> Guidelines for Eurostat’s ex-ante advice on methodological issues is available at: [ec.europa.eu/eurostat/documents/1015035/2046549/Ex-ante-advice-final-2013-01-18.pdf/483cc8b1-d384-416f-b7ed-7a788f246517](https://ec.europa.eu/eurostat/documents/1015035/2046549/Ex-ante-advice-final-2013-01-18.pdf/483cc8b1-d384-416f-b7ed-7a788f246517)

- The Guide concerns only the treatment of EPCs in national accounts. The public sector or business accounting treatment of EPC arrangements is outside the remit of Eurostat and therefore outside the scope of the Guide;
- The Guide does not deal with “value for money” and “bankability” issues relating to EPC arrangements. It must not be interpreted as providing an endorsement of, or advice on, the value for money and bankability of the EPC provisions that it describes. Likewise, it must not be interpreted as providing an endorsement of, or advice on, the value for money and bankability implications of using, structuring or amending any EPC provisions in order to arrive at an off government balance sheet treatment;
- The comments on the statistical treatment expressed in the Guide are those of Eurostat<sup>11</sup> alone and do not reflect the views or interests of the EIB as a lender or adviser to EPC arrangements.

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<sup>11</sup> The contributions of Luca Ascoli, Galjinka Dominić and Thomas Forster from Eurostat in producing the Guide are acknowledged.

## CHAPTER 1

# Background to the Rules

## Overview

This Chapter provides users with the background required for understanding the statistical treatment of EPCs. It gives a general overview of the development of the Rules and their key underlying principles. It also explains when the statistical treatment of an EPC should be assessed.

## Development of the Rules

The “Excessive Deficit Procedure”, defined by the Maastricht Treaty (Article 104), has been in force in the EU since 1994. The European Commission (through Eurostat) endeavours to guarantee the proper application of the European system of accounts in order to gather reliable and comparable statistics on the debt and deficit position of Member States. As of September 2014, ESA 2010 is the reference framework for these data. Its use is legally binding for all EU countries.

ESA 2010 is aimed at producing economic statistics and seeks to record the economic substance of transactions (rather than their legal form). The MGDD 2016 is harmonised with ESA 2010 and is its indispensable complement.

Eurostat released its first communication on the statistical treatment of EPCs in a guidance note dated August 2015.<sup>12</sup> This established a practical rule that, by default, all capital expenditure incurred in EPC arrangements should be recorded in government accounts as debt and as having an immediate impact on deficit.<sup>13</sup> That guidance is now superseded by the 2017 Guidance Note, which aligns with the Excessive Deficit Procedure Statistics Working Group’s most recent interpretation of the relevant ESA10 provisions.

The Rules (as explained in the Guide) are therefore drawn from ESA 2010, the MGDD 2016 and the 2017 Guidance Note.

## Key principles for assessing the statistical treatment of EPCs

The purpose of the Rules is to establish which party to the EPC is the economic owner of the measures comprising capital expenditure (e.g. construction works, equipment) that are implemented under the EPC (the EPC assets). The economic owner is the party that bears most of the risks and has the right to most of the rewards associated with those assets.

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<sup>12</sup> See: [ec.europa.eu/eurostat/documents/1015035/6934993/EUROSTAT-Guidance-Note-on-Energy-Performance-Contracts-August-2015.pdf/dc5255f7-a5b8-42e5-bc5d-887dbf9434c9](https://ec.europa.eu/eurostat/documents/1015035/6934993/EUROSTAT-Guidance-Note-on-Energy-Performance-Contracts-August-2015.pdf/dc5255f7-a5b8-42e5-bc5d-887dbf9434c9)

<sup>13</sup> The note recognised that there may be some limited circumstances where an EPC might be treated as an operational lease or a PPP. Further guidance on the interaction of Eurostat rules on EPCs and PPPs is given in Chapter 2.

Chapters 2 to 4 of the Guide explain how Eurostat applies this key principle in practice.

If the assessment of risks and rewards, as explained in the Guide, indicates that government is the economic owner of the EPC assets, then the EPC must be recorded on balance sheet for government.

If, however, the assessment of risks and rewards indicates that government is *not* the economic owner of the EPC assets, then the EPC can be recorded off balance sheet for government.

In either case, it is for the national statistical authority to determine the recording of the EPC assets in accordance with the relevant ESA10 rules.

## Timing of the assessment of the statistical treatment of EPCs

The statistical treatment of an EPC is assessed by examining the EPC arrangements as they stand at the date of financial close<sup>14</sup> against the Rules in force at financial close. In normal circumstances, the conclusion of the assessment made at that time will hold for the duration of the EPC.

If the Rules change after financial close there is no requirement to reassess the EPC arrangements under the revised Rules, although it is within a national statistical authority's discretion to do so.<sup>15</sup>

However, if the EPC is changed, or the nature or control of one of the parties to the EPC changes,<sup>16</sup> it is necessary to consider whether the change affects the original conclusion on the statistical treatment. The change itself is assessed under the Rules as they stand at the time the change is made. If, according to those Rules, the change itself directly alters the balance of risk and reward (or nature or control of the relevant party) in a way that would alter the statistical treatment, the original statistical treatment must be revised.

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<sup>14</sup> This is the date that the financing arrangements for an EPC become unconditional and the financing becomes available (for an EPC undertaken on a project finance basis) or the date that the contractual obligations under an EPC become unconditional (for an EPC undertaken on a corporate finance basis).

<sup>15</sup> For example, an EPC that reached financial close in June 2017 and was assessed as on balance sheet for government on the basis of the Rules at that time may now be reassessed by the national statistical authority on the basis of the Rules (as reflected in the 2017 Guidance Note and the Guide).

<sup>16</sup> Chapter 2 explains how the nature or control of the parties is relevant to the statistical treatment.

By way of illustration, an EPC that reaches financial close and is assessed as off balance sheet for government under the Rules (and the Guide) is later amended to incorporate additional energy efficiency measures. If those additional measures are provided on the same contractual and commercial basis as the original measures, there is no change to the off balance sheet recording for government. If, however, those additional measures are combined with, for example, a change to the contract provisions which introduces a cap on the Partner's share of excess energy savings, then the statistical treatment needs to be changed to reflect all of the EPC assets being recorded on balance sheet for government. This is because the change to the contract has altered the balance of risk and reward in a relevant way (see Theme 5.6.5).

The process that leads up to financial close (e.g. whether the EPC is entered into following a mini-competition under a framework agreement or procured through an individual public procurement exercise) and the legal form that the contract takes (e.g. whether a simple form of contract that cross-refers to the terms of a framework agreement or a stand-alone contract; whether the contract is categorised/procured as a PPP or a lease or other form of contract according to national laws) are not relevant to the statistical treatment.

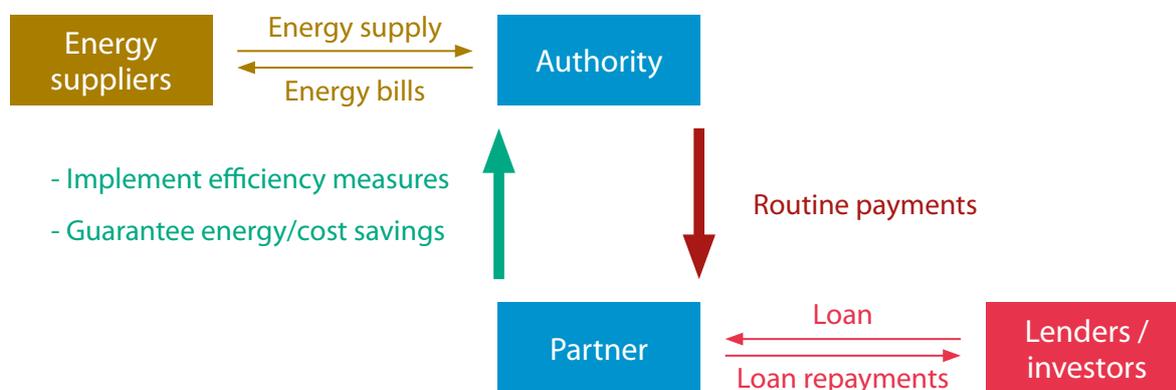
## CHAPTER 2

# The Features of an EPC

## Overview

The term “EPC” is typically used to describe a contractual arrangement between a public authority and a partner for the provision of energy efficiency measures (involving capital expenditure in construction works and/or equipment and/or the delivery of related services). In exchange the Partner receives from the Authority routine performance-based payments linked to the energy consumption and/or cost savings delivered by those measures.

The following diagram illustrates, very simply, a typical EPC arrangement<sup>17</sup>:



This Chapter explains the particular features of an arrangement that determine whether or not it falls within Eurostat’s own definition of an EPC and therefore whether or not the Rules (and the later Chapters of the Guide) apply. These features are:

- the “statistical sector classification”<sup>18</sup> of the public authority that enters into the EPC (the Authority);
- the “statistical sector classification” of the entity that enters into the EPC with the Authority (the Partner);
- the types of assets provided by the Partner under the contract;

<sup>17</sup> For illustrative purposes only. In reality EPC arrangements vary widely in practice and may look quite different from what is presented here (e.g. the Partner might have a contractual relationship with energy suppliers, the Authority might itself be a lender to the Partner). The variety of typical arrangements is explored in detail through Chapters 2 and 3 of the Guide.

<sup>18</sup> The parties involved in an EPC arrangement will, for statistical purposes, be classified as entities either inside or outside the general government sector. This will be determined by the same rules used to determine the statistical sector classification of all entities within a Member State. This is a technical and complex area of national accounts. While Chapter 2 considers the likely relevance of the general rules to typical EPC arrangements, users are strongly advised to consult their national statistical authorities for any specific queries or concerns.

- the duration of the contract;
- the scope of services provided by the Partner under the contract;
- the type of contract payments (i.e. the distinction between EPCs and PPPs); and
- third party revenues generated from the arrangements.

As already mentioned, the statistical treatment of energy efficiency arrangements that do not fall within Eurostat’s definition of EPCs (as explained in this Chapter 2) is outside the scope of the Guide.

### Statistical sector classification of the Authority

Eurostat’s definition of an EPC requires that the Authority is, for statistical purposes, classified inside the general government sector. Examples of entities classified inside the general government sector for statistical purposes include central government ministries or departments, regional or local government entities.<sup>19</sup>

If the Authority is, for statistical purposes, classified outside the general government sector (e.g. a company that is owned by government but, in statistical terms, considered a “market producer”), Eurostat does not consider the arrangement to be an EPC for the purposes of the Rules and the Guide does not apply.<sup>20</sup>

### Statistical sector classification of the Partner

Eurostat’s definition of an EPC requires that the Partner is, for statistical purposes, an entity classified outside the general government sector. The tests applied to determine if an entity is classified inside or outside the general government sector differ depending on whether or not the entity is a special purpose vehicle (SPV).<sup>21</sup> These tests are described below.

<sup>19</sup> EDP Inventories Annex I: list of units classified in the general government sector by countries available at: [ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-inventories](http://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-inventories)

<sup>20</sup> An example of this would be where a rail company (owned by government but classified as a market producer outside the general government sector) enters into a contract to deliver energy efficiency measures in its buildings. It should be noted that any government involvement in such a project can have an impact on its statistical treatment through the application of other (i.e. non-EPC) Eurostat rules.

<sup>21</sup> EPC arrangements involving large-scale investments might use a project finance solution, in which case the Partner will constitute itself as an SPV. Smaller-scale investments, on the other hand, are typically financed through corporate loans and therefore may not involve the creation of an SPV.

## Cases where the Partner is an SPV

If the SPV is controlled by private entities<sup>22</sup> it will, for statistical purposes, be classified outside the general government sector.<sup>23</sup> Assuming that the contracting arrangement has the other features of an EPC (as defined by Eurostat and explained in this Chapter), it will be considered to be an EPC and its statistical treatment will be assessed using the Rules and the Guide (see Chapters 3 and 4).

If however the SPV is controlled by government it will, for statistical purposes, be classified inside the general government sector. As a result, the arrangement will not be considered to be an EPC (according to Eurostat's definition) and it will be on balance sheet for government.

For statistical classification purposes, government control of an SPV can be established in a number of ways including, for example, through ownership rights, contractual rights, financing arrangements, law, regulation or vetoes over the SPV's important decisions.<sup>24</sup>

Determining whether government controls<sup>25</sup> an SPV is often a matter of degree and it is important to assess each case on its own particular facts and circumstances.<sup>26</sup> The following is a non-exhaustive list of examples of government control, which are given for illustrative purposes only:

- If government has a 51% share in the ownership and voting rights of the SPV, the SPV is deemed to be controlled by government through its majority share;
- If government has a 25% share in the ownership of the SPV which gives it rights to veto important decisions of the SPV (for example through shareholder agreements

<sup>22</sup> This includes where an SPV is controlled by one or more public entities classified outside the general government sector (such as national public banks or government companies that are, for statistical purposes, considered to be "market producers" – see footnote 27). However, an important exception to this is where those public entities are acting on an instruction of government (see the final paragraph of this section).

<sup>23</sup> It is usually the case that an SPV enters into a single EPC contract to deliver a single EPC. However, an SPV that is controlled by private entities could enter into multiple EPC contracts with one or more Authorities, without this affecting its classification outside the general government sector.

<sup>24</sup> See ESA 2010 paragraphs 2.38, 20.309 and 20.316 to 20.318 and MGDD 2016 Chapters I.2.3 and I.6.2.

<sup>25</sup> It is important to note that government control of an SPV can be established through the relationships that the SPV has with any government entity in the relevant Member State, and not only through its relationships with the Authority. For example, where the Authority is a local government entity, a majority or controlling ownership share in the SPV that is held by another government entity (e.g. if central government invests in the SPV) would establish government control of the SPV.

<sup>26</sup> A condition imposed in the tender process that government will participate in the ownership of the SPV for an EPC is not, in and of itself a relevant factor in determining whether the SPV is controlled by government.

or through general company law), the SPV is deemed to be controlled by government through those rights. This is the case even if the veto rights mirror veto rights held by other owners of the SPV; and

- If government has no share in the ownership of the SPV but has rights to veto important decisions of the SPV through a financing agreement or a contract, the SPV is deemed to be controlled by government through those veto rights.

In all of the examples mentioned above, the SPV is classified inside the general government sector and the arrangement will be on balance sheet for government.

It is important to stress that in looking at the issue of government control of an SPV, any relationship between the SPV and a public entity that is classified outside the general government sector will be deemed by Eurostat to be a relationship between the SPV and government if the public entity is acting on an express or implied instruction of government in the context of the specific arrangements. For example, if a national public bank (even though classified outside the general government sector) is instructed by government to take an equity share in the SPV, that equity share is considered by Eurostat to be held by government. As a result, any rights attached to that equity share will be considered to be rights held by government and will be taken into account in assessing whether or not government has control of the SPV.

### Cases where the Partner is not an SPV

In cases where the Partner is not an SPV (which has been more common in the EU EPC market to date), the sector classification of the Partner is assessed in a slightly different way.

The first step is to determine whether the Partner is controlled by government (using the same tests that apply to SPVs, as described above).

If the Partner is not controlled by government, it is classified outside the general government sector. Assuming that the contracting arrangement has the other features of an EPC (as defined by Eurostat and explained in this Chapter), it will be considered to be an EPC and its statistical treatment will be assessed using the Rules and the Guide (see Chapters 3 and 4).

If the Partner is controlled by government, there is a second step, which is to determine whether the Partner is, in statistical terms, a “market producer”. This involves both a qualitative and a quantitative assessment:<sup>27</sup>

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<sup>27</sup> See ESA 2010 paragraphs 20.19 to 20.34 and MGDD 2016 Chapter I.2.4.

- If, on the basis of the qualitative and quantitative assessment, the Partner is deemed to be a “market producer”, it will be classified outside the general government sector. Assuming that the contracting arrangement has the other features of an EPC as defined by Eurostat and explained in this Chapter, it will be considered to be an EPC and its statistical treatment will be assessed under the Rules and the Guide (see Chapters 3 and 4). This situation may arise where an Authority enters into an EPC arrangement with, for example, a government-owned utility company which is considered to be a “market producer”; and
- If, on the basis of the qualitative and quantitative assessment, the Partner is not deemed to be a “market producer”, the Partner will be classified inside the general government sector. In that case, the contracting arrangement will not be an EPC (according to Eurostat’s definition) and it will be on balance sheet for government.

## Types of assets

The Rules require that an EPC involves initial capital investment in one or a series of measures (e.g. construction works, provision of equipment) designed to improve energy efficiency through reducing the energy consumption of existing infrastructure. Arrangements to deliver energy efficiency through energy management measures such as planning, optimisation, maintenance of equipment etc. without any capital investment in the provision of new or renewed assets or equipment are, for statistical treatment purposes, to be treated as service contracts, and are outside the scope of the Guide.

The capital investment undertaken can be in removable assets (e.g. boilers) and/or non-removable assets (e.g. insulation). Typical examples of capital investment measures that fall within the scope of Eurostat’s definition of an EPC include new (and/or improvements to):

- heating, ventilation and air conditioning (HVAC) systems;
- combined heat and power (CHP) plant;
- lighting systems;
- hot water systems;
- building management systems;
- external shading, solar control systems;
- boilers and chillers;
- insulation of the building envelope;
- roofing;
- windows;
- street-lighting.

An EPC (according to Eurostat's definition) must involve capital investment in assets (such as those described above) that reduce energy consumption.<sup>28</sup> However, in addition, an EPC can also include capital investment in:

- ancillary equipment and assets that facilitate the delivery of the services provided under the EPC (e.g. equipment for monitoring energy consumption); and/or
- assets that produce energy (e.g. photovoltaics) for consumption in existing facilities and/or sale to third parties. However, if the capital expenditure on such assets represents 50% or more of the total capital expenditure on the assets constructed and/or installed under the contract, the contract will not be an EPC for the purposes of the Rules and the Guide will not apply.

If an EPC involves a series of individual measures, those measures are treated collectively as the EPC assets for the purposes of the statistical treatment, and the aggregate value of those assets is recorded as either on or off government's balance sheet.<sup>29</sup>

The value of the existing infrastructure in which (or for which) the measures are implemented is not relevant for the purposes of recording the EPC assets as on or off government's balance sheet.

Eurostat does not apply any minimum threshold of capital expenditure in its definition of an EPC.

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<sup>28</sup> The installation of CHP plant in an existing facility will, by itself, not necessarily lead to a reduction in the volume of energy (kWh) consumed in the facility. However, Eurostat acknowledges the energy efficient nature of CHP plant and therefore CHP plant is, by exception and for the purposes of the Rules and the Guide, treated as if it is an asset that reduces energy consumption.

<sup>29</sup> Any assets that are provided, but not maintained/operated, by the partner under an EPC are not considered by Eurostat to be EPC assets. The statistical treatment of such assets requires separate analysis, in which they are treated as assets procured under a conventional contract and accounted for under the relevant Eurostat rules. An example of this would be an EPC that (in addition to requiring the Partner to install, maintain, replace and ensure the performance of a new energy efficient heating system) requires the Partner to install thermal insulation throughout the building envelope but places no ongoing responsibility on the Partner for the maintenance, replacement or performance of the thermal insulation.

The example in Box 1 illustrates how Eurostat applies the Rules relating to the type of assets.

### Box 1: The EPC assets

A regional government enters into a contract for energy efficient renovations in 20 of its schools. The renovations will involve a total of EUR 4.5 million capital investment in the following measures:

- HVAC, LED lighting and insulation, which will directly **reduce energy consumption** in the schools) at a capital cost of EUR 2.5 million across all schools;
- photovoltaics (which will **produce low-cost energy** for consumption in the schools) at a capital cost of EUR 1.5 million across all schools;
- meters and monitors (which will **measure energy consumption and efficiency** in the schools) at a capital cost of EUR 0.5 million across all schools.

For the purposes of the statistical treatment assessment:

- the assets satisfy Eurostat’s requirement for the definition of an EPC (i.e. the contract requires the provision of measures that **reduce energy** consumption, and the additional measures that **produce energy** represent less than 50% of the total capital investment under the contract);
- the capital investment measures are collectively treated as the “EPC assets” with a value of EUR 4.5 million which will, according to the provisions of the Guide, be assessed as either on or off government’s balance sheet.

## Duration of the EPC

The Rules require that the duration of the EPC is sufficient to cover a meaningful part of the economic life of the EPC assets.

On this basis, Eurostat will apply the Rules (and therefore the Guide) to any contract with a duration of eight years or longer. This will be the case whether the economic life of some or all of the EPC assets is longer or shorter than eight years.

On the other hand, a contract with a duration of less than eight years will not fall within Eurostat’s definition of an EPC, which means that the Guide will not apply and the statistical treatment of the contract will be considered under other Eurostat rules.

## Scope of services to be provided by the Partner

In order for an arrangement to be considered an EPC by Eurostat, the Partner must, as a minimum, be obliged to maintain (and, as necessary, replace) the EPC assets for the duration of the contract with a view to ensuring their ongoing ability to deliver the energy consumption and/or cost savings required under the EPC.

The extent to which the Partner is required to provide other services in addition to maintaining and replacing the EPC assets<sup>30</sup> does not affect Eurostat's view on whether the arrangements fall within its definition of an EPC.

## EPC or PPP?

Contracts to deliver energy efficiency improvements through substantial refurbishment, renovation or upgrade of existing infrastructure could, in some circumstances, be interpreted as falling within the scope of Eurostat's rules on PPPs. This is because rules on PPPs are stated to apply where the amount of capital expenditure in the refurbishment of an existing asset represents 50% or more of the value of the asset after completion of the works.<sup>31</sup>

If this 50% threshold is met and the Partner is remunerated on the basis of the availability of and/or demand for the existing infrastructure (as refurbished, renovated or upgraded) then the arrangement should be treated as a PPP and assessed according to Eurostat's rules on PPPs (and not according to Eurostat's rules on EPCs and the Guide).

If, however, this 50% threshold is met, but the Partner is remunerated on the basis of energy consumption and/or cost savings associated with the existing infrastructure, then (assuming it has the other features of an EPC as defined by Eurostat and explained in this Chapter) the arrangement will be considered to be an EPC and its statistical treatment will be assessed using the Rules and the Guide (see Chapters 3 and 4).

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<sup>30</sup> For example monitoring performance, verifying savings, energy supply.

<sup>31</sup> See *A Guide to the Statistical Treatment of PPPs* [ec.europa.eu/eurostat/web/government-finance-statistics/methodology/guidance-on-accounting-rules](https://ec.europa.eu/eurostat/web/government-finance-statistics/methodology/guidance-on-accounting-rules)

## Third party revenues

If the measures implemented under an energy efficiency arrangement are expected to generate revenues from third parties,<sup>32</sup> this can affect whether the arrangement falls within Eurostat's definition of an EPC. Two tests (illustrated in Box 2 below) are applied at financial close. These tests look at the extent to which the Partner and the Authority each benefit from third party revenues:

- If, at financial close, it is forecast that the amount of revenues that the Partner will receive from third parties (directly or indirectly)<sup>33</sup> is greater than the total amount of the contractual payments that it is forecast to receive from the Authority, Eurostat will not consider the arrangement to be an EPC and the statistical treatment will be assessed under separate rules (which are outside the scope of the Guide); and
- If, at financial close, the third party revenues that the Authority (and/or government more widely) is forecast to receive from the assets will exceed 50% of the total amount of the contractual payments that the Authority is forecast to make to the Partner over the life of the contract, Eurostat will not consider the arrangement to be an EPC and it should be recorded on balance sheet for government. Forecast third party revenues that are included in the scope of the guarantee (see Theme 4.1) should be excluded from this comparison.

For both tests:

- Forecast third party revenues and forecast payments should be compared on a net present value basis at financial close, based on genuine best estimates that can be made at that time; and
- A change in the forecast third party revenues at any time during the contract does not (in itself) trigger a reassessment of the statistical treatment. However, any reassessment of the statistical treatment triggered by a change to the provisions of the EPC would need to take account of the forecast third party revenues at the date of the reassessment.

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<sup>32</sup> An example would be where the partner installs photovoltaics which produce energy for the building in which they are installed and surplus energy for sale to the grid.

<sup>33</sup> The revenues from sales of surplus energy to the grid, for example, might be received by the Partner directly or might be received by the Authority who passes them on to the Partner.

### Box 2: Third Party Revenues

A government health authority enters into a contract for the installation of new combined heat and power (CHP) plant that will improve the energy efficiency of heat supply in a hospital. The electricity generated by the CHP plant will exceed the amount consumed in the hospital and the surplus electricity will be sold to the grid. The payments due from the health authority to the Partner are EUR 1 million per year and the contract has a duration of 8 years.

In order for Eurostat to consider this arrangement as an EPC (and therefore for its statistical treatment to be assessed using the Rules and the Guide), at financial close the following conditions must be met:

- the revenues that the Partner is expected to receive from forecast sales of surplus energy are less than EUR 8 million (i.e. annual payments of EUR 1 million over the duration of 8 years);
- the revenues that the Authority is expected to receive from forecast sales of surplus electricity are less than EUR 4 million (i.e. 50% of the annual payments of EUR 1 million over the duration of 8 years).

The arrangement must, of course, satisfy other features of an EPC described in this Chapter 2 (e.g. types of assets, the sector classification of the Authority and the Partner).



CHAPTER 3

# The EPC

## Overview

The commercial structures and contract provisions used in EPC arrangements, and the approaches and styles used in documenting them, vary widely across Member States and depending on individual circumstances.

Rather than attempt to opine on individual contract clauses used on EPCs across the EU, this Chapter takes the key Themes of typical EPC arrangements, summarises the typical approaches taken in the EU to dealing with the main issues relating to each Theme, and provides Eurostat's view on the relevance of each approach to the statistical treatment. For ease of reference, Eurostat's comments are shown in *colours and italics*.

As already stated, the Guide does not claim to cover all possible EPC provisions that may appear in individual contracts, but it does cover those most commonly observed across the EU.

It is also important to recall that, as stated in the introduction, the Rules are concerned with the substance rather than the form of contracting arrangements. This means that:

- A view stated by Eurostat on a provision described in the Guide will apply equally to a provision that achieves the same commercial effect using a different drafting mechanism or different terminology; and
- Although the Guide may assume that a provision is contained in the contract between the Authority and the Partner, the view stated by Eurostat will apply equally to a provision that achieves the same commercial effect but is contained in a different document or in the underlying law.

In addition, when assessing the statistical treatment of an EPC, it is important to look at the risks and rewards that are taken by all entities classified in the general government sector and not just those that are taken by the Authority that enters into the contract. Theme 14 in this Chapter makes specific reference to this, as financing is an area where a government entity other than the Authority itself is most likely to be involved in an EPC arrangement. However, the same principle applies to all aspects of the EPC arrangement. Examples include:

- Where a government entity is one of the Partner's construction or maintenance sub-contractors (i.e. here the government entity takes risk through the sub-contract); and
- Where a public entity (classified outside the general government sector) is a shareholder in the Partner and has a specific arrangement to transfer any profit it receives from the EPC to a government entity (i.e. here the government entity takes reward through the profit transfer arrangement).

This Chapter identifies whether an EPC provision influences the statistical treatment (meaning that it points towards the EPC being on balance sheet for government) or does not influence the statistical treatment (meaning that it is neutral to the statistical treatment). It is worth stressing that:

- In some cases, Eurostat’s comments state that an EPC provision does not influence the statistical treatment if it meets particular conditions or has certain features. The provision would therefore influence the statistical treatment if the particular conditions or features were not met; and
- In other cases, Eurostat’s comments state that an EPC provision does influence the statistical treatment if it has certain features. The provision without those features would therefore not influence the statistical treatment.

Eurostat’s comments contained in this Chapter also indicate whether a provision that influences the statistical treatment is an issue of MODERATE, HIGH or VERY HIGH importance to the statistical treatment or whether it is sufficient in itself to lead to the EPC being ON BALANCE SHEET for government. The process that Eurostat then follows to reach a conclusion on the statistical treatment of an EPC is explained in Chapter 4.

# Legal ownership and access rights

## 1.1 Legal ownership and access rights: the site

Typically, legal ownership of the site (i.e. the land and/or facilities in/for which the energy efficiency measures will be implemented) remains with the Authority for the duration of the EPC (and after its expiry) and the Authority grants access rights over the site to the Partner. If a third party has legal ownership of the site, the Authority is usually obliged to obtain the access rights required.

The EPC usually contains an express obligation on the Authority to ensure that those access rights subsist for the duration of the EPC. The access rights are typically expressed as simple contractual rights, contained either in the EPC itself or in a separate licence agreement. More rarely, a formal lease arrangement might be entered into (e.g. if the EPC assets are located separately from existing facilities or equipment).

The Partner is typically restricted to exercising its access rights over the site to the extent necessary for it to perform its obligations and exercise its rights under the EPC.

### **Eurostat's comments**

*Eurostat's view is that:*

- *the retention of legal ownership of the site by the Authority during the EPC;*
- *the fact that the Authority takes some or all responsibility and/or risk under the EPC for obtaining and granting access rights necessary for delivering the EPC;*
- *the legal form of access rights granted to the Partner; and*
- *the restriction of the Partner's access rights to those that are necessary for the performance of its rights and obligations under the EPC;*

***do not influence the statistical treatment.***

## 1.2 Legal ownership and access rights: the EPC assets

Most EPC assets become fixtures to the site and therefore, after construction and/or installation, their legal ownership transfers automatically (by law) to the owner of the site (i.e. typically the Authority).

The legal ownership of any EPC assets that do not become fixtures to the site will typically (under the provisions of the EPC) transfer to the Authority either on completion of the construction and/or installation or on expiry/termination of the EPC.

There may be some EPC assets that remain in the legal ownership of the Partner during the EPC (and after its expiry) and which the Partner is required to remove on expiry or early termination of the EPC.

The access rights granted by the Authority to the Partner will incorporate rights to access the EPC assets after construction and/or installation for the purposes of performing its obligations and exercising its rights for the duration of the EPC.

### **Eurostat's comments**

*Eurostat's view is that the fact that legal ownership of some or all of the EPC assets transfers to the Authority (and, by extension, that legal ownership of some or all of the EPC assets remains with the Partner) during or after expiry of the EPC **does not influence the statistical treatment.***

*In addition:*

- the legal form of access rights granted to the Partner; and*
- the restriction of the Partner's access rights to those that are necessary for the performance of its rights and obligations under the EPC;*

**do not influence the statistical treatment.**

# Specification, design, construction and installation of the EPC assets

## 2.1 Responsibility for specification and design

The extent to which the energy efficiency measures and EPC assets are specified and designed before the EPC is signed, and who is responsible for that, varies widely in practice.

In some cases the task of specification and design is led by the Partner (e.g. during a procurement process or during an initial phase under a framework arrangement). In other cases the Authority itself specifies the energy efficiency measures and the EPC assets (and may carry out some or all design work) before initiating a procurement process. In exceptional cases, EPCs envisage that the Partner might identify, specify and design some or all of the energy efficiency measures and EPC assets after the EPC is signed.

Where the EPC envisages further specification and/or design of the EPC assets by the Partner after the EPC is signed, the EPC typically gives the Authority the right to review, comment on or approve all (or certain aspects) of what the Partner does.

In all cases, the EPC will typically make it clear that the Partner is responsible for ensuring that the design, construction and/or installation and performance of the EPC assets (including any that have been specified and designed by the Authority) meet the standards set out in the EPC.

Any comment or approval given by the Authority does not typically remove or reduce the Partner's responsibility to ensure that the design, construction and/or installation and performance of the EPC assets meet the standards set out in the EPC.

### **Eurostat's comments**

*Eurostat's view is that the extent to which the Authority develops, reviews or approves the specification and/or design of the EPC assets **does not influence the statistical treatment**. However, any risk that the Authority takes under the EPC for:*

- *construction and/or installation delays or deficiencies;*
- *increased construction, installation or maintenance/operating costs; and/or*
- *performance failures;*

*that may arise as a consequence of developing, reviewing and/or approving the specification and/or design **does influence the statistical treatment** and is an issue of HIGH importance.*

## 2.2 Responsibility for construction and/or installation

The conventional EPC approach to construction and/or installation is that:

- The Partner is responsible for completing the construction and/or installation of the EPC assets by a fixed date. In some cases, the EPC makes the Partner liable to pay liquidated damages or imposes some other form of penalty (e.g. a reduction in the Operational Payments or a reduced share of excess savings (see Theme 5.6.4)) on the Partner if completion is delayed;
- The Partner takes responsibility for obtaining permits and authorisations as far as this is in its control (with the Authority taking responsibility for, and risk on, permits and authorisations that rely on actions of the Authority and/or that cannot be obtained by the Partner);
- The Partner takes responsibility for constructing and/or installing the EPC assets to the specification and design requirements in accordance with relevant law, industry standards and good practice (including any of the Authority's own standards e.g. health and safety procedures);
- The Partner takes responsibility for managing all design, construction and installation interfaces between the site (e.g. the facilities, existing equipment) and the EPC assets;
- The Partner takes responsibility for the performance of all parties in its construction and installation supply chain (e.g. designers, construction sub-contractors). The EPC sometimes specifies conditions for appointing the supply chain (e.g. appointments must be made through an open tender process, appointments must contain fair payment terms, a percentage of sub-contracts must be with small or medium sized enterprises);
- The Authority has rights to monitor the progress and quality of the construction and/or installation work and to require the Partner to rectify issues of non-compliance;
- The completion of the EPC assets is assessed by reference to objective criteria specified in the EPC (see Theme 2.3 below); and
- There are typically some limited specific circumstances in which the Partner can claim relief and/or compensation for delays and increased costs, lost revenues and/or changes in the project's risk profile caused by events (see Theme 6) that arise in the period during which the EPC assets are constructed and installed (the Construction Phase).

There are limited examples of EPCs in which the Authority is entitled to share the financial benefit of the Partner incurring lower costs than anticipated in the design, construction and/or installation of the EPC assets (e.g. through a reduction in the Operational Payments).

### **Eurostat's comments**

*Eurostat's view is that the conventional approach to responsibility for construction and/or installation described above **does not influence the statistical treatment**. In particular, it is the case that:*

- providing (or not providing) for payment of liquidated damages by the Partner to the Authority (or some other form of penalty) on late completion of the EPC assets **does not influence the statistical treatment**; and*
- provisions for the Authority to take responsibility for, and risk on, permits and authorisations that rely on actions of the Authority and/or that cannot be obtained by the Partner (for reasons that are not connected with its failure) **do not influence the statistical treatment**.*

*However, when looking at the transfer of construction risk, it is important to note Eurostat's views on three related matters: Theme 2.3 on completion tests, Theme 5.2 on commencement of Operational Payments and Theme 6 on the circumstances in which the Partner can claim relief and/or compensation.*

*Eurostat's view is that any mechanism through which the Authority is entitled to share in cost savings generated by the Partner through its management of design, construction and/or installation risk **does influence the statistical treatment** and leads to the EPC being automatically ON BALANCE SHEET for government.*

## **2.3 Construction completion**

EPCs set out objective criteria which are used for determining whether the construction and/or installation of the EPC assets is complete. Satisfaction of these criteria is what typically triggers the Partner's right to start receiving routine payments (the Operational Payments) from the Authority, linked to the performance of the EPC assets and/or delivery of related services (see Theme 5). These criteria can be highly technical and vary significantly from EPC to EPC.

The process for determining whether the completion criteria have been satisfied also varies from EPC to EPC. On some, completion is certified by one of the parties (most typically the Authority) and any dispute is dealt with through the dispute resolution procedure set out in the EPC. On others, an independent third party is appointed to certify

that the EPC assets meet the completion criteria. Whatever process is followed, both parties are typically involved in witnessing the completion tests, and confirmation under the EPC that the completion tests have been satisfied does not remove or reduce the risk taken by the Partner that the EPC assets (as designed, constructed and/or installed) satisfy the contractual standards for the Operational Phase.

Some EPCs envisage that the construction and/or installation of the EPC assets will be completed in phases. Where this is the case, the Partner starts to receive the Operational Payments when the first phase is deemed to have met the relevant completion criteria, and the Operational Payments increase as and when the later phases are deemed to be complete.

#### **Eurostat's comments**

*Eurostat's view on the approach to construction completion described above is as follows:*

- *The process for determining whether the completion criteria have been satisfied (and in particular whether this is to be agreed or determined by the parties or by an independent third party) **does not influence the statistical treatment**;*
- *The specific criteria used for determining whether construction and/or installation of the EPC assets is complete **do not influence the statistical treatment if** they are (i) objective and clearly set out in the EPC (i.e. they are not left open to the discretion of either party or to negotiation between the parties) and (ii) robust (i.e. they require the EPC assets to be in a condition that enables them to perform to the standards set out in the EPC). Where this is not the case, the issue is of HIGH importance to the statistical treatment; and*
- *Provisions for phased completion of the EPC assets that triggers the phased commencement of Operational Payments **do not influence the statistical treatment if** (i) each phase is linked to a component of the EPC assets that is genuinely capable of performing independently and (ii) the proportion of the Operational Payments linked to each phase is not greater than the proportion of the phase's capital cost to the capital cost of the EPC assets in aggregate. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

*However, when looking at the transfer of construction risk, it is important to note Eurostat's views on two related matters in particular: Theme 5.2 on commencement of Operational Payments and Theme 6 on the circumstances in which the Partner can claim relief and/or compensation.*

## 2.4 Minor incomplete (snagging) works

EPCs often stipulate that the completion criteria can be deemed to have been satisfied in spite of the fact that minor aspects of the construction and installation (sometimes referred to as “snagging works”) are incomplete.

Typically the Partner is obliged to complete any snagging works within a limited period of time.

### **Eurostat's comments**

*Eurostat's view is that provisions that allow for minor (or snagging) works to be excluded from the completion criteria tests **do not influence the statistical treatment** if they are limited to works that do not affect the performance of the EPC assets in delivering the energy consumption and/or cost savings required under the EPC. Where this is not the case, the issue is of HIGH importance to the statistical treatment.*

## 2.5 Partner performance guarantees

Many EPCs require the Partner to provide the Authority with a third party guarantee that covers the performance of the construction and/or installation obligations placed on the Partner or its key sub-contractors. The guarantee may be issued by, for example, a bank or a company with an equity share in the Partner.

### **Eurostat's comments**

*Eurostat's view is that the provision of performance guarantees to the Authority **does not influence the statistical treatment**.*

## 2.6 Partner reimbursement of Authority costs

Contracts might include a provision that requires the Partner to pay the Authority an amount to cover costs incurred in connection with the preparation of the EPC in the period up to financial close (e.g. for site investigations or site preparation works).

### **Eurostat's comments**

*Eurostat's view is that provisions for the Partner to make any such payment to the Authority **do not influence the statistical treatment if** the payment covers clearly identifiable costs incurred by the Authority that relate directly to the Partner's implementation of the EPC (e.g. the payment covers site investigations carried out by the Authority prior to financial close).*

*Where this is not the case (e.g. the payment is used by the Authority for other purposes such as paying its own advisory team fees), the issue is of HIGH importance to the statistical treatment of the EPC. A separate issue to consider in this situation is whether any such payment from the Partner to the Authority constitutes a loan that the Authority is then repaying through the Operational Payments it makes under the EPC. The statistical treatment of a loan would require assessment under separate Eurostat rules (outside the scope of the Guide).*

# Maintenance and operation of the EPC assets

## 3.1 Responsibility for maintenance and operation

Market practice varies widely when it comes to defining the scope of the Partner's maintenance and/or operational responsibilities under the EPC.

The scope of the Partner's obligations is typically influenced by factors including the scale and nature of the EPC assets themselves and the facilities management arrangements that the Authority has in place at the site. For example:

- a specialist stand-alone item such as a CHP boiler will typically be maintained by the Partner;
- a light emitting diode (LED) lighting system might be maintained by the Authority itself or by its facilities management provider for the site.

Where some maintenance of the EPC assets sits outside the scope of the Partner's obligations, the Authority typically undertakes to ensure that this maintenance is carried out (either by the Authority itself or by a sub-contractor) in accordance with the Partner's instructions and any relevant manufacturers' warranties etc.

In many cases the operation or use of the EPC assets is controlled by the Authority (e.g. the Authority might regulate the timer on a heating system or the hours of operation for a street-lighting system), but again this can depend on factors such as the scale and nature of the EPC assets.

The Authority is usually responsible for maintaining and operating the site excluding the EPC assets (e.g. the facilities, its own equipment, utility connections). Some (but not all) EPCs include this as an explicit obligation and provide the Partner with relief or compensation to the extent that the Authority fails to comply (see Themes 4.6 and 6.1).

In some EPCs the Partner's service obligations go beyond maintaining and/or replacing the EPC assets to include, for example, cleaning the EPC assets, monitoring and verifying performance, supplying energy. In some cases, the Partner's obligations include additional services that are unrelated to the EPC assets themselves (e.g. where the Partner takes on the role of facilities management for the site). The EPC will typically define standards for the performance of these services and apply sanctions for non-compliance with those standards (e.g. delayed response to a request for maintenance, failure to submit a report).

### **Eurostat's comments**

As stated in Chapter 2, in order for an energy efficiency arrangement to be considered an EPC for the purposes of the Rules, the Partner must be obliged to maintain the condition of (and, as necessary, replace) the EPC assets for the duration of the contract with a view to ensuring their ongoing ability to deliver the energy consumption and/or cost savings required under the EPC.

Where that is the case, the fact that the Partner's obligations include or exclude additional activities or services such as those mentioned above **does not influence the statistical treatment**.

Eurostat's view is that the Authority taking some responsibility for maintaining and/or replacing the EPC assets (either itself or through a sub-contractor) **does influence the statistical treatment** and is an issue of HIGH importance. An exception to this is (i.e. that **does not influence the statistical treatment**) is where the Authority undertakes light maintenance activities that do not affect the performance of the EPC assets in delivering energy consumption and/or cost savings required under the EPC (e.g. cleaning, fitting replacement lamps provided by the Partner for an LED lighting system).

The Authority controlling the use or operation of the EPC assets (e.g. regulating times at which systems operate) **does not influence the statistical treatment**.

The fact that the Authority remains responsible for maintaining and operating the site (excluding the EPC assets) either impliedly or expressly in the EPC, or that the EPC gives the Partner relief or compensation for the Authority's failure to do so, **does not influence the statistical treatment**.

The Authority taking responsibility for maintaining and/or replacing any asset or equipment that is provided by the Partner but is otherwise outside the scope of the Partner's responsibilities and not linked to the performance of the EPC assets, **does not influence the statistical treatment** of the EPC assets. However, the statistical treatment of the asset or equipment itself or the arrangements for the financing of the asset or equipment may require separate analysis (see comments in Chapter 1).

## 3.2 Maintenance standards

The EPC will typically specify standards to which the Partner is required to maintain the EPC assets. The specific standards vary significantly from EPC to EPC but usually include compliance with legislation, manufacturers' warranties etc. The consequences for the Partner of failing to meet those standards also varies from EPC to EPC. However, maintenance failures that result in the EPC assets failing to deliver the energy consumption and/or cost savings required under the EPC trigger a payment liability for the Partner and/or reduction in the Operational Payments (see Theme 5.6).

Some EPCs set out processes for regular monitoring and reporting of maintenance against the relevant standards. Although the detailed processes (including frequency and methodology of monitoring and reporting) can vary significantly from EPC to EPC, most rely on self-reporting by the Partner, with the Authority having rights to dual-monitor and/or audit the Partner's reports.

The specification, monitoring and reporting of the Partner's maintenance obligations is typically in addition to (but can be combined with) the specification, monitoring and reporting of the performance of the EPC assets in delivering the energy consumption and/or cost savings required under the EPC (see Theme 4).

### **Eurostat's comments**

*Eurostat's view is that:*

- *the standards to which the Partner is required to maintain the EPC assets must, as a minimum, establish conditions in which the EPC assets are genuinely capable of delivering the energy consumption and/or cost savings required under the EPC; and*
- *the regime for monitoring and reporting on the Partner's performance against those standards must allow the Authority to sanction the Partner for non-performance (as explained in detail in Theme 5.6).*

*An EPC that does not meet either of these conditions **does influence the statistical treatment** and is automatically ON BALANCE SHEET for government.*

### 3.3 Maintenance plan

Most EPCs impose both planned and reactive maintenance obligations on the Partner in order to ensure that the EPC assets meet the required standards.

In most EPCs, planned maintenance must be carried out in accordance with an agreed plan or programme. The maintenance plan or programme is typically updated by the Partner on a regular basis and issued to the Authority for approval.

#### **Eurostat's comments**

*Eurostat's view is that provisions that give the Authority a right to approve the maintenance plans or programmes **do not influence the statistical treatment** if the following conditions are met:*

- *The Authority's approval does not remove or reduce the Partner's liability for deficiencies in the EPC assets and/or delivery of related services. Where this is not the case, the issue is of HIGH importance to the statistical treatment; and/or*
- *The Partner is not obliged to incur the cost of maintenance at the scheduled time if it can demonstrate that deferring the maintenance will not have a negative impact on the condition or performance of the EPC assets and the services, the Authority or end-users. Where this is not the case, the issue is of MODERATE importance to the statistical treatment.*

### 3.4 Maintenance funds

A feature of some performance-based contracts such as PPPs (which is not currently observed in the EPC market but could be applied similarly to EPCs) is to impose an obligation on the Partner to reserve cash to fund its future maintenance obligations. This obligation, enforceable by the Authority, is distinct from the maintenance cash reserve requirements that may be imposed on the Partner by the finance providers.

Another feature of some performance-based contracts (again, not currently observed in the EPC market but with potential similar application to EPCs) is a right for the Authority to share the financial benefit of the Partner incurring lower costs than anticipated in maintaining the EPC assets. The Authority may, for example, be entitled to receive all or a share of the cost savings that arise if the actual costs incurred by the Partner in maintaining the asset to the required standards (assessed at intervals or at the end of the contract) are lower than the costs that were forecast when the contract reached financial close.

### **Eurostat's comments**

*Eurostat's view on provisions that require the Partner to create a maintenance fund **do influence the statistical treatment if** the contract also envisages that the Authority:*

- *takes risk in relation to the fund, for example by contributing to the fund to meet actual maintenance costs incurred (in which case the issue is of HIGH importance to the statistical treatment); or*
- *takes reward in relation to the fund, for example by taking a share or all of the surplus in the fund if the Partner spends less than anticipated on maintaining the asset (in which case the EPC is automatically ON BALANCE SHEET for government).*

*Independently of specific provisions for maintenance funds, any other mechanism through which the Authority is entitled to any share in cost savings generated through the Partner's management of maintenance risk (e.g. by taking all or a share of savings where maintenance costs incurred by the Partner are lower than anticipated) **does influence the statistical treatment** and leads to the EPC being automatically ON BALANCE SHEET for government.*

## **3.5 Partner performance guarantees**

Many EPCs require the Partner to provide the Authority with a third party guarantee that covers the performance of the maintenance and/or operation obligations placed on the Partner or its key sub-contractors. The guarantee may be issued by, for example, a bank or a company with an equity share in the Partner.

### **Eurostat's comments**

*Eurostat's view is that the provision of performance guarantees to the Authority **does not influence the statistical treatment.***

### 3.6 Staffing issues

Some EPCs contain provisions relating to the staff that will be involved in the performing the contract. These provisions can cover a variety of issues including:

- rights and obligations of each party in connection with staff transfers under relevant law during and at the end of the EPC;
- rights and obligations of each party in connection with the protection of employment and pension rights for staff that transfer to the Partner and new staff employed;
- staff pension liabilities;
- requirements for certain qualifications and skills and eligibility for individuals involved in the delivery of the EPC; and
- provision of information relating to staff involved in the delivery of the EPC.

#### **Eurostat's comments**

*Eurostat's view is that provisions dealing with staffing issues connected to the delivery of the project **do not influence the statistical treatment.***

# The Guaranteed Savings

The EPC typically contains a guarantee from the Partner that the EPC assets will deliver a minimum level of energy consumption and/or cost savings for the Authority over the lifetime of the contract. There is a form of EPC that has no such guarantee and simply allocates any savings achieved between the parties, but this type of “pure savings” EPC is rare in the current public sector market for EPCs.<sup>34</sup>

### **Eurostat’s comments**

*Eurostat’s view is that the absence of a guaranteed level of savings in the EPC **does not influence the statistical treatment** if the EPC imposes no payment obligations on the Authority (see Theme 5) and involves no government financing (see Theme 14). An EPC that has no guaranteed level of savings and imposes payment obligations on the Authority and/or involves government financing will be automatically recorded ON BALANCE SHEET for government*

## 4.1 Defining the guaranteed savings

The savings guaranteed in the EPC will most typically relate to a minimum reduction in volume of energy consumption (energy consumption savings). Energy consumption savings might be expressed in units of energy (e.g. kWh) or in monetary terms (e.g. a reduction in energy consumption is converted into EUR at an assumed energy price), and might relate to a particular form of energy (e.g. electricity, gas) or output (e.g. lighting, heating). Energy consumption savings also typically include savings of CO<sub>2</sub>. Where the EPC assets comprise measures across various forms of energy and/or various outputs, the guarantee tends to be expressed in monetary terms.

In some EPCs, the scope of the guarantee extends beyond energy consumption savings to include, for example:

- reductions in the Authority’s environmental liabilities (e.g. environmental taxes); and/or
- reduced energy costs resulting from on-site generation of energy by the EPC assets (e.g. electricity generation from renewables such as photovoltaic cells); and/or

<sup>34</sup> This form of EPC is therefore not considered further in this Theme.

- revenue generated from the export of surplus energy generated by the EPC assets (i.e. energy that is surplus to the site’s requirements); and/or
- (rarely) reductions in the Authority’s future capital and/or operational costs.

In some cases the EPC will treat these individual categories of savings and revenues separately from each other (e.g. the guaranteed energy consumption savings will be expressed separately from the guaranteed cost savings derived from on-site renewables and the performance in delivering one category of saving will not influence the assessment of performance in delivering other).

More commonly, the EPC will provide for a single guaranteed savings figure which reflects an aggregate of the energy consumption savings, other savings and revenues (the guaranteed savings).

Box 3 below contains a simple of example of how an EPC might approach guaranteed savings.

### Box 3: Guaranteed savings

A government agency enters into an EPC which involves the upgrade of its boilers, lighting systems and building management systems that will reduce energy consumption in its office buildings and reduce its environmental tax liabilities. The Partner will also install photovoltaics which produce low-cost energy for consumption in the buildings, with surplus energy being sold to the grid.

These measures are expected to produce the following energy consumption savings, energy cost savings and revenues for the government agency on an annual basis:

- Boiler efficiency (energy consumption saving) – EUR 80,000
- Lighting efficiency (energy consumption saving)– EUR 30,000
- Building management system upgrade efficiency (energy consumption saving) – EUR 15,000
- Reduction in environmental taxes ( energy cost saving) – EUR 10,000
- Sale of surplus energy (additional revenues) – EUR 15,000

In the EPC the Partner guarantees to deliver annual savings of EUR 150,000, which is the aggregate of the energy consumption savings, cost savings and additional revenues listed above.

Where the EPC assets are spread across a portfolio of sites, the savings and (if applicable) revenues achieved might be aggregated, meaning that savings and revenues achieved in relation to individual sites compensate for each other when it comes to testing performance against the guarantee.

The EPC will identify a baseline (in units of energy such as kWh or in monetary terms such as EUR) against which actual savings and (if applicable) revenues are compared and therefore performance in delivering the guaranteed savings is tested (see Themes 4.3 to 4.6).

On some EPCs the defined amount of guaranteed savings varies from year to year, usually increasing in later years of the contract.

#### **Eurostat's comments**

*Eurostat's view is that the EPC must guarantee an amount of savings which, at financial close, are calculated so as to satisfy the following conditions:*

- *on a net present value basis, the level of savings guaranteed over the duration of the EPC is equal to or greater than the sum of (a) the Operational Payments forecast to be made over the duration of the EPC and (b) any amount of government financing (see Theme 14) that is not repayable by the Partner (e.g. capital grant); and*
- *the level of savings guaranteed for each period over which performance against the guarantee is tested (see Theme 4.3) is equal to or greater than the Operational Payments that the Authority is forecast to make to the Partner in that period.*

*Guaranteed savings that are expressed in units of energy (e.g. kWh) in the EPC must be demonstrated to satisfy these conditions by applying a reasonably assumed baseline energy price. An EPC that does not meet either of these conditions **does influence the statistical treatment** and is automatically ON BALANCE SHEET for government.*

*In determining whether the above conditions are satisfied, the guaranteed savings must (in whole or in part) reflect energy consumption savings.<sup>35</sup> The conditions can, however, be satisfied by aggregating energy consumption savings with:*

- energy-related cost savings (e.g. savings derived from reduced environmental tax and other environmental liabilities, or savings derived from on-site energy generation by the EPC assets); and/or*
- revenues generated from the export of surplus on-site energy generation (provided that, on a net present value basis at financial close, these revenues are forecast to count towards less than 50% of the guaranteed savings). Where such revenues are forecast to count towards 50% or more of the guaranteed savings, the arrangement should be recorded ON BALANCE SHEET for government).*

*However, Eurostat's view is that the conditions above are not satisfied by aggregating energy consumption savings with savings that have no connection to energy demand or supply (e.g. reduced operating and maintenance costs).*

*The conditions above can be satisfied by aggregating energy consumption savings, other energy-related cost savings and revenues across a portfolio of sites.*

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<sup>35</sup> See Eurostat's comments at footnote 28 in Chapter 2. CHP plant is, for the purposes of the Rules and the Guide, treated as an asset that reduces energy consumption. As such, the savings generated from CHP plant (typically expressed in relation to particular forms of energy usage) are, for the purposes of the Rules and the Guide, treated as energy consumption savings even if the CHP plant itself does not reduce the volume of energy consumed by the existing facilities.

*An illustration of Eurostat's views on defining the guaranteed savings is provided in Box 4 below.*

#### **Box 4: Guaranteed savings example (Eurostat's view)**

*By way of illustration, take the example of the government agency in Box 3 above and assume (i) annual Operational Payments of EUR 130k (ii) no government financing and (iii) an Operational Phase of 10 years.*

*The conditions on the guaranteed savings expressed by Eurostat in this Theme 4.1 will be satisfied in this example as follows:*

- The savings guaranteed over the life of the contract (EUR 1.5 million) are greater than the sum of the Operational Payments and government financing over the life of the contract (EUR 1.3 million);*
- The amount of guaranteed savings for each year (EUR 150,000) are greater than the annual Operational payments (EUR 130,000);*
- The guarantee is calculated on the basis of some level of energy consumption savings;*
- The inclusion of energy-related cost savings derived from a reduction in environmental liabilities, in addition to the energy consumption savings, is permitted;*
- The inclusion of revenues from the sale of surplus energy to third parties is permitted on the basis that these revenues (EUR 15,000) constitute less than 50% of the total sum guaranteed (EUR 150,000).*

*The interaction between the guaranteed savings, Operational Payments and financing arrangements (including government and EU financing) is illustrated in the examples set out in Annex 2.*

## 4.2 Monitoring and measuring performance of the EPC assets

Ongoing monitoring and measurement of the EPC assets' performance in delivering energy consumption and/or cost savings is a core element of the EPC. It is typically defined as a service to be provided by the Partner but in some cases the EPC might provide for it to be undertaken by an independent third party.

The EPC defines the scope, frequency and standards of monitoring and measurement activities. These can be highly technical and can vary significantly from EPC to EPC. Reference is often made to independent industry-standard protocols such as the International Performance Measurement and Verification Protocol (IPMPV) as well as to applicable laws, manufacturers' specifications and guarantees and the Authority's access restrictions.

Most EPCs provide for monitoring and measurement activities to be carried out in accordance with an agreed plan. The plan is typically produced and updated by the Partner on a regular basis and issued to the Authority for approval. Performance is typically measured and reported on an annual basis. Assessment of performance is covered in Theme 4.3 below.

Monitoring and measuring performance of the EPC assets in delivering the guaranteed savings is typically additional to (but can be combined with) monitoring and reporting of the Partner's maintenance obligations (see Themes 3.2 and 3.3).

On some EPCs any under-performance in delivering the guaranteed savings that is detected during the ongoing monitoring and measurement might result in an obligation on the Partner to undertake remedial measures (see Theme 4.7).

### **Eurostat's comments**

*Eurostat's view is that the EPC must contain a regime that allows for objective and robust measurement of the EPC assets' performance in delivering the guaranteed savings. An EPC that does not contain such a regime **does influence the statistical treatment** and is automatically ON BALANCE SHEET for government.*

*Eurostat's view is that provisions that give the Authority a right to approve the monitoring and measurement plans or programmes **do influence the statistical treatment if** the Authority's approval removes or reduces the Partner's liability for failing to achieve the guaranteed savings. Where this is the case the issue is of HIGH importance to the statistical treatment.*

### 4.3 Testing performance of the EPC assets in delivering the guaranteed savings

The majority of EPCs provide for performance in delivering the guaranteed savings to be tested annually on each anniversary of completion of the construction and/or installation of the EPC assets.

Some EPCs allow for an initial “grace period” following completion, giving the EPC assets time to settle in to their full operation and performance, in which case the guarantee is tested on each anniversary of the end of the grace period. Some EPCs might allow for a similar grace period to apply when the Partner replaces a key sub-contractor or when lenders have stepped-in and replaced the Partner (see Theme 14.8).

At each test, the Partner is typically required to produce an annual report and savings statement, demonstrating whether the actual savings over the measurement period are equal to, higher or lower than the level of guaranteed savings.

In calculating performance against the guarantee, the EPC will typically allow adjustments for the following:

- energy prices (see Theme 4.4);
- “routine” matters (see Theme 4.5);
- “non-routine” matters (see Theme 4.6).

The consequences of performance (or under-performance or over-performance) in delivering the guaranteed savings are reflected in the payment mechanism (see Theme 5).

#### **Eurostat’s comments**

*Eurostat’s view is that the EPC must provide for routine testing of performance against the guarantee at least annually (with consequences of performance being dealt with through the payment mechanism as explained in Theme 5). An EPC with no mechanism for routine testing of performance against the guarantee, or that provides for testing less frequently than annually, will be automatically recorded ON BALANCE SHEET for government.*

*Eurostat’s view is that provision for a “grace period” that delays the testing of the performance of the EPC assets against the guarantee **does not influence the statistical treatment** if the period of time is reasonable in the specific circumstances (e.g. given the nature of the EPC assets, the duration of the EPC). To illustrate this, Eurostat’s view is that a grace period of up to a maximum of three months is*

*reasonable for an EPC with a duration of eight years. A proportionally longer grace period would be reasonable for an EPC with a longer duration. A grace period that is considered longer than reasonable is of MODERATE importance to the statistical treatment. These views apply to grace periods that apply at the start of the Operational Phase, those that apply when the Partner replaces a key subcontractor and those that apply when lenders replace the Partner.*

*When it comes to testing performance of the EPC assets in delivering the guaranteed savings, Eurostat's view (consistent with the views expressed in Theme 4.1) is that provision for:*

- aggregating actual energy consumption savings and other actual energy-related cost savings (e.g. savings/revenues from on-site energy generation); and/or*
- aggregating such savings across a portfolio of sites;*

***do not influence the statistical treatment.***

*However, provision to aggregate actual energy consumption savings with other cost savings that are unrelated to energy (e.g. reduced operating and maintenance costs) **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.*

## 4.4 Energy prices

In the vast majority of cases, the Authority takes the risk/benefit of fluctuations in future energy prices and these are neutralised in the guarantee mechanism (e.g. by recalculating the baseline data using actual prices for the purposes of testing performance against the guarantee).

Alternatively, the risk/benefit of fluctuations in energy prices is shared (e.g. by applying an agreed index to the baseline data for the purposes of testing performance against the guarantee).

It is rare in the current EPC market to see the Partner take the full risk on fluctuations in future energy prices.

### **Eurostat's comments**

*Eurostat's view is that the Authority taking or sharing the risk/benefit of fluctuations in future energy prices **does not influence the statistical treatment.***

## 4.5 Routine adjustments

The EPC will typically define a number of factors which lead to an adjustment of the guaranteed savings on a routine basis to reflect departures from assumptions that underpin the guarantee, for example:

- weather;
- indoor temperature and humidity set-points (comfort values);
- hours/days of usage/occupancy of the site; or
- number of occupants/users at the site.

In some cases a tolerance may apply before an adjustment is made (e.g. number of days where the temperature is above/below a temperature range).

The purpose of the adjustment is to put the parties in a “no better, no worse” position than if the assumption underpinning the guarantee had held true.

### **Eurostat’s comments**

*Eurostat’s view is that routine adjustments of the nature described above (i.e. external variables outside of the Partner’s control) **do not influence the statistical treatment.***

*Generally, and in accordance with the principles on compensation and relief explained in Theme 6.1, EPC provisions for routine adjustments **do not influence the statistical treatment if all of the following conditions are met:***

- *there is a finite number of well-defined events (i.e. the Authority should not be exposed to an indefinite number of risks);*
- *the events do not capture changes in macro-economic conditions;*
- *the events are not attributable to the acts or omissions of the Partner;*
- *the events, or the consequences of the events are not reasonably foreseeable or estimable. This is to be assessed by reference to a level of due diligence carried out before financial close that is reasonably appropriate given the specific circumstances (e.g. the ability of the parties to carry out investigations at the site before the EPC is signed); and*

- *the adjustments do not compensate for anything other than the effects of the event in question.*

*Provisions that do not meet one or more of the conditions listed above are issues of HIGH importance to the statistical treatment.*

## 4.6 Non-routine adjustments

The EPC will also typically define a number of factors for which the guaranteed savings may need to be adjusted on an ad-hoc basis to reflect one-off or non-recurring departures from assumptions underpinning the guarantee. These are typically factors that are linked to the Authority's behaviour and/or operations such as:

- Authority breach or interference with the Partner's operations (e.g. failing to maintain the site, failing to give the Partner access to the site);
- inaccurate baseline data provided by the Authority;
- adverse site conditions (e.g. contamination, asbestos, latent defects or deficiencies in existing structures/equipment);
- additional works carried out by the Authority at the site;
- change in law (see Theme 8);
- failure by the Authority to operate the EPC assets within agreed parameters (e.g. bypassing controls, interfering with sensors);
- alteration of the EPC assets or the site by the Authority;
- the Authority vacating all or part of the site;
- changes in the electrical and/or heat baseload of the site; and
- non-typical variations in the number of occupants/users at the site;
- other delay, relief, compensation or force majeure events (see Theme 6).

As well as resulting in adjustment to the calculation of savings achieved against the guarantee, these types of events may also give rise to additional relief and/or compensation through other mechanisms (see Theme 6), the purpose being to put the Partner in a position that is a "no better, no worse" position than if the relevant event had not occurred.

### **Eurostat's comments**

*Eurostat's view is that non-routine adjustments of the nature described above (i.e. external variables outside of the Partner's control) **do not influence the statistical treatment.***

*Generally, and in accordance with the principles on compensation and relief explained in Theme 6.1, EPC provisions for non-routine adjustments **do not influence the statistical treatment if** all of the following conditions are met:*

- there is a finite number of well-defined events (i.e. the Authority should not be exposed to an indefinite number of risks);*
- the events do not capture changes in macro-economic conditions;*
- the events are not attributable to the acts or omissions of the Partner;*
- the events, or the consequences of the events are not reasonably foreseeable or estimable. This is to be assessed by reference to a level of due diligence carried out before financial close that is reasonably appropriate given the specific circumstances (e.g. the ability of the parties to carry out investigations at the site before the EPC is signed); and*
- the adjustments do not compensate for anything other than the effects of the event in question.*

*Provisions that do not meet one or more of the conditions listed above are issues of HIGH importance to the statistical treatment.*

## **4.7 Rectifying poor performance**

Some EPCs require the Partner to undertake remediation or rectification measures to improve the performance of any EPC assets that are found to be under-performing (i.e. failing to achieve the guaranteed savings). Any remediation or rectification measures are typically agreed with the Authority.

### **Eurostat's comments**

*Eurostat's view is that rectification provisions of the nature referred to above **do not influence the statistical treatment.***

## 4.8 Continuous improvement

Some EPCs contain an express commitment from the Partner to pursue continuous improvement in the energy efficiency of the site. This is usually met through the provisions on ongoing monitoring and measuring of performance, when the Partner keeping the Authority informed of any scope for improvement. If there is scope for improvement (e.g. through replacing the EPC assets with newer technology or investing in additional measures) then this is typically agreed through the change mechanism (see Theme 7).

### **Eurostat's comments**

*Eurostat's view is that continuous improvement provisions of the nature referred to above **do not influence the statistical treatment.***

# The payment mechanism

## 5.1 Structure of the Operational Payments

The Operational Payments are defined in the EPC as an amount (typically expressed annually) which then adjusted for:

- indexation (see Theme 5.3);
- pass-through costs (see Theme 5.4); and
- deductions for failures in service delivery (see Theme 5.5).

The Operational Payments are designed to reimburse the Partner's costs of delivering the EPC and provide the Partner with an element of profit. The annual amount is typically due in equal monthly or quarterly instalments.

On some EPCs, the Partner's obligations extend to providing services that are unrelated to the EPC assets (e.g. the Partner takes responsibility for facilities management of the site). For the purposes of the Rules and the Guide, the Operational Payments do not include any clearly identifiable and quantifiable amounts paid by the Authority to the Partner for such services.

## 5.2 Commencement of Operational Payments

In EPCs, the Partner's right to start receiving the Operational Payments is triggered on or after the date that the construction and/or installation of the EPC assets is complete (see Theme 2.3).

In some cases, the Partner is required to provide some services in relation to existing infrastructure during the Construction Phase, which the Authority pays for as and when they are provided (i.e. payments for these services are made during the Construction Phase). These services might be subject to a different regime to the one that applies to the services that the Partner is later required to provide for the EPC assets once they are complete. As an example, an EPC might provide for the upgrade of a street lighting system in two phases. During the upgrade of phase one, the Partner might receive an interim fee for light maintenance on the phase two assets, which it will continue to receive up to the point that it starts the upgrade of phase two.

### **Eurostat's comments**

*Eurostat's view is that the Partner should not be entitled to receive Operational Payments before the date on which construction and/or installation of the EPC assets is complete (see Theme 2.3). Therefore, an obligation on the Authority to start making Operational Payments in respect of the EPC assets before the date on which they are complete **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.<sup>36</sup>*

*Eurostat's view is that provisions for payments to the Partner for services linked to existing infrastructure during the Construction Phase, as described above, **do not influence the statistical treatment**. However, any interim payments that are in effect reimbursements for capital expenditure incurred by the Partner on that infrastructure will constitute government financing (see Theme 14).*

## **5.3 Indexation**

Most EPCs provide for regular indexation of the Operational Payments. The indices used, the proportion of the Operational Payments that is indexed, and the frequency with which the indexation provisions are applied, varies from contract to contract.

Indexation is also typically applied to:

- other payments due by either party, for example liquidated damages due by the Partner (see Theme 2.2), lump sum payments due by the Authority (see Theme 14.1.1); and
- amounts specified for other purposes such as defining triggers for early termination of the EPC or defining minimum levels of insurance cover.

### **Eurostat's comments**

*Eurostat's view is that provisions for the indexation of the Operational Payments **do not influence the statistical treatment if** the provisions are based on an index or indices generally recognised in the relevant jurisdiction or sector. Where this is not the case, the issue is of MODERATE importance to the statistical treatment.*

<sup>36</sup> Theme 2.3 refers to an exception to this, which is where the EPC assets are constructed and/or installed in phases.

*The application of different generally recognised indices for different elements of the Operational Payments **does not influence the statistical treatment.***

*Provisions for the indexation of other payments and amounts (as mentioned above) **do not influence the statistical treatment.***

## 5.4 Pass-through costs

Some EPCs make provision for certain costs to be charged to the Authority on a pass-through basis, meaning that the Operational Payments are adjusted on the basis of the actual costs incurred by the Partner.

The most common example of this is where energy supply is a service delivered by the Partner, in which case the energy supply costs (i.e. costs charged by third party energy providers to the Partner) are added to the Operational Payments.<sup>37</sup>

In rare cases, EPCs make provision for the Partner's cost of delivering the services to be paid for by the Authority on a pass-through basis (e.g. costs of maintaining or replacing the EPC assets, costs of energy monitoring services). These provisions adjust the Operational Payments from time to time to reflect actual costs of delivering the services as and when they are incurred by the Partner. For example, if the Partner needs to replace a component of a boiler in year six of the contract, the cost to the Partner of doing so is reflected in the Operational Payment at that time.

### **Eurostat's comments**

*Eurostat's view is that provisions for the Authority to reimburse the Partner for energy supply costs, where this is included as a service in the EPC, **do not influence the statistical treatment.***

*However, provisions that treat other costs that the Partner incurs in providing the services (e.g. maintaining and/or replacing the EPC assets, monitoring/measurement of energy consumption) on a pass-through basis **do influence the statistical treatment** and lead automatically to the EPC being ON BALANCE SHEET for government. An exception to this is for costs that the Guide states can be reimbursed by the Authority without an influence on the statistical treatment (e.g. the costs of implementing an Authority change, as referred to in Theme 7).*

<sup>37</sup> For the purposes of the Rules and the Guide, the Operational Payments do not include clearly identifiable and quantifiable payments made by the Authority to the Partner for energy supply.

## 5.5 Service delivery failures

### 5.5.1 Defining service delivery standards

The Partner's obligation to ensure that the EPC assets deliver guaranteed savings (see Theme 4) is at the core of the EPC. In addition, some EPCs specify standards for the delivery of services by the Partner and apply deductions to the Operational Payments for failures to meet some or all of those standards.

Some of these standards may be intrinsically linked to the performance of the EPC assets in delivering the guaranteed savings (e.g. an obligation to provide a reactive repair service for the EPC assets). Others may be more general in nature (e.g. submitting monthly reports to the Authority, complying with the Authority's on-site access rules).

Some obligations must be met routinely and are therefore measured routinely (e.g. an obligation to submit monthly reports to the Authority). Others are met and measured on an ad-hoc basis (e.g. responding to maintenance requests).

The EPC typically sets out a process for regular monitoring and reporting on the quality of the Partner's service delivery against the relevant standards. The details of the process (including frequency and methodology of measuring and reporting) can vary significantly from contract to contract, but most rely on self-reporting by the Partner and give the Authority rights to dual-monitor and/or audit the Partner's report. See Theme 3.

Not all EPCs specify, measure and sanction/reward service delivery, but focus solely on performance of the EPC assets in delivering guaranteed savings.

### 5.5.2 Quantifying deductions for service failures

The EPC will typically allocate a fixed monetary value to each service failure (or category of failure) and deduct that amount from the Operational Payments on the occurrence of each failure. An alternative approach is to have a system which allocates points to each service failure and a monetary value to the points, and then deducts from the Operational Payments the amount corresponding to the number of points accrued. Both approaches can include weightings that reflect the significance or impact of the failure (e.g. the time at which the failure occurs, the period for which the failure continues, the frequency with which the failure has been occurring).

### 5.5.3 Rectification periods

The EPC will typically specify time periods for the Partner to repair or rectify service failures, and apply deductions only if repairs or rectification are not carried out within those time periods. Those time period might be pre-defined (e.g. four hours, two days) or defined more generally (e.g. as a reasonable period of time in the circumstances).

In some EPCs, the time periods are embedded in the way in which service failures are defined (i.e. the service failure is only deemed to have occurred if the failure is not repaired or rectified within the relevant time period). An approach taken in other contracts is to state that a service failure has occurred, but to provide that deductions will only be applied if the failure is not repaired or rectified within the relevant time period.

Finally, some EPCs allow the Partner an initial period of time to find a temporary solution to a failure and a further time period to implement a full repair or rectification.

### 5.5.4 Ratchets and multipliers

Some EPCs contain provisions (often referred to as “ratchets” or “multipliers”) that increase the deduction amounts for service failures that continue for a prolonged period of time. The deduction amounts are sometimes also increased for service failures that occur repeatedly.

### 5.5.5 Excusing causes

The Partner will usually be relieved from deductions for service failures that it has not caused. There are a variety of ways in which the EPC can achieve this, for example:

- The service failure may be deemed not to have occurred;
- The service failure is deemed to have occurred but is ignored for the purpose of calculating deductions; or
- The service failure is deemed to have occurred and a deduction is made, but the Partner has the right to recover the deduction from the Authority through another route (e.g. a compensation event mechanism, as referred to in Theme 6).

Common examples of situations where such relief is give include service failures directly caused by:

- Authority breach or interference with the Partner’s operations (e.g. failing to maintain the site, failing to give the Partner access to the site);

- adverse site conditions (e.g. contamination, asbestos, latent defects or deficiencies in existing structures/equipment);
- additional works carried out by the Authority at the site;
- change in law (see Theme 8);
- alteration of the EPC assets or the site by the Authority;
- planned maintenance of the EPC assets by the Partner;
- other relief, compensation or force majeure events (see Theme 6).

#### 5.5.6 Grace periods

Some EPCs provide relief from service failure deductions for certain periods of time during the Operational Phase (commonly referred to as “grace periods”).

A grace period might be a period of time at the start of the Operational Phase during which deductions are not applied (or are not applied in full), or where deductions are made but the failures/deductions accrued during that period are ignored for the purposes of triggering early termination of the EPC.

The grace period provisions sometimes also apply when the Partner replaces a key sub-contractor and/or when lenders replace the Partner after having stepped into the EPC (see Theme 14.8).

#### 5.5.7 Tolerances / de minimis exceptions

Some EPCs provide that no service failure deductions are applied for a period if the number of service failures or performance points or the amount of deductions accrued in that period is below a specified threshold. For example:

- No service failure deductions are applied if fewer than x performance failures have occurred in the month; or
- No deductions are applied if the total amount of service failure deductions accrued in the month is less than EUR x.

### 5.5.8 Caps on deductions

It is common for EPCs to cap the Partner's exposure to service failure deductions. The mechanism used to cap such deductions, and the level at which they are capped, varies significantly from contract to contract. For example:

- deductions for a month are applied only to a certain percentage of the notional monthly Operational Payment; or
- deductions for a month period are capped at a specified amount.

With either approach, the EPC might allow service failure deductions that exceed the cap in one month to be carried forward and off-set in future months.

#### **Eurostat's comments**

*Eurostat's view is that the inclusion or absence of contractual standards to define and measure the delivery of services (in addition to the performance of the EPC assets in delivering guaranteed savings) **does not influence the statistical treatment.***

*As a result, users should note that the typical payment mechanism provisions described in Themes 5.5.1 to 5.5.8 **do not influence the statistical treatment** to the extent that they relate to delivery of services only (as opposed to delivery of guaranteed savings, which is dealt with in Theme 5.6).*

## 5.6 Performance in delivering the guaranteed savings

The guarantee of energy consumption and/or cost savings is at the core of the EPC. Theme 4 describes the approaches taken to defining the scope of the guarantee and measuring performance of the EPC assets in terms of delivering the guaranteed savings. This Theme 5.6 addresses how the consequences of that performance against the guarantee are typically reflected in the EPC's payment mechanism.

In broad terms, the baseline Operational Payments represent the "steady state" situation where actual savings are equal to the guaranteed savings. In this situation, the Operational Payments are due by the Authority to the Partner (adjusted for indexation, energy-supply costs and service failure deductions) and no further amount is due by either party to the other.

The payment mechanism also contains provisions that foresee under-performance against the guarantee (i.e. where actual savings are less than guaranteed savings, including where no savings are achieved and energy consumption and/or costs increase) and over-performance against the guarantee (i.e. where actual savings are greater than guaranteed savings).

### 5.6.1 Timing of guarantee-related payment adjustment

In most EPCs, the Authority starts to pay the Operational Payments from the start of the Operational Phase (typically on a monthly or quarterly basis) and performance in delivering the guaranteed savings is tested on each anniversary of the start of the Operational Phase (see Theme 4.3). This means that for each year of the Operational Phase, the Operational Payments are typically paid by the Authority in advance of the performance of the EPC assets being tested. As such, any adjustment to the payments to reflect performance in delivering the guaranteed savings happens only annually and on a “look-back” basis.

#### **Eurostat’s comments**

*Eurostat’s view is that the fact that the Operational Payments for the relevant period are paid before the achievement of guaranteed savings for that period has been tested **does not influence the statistical treatment.***

*However see Theme 4.3 for Eurostat’s views on the frequency with which performance against the guarantee is tested.*

### 5.6.2 Savings shortfalls

The situation where actual savings are less than the guaranteed savings is typically approached in one of two ways.

#### Approach 1

Some EPCs envisage that an amount equal to the monetary value of the difference between the guaranteed savings and the savings achieved (the savings shortfall) for the relevant period is a payment due by the Partner to the Authority.

In most cases, the amount due by the Partner can be carried forward and set-off against future Operational Payments due by the Authority. Some EPCs provide that savings shortfalls can be carried forward and set-off against only part (e.g. 20%) of the future Operational Payments, the result being that savings shortfalls cannot reduce the future Operational Payments in full.

This approach is illustrated in the example provided in Box 5 below.

#### Box 5: Approach 1 to savings shortfalls

An EPC specifies annual guaranteed savings of EUR 1.4 million. The annual Operational Payment is EUR 1.2 million, paid in 12 monthly instalments from the start of the Operational Phase.

In year one the Authority pays the Partner monthly instalments of EUR 100,000. At the end of year one, the actual savings are calculated to be EUR 1.2 million after adjustment (i.e. a savings shortfall of EUR 200,000 has arisen).

In year two, the EUR 200,000 savings shortfall is set-off against the Operational Payments due by the Authority to the Partner for that period. The payment mechanism might achieve this set-off by, for example:

- reducing each of the monthly payments in year two to EUR 83,000; or
- reducing the first two monthly payments in year two EUR 0;

If the payment mechanism limits set-off to part of the future payments (e.g. 20%) then a maximum of EUR 20,000 can be deducted from each monthly instalment and so the savings shortfall will be recovered by reducing the monthly instalments for the first 10 months of year two to EUR 80,000.

Some EPCs impose a time limit (e.g. one to two years) after which any amount of a savings shortfall which has not been set-off against the Operational Payments becomes due for immediate payment by the Partner. Others allow for savings shortfalls to be carried forward for the duration of the EPC (e.g. a shortfall in year one that has not set-off in full by year five can be carried forward again into year six and so on), with any residual savings shortfall due as a payment by the Partner at the end of the EPC.

In some cases, the amount due by the Partner for savings shortfalls can also be:

- set-off against any savings excesses that have accrued to date; and/or
- carried forward and set-off against any savings excesses that occur in the future.

Theme 5.6.3 describes typical provisions to deal with savings excesses.

## Approach 2

More rarely, there are examples of EPCs that do not structure the savings shortfall as a payment due by the Partner but instead provide for a savings shortfall to be reflected in a downward adjustment to the baseline Operational Payments for the following period. This might be achieved by:

- deducting the monetary value of the savings shortfall in the calculation of the baseline Operational Payments for the following period. For example, if the savings achieved for year “n” amount to EUR x less than savings guaranteed for year “n” then the baseline Operational Payments due in year “n+1” are reduced by EUR x (and paid in equal instalments monthly or quarterly); or
- reducing the notional Operational Payments for the following period by a factor that reflects the extent to which savings have not been achieved. For example, if the savings achieved for year “n” are 50% of the savings guaranteed for year “n” then the baseline Operational Payments due in year “n+1” are reduced by 50% (and paid in equal instalments monthly or quarterly).

This approach is illustrated in the example provided in Box 6 below.

### **Box 6: Approach 2 to savings shortfalls**

An EPC specifies annual guaranteed savings on EUR 1.4 million. The annual Operational Payment is EUR 1.2 million, paid in 12 monthly instalments from the start of the Operational Phase.

In year one the Authority pays the Partner monthly instalments of EUR 100,000. At the end of year one, the actual savings are calculated to be EUR 1.2 million after adjustment (i.e. a savings shortfall of EUR 200,000 has arisen).

In year two, the annual Operational Payment due by the Authority to the Partner is reduced (as described in the text above) to either:

- a) EUR 1 million and paid in 12 monthly instalments of EUR 83,000 (reflecting the amount of the savings shortfall); or
- b) EUR 1.028 million and paid in 12 monthly instalments of EUR 85,700 (reflecting direct proportionality to the extent to which the guaranteed savings have been achieved).

### **Eurostat's comments**

*Eurostat's view is that the principle of proportionality is fundamental to the EPC provisions that deal with the performance of the EPC assets in delivering guaranteed savings. This means that the Partner's liability for a savings shortfall must be proportional (or over-proportional) to the proportion of guaranteed savings that have been achieved. If an EPC does not comply with this principle of proportionality it will be automatically ON BALANCE SHEET for government.*

*Eurostat's view is that this principle can be achieved using either Approach 1 (where the Partner's liability for a savings shortfall is structured as a payment due by the Partner) or Approach 2 (where the Partner's liability for a savings shortfall is structured as a reduction in future Operational Payments). Over-proportionality is demonstrated in the examples of Approach 1 in Box 5 above and the example of Approach 2(a) in Box 6 above. Proportionality is demonstrated in the example of Approach 2(b) in Box 6 above.*

*In addition, the following points on the provisions to deal with savings shortfalls using Approach 1 must be noted:*

- the EPC must allow the Authority to set-off the Partner's liability for a savings shortfall against future Operational Payments. Provisions that do not allow for this **do influence the statistical treatment** and lead automatically to the EPC being ON BALANCE SHEET for government; and*
- the EPC must impose a time limit on the carry-forward and set-off of savings shortfalls, meaning that the Authority must have appropriate recourse against the Partner if any amount of a savings shortfall has not been set-off within a maximum period of one year from when the savings shortfall is determined. That recourse might be through a demand for immediate payment from the Partner and/or a right for the Authority to terminate the EPC. The same principle of a time limit applies to provisions that allow savings shortfall to be carried forward and set-off against future savings excesses. Provisions that do not provide for such a time limit **do influence the statistical treatment** and lead automatically to the EPC being ON BALANCE SHEET for government.*

*Under either Approach 1 or Approach 2, failure to make the Partner liable for any residual savings shortfall at the end of the EPC **does influence the statistical treatment** and leads automatically to the EPC being ON BALANCE SHEET for government.*

*Eurostat's view is that provision for the savings shortfall to be set-off against excess savings that have already accrued under the EPC (see Theme 5.6.4) **does not influence the statistical treatment**.*

### 5.6.3 Caps on savings shortfalls

Some EPCs limit the Partner's liability for savings shortfalls.

Under Approach 1 (described in Theme 5.6.2) this might be expressed as a financial cap applied annually or over the duration of the EPC.

Under Approach 2 (described in Theme 5.6.2) this might materialise through provision that the notional Operational Payments cannot, on adjustment for a savings shortfall, fall below a specified amount (or below zero).

#### **Eurostat's comments**

*Eurostat's view is that any provision that caps the Partner's liability for the full amount of any savings shortfalls undermines the principle of proportionality described in Theme 5.6.2. Any such provision (including, for example, one that limits the Partner's liability to the value of the notional Operational Payment) therefore **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.*

### 5.6.4 Savings excesses

The vast majority of EPCs provide for the parties to share the benefit of the EPC assets generating a higher level of savings than the guaranteed savings. In most cases the underlying energy bills are paid by the Authority, in which case the full benefit of the excess savings accrues automatically to the Authority. The EPC therefore usually makes provision for Partner to receive its share of the difference between the guaranteed savings and actual savings for the relevant period (the savings excess) by way of a payment from the Authority. The proportion in which the savings excess is shared varies widely from contract to contract.

Beyond a straightforward split of excess savings, some EPCs introduce provisions such as:

- the proportions in which the savings excess is shared vary depending on the amount of the savings excess;
- allocating some or all of the savings excess to off-set savings shortfalls that have been carried forward from previous years (see Theme 5.6.2);

- allocating some or all of the savings excess to compensate the Partner for savings shortfalls that have occurred in previous years and for which it has already suffered the financial consequences (see Theme 5.6.2);
- setting aside (notionally or actually) a proportion of the savings excess to hold in reserve for the purposes of off-setting future savings shortfalls (with any residual reserve being allocated between the parties at the end of the EPC).

Some EPCs do not contain a sharing mechanism but instead provide for a bonus payment (not expressed as a proportion of the savings excess) by the Authority to the Partner when a savings excess occurs.

There are (rare) examples of EPCs in which the Partner is entitled to no share of the savings and no bonus payment.

#### **Eurostat's comments**

*Eurostat's view is that there are two different approaches to sharing savings excesses that **do not influence the statistical treatment**:*

- *The first approach is where the EPC states that the Authority is entitled to the share of any savings excesses that result from identifiable and measurable actions of the Authority (e.g. where the Authority changes the maximum/minimum temperatures to be maintained in a building or reduces the operational hours of a building);*
- *The second approach is where the EPC states that the Partner is entitled to a specified share of any savings excesses that arise. The Partner's share must be no less than two thirds (correspondingly, if the EPC refers to the Authority's share then this must be no greater than one third). Under this approach no assessment is made of whether a savings excess results from the actions of the Authority or the Partner or other factors. Under this approach, specifying that the Partner is entitled to a share of less than two thirds (or, correspondingly, that the Authority is entitled to a share of more than one third) of any savings excesses automatically leads to the EPC being ON BALANCE SHEET for government.*

*A sharing mechanism which varies the proportions in which the savings excesses are shared depending on the level of savings excesses achieved **does not influence the statistical treatment if** the Partner's share is always equal to or greater than two thirds. Where this is not the case the EPC will automatically be ON BALANCE SHEET for government.*

*Provisions that allocate savings excesses to:*

- off-set savings shortfalls that have been carried forward from previous years; and/or*
- compensate the Partner for savings shortfalls that have occurred in previous years and for which it has already suffered the financial consequences (e.g. through having made a payment to the Authority and/or suffered a downward adjustment to the Operational Payments, as described in Theme 5.6.2);*
- a reserve (notional or actual) for the purposes of off-setting future savings shortfalls;*

***do not influence the statistical treatment.*** However, see Eurostat's comments at Theme 5.6.2 above relating to the one year time limit carry-forward of savings shortfalls. Further, if the Authority is entitled to receive a share any greater than one third of any residual amount in any notional or actual reserve account the EPC will be automatically ON BALANCE SHEET for government.

*Provision to award the Partner a bonus payment that is not readily identifiable as a proportion of savings excesses **does influence the statistical treatment** and leads to the EPC being automatically ON BALANCE SHEET for government.*

### 5.6.5 Caps on savings excesses

Some EPCs cap the Partner's share of savings excesses. This is sometimes achieved by expressing a cap with a monetary value (applied annually and/or over the duration of the contract) and sometimes achieved by providing for the EPC to expire once a certain level of savings have been achieved.

#### **Eurostat's comments**

*Eurostat's view is that any provision that imposes a cap on the Partner's share of excess savings **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.*

*Likewise, provisions that link the expiry date of the EPC to a level of savings having been achieved is akin to a cap on the Partner's share of savings and automatically leads to the EPC being ON BALANCE SHEET for government (see Themes 13.1 and 15.4).*

## 5.7 Late payments

Late payment by either party will typically attract interest calculated from the due date for payment until payment is made in full. The interest rate applicable varies from contract to contract but typical examples include the rate prescribed by underlying law, or a percentage above underlying interest rates, or the default payment rate contained in the Partner's financing agreements.

### **Eurostat's comments**

*Eurostat's view is that provisions for interest on late payments (including the interest rate applied) **do not influence the statistical treatment.***

## 5.8 Disputed payments

The EPC typically allows either party to refer any disputes on amounts due by either party to the other to an independent dispute resolution procedure. In some contracts, pending resolution of a dispute, the disputed amount can be withheld but any undisputed amount must be paid.

### **Eurostat's comments**

*Eurostat's view is that provisions on disputed payments, as described above, **do not influence the statistical treatment.***

## 5.9 Payment mechanism reviews

Some EPCs provide for a renegotiation of the guarantee if savings excesses occur in one or consecutive periods. This type of provision protects the Authority from savings being understated in defining the guaranteed savings.

### **Eurostat's comments**

*Eurostat's view is that provision for an increase in the level of guaranteed savings in order to reflect the occurrence of savings excesses in one or consecutive periods **does influence the statistical treatment if the adjustment reflects more than a one third share of the savings excesses and leads automatically to the EPC being ON BALANCE SHEET for government.***



# Compensation, relief and force majeure events

## 6.1 Mechanisms for compensation, relief and force majeure events

Most EPCs contain mechanisms by which certain risks, linked to the provision and performance of the EPC assets and/or delivery of the services, are either taken by the Authority or are shared between the Authority and the Partner. The mechanisms (and terminology used to describe them) vary from contract to contract but many jurisdictions have adopted a three-tier approach which the Guide categorises as “compensation events”, “relief events” and “force majeure events”.

### 6.1.1 Compensation events

The following types of event are commonly treated as compensation events:

- Authority breach of the EPC;
- change in law;
- delays in the Authority giving site access to the Partner;
- delays in third party approvals or permitting processes;
- site conditions that are unforeseeable or for which the consequences are not estimable (e.g. archaeological discoveries, geological conditions, contamination, utilities relocations, latent defects or deficiencies in existing structures/equipment);
- additional works at the site (that do not form part of the EPC assets);
- alternation of the EPC assets or the site by the Authority;
- the Authority vacating or selling all or part of the site; and
- vandalism to the EPC assets.

The compensation event mechanism typically puts the full risk of an event on the Authority, meaning that the Partner is to be put in the same position as it would have been had the event not occurred.

The EPC typically achieves this by giving the Partner relief and/or financial compensation as follows:

- If the event causes delay to the construction and/or installation, the Partner is given an extension of time for the construction milestones and/or required completion date and (if applicable) relief from paying any liquidated damages (or other form of penalty) to the Authority;
- If the event causes service failures or other performance issues, the Partner is given relief from any deductions that would otherwise occur under the payment mechanism and relief from its failure to perform (e.g. relief from early termination of the EPC); and
- If the event causes an increase in the Partner's costs (construction or operational) or loss in the Partner's revenues, the Partner receives full financial compensation from the Authority.

If an event of this nature affects the performance of the EPC assets in delivering the guaranteed savings, this will typically be reflected in an adjustment to the guarantee at the time performance is tested (see Theme 4.6).

### 6.1.2 Relief events

The following types of event are commonly treated as relief events where they affect the Partner's performance of the EPC and have not been caused by the Partner's actions or failures:

- fire;
- explosion;
- bursting or overflowing water tanks, apparatus or pipes;
- accidental loss or damage to the EPCs assets or other assets on which the Partner relies for the performance of its obligations;
- failure or shortage of power, fuel or transport; and
- industry-wide labour disputes or strikes.

The relief event mechanism typically shares the risk of an event between the Authority and the Partner, meaning that the Partner is often expected to bear (fully or partly) the financial consequences of the event but is given relief from the other contractual consequences of the event.

EPCs typically provide relief for the Partner as follows:

- If the event causes delay to the construction and/or installation, the Partner is given an extension of time for the construction milestones and/or required completion date and (if applicable) relief from paying any liquidated damages (or other form of penalty) to the Authority;
- If the event causes service failures, deductions are usually still applied to the Operational Payments (or, in some EPCs, deductions are partially applied) but the Partner is given relief from its failure to perform (e.g. relief from early termination if the EPC would otherwise give the Authority the right to terminate for the deductions or service failures that has been caused by the relief event);
- Most EPCs leave the Partner to bear any increase in costs or loss in revenues caused by the event but some give the Partner the right to receive a limited amount of financial compensation (lower than for a compensation event). These EPCs may, for example, provide compensation once the event has continued for x days, provide compensation for costs exceeding EUR y, or provide compensation equivalent to z% of the Operational Payments that would have been due had the relief event not occurred; and
- If the event continues for an extended period of time (typically 6 to 12 months), some contracts allow either party to treat it as a force majeure event (see Theme 6.1.3).

If an event of this nature affects the performance of the EPC assets in delivering the guaranteed savings, this will typically be reflected in an adjustment to the guarantee at the time performance is tested (see Theme 4.6).

### 6.1.3 Force majeure events

The following types of event are commonly treated as force majeure events where they affect either party's ability to perform its obligations under the EPC and have not been caused by the actions or failures of the party claiming relief:

- war, civil war, riot, armed conflict, revolution, terrorism, protests;
- nuclear explosions, ionising radiations or radioactive, chemical or biological contamination;
- pressure waves caused by airplanes travelling at supersonic speeds;

- plane crash; and
- natural disasters such as earthquakes, landslides, lightning, floods, storms, cyclones and other extreme climatic or environmental circumstances recognised as natural disasters by the authorities.

The force majeure event mechanism typically shares the risk of an event between the Authority and the Partner, meaning that the Partner is often expected to bear some or all of the financial consequences of the event but is given relief from the other contractual consequences of the event (e.g. relief from early termination of the EPC). What typically distinguishes the force majeure event mechanism from the other mechanisms is that either party has the right to elect to terminate the EPC if the event continues for an extended period of time.

The force majeure event mechanism typically grants relief as follows:

- If the event causes delay to the construction and/or installation, the Partner is given an extension of time for the construction milestones and/or the required completion date and (if applicable) relief from paying any liquidated damages (or other form of penalty) to the Authority;
- If the event causes a breach of the EPC (e.g. service failures), the relevant party's failure to perform is excused (although in some EPCs deductions for service failures will still be applied);
- Some EPCs leave the Partner to bear any increase in costs or loss in revenues caused by the event. Others give the Partner the right to financial compensation from the Authority, with some giving the Partner full compensation and others giving partial compensation only (e.g. to cover debt servicing costs); and
- If the event continues for an extended period of time (typically 6 to 12 months), either party has the right to terminate the EPC. The period of time is usually shorter in contracts where the Partner is not entitled to financial compensation in the intervening period.

If an event of this nature affects the performance of the EPC assets in delivering the guaranteed savings, this will typically be reflected in an adjustment to the guarantee at the time performance is tested (see Theme 4.6).

In some jurisdictions the Partner has the right to claim relief from force majeure events through provisions in the underlying law (see Theme 6.2). In these cases, the events giving rise to relief, and the relief available, are determined by the underlying law.

### **Eurostat's comments**

Regarding Themes 6.1.1, 6.1.2 and 6.1.3, Eurostat's view is that provisions by which the Authority takes or shares the risk of events that affect the delivery of the EPC **do not influence the statistical treatment** if all of the following conditions are met:

- There is a finite number of well-defined events (i.e. the Authority should not be exposed to an indefinite number of risks);
- The events do not capture changes in macro-economic conditions;
- The events are not attributable to the acts or omissions of the Partner; and
- The events, or the consequences of the events, are not reasonably foreseeable or estimable. This is to be assessed by reference to a level of due diligence carried out before financial close that is reasonably appropriate given the specific circumstances of the project (e.g. the ability of the parties to access the site for investigations before the EPC is signed).

Eurostat's view is that the examples of compensation events, relief events and force majeure events listed in Themes 6.1.1, 6.1.2 and 6.1.3 satisfy the above conditions. Provisions that do not meet these conditions are issues of HIGH importance to the statistical treatment.

The choice to treat any event that satisfies the above conditions as either a compensation event, a relief event or a force majeure event (according to the descriptions provided above) **does not influence the statistical treatment**. However, users should refer to Eurostat's comments in Theme 6.1.4 on quantifying the amount of compensation and/or relief that should be given to the Partner for these types of events.

#### **6.1.4 Quantifying compensation and/or relief**

In most cases, the EPC provides that the Partner is only entitled to compensation and/or relief to the extent that the relevant event has caused its non-performance, costs or losses. The Partner is given relief and/or compensation to put it in a "no better, no worse" position than it was before the event occurred, meaning that it will continue to bear the consequences of any under-performance, costs or losses for which it was responsible before the event occurred.

In a minority of cases, however, the compensation and/or relief given to the Partner puts it in the position that it was forecast (at financial close) to be in at that point in time had the event not occurred. This means that the compensation and/or relief for the event effectively also compensates and/or relieves the Partner for any under-performance, costs or losses for which it was responsible before the event occurred.

Where compensation is due by the Authority, it is typically net of amounts which the Partner should be able to recover through the required insurances.

#### **Eurostat's comments**

*Eurostat's view is that provisions for calculating compensation and/or relief for the Partner **do not influence the statistical treatment if:***

- *the provisions do not compensate or provide relief for anything other than the effects of the event in question (i.e. provisions that give compensation/relief for under-performance that is unrelated to the event **do influence the statistical treatment**);*
- *the provisions exclude from any compensation due by the Authority any amounts that the Partner should be able to recover under the required insurances (see Theme 9) or under the normal terms of insurance that is available on commercially viable terms.*

*Provisions that do not meet either or both of the conditions listed above are issues of HIGH importance to the statistical treatment.*

#### **6.1.5 Paying compensation**

The EPC may provide for compensation to be paid by the Authority in a lump sum or through adjustments to the Operational Payments or a combination of both, usually depending on the nature and/or amount of costs and losses incurred by the Partner.

An alternative (rare) approach is to extend the duration of the contract as an alternative to paying compensation, thereby giving the Partner the opportunity to generate additional revenues from the EPC (equivalent to the amount of compensation due).

#### **Eurostat's comments**

*Eurostat's view is that provisions relating to payment of compensation to the Partner (e.g. the timing of payment, whether payment is made in a lump sum or through adjustment to the Operational Payments or by extending the duration of the contract) **do not influence the statistical treatment.***

## 6.2 Public law doctrines on compensation, relief and force majeure events

In some jurisdictions, the Partner is entitled, as a matter of public law, to raise a court action seeking compensation from the Authority in situations where the performance or “economic balance” of the EPC is disrupted by certain types of event (e.g. an event that is unforeseeable or outside the Partner’s control).

In these jurisdictions, if the parties do not or cannot waive their rights under the public law doctrine, the EPC itself may contain:

- provisions to clarify or qualify the circumstances in which the parties would intend the underlying public law doctrine to apply;
- provisions that reflect or repeat the underlying public law doctrine; or
- no express provisions on the circumstances in which the compensation, relief or force majeure events may apply, the implication being that the parties will simply rely on the application of the underlying public law doctrine.

The detail of these public law doctrines, and their potential impact on EPC arrangements, varies significantly from jurisdiction to jurisdiction. In practical terms, their existence often creates uncertainty as to both the events for which the Authority may be required to relieve and/or compensate the Partner and the amount of relief and/or compensation that would be due.

### **Eurostat’s comments**

*Eurostat’s view is that the existence of public law doctrines of the nature described above **may influence the statistical treatment**. Analysis of the particular public law and jurisprudence would be required to ascertain whether it could result in the Authority taking or sharing the risk of events which, according to the Guide, would influence the statistical treatment. For example, a public law doctrine that would compensate the Partner for a reasonably foreseeable event would be an issue of HIGH importance (see Eurostat’s comments in Theme 6.1).*



# Changes to the EPC

## 7.1 Changes proposed by the Authority

Most EPCs recognise a right for the Authority to propose changes to the terms of the contract (including the agreed terms of the design, construction, operation and maintenance of the EPC assets) and that the Partner is entitled to relief and/or compensation for the consequences of complying with those changes.

In some EPCs, the Authority's right to propose changes is restricted (e.g. to changes below a certain value, to changes of a certain type) and/or by the Partner having grounds for objecting to the proposed change (e.g. that the change would adversely affect health and safety, good industry practice, permits).

Most EPCs contain provisions that allow the Partner to claim:

- compensation from the Authority for any increase in costs or loss in revenues or change in the EPC's risk profile; and
- relief from any non-performance of the EPC;

that arise as a result of the change.

Similarly, most EPCs provide that the Authority benefits from any cost savings or increases in revenues that arise from Authority changes.

Some EPCs provide that the Authority can require the Partner to finance the change, although if the Partner is unable to obtain financing the Authority will finance the change itself.

In some cases, the financial adjustment for an Authority change is made by reference to an underlying principle of public law (see Theme 6.2).

### **Eurostat's comments**

*Eurostat's view is that:*

- *provisions that give the Authority a right to propose changes to the EPC (either on a restricted or an unrestricted basis) **do not influence the statistical treatment**;*
- *provisions that give the Partner a right to claim compensation and/or relief for the consequences of complying with an Authority change, and the method for calculating and paying compensation, **do not influence the statistical treatment if the compensation and/or relief are limited to addressing the***

*effects of the Authority change (i.e. they do not indirectly compensate or relieve the Partner for its own poor performance or other Partner risks). Where this is not the case, the issue is of HIGH importance to the statistical treatment;*

- *provisions that pass on to the Authority any cost savings or increases in revenues that arise from an Authority change, and the method for calculating and passing those on to the Authority, **do not influence the statistical treatment**; and*
- *provisions that allow the Authority to require the Partner to finance an Authority change **do not influence the statistical treatment**.*

*As explained in Chapter 1, at the time of implementing any change to the EPC, it is important to consider the impact that the change may have on the statistical treatment.*

## 7.2 Changes proposed by the Partner

Some EPCs provide a right for the Partner to propose changes to the terms of the EPC (including the agreed terms of the design, construction, operation and maintenance of the EPC assets). The Partner might initiate a change proposal as a response to a continuous improvement obligation (see Theme 4.8).

The Partner's right to propose changes is usually qualified as follows:

- the Authority is not obliged to accept any such proposal (other than where the change is required in order to comply with law) or has grounds on which the proposal can be rejected;
- the Authority is not obliged to compensate the Partner for any costs incurred or revenues lost as a result of the change; and
- the Authority is entitled to share in any cost savings or increases in revenues that arise for the Partner.

Other EPCs contain no formal right for the Partner to propose a change.

### **Eurostat's comments**

*Eurostat's view is that:*

- *providing the Partner with a right to propose changes to the EPC contract, as described above; and*
- *providing the Authority with a right to share (to whatever degree) in any cost savings or increases in revenues that result from a Partner change;*

**do not influence the statistical treatment.**

*Equally, not providing the Partner with a right to propose changes to the EPC and not providing the Authority with a right to share in any cost savings or increases in revenues resulting from a Partner change, **does not influence the statistical treatment.***

*However, Eurostat's view is that an obligation on the Authority to bear the financial consequences of a Partner change proposal (other than one that is required in order to comply with law, as described in Theme 8) **does influence the statistical treatment** and is an issue of HIGH importance.*



## Theme 8

# Changes in law

Almost all EPCs contain specific provisions through which the Authority takes the risk of changes in law that affect the EPC, meaning that the Authority is required to compensate the Partner for costs incurred or revenues lost as a result of changes in law.

In many EPCs, the Partner's right to claim compensation is limited to changes in law that were unforeseeable at the time the contract is entered into. The definition of "unforeseeable" varies from contract to contract, but usually encompasses changes in law that the Partner could not have been expected to reflect in its bid for the EPC.

Some EPCs limit the Partner's right to claim compensation further by providing, for example, that the Partner:

- bears the risk of changes in law for a period of time; and/or
- shares the risk of changes in law (e.g. by absorbing costs up to a specified threshold or by absorbing costs of general changes in law).

In some jurisdictions the Partner's right to claim some form of compensation for unforeseeable changes in law is enshrined in public law (which may also be referred to in the EPC).

### **Eurostat's comments**

*Eurostat's view is that provisions that allocate change in law risk to the Authority **do influence the statistical treatment** if they include the Authority taking the risk of:*

- *changes in law that are foreseeable when the EPC is entered into; and/or*
- *changes in law that are general in nature (i.e. that do not relate solely to the EPC or to the Partner or to similar transactions or businesses) and affect the general operating costs of businesses in the relevant jurisdiction (e.g. changes in rates of taxation,<sup>38</sup> changes in employment laws).*

*Where this is the case, the issue is of MODERATE importance to the statistical treatment. By contrast, provisions that allocate to the Authority the risk of unforeseeable changes in law that are general in nature and require capital expenditure on the EPC assets **do not influence the statistical treatment**.*

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<sup>38</sup> An exception is only made for cases where the Authority takes the risk of a general change to the value added tax regime (i.e. the Authority taking the risk of such changes does not influence the statistical treatment).

# Insurance

## 9.1 Insurance requirements

The EPC typically specifies particular insurances that the Partner is (as a minimum) required to have in place during the contract.

The required insurances typically include:

- professional indemnity insurance (covering the Partner’s design liabilities);
- construction/property damage insurance (covering damage to the construction works/EPC assets);
- public liability insurance (covering product liability and liabilities to third parties); and
- insurances required by law.

Depending on the nature of the EPC assets and their integration with the site on which they are located it is often envisaged that during the Operational Phase the EPC assets will be covered by property damage and/or public liability insurances taken out by the Authority. In some cases this is included an express obligation on the Authority in the EPC, in other cases it is implied.

The EPC typically specifies key terms for each of the required insurances (e.g. the parties to be covered, the period of cover, the minimum amount of cover, the maximum deductible, specific inclusions and exclusions) as well as requirements for:

- the Authority to be a “named party” on the Partner’s construction/property damage and public liability insurance (and/or vice versa);
- the Authority’s approval of the identity of the Partner’s insurer;
- construction/property damage policies to cover the full reinstatement value of the EPC assets;
- “non-vitiation” protection, to ensure that the Authority’s claims cannot be refused by the insurers as a result of actions by the Partner (e.g. the Partner’s non-disclosure or misrepresentation to the insurers); and
- “subrogation waiver”, to limit the insurers’ recourse to the Authority in connection with any claims on the insurances.

### **Eurostat's comments**

*Eurostat's view is that provisions in the EPC requiring the Partner to have certain insurances in place, the scope of those insurances and the terms on which they must be put in place **do not influence the statistical treatment**.*

*Eurostat's view is that provisions in the EPC requiring the Authority to have property damage and/or public liability insurances in place to cover the EPC assets during the Operational Phase, the scope of those insurances and the terms on which they must be put in place, **do not influence the statistical treatment**. However, extending the Authority's obligation to take out any other insurance for the benefit of the Partner (e.g. insurance against malfunction or poor performance of the EPC assets, business interruption insurance), **does influence the statistical treatment** and is an issue of HIGH importance.*

## **9.2 Reinstatement of the asset**

The EPC often specifies that the proceeds of property damage insurances are used to reinstate the EPC assets if they are damaged, and will typically include a process by which the Authority and the Partner agree on the reinstatement proposals, plans and timetable.

### **Eurostat's comments**

*Eurostat's view is that provision in the EPC for the Authority and Partner to agree the proposals, plan and timetable for reinstatement of the asset **do not influence the statistical treatment**.*

## **9.3 Insurance costs**

There are some examples of EPCs in which the Partner takes full responsibility for meeting the costs of the required insurances, and takes the risk and benefits of fluctuations in insurance costs for the duration of the contract.

There are other examples where the costs of some insurances are shared between the parties and/or met in full by the Authority either directly (e.g. where the Authority is obliged to insure against damage to the EPC assets) or indirectly (e.g. by reimbursing the Partner for some or part of the insurance costs).

### **Eurostat's comments**

*Eurostat's view is that provision in the EPC for the Authority to take or share responsibility for meeting the costs of property damage and/or public liability insurances to cover the EPC assets during the Operational Phase **do not influence the statistical treatment**.*

*Provisions by which the Authority takes or shares the risk/benefit of changes in the costs of other insurances taken out by or for the benefit of the Partner (e.g. insurance against malfunction or poor performance of the EPC assets) are, however, treated differently. Such provisions **do not influence the statistical treatment** if all of the following conditions are met:*

- The Authority takes or shares the risk where insurance costs increase above a specified ceiling and/or takes or shares the benefit where insurance costs fall below a specified floor;*
- The ceiling (if applicable) is set no lower than twice the amount of the insurance costs forecast at financial close;*
- The floor (if applicable) is set no higher than half the amount of the insurance costs forecast at financial close;*
- If insurance costs increase above the ceiling, the Authority is only liable for the difference between the actual costs and the ceiling;*
- If insurance costs fall below the floor, the Authority only takes or shares the benefit of the difference between the actual costs and the floor; and*
- The provisions do not allow the Authority to take the risk and/or benefit of changes in insurance costs that are attributable to the actions of the Partner.*

*Provisions for the Authority to take or share the risk/benefit of changes in such insurance costs (other than in situations of uninsurability as described in Theme 9.4) that do not meet all of the conditions described above **do influence the statistical treatment** and are of HIGH importance.*

*The following example illustrates the way that Eurostat expects the conditions described above to apply (i.e. so that the provisions would not influence the statistical treatment). The example assumes an EPC where the annual cost of insuring against malfunction/poor performance of the EPC assets is EUR 20,000. The EPC sets a cost increase ceiling at twice this amount (i.e. EUR 40,000) and a cost decrease floor at half this amount (i.e. EUR 10,000). The example assumes that the Authority takes (rather than shares) the full risk and benefit of cost increases above the ceiling and decreases below the floor. In this example:*

- If annual insurance costs increase to EUR 45,000, the Partner is liable for EUR 40,000 and the Authority is liable for EUR 5,000 (i.e. the difference between actual costs and the ceiling); and*

- *If annual insurance costs fall to EUR 8,000, the Partner keeps the benefit of the cost saving of EUR 10,000 and the Authority takes the benefit of a saving of EUR 2,000 (i.e. the difference between actual costs and the floor).*

## 9.4 Uninsurability

Some EPCs include “uninsurability” provisions that deal with the situation where an insurance that the Partner is required to take out ceases to be available in the insurance market or is only available at excessive cost.

Typically, if a situation of uninsurability arises, either party can elect to terminate the EPC and compensation is paid to the Partner (see Theme 12.5). In some situations, the Authority may have the right to elect for the EPC to continue, on the basis that it will act as insurer of last resort if and when the uninsurable risk occurs.

The provisions typically do not apply if the uninsurability has been caused by the Partner’s acts or omissions, and deal only with the prevailing conditions in the wider insurance market. As such, they typically cover two scenarios:

- Where insurance for a risk is simply not provided by reputable insurers in the market; and
- Where insurance for a risk is provided by the market but only on terms that are commercially unviable. This is sometimes assessed by reference to the deductible or premium being above a specified threshold and sometimes assessed more generally by looking at whether other entities similar to the Partner have stopped insuring the risk.

### **Eurostat’s comments**

*Eurostat’s view is that provisions that treat the unavailability of insurance that the Partner is required to take out in the way described above **do not influence the statistical treatment if** they apply only in situations of disruption in the insurance market and not in situations where the insurance is unavailable because of the Partner’s acts or omissions. Disruption in the insurance market is assumed to exist where:*

- *the insurance is not provided by reputable insurers in the market; or*
- *the terms on which the insurance is available are commercially unviable such that entities similar to the Partner are generally not taking out the insurance.*

*Provisions that assess the commercial viability of such insurance by reference to any other test (e.g. an increase in insurance costs above a specified level) **do influence the statistical treatment** if they are likely to apply in a scenario other than disruption in the insurance market. Where this is the case, the issue is of HIGH importance to the statistical treatment.*

## 9.5 Unavailability of required insurance terms

Some EPCs provide for the situation where insurance is available on the market on commercially viable terms (i.e. the risk is not “uninsurable”) but it is not available on the terms specified in the contract (e.g. the level of deductible available in the insurance market is higher than the level specified in the contract).

In this situation, the Partner is relieved of its obligation to take out the insurance on the required terms (i.e. it will not be considered to be in breach of the EPC) but is expected to bear the additional risk as a result of not being able to insure on the required terms (e.g. it will bear the financial impact of the level of deductible being higher than stated in the contract).

### **Eurostat’s comments**

*Eurostat’s view is that provisions that deal with the unavailability of a term or condition of insurance specified in the EPC (as described above) **do not influence the statistical treatment.***



# Warranties and indemnities

## 10.1 Warranties

It is common for the Authority and Partner each to provide the types of warranties that are typical to commercial deals, warranting for example:

- their legal status and capacity to enter into the contract;
- that they have followed due process in entering into the contract; and
- their compliance with law.

These types of typical commercial warranties tend to be focussed on the parties' own corporate status, actions and behaviour.

In some EPCs, however, warranties are also used as a mechanism to allocate risks/rewards associated more directly with the delivery or performance of the contract. For example:

- a warranty from the Authority relating to the condition of the site (e.g. building and/or existing equipment);
- a warranty from the Authority relating to the accuracy of energy consumption data provided; or
- a warranty from the Partner that it has exercised due skill and care in the design of the EPC assets.

In most cases, however, the parties prefer to use specific contract mechanisms to deal with the risks and rewards inherent in the EPC (e.g. compensation events, adjustments to the guarantee) rather than rely on general remedies available for a breach of warranty.

### **Eurostat's comments**

*Eurostat's view is that the provision of "typical" commercial warranties of the nature described above **does not influence the statistical treatment**.*

*However, users should be aware that warranties may influence the statistical treatment if, in substance, they allocate risks and rewards in a way that influences the statistical treatment as described in other provisions of the Guide (see Themes 5 and 6). For example, a warranty from the Authority that it will not enforce savings shortfalls above a certain amount would amount to a cap on savings shortfalls and be assessed accordingly (see Theme 5.6.3).*

## 10.2 Indemnities given by the Partner

Most EPCs contain provisions which require the Partner to indemnify the Authority for any losses or liabilities that the Authority incurs as a result of the Partner's performance or non-performance of the EPC.

The indemnities typically cover matters for which the Partner would otherwise have legal liability. In some cases the indemnities cover additional matters, for which the Partner would not necessarily have legal liability, but which the Authority has identified are capable of arising as a result of the Partner's performance of the EPC.

The categories of losses and claims covered by the Partner indemnities typically include:

- death or personal injury;
- loss or damage to property;
- breach of the Authority's statutory duties; and
- third party claims brought against the Authority.

The indemnities granted by the Partner are often limited in the following ways:

- through excluding specific losses or claims (e.g. those that arise from the Authority's own breach or negligence, those related to matters which are Authority risks under the EPC such as unforeseeable site conditions, those for damage to the EPC assets themselves); and
- through financial caps on the Partner's liability for specific losses or claims.

The limitations on the indemnities are often designed to protect the Partner from exposure to losses or claims which would not be recoverable through the insurances required under the EPC.

### **Eurostat's comments**

*Eurostat's view is that the scope of indemnities granted by the Partner (including provisions that limit or exclude the Partner's liability) **does not influence the statistical treatment if** the limits or exclusions apply only to the Partner's liabilities for events:*

- that are unforeseeable (and are not covered under the insurances that the Partner is required to maintain under the EPC);*
- that arise from matters that are within the scope of the Authority's management or control; or*
- for which the Authority has another remedy against the Partner either under the EPC or at law (e.g. by enforcing the Partner's contractual obligation to maintain the EPC assets and/or making deductions from the Operational Payments).*

*Limits or exclusions on the Partner's indemnities that do not meet the conditions listed above are of HIGH importance to the statistical treatment.*

## **10.3 Indemnities given by the Authority**

A minority of EPCs contain indemnities from the Authority in favour of the Partner, typically limited to losses and claims for:

- death or personal injury; or
- damage to property;

caused by the Authority or parties that the Authority controls or manages.

The indemnities granted by the Authority typically exclude losses and claims that are caused by the Partner and losses and claims which the Partner should be able to recover from the insurances required under the EPC.

### **Eurostat's comments**

*Eurostat's view is that the provision of indemnities from the Authority to the Partner, in the nature and manner described above, **does not influence the statistical treatment.***

*However, Eurostat's view is that the provision of an indemnity from the Authority to the Partner for any risk other than:*

- the Authority's own acts or omissions;*
- acts or omissions of any third party that the Authority manages or controls;*
- risks that the Guide states can be taken by the Authority without influencing the statistical treatment (e.g. the risk of unforeseeable ground conditions as described in Theme 6);*

***does influence the statistical treatment** and is an issue of HIGH importance.*

# Early termination of the EPC

Early termination of EPCs can typically be triggered by the following events:

- default by the Partner;
- default by the Authority;
- unilateral (or voluntary) decision by the Authority;
- extended and continuing force majeure event; or
- uninsurability or the occurrence of an uninsurable risk.

## 11.1 Partner default termination

Some EPCs contain an itemised list of Partner defaults that give the Authority a right (although not an obligation) to terminate. The list usually contains the following events:

- insolvency/bankruptcy of the Partner;
- failure by the Partner to reach certain milestones in the construction and/or installation of the EPC assets;
- failure by the Partner to deliver services to the agreed standards;
- failure by the Partner to take out the required insurances;
- breach by the Partner of restrictions on changes in ownership or transfers of the contract;
- material or persistent breach of the EPC by the Partner;
- fraudulent or corrupt behaviour by the Partner; and
- in rare cases, major default of the Partner under the senior loan agreement.

Some EPCs rely on a broad or general definition of Partner default, rather than an itemised list of events. Where this is the case, the definition often contains a “materiality test” so that early termination can be triggered only by defaults that are of a serious nature or have a significant impact.

The EPC will typically (but not always) give the Partner a limited period of time in which to remedy the default or the circumstances that have given rise to the default, and thereby avoid termination by the Authority. This usually depends on the severity or nature of the default (e.g. whether it is capable of remedy).

In some EPCs, the Authority's right to terminate the EPC for Partner default is subject to the right of lenders to step in to the contract in an attempt to remedy the default and avoid termination (see Theme 14.8).

### **Eurostat's comments**

*Eurostat's view is that the provisions that define the circumstances and process by which the Authority may terminate the EPC for Partner default, including:*

- *the definition of the termination triggers themselves (and whether they are itemised in a list or defined more broadly); and*
- *the circumstances in which the Partner may or may not have an opportunity to remedy the default and, where that opportunity exists, the length of the remedy periods;*

***do not influence the statistical treatment.** However, separate consideration must be given to provisions for compensation that may be payable by the Authority on early termination of the EPC for Partner default (see Theme 12.1).*

## **11.2 Authority default termination**

EPCs usually give the Partner a right (although not an obligation) to terminate the contract in situations of Authority default.

EPCs typically rely on a broad definition of Authority default, often based on a "materiality test" so that termination can be triggered only by defaults that are of a serious nature or have a significant impact.

Some EPCs, however, list the events that constitute Authority default. These events might include, for example:

- non-payment of amounts owed by the Authority to the Partner;
- material or persistent breach of contract by the Authority that prevents the Partner's performance;
- breach by the Authority of restrictions on its right to transfer the contract;

- sale of the site (e.g. land and/or facilities) in which the EPC assets are located; and
- sometimes, a change in the Authority's credit-worthiness or legal status.

In some jurisdictions where there is no express contractual right for the Partner to terminate for Authority default, the Partner can usually rely on provisions of underlying law to the same effect. In some cases the Partner's only remedy for non-payment by the Authority is the right to charge interest on unpaid amounts.

The EPC may give the Authority a period of time in which to remedy a default (where this would be possible) in order to avoid termination by the Partner.

#### **Eurostat's comments**

*Eurostat's view is that the provisions that define the circumstances and process by which the Partner may terminate the EPC for Authority default, including:*

- *the definition of the termination triggers themselves (and whether they are itemised in a list or defined more broadly); and*
- *the circumstances in which the Authority may or may not have an opportunity to remedy the default and, where that opportunity does exist, the length of the remedy periods;*

#### **do not influence the statistical treatment.**

*However, it should be noted that if the triggers for early termination for Authority default result in the Authority taking risks that, as stated elsewhere in the Guide, **do influence the statistical treatment** (e.g. the Authority taking the risk of the Partner's own performance or general macro-economic risks, as referred to in Theme 6), this is an issue of HIGH importance to the statistical treatment.*

*In addition, separate consideration must be given to provisions for compensation that may be payable by the Authority on early termination of the EPC for Authority default (see Theme 12.2).*

### **11.3 Authority voluntary termination**

The Authority usually has an express right (in the EPC or in underlying law) to terminate the EPC at will on giving prior notice to the Partner (regardless of either party's performance of the contract). Sometimes this right is limited to situations where the Authority is motivated by particular circumstances (e.g. overriding public interest).

### **Eurostat's comments**

*Eurostat's view is that the provision (or non-provision) of a right by the Authority to terminate the EPC at will, on unlimited or limited grounds, **does not influence the statistical treatment**. However, separate consideration must be given to provisions for compensation that may be payable by the Authority on the Authority's voluntary early termination of the EPC (see Theme 12.3).*

## **11.4 Force majeure termination**

EPCs often recognise the right for either party to terminate the contract in circumstances where a force majeure event has subsisted for an extended period of time (typically six to 12 months).

### **Eurostat's comments**

*Eurostat's view is that the provision of an early termination trigger for force majeure risks, and the period of time after which a force majeure event can trigger termination, **do not influence the statistical treatment**. Equally, not providing an early termination trigger for force majeure risks **does not influence the statistical treatment**. However, the definition of force majeure itself may influence the statistical treatment (see Theme 6) as may the provisions for compensation payable by the Authority on early termination of the EPC for force majeure (see Theme 12.4).*

## **11.5 Termination linked to uninsurability**

Some EPCs treat the unavailability of key insurances as a shared risk or an Authority risk. Typically this is achieved by way of the Authority deciding, when a risk becomes uninsurable, to:

- terminate the contract immediately; or
- “self-insure” and to pay the Partner an amount equivalent to insurance proceeds if the risk later occurs.

If the Authority chooses to “self-insure” and the uninsurable risk does later occur, the Authority usually has the option to terminate the EPC as an alternative to paying the Partner an equivalent of the insurance proceeds. Some EPCs contain an explicit right for the Authority to terminate in this particular situation, but otherwise the Authority may opt to use its right to terminate unilaterally at any time (see Theme 11.3) or to terminate for force majeure (see Theme 11.4).

### **Eurostat's comments**

*Eurostat's view is that the provision or non-provision of a right of termination linked to uninsurability or the occurrence of an uninsurable risk **does not influence the statistical treatment**. However, the underlying uninsurability provisions themselves may influence the statistical treatment (see Theme 9.4) as may provisions for compensation payable by the Authority on early termination of the EPC (see Themes 12.4 and 12.5).*

## **11.6 Rights of suspension**

In addition, or as an alternative, to the right to terminate the EPC, some EPCs recognise a right for one party to suspend the performance of its obligations in a situation where the other party is in breach. Typically the party exercising the right of suspension must give the other party notice of its intention to do so, and must lift the suspension and resume performance once the defaulting party has remedied the breach.

In some cases, the right of suspension is limited to only one of the parties and/or to particular breaches.

### **Eurostat's comments**

*Eurostat's view is that provisions that give either or both parties the right to suspend performance as described above **do not influence the statistical treatment if** the provisions are limited to providing the defaulting party relief from termination only and do not otherwise compensate the defaulting party for its default or the consequences of its default. Provisions that do not meet this condition are of HIGH importance to the statistical treatment.*



## Theme 12

# Compensation on early termination of the EPC

The vast majority of EPCs provide for the payment of compensation by the Authority to the Partner on early termination of the EPC. The amount of compensation payable varies depending on the circumstances giving rise to termination, as explained below. Responsibility for the EPC assets themselves will usually revert to the Authority or, if the EPC is re-tendered by the Authority, to a third party.

Where an EPC makes no such provision, compensation payable is typically governed by the underlying law in the relevant jurisdiction.

### **Eurostat's comments**

*Eurostat's view, which applies to all early termination scenarios, is that the payment of compensation should not cancel any liabilities of the Partner to the Authority that pre-date termination (e.g. an indemnity claim that the Authority has against the Partner). Provisions (in the EPC or underlying law) that do not preserve pre-termination liabilities **do influence the statistical treatment** and are issues of HIGH importance.*

*Eurostat's view is that the absence of express provision in the EPC as to the amount of compensation due on early termination creates uncertainty which **may influence the statistical treatment**. Further analysis (e.g. of the underlying law and jurisprudence in the relevant jurisdiction) will be required to determine the amount of compensation to which the Partner may be entitled and how this aligns with Eurostat's view on compensation on early termination that are stated in this Theme 12.*

## 12.1 Partner default termination compensation

### 12.1.1 Approach 1 - Market value calculation

This approach entitles the Partner to compensation based on the market value of the EPC, determined either:

- by the market itself through a process of re-tendering the EPC; or
- by estimating how the market would value the EPC.

Typically, the EPC gives the Authority the right to choose which approach to take (i.e. whether re-tendering or estimated market value). The right to choose re-tendering is usually subject to a condition that, at the point of termination, a “liquid market” for the relevant type of EPC in the relevant jurisdiction exists. The EPC usually provides that where there is no liquid market, the market value of the contract is to be estimated. Usually the EPC will allow the Authority (but not the Partner) to change its choice from re-tendering to estimated value at any time before bids are received.

Some EPCs require the Authority to make ongoing payments to the Partner during the re-tendering process and these are then deducted from the final compensation payment. Some EPCs also impose a time limit (e.g. two years from the termination date) on the Authority to complete the tendering process and pay the re-tendering market value of the contract to the Partner.

Some EPCs might not include a re-tendering option but instead only provide for compensation on the basis of an estimated market value of the contract. Others might provide only for a re-tendering process.

Where the market value of the contract is to be estimated, this is usually done on the basis of a detailed methodology specified in the EPC. This methodology usually envisages a calculation (on a net present value basis) of the aggregate of payments forecast to be made by the Authority over the remaining term of the EPC, net of all costs (including any remediation costs resulting from the Partner’s under-performance) forecast to be incurred over the remaining term of the EPC.

Some EPCs provide for the estimated market value of the contract to be agreed between the parties, based on a methodology set out in the contract (as described above), failing which it is determined through the contractual dispute resolution procedure. Others may provide for referral to an independent expert to determine the market value, again based on the methodology set out in the contract, and in some cases either party can refer the independent expert’s determination to the contractual dispute resolution procedure.

#### **Eurostat’s comments**

*Eurostat’s view is that the Approach 1 described above **does not influence the statistical treatment if** all of the following conditions are met:*

- *Under the conditions of the re-tendering process set out in the EPC, the bidders for the EPC are required to take into account any remediation costs resulting from the Partner’s under-performance (i.e. costs to complete/rectify the EPC assets as well as additional operation, maintenance and financing costs);*

- *The methodology for estimating the market value of the contract (where the re-tendering process is not followed) is designed to reflect the approach that the market would take in valuing the EPC and not to ensure the recovery of the Partner's incurred costs or outstanding debt. The methodology needs to take into account any remediation costs resulting from the Partner's under-performance (i.e. the forecast cash-flows should take into account costs to complete/rectify the EPC assets as well as additional operation, maintenance and financing costs);*
- *Where the EPC provides for a choice between re-tendering and an estimated market value, that choice lies with the Authority and not the Partner;*
- *The Authority is only obliged to opt for an estimated market value in situations in which there is no liquid market;*
- *The definition of liquid market ensures that (as at the time the choice is made) there are a sufficient number of capable and willing parties in the market for the relevant type of EPCs or similar contracts to allow for a market price to be determined;*
- *Any decision to switch to an estimated market value of the EPC instead of a re-tendered market value after the decision to follow a re-tendering process has been taken, but before bids are received, is solely at the discretion of the Authority and cannot be initiated or influenced by the Partner;*
- *Under the conditions of the re-tendering process set out in the EPC, the validity of the re-tendering process is not conditional on a minimum number of bids being received or a minimum contract value being offered (i.e. the results of the re-tendering process are held to be valid even if no bids are received or if bids have a lower value than expected);*
- *Under the conditions of the re-tendering process set out in the EPC, if the re-tendering process is followed and the number of bids received is below a certain number (or lower than expected) or the prices offered are below a certain value (or lower than expected), the price offered is deemed to be the market value and the contract does not provide for some other amount (e.g. an estimated market value) to be used to determine the market value;*
- *Under the conditions of the re-tendering process set out in the EPC, if the re-tendering process is followed and no bids are received then the market value of the contract is deemed to be zero (i.e. the contract does not provide for some other amount, such as an estimated market value, to be used as an alternative basis for the compensation payment);*

- *Under the conditions of the re-tendering process set out in the EPC, if the re-tendering process establishes a market value that is less than zero, the contract provides for the possibility of a negative compensation payment (i.e. a payment that would be due by the Partner to the Authority);*
- *Any interim payments made by the Authority to the Partner between the termination date and the date that compensation is paid are deducted from the compensation payment;*
- *If the conditions of the re-tendering process impose a time limit on the Authority to complete the re-tendering process and pay the market value of the contract to the Partner, that time limit is no less than six months from the termination date;*
- *If the re-tendering process is not followed, the estimated market value of the EPC is calculated (using the methodology provided in the contract) either by an expert or jointly by the parties. Where the contract provides for an expert to be used, the expert should be independent of both the Authority and the Partner (and the Authority and the Partner can agree the precise tests for independence and expertise). Where the contract provides for the calculation to be agreed by the parties, both parties must have the right to refer any disagreement to an independent expert or to a dispute resolution procedure set out in the EPC; and*
- *If the methodology for calculating the estimated fair value of the contract establishes a value that is less than zero, the contract provides for the possibility of a negative compensation payment (i.e. a payment that would be due by the Partner to the Authority).*

*Where either of the first two conditions listed above is not met, the EPC is automatically ON BALANCE SHEET for government. Each of the remaining conditions listed above is of HIGH importance to the statistical treatment.*

### 12.1.2 Approach 2 – Investment based calculation

Some EPCs provide that the compensation payable to the Partner is based on the value of the Partner's investment in the EPC assets as at the date of termination. The investment value might be determined either by reference to:

- the amount of capital (debt and equity) invested in the EPC assets; or
- the costs expended by the Partner in constructing and/or installing the EPC assets.

The main difference between these approaches is that the first takes account of financing costs whereas the second does not.

This approach does not in itself take into account the cost to the Authority (if any) of remedying any poor performance issues associated with the project (e.g. rectifying construction defects). In some jurisdictions, the compensation paid to the Partner will therefore be the book value of the asset minus remediation costs.

The investment-based calculation typically does not include any compensation for other costs and losses incurred by the Partner (e.g. redundancy payments, sub-contractor or financing breakage costs). However in some EPCs the calculation does make allowance for and include an element of compensation for the Partner's expected profit on the investment.

#### **Eurostat's comments**

*Eurostat's view is that provisions that calculate the compensation payable on Partner default on the basis of the book value of the investment but do not take into account the Authority's remediation costs **do influence the statistical treatment** and automatically lead to the EPC being ON BALANCE SHEET for government.*

*Further, any calculation that takes account of and compensates the Partner for an element of its expected profit on the investment **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.*

*In contrast, provisions that calculate the compensation payable on Partner default on the basis of the book value of the investment (disregarding the Partner's return on investment) and take into account the Authority's remediation costs (both the costs to complete/rectify the EPC assets and additional operating/maintenance costs) **do not influence the statistical treatment**.*

*If only some remediation costs are deducted from the book value of the investment calculation (e.g. additional maintenance/operating costs are not deducted), the provisions **do influence the statistical treatment** and are an issue of HIGH importance.*

#### **12.1.3 Approach 3 - Senior debt compensation**

Some EPCs provide that the compensation payable to the Partner is based on the amount (or a percentage of the amount) of senior debt outstanding at the date of termination.

In some cases deductions will be made from the senior debt outstanding to take account of the Authority's costs (e.g. re-tendering, remediation).

In some jurisdictions, a senior debt outstanding calculation is used for all Partner defaults. In other jurisdictions it is used only for a limited range of Partner defaults (typically breach of refinancing provisions and/or Partner fraud or corruption).

#### **Eurostat's comments**

*Eurostat's view is that EPC provisions that base the compensation payable on Partner default on the senior debt outstanding (or a percentage of it) are akin to a financing guarantee (see Theme 14.1.4) **and do influence the statistical treatment**. Accordingly, the influence of such compensation provisions on the statistical treatment needs to be assessed (in combination with other government financing provisions) according to the principles stated in Theme 14.1.*

#### 12.1.4 Approach 4 - No compensation

Some EPCs provide that no compensation is payable to the Partner on early termination that is triggered by its default.

#### **Eurostat's comments**

*Eurostat's view is that this approach **does not influence the statistical treatment**.*

## 12.2 Authority default termination compensation

In most EPCs, the compensation due by the Authority to the Partner on termination for Authority default is designed to ensure that the Partner and its lenders are left no worse off as a result of the Authority default than they would have been if the EPC had continued as expected.

Typically the payment will reflect compensation for:

- the capital investment;
- loss of profit; and
- payments due to third parties.

The first component will typically include any accrued interest and costs associated with early breakage of financing agreements (including hedging breakage costs) in addition to interest that will accrue on the compensation payment from the date of termination up until the date that the compensation is actually paid.

The second component might be a pre-determined amount (e.g. a certain percentage return) or might be determined by looking at how the market would (theoretically) value the opportunity to take on the EPC.

The third component will typically include amounts due by the Partner to third parties such as sub-contractor breakage costs and redundancy payments.

#### **Eurostat's comments**

*Eurostat's view is that the calculation of compensation due by the Authority to the Partner on termination for Authority default as described above **does not influence the statistical treatment.***

### **12.3 Authority voluntary termination compensation**

The compensation due by the Authority on its voluntary termination of the EPC is typically the same as that due on termination for Authority default (see Theme 12.2).

#### **Eurostat's comments**

*Eurostat's view is that the calculation of compensation due on voluntary termination made on the basis of Theme 12.2 **does not influence the statistical treatment.***

### **12.4 Force majeure termination compensation**

The compensation payable by the Authority to the Partner following termination of the EPC for force majeure will typically recognise the fact that termination has occurred through circumstances outside either party's control. As such, the most common approach is to compensate the Partner with an amount that covers:

- the capital invested at the date of termination (including accrued interest and breakage costs); and
- payments due to third parties (such as sub-contractor breakage costs and redundancy payments).

It is the lack of compensation for loss of return that typically distinguishes this from compensation due on Authority default and Authority voluntary termination (reflecting the "no-fault" nature of force majeure events). In some cases an amount of compensation for loss of profit is included in the payment on termination for force majeure, although this is typically a lower than would be payable on termination for Authority default (again intended to reflect the "no-fault" nature of force majeure events).

A minority of EPCs, however, assimilate force majeure events with other events for which the risk lies with the Authority (e.g. Authority default).

#### **Eurostat's comments**

*Eurostat's view is that the "no-fault" approach to calculating compensation on termination for force majeure described above **does not influence the statistical treatment**. The definition of force majeure itself may, however, influence the statistical treatment (see Theme 6).*

*An approach that calculates compensation on termination for force majeure on the same basis as compensation on termination for Authority default or Authority voluntary termination **does influence the statistical treatment** and is an issue of MODERATE importance.*

## **12.5 Uninsurability termination compensation**

Compensation payable where the Authority has elected to terminate the EPC due to a risk becoming uninsurable is typically calculated on the same basis as compensation on termination for force majeure.

In some EPCs, this is also the basis for calculating the amount payable if the Authority later terminates the contract on the occurrence of the uninsurable risk.

#### **Eurostat's comments**

*Eurostat's view is that the approaches described above **do not influence the statistical treatment**. However, the underlying uninsurability provisions themselves may influence the statistical treatment (see Theme 9.4).*

## **12.6 Schedule of termination payments**

Some EPCs provide a schedule of pre-agreed amounts that are payable on early termination. The amounts typically vary depending on the date of termination and the reason for termination.

### **Eurostat's comments**

*Eurostat's view is that the provision of a pre-agreed schedule of termination payments **does influence the statistical treatment** as follows:*

- *a pre-agreed amount due by the Authority to the Partner on termination for Partner default automatically leads to the EPC being ON BALANCE SHEET for government;*
- *a pre-agreed amount due by the Authority to the Partner on termination for force majeure that is the same as or higher than the pre-agreed amount due by the Authority to the Partner on termination for Authority default is an issue of MODERATE importance.*

*Eurostat's view is that the provision of pre-agreed amounts due by the Authority to the Partner on termination for Authority default or voluntary termination by the Authority **does not influence the statistical treatment**.*

## **12.7 Payment of compensation**

Compensation will usually be payable by the Authority in a lump sum within a specified period after the termination date.

In some EPCs the Authority has the right to opt to pay some or all of the compensation in instalments. Usually any right to pay in instalments will not exist on voluntary termination by the Authority or on termination for Authority default.

### **Eurostat's comments**

*Eurostat's view is that the mechanism and timing for payment of compensation on early termination **does not influence the statistical treatment**.*

## 12.8 Partner obligations on termination

The EPC typically contains provisions that require the Partner to co-operate with the Authority to ensure a smooth transition in the hand-over of the construction, operation and maintenance of the EPC assets back to the Authority (or to a third party). These provisions typically include obligations on the Partner to:

- vacate the site;
- remove any of its own equipment (not forming part of the EPC assets) or transfer legal ownership of its equipment to the Authority (in some cases for a fee);
- transfer legal ownership of any of the EPC assets to the Authority (where this has not already occurred);
- provide information relating to the design, construction and operation of the asset (e.g. operating manuals, equipment access codes);
- provide information relating to staff and comply with obligations under relevant law; and
- transfer the benefit of third party warranties and guarantees relevant to the design, construction and operation of the asset (e.g. manufacturers' warranties).

### **Eurostat's comments**

*Eurostat's view is that provisions that impose obligations on the Partner that are of a nature similar to those described above (i.e. are intended to facilitate the transfer of the construction, operation and maintenance of the EPC assets to the Authority or a third party at the end of the EPC) **do not influence the statistical treatment.***

# Expiry of the EPC

## 13.1 Expiry date

There are two typical approaches to defining the date on which the EPC expires:

- Some expire on a date that is a fixed period of time from the date of financial close (i.e. the overall duration of the EPC is fixed); and
- Others expire on a date that is a fixed period from the date on which the EPC assets become operational (i.e. the Operational Phase is fixed).

In rare cases the EPC does not have a fixed overall duration or a fixed Operational Phase but instead provides that the EPC will expire once a particular level of energy consumption and/or cost savings has been achieved and/or the Partner has generated a particular level of profit or revenue.

### ***Eurostat's comments***

*Eurostat's view is that approaches that defined a fixed overall duration or a fixed Operational Phase (as explained above) **do not influence the statistical treatment.***

*However provisions that link the expiry of the EPC to a milestone such as level of savings, profit or revenue achieved **do influence the statistical treatment** and lead automatically to the EPC being ON BALANCE SHEET for government.*

## 13.2 Allocation of the EPC assets on expiry

The Authority typically takes responsibility for the EPC assets on expiry of the EPC, with no payment for the EPC assets being due by the Authority to the Partner. This position may be stated expressly in the EPC, although it is more typically implied by the simple fact that the Partner's rights and obligations in relation to the EPC assets come to an end when the contract expires.

In some cases, the EPC will specify that a payment for the EPC assets is due by the Authority to the Partner on expiry.

There may be some cases where some or all of the EPC assets will be removed and retained by the Partner.

### **Eurostat's comments**

*Eurostat's view is that the allocation of the EPC assets on expiry (and any related payment provisions) **does not influence the statistical treatment.***

## **13.3 Condition of the asset on expiry**

The EPC typically contains provisions by which the Partner takes the risk that, on expiry of the contract, the physical condition of the EPC assets meets a minimum specified standard that is consistent with them having been maintained in accordance with the contract.

The mechanisms by which this is achieved (e.g. the condition required of the asset, the method for assessing its condition, and the consequences of deficiencies in the EPC assets' condition) vary from contract to contract but, typically:

- The EPC requires an independent assessment of the condition of the EPC assets to be carried out several months (usually not less than six) before the expiry date;
- From the independent assessment, the parties agree the work needed to bring the EPC assets into the condition required on expiry and an estimate of the cost of that work;
- The Partner is required to carry out the agreed scope of work before the expiry date at its own cost;
- The Partner may be required to establish a fund or provide a bond or guarantee to cover the estimated cost of the work. Alternatively, the Authority may be entitled to withhold amounts from the Operational Payments to cover the estimated cost of the work;
- The Partner is entitled to access the fund or receive the withheld amounts as and when it carries out the required work;
- The Authority is entitled to access the fund, guarantee or withheld amounts if the Partner fails to carry out the work by the expiry date; and
- No payment or compensation is due by the Authority to the Partner if the condition of the EPC assets exceeds the specified standard.

### **Eurostat's comments**

*Eurostat's view is that where responsibility for the EPC assets will revert to the Authority on expiry of the EPC, the Partner must take the risk that on expiry of the EPC the EPC assets meet a standard that is consistent with them having been maintained in accordance with the contract. Failure to transfer this risk to the Partner under the EPC **does influence the statistical treatment** and is an issue of HIGH importance.*

*However, the specific mechanism used to allocate this risk to the Partner (e.g. through detailed provisions that align with the typical approach described above, through more general provisions and reliance on breach of contract remedies) **does not influence the statistical treatment**.*

*The fact that an EPC makes no provision to compensate the Partner if the condition of the asset on expiry is better than the specified standard **does not influence the statistical treatment**.*

## **13.4 Partner obligations on expiry**

The EPC typically contains provisions that require the Partner to co-operate with the Authority to ensure a smooth transition in the hand-over of the operation and maintenance of the EPC assets back to the Authority (or to a third party). These provisions typically include obligations on the Partner to:

- vacate the site;
- remove any of its own equipment (not forming part of the EPC assets) or transfer legal ownership of its equipment to the Authority (in some cases for a fee);
- transfer legal ownership of any of the EPC assets to the Authority (where this has not already occurred);
- provide information relating to the design, construction and operation of the asset (e.g. operating manuals, equipment access codes);
- transfer or grant software licences etc;
- provide information relating to staff and comply with obligations under relevant law; and
- transfer the benefit of third party warranties and guarantees relevant to the design, construction and operation of the asset (e.g. manufacturers' warranties).

### **Eurostat's comments**

*Eurostat's view is that provisions that impose obligations on the Partner that are of a nature similar to those described above (i.e. are intended to facilitate the transfer of the asset to the Authority or a third party at the end of the EPC) **do not influence the statistical treatment.***

# Financing arrangements

## 14.1 Authority/government participation in financing

It is common for the Authority (or other government entities) to participate in the financing of an EPC arrangement. The reasons for an Authority to participate in the financing vary from EPC to EPC, as do the ways in which it may choose to do so. The most common examples are:

- milestone payments (non-refundable) and/or direct provision of EPC assets to the Partner during or at the end of the Construction Phase (see Theme 14.1.1);
- loans to the Partner (see Theme 14.1.2);
- equity participation in the Partner (see Theme 14.1.3);
- financing guarantees (see Theme 14.1.4); and
- financial incentives (e.g. reduced energy tariffs) and/or exemptions from liabilities (e.g. corporate tax, value added tax) that the Partner would otherwise incur (see Theme 14.1.5).

Alternatively, or in addition, financing or guarantees in these forms are in some cases provided by government entities other than the Authority or by public entities that are classified for statistical purposes outside the general government sector (see Chapter 2).

### ***Eurostat's comments***

*Eurostat's view is that a government commitment to the financing of an EPC in any form and any amount (i.e. taking into account all commitments, such as those described above, provided by the Authority or other government entities) **does influence the statistical treatment** as follows:*

- *If a government commitment of financing or any other support amounts to 50% or more of the capital expenditure to be incurred in the construction and/or installation of the EPC assets, the EPC is automatically recorded ON BALANCE SHEET for government;*
- *A government commitment of financing or any other support that amounts to less than 50% but more than one third of the capital expenditure to be incurred in the construction and/or installation of the EPC assets is an issue of VERY HIGH importance to the statistical treatment;*

- *A government commitment of financing or any other support that amounts to one third or less but more than 10% of the capital expenditure to be incurred in the construction and/or installation of the EPC assets is an issue of HIGH importance to the statistical treatment; and*
- *A government commitment of financing or any other support that amounts to 10% or less of the capital expenditure to be incurred in the construction and/or installation of the EPC assets is an issue of MODERATE importance to the statistical treatment.*

*In considering the influence of government financing on the statistical treatment the following points must be noted:*

- *EU financing (e.g. grant, loan) is not counted as government financing;*
- *Any amount of capital expenditure that is funded by EU grant is deducted from the capital expenditure against which government's contribution of financing is calculated, irrespective of whether the recipient of the EU grant is the Partner or the Authority (or other government entity). If the decision to allocate the EU grant to the particular EPC is made by the Authority itself (or another government entity),<sup>39</sup> the amount of the grant is only deducted from the capital expenditure if it originates from a specific EU fund or programme (otherwise the grant is considered to be government financing);*
- *National government co-financing to match an EU grant is considered to be government financing;*
- *Financing arranged between the Partner and the EIB or any other international finance institution is considered to be financing from the private sector;*
- *Financing by a public entity classified outside the general government sector (e.g. a national public bank classified as a public corporation) is considered to be government financing if the public entity is considered by Eurostat to be acting on behalf of or on an express or implied instruction of government in connection with the project (see comments on the statistical sector classification of the Partner in Chapter 2);*
- *Government's total financing commitment must be considered by looking in aggregate at all forms of commitments it has made across the project (see Themes 14.1.1 to 14.1.4 and 14.2); and*

<sup>39</sup> This is where the relevant managing authority administering the EU grant is a government entity in the relevant EU Member State

- *An adjustment must be made to the amount of any loan provided by government to reflect the risk profile of the loan. In the case of debt that is fully subordinated (i.e. the highest risk debt) the amount of debt must be adjusted by a multiplier of 2.5. In the case of debt that is on a par with senior debt (i.e. the lowest risk debt) no adjustment is necessary. In the case of debt that falls between subordinated and senior debt, a reasoned analysis must be applied in determining a multiplier between 1 and 2.5 that reflects the risk it carries relative to the other forms of debt (see example in Box 7).*

*Annex 2 contains further worked examples that illustrate the application of Eurostat's rules on government financing as described in this Theme 14.1 (and Themes 14.1.1 to 14.1.4 below).*

#### **Box 7: Government financing multiplier**

This example assumes an EPC with capital costs of EUR 10 million, to which the Authority makes a capital contribution of EUR 1 million and provides a subordinated loan of EUR 0.5 million. In assessing the impact of the government financing on the statistical treatment of the EPC, the total government financing is calculated to be:

$$\text{EUR 0.5 million} \times 2.5 \text{ (i.e. subordinated debt} \times 2.5 \text{ multiplier)} \\ + \text{EUR 1 million (i.e. capital contribution)} = \text{EUR 2.25 million}$$

The total government financing is 22.5% of the capital costs of the EPC assets and is therefore of HIGH importance to the statistical treatment.

#### **14.1.1 Milestone or other lump-sum payments, provision of EPC assets**

The Authority (or other government entities) may be required to make the following types of payment to the Partner:

- a significant payment shortly after the EPC is signed, the purpose of that payment being to meet the Partner's bidding and initial mobilisation costs;
- a single or series of payments during or at the end of the Construction Phase (usually linked to the achievement of defined milestones in the construction and/or installation of the EPC assets); or

- a single or series of payments during the Operational Phase that do not align with the requirement that throughout the EPC the level of guaranteed savings for each relevant period is equal to or greater than the payments to be made by the Authority (e.g. payments to cover significant lifecycle maintenance costs at the time they are incurred). See also Theme 4.1 on the relationship between the guarantee and the annual Operational Payments and Theme 5.4 on pass-through costs.

The purpose of milestone payments is typically to reduce the amount of financing that the Partner needs to raise for the project or to enable the Partner to make early repayment of some of its financing.

A variant on this type of financing is direct provision of EPC assets by the Authority to the Partner (e.g. the Authority procures certain items of equipment which the Partner will install and maintain for the duration of the EPC).

#### **Eurostat's comments**

*Eurostat's view is that the amount of milestone payments (of the types described above) that government is committed to make **does influence the statistical treatment** (as referred to in Theme 14.1). However, the profile and timing of any such payments **do not influence the statistical treatment**. The same applies to direct provision of EPC assets by the Authority.*

#### 14.1.2 Loans

There is no “typical” approach as to the amount, terms and conditions on which the Authority (or other government entities) provides loans to the Partner.

#### **Eurostat's comments**

*Eurostat's view is that the amount of any loans committed by government **does influence the statistical treatment** (as referred to in Theme 14.1). Any rights of control that the Authority (or government) has over the Partner through the terms and conditions of loans may be relevant in determining the sector classification of the Partner and therefore whether the arrangement falls within Eurostat's definition of an EPC (see comments in Chapter 2).*

### 14.1.3 Equity participation

A feature of some PPP projects (which is not currently observed in the EPC market but could similarly be applied to EPCs) is where the Authority (or other government entities) holds an equity stake in the Partner. The equity might be provided through a combination of pure equity (i.e. share capital) and shareholder loans (i.e. subordinated debt). The pure equity might be a negligible amount in the overall financing structure (e.g. 2%). The pure equity and subordinated debt would typically be held by the same parties.

#### **Eurostat's comments**

*Eurostat's view is that, in the scenario described above, the amount of any equity provided by government constitutes government financing and therefore **does influence the statistical treatment** (as referred to in Theme 14.1). Equity carries the same weighting as subordinated debt for the purposes of the statistical treatment.*

*In addition, any rights that the Authority (or government) has to a share in the profits of the Partner **do influence the statistical treatment** (see Theme 15.1).*

*Any rights of control that the Authority (or government) has over the Partner through its share in the equity are relevant in determining the sector classification of the Partner and therefore whether the project falls within Eurostat's definition of an EPC (see comments in Chapter 2).*

### 14.1.4 Financing Guarantees

Some EPC arrangements involve government guarantees, given to third party debt or equity providers in order to attract financing or benefit from a lower cost of financing.

The terms of such guarantees (which may or may not be separate legal documents from the EPCs themselves) vary significantly from EPC to EPC. Typically the Partner will be required to indemnify government for any payments that government makes under the guarantee.

#### **Eurostat's comments**

*Eurostat's view is that any amount of the Partner's debt that is guaranteed by government **does influence the statistical treatment** (see Theme 14.1).*

*The amount of the guarantee must be adjusted to reflect the risk profile of the underlying debt/guarantee instrument (e.g. the multiplier applied to the underlying debt must also be applied to the guarantee, as mentioned above).*

### 14.1.5 Exemptions and incentives

Some EPC arrangements can benefit from government-led initiatives in the form of exemptions from liabilities (e.g. reduced tax liabilities for the Partner) or incentives (e.g. reduced energy tariffs for use of renewable energy sources).

#### **Eurostat's comments**

*Eurostat's view is that the value of any exemption or incentive provided by the Authority (or government) to an EPC arrangement constitutes government financing (see Theme 14.1) and therefore **does influence the statistical treatment** if the type of exemption or incentive is unique to the EPC arrangement in question. By contrast, if the exemption or incentive is of a type that is available to the wider market in the relevant jurisdiction (e.g. as a matter of law) it **does not influence the statistical treatment**.*

## 14.2 Other forms of Authority/government support

Other forms of financial support provided by the Authority (or any other government entity) can include provisions that limit the Partner's liability for savings shortfalls (i.e. failures to deliver the level of guaranteed savings). These types of support are usually included in the payment mechanism itself (see Theme 5.6).

A guarantee of the performance of some or all of the Authority's obligations under the EPC is sometimes given by another government entity on projects where there is concern about the Authority's ability to perform throughout the contract (e.g. a guarantee of its payment obligations is sometimes given where there are concerns about the Authority's credit-worthiness).

#### **Eurostat's comments**

*As mentioned in Theme 5.6, Eurostat's view is that forms of government support which limit the Partner's liability for savings shortfalls **do influence the statistical treatment** and automatically lead to the EPC being ON BALANCE SHEET for government.*

*Eurostat's view is that government support in the form of a guarantee that is limited to the performance of the Authority's own contractual obligations **does not influence the statistical treatment**.*

### 14.3 Financial close

On corporate-financed EPCs, and on project-financed EPCs where signature of the EPC and financial close occur simultaneously, the EPC makes no provision for adjustment to the Operational Payments to reflect the Partner's actual financing costs.

Where project-financing is used and the EPC is signed before financial close, it is common practice for the contract to contain a mechanism that adjusts and fixes the Operational Payments to reflect the underlying financing costs (usually the only variable being the base interest rate) achieved at financial close. If the EPC is signed before financial close and does not contain explicit provision for the impact of financial close, it is often unclear if either party has a right to seek adjustment of the Operational Payments to reflect the underlying financing costs achieved at financial close.

#### **Eurostat's comments**

*As mentioned in Chapter 1, Eurostat's position is that the statistical treatment is capable of being confirmed only at the point that financial close is achieved. As a result, making provision (or not) in the EPC to adjust the Operational Payments to reflect the impact of financial close (when it occurs) **does not influence the statistical treatment.***

### 14.4 Interest rate adjustments

On project-financed EPCs, the Partner's exposure to movements in interest rates is typically hedged through a long-term interest rate hedging arrangement. In most cases, the hedging arrangement is put in place simultaneously with financial close. However, in some cases, it is not put in place until an early point in the Construction Phase (e.g. once key permits have been awarded). If contract signature, financial close and hedging do not happen simultaneously, the EPC provides for an adjustment to the Operational Payments to reflect the interest rate set through the initial hedging arrangement.

#### **Eurostat's comments**

*Eurostat's view is that provisions for adjusting the Operational Payments to reflect the interest rate set through the initial hedging process (whether at financial close or at a later key milestone during the Construction Phase) **do not influence the statistical treatment.***

*Provisions for adjusting the Operational Payments to reflect fluctuations in interest rates in any other scenarios however (e.g. where only partial hedging arrangements are in place) **do influence the statistical treatment** and are an issue of HIGH importance.*

## 14.5 Availability of financing

Although the Authority (or government) may participate in the financing of an EPC (see Theme 14.1), the Partner typically takes the risk of the availability and cost of financing after financial close. There are very rare examples of projects in the PPP market (which has parallels with the EPC market) where the Authority has taken or shared this risk (e.g. through provisions for an upward/downward adjustment to the Operational Payments to reflect a change in financing costs following the refinancing of short-term debt arrangements put in place at financial close).

### **Eurostat's comments**

*Eurostat's view is that provisions by which the Authority takes risk on the availability and/or cost of financing after financial close through, for example:*

- *a commitment to provide financing itself; and/or*
- *increases in the Operational Payments to reflect changes in financing conditions or costs put in place at financial close;*

*are to be treated as financing guarantees. Theme 14.1.4 explains how the provision of financing guarantees **does influence the statistical treatment.***

*In addition, Eurostat's view is that provisions for a decrease in the Operational Payments to reflect a change in financing conditions or costs following the refinancing of short-term debt arrangements put in place at financial close represent an entitlement for the Authority to share in refinancing gains (see Theme 14.6.2 explaining how sharing refinancing gains may influence the statistical treatment).*

## 14.6 Refinancing

Some EPCs contain provisions dealing with the situation where the Partner wishes to refinance the original financing package that it put in place at financial close. These provisions typically:

- define the Partner's right to proceed with a refinancing with or without the approval of the Authority (see Theme 14.6.1); and
- set out the Authority's right to share in any financial gains that result from a refinancing (see Theme 14.6.2).

### 14.6.1 Authority approval to refinance

The EPC typically takes one of the following approaches to Authority approval of a proposed refinancing:

- the Authority can withhold its approval on any grounds;
- the Authority cannot unreasonably withhold or delay its approval;
- the Authority can withhold its approval only if the proposed refinancing would have an adverse effect on the performance of the EPC or would increase the Authority's liabilities on termination of the EPC;
- the Authority's approval is not required but the Authority has the right to audit the refinancing in order to determine its share of any refinancing gain (where applicable); and
- the Authority's approval is not required.

In EPCs where the Authority's approval to proceed with a refinancing is not required, it is likely that new financing terms put in place on a refinancing will not be reflected automatically in the termination compensation provisions. This means that, in practice, the Partner will not proceed without approval from the Authority and confirmation that the new financing terms will be used as the basis for calculating compensation on early termination.

In rare cases, the Authority might have the right to require the Partner to investigate opportunities for and/or to proceed with a refinancing.

#### **Eurostat's comments**

*Eurostat's views on the approaches described above are as follows:*

- *A right for the Authority to withhold its approval to a proposed refinancing **does not influence the statistical treatment** if its approval cannot be withheld or delayed unreasonably or if the grounds on which it can withhold its approval are limited to circumstances where the refinancing would have an adverse impact on the Authority (e.g. an increase in the Authority's potential liabilities on early termination) or on the performance of the EPC. Where this is not the case, the issue is of HIGH importance to the statistical treatment;*

- A right for the Partner to proceed with any refinancing without the Authority's approval **does influence the statistical treatment** if the effect of this is that the Authority's liabilities under the EPC could increase without its prior consent. Where this is the case, the issue is of HIGH importance to the statistical treatment;
- A right for the Authority to require the Partner to investigate opportunities for refinancing during the EPC **does influence the statistical treatment** if the Authority has a right to require the Partner to proceed with a refinancing (see below); and
- A right for the Authority to require the Partner to proceed with a refinancing **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.

#### 14.6.2 Refinancing gains

Refinancing gains arise through improvements in the terms of finance available for the project, and some EPCs provide that the Authority is entitled to share in such gains.

The Authority's share is usually specified as a fixed percentage or fixed percentages of the gain (with the Authority's percentage share varying according to the size of the gain).

In some EPCs, the refinancing gain is calculated on the assumption that the EPC is performing as forecast at financial close.

Typically the Authority will be entitled to receive its share of the gain in the form of a lump-sum payment, an adjustment to the Operational Payments or a combination of both (depending on the nature and the timing of the gain).

#### **Eurostat's comments**

*Eurostat's view is that there are two different approaches to refinancing gain sharing that **do not influence the statistical treatment**:*

- *The first approach is where the EPC states that the Authority is entitled to the share of any refinancing gain that results from identifiable actions of government. This approach is intended to allow the Authority to share in a refinancing gain to the extent that an action of government has led to improved terms of finance becoming available. An example would be Authority (or government) action that improves the Authority's credit rating, causing the financing market to reconsider the EPC's risk profile and offer more favourable finance terms. The Authority simply giving its approval to*

*the Partner proceeding with a refinancing (e.g. where the Authority's approval is required because the refinancing gain would increase its termination liabilities) is not, in Eurostat's view, a specific action of government that would entitle the Authority to a share of the refinancing gain; and*

- *The second approach is where the EPC states that the Authority is entitled to a specified share (no greater than one third) of any refinancing gain. Under this approach, no assessment is made of whether the refinancing gain results from the actions of the Authority or the Partner or other factors. Under this approach, specifying that the Authority is entitled to a share of more than one third of any refinancing gains automatically leads to the EPC being ON BALANCE SHEET for government.*

*Eurostat's view is that the EPC may adopt either one of the two approaches described above. Any provisions that attempt to combine the two approaches or that adopt any alternative approach to refinancing gain sharing automatically lead to the EPC being ON BALANCE SHEET for government.*

*In addition, Eurostat's view is that:*

- *The Authority having no right to share in refinancing gains **does not influence the statistical treatment;***
- *Calculating the refinancing gain on the assumption that the Partner's performance is as forecast at financial close **does not influence the statistical treatment;** and*
- *The mechanism by which the Authority receives its share of a refinancing gain **does not influence the statistical treatment.***

## 14.7 Foreign exchange rate risk

On EPCs where all or part of the financing raised by the Partner is in a different currency from the national currency, the Authority might take the risk of fluctuations in the relevant exchange rate. This is usually achieved through:

- the Operational Payments being denominated in the national currency, with a periodic adjustment to a proportion of the Operational Payments to reflect the impact of exchange rate fluctuations; or
- a proportion of the Operational Payments being denominated in the currency of the financing.

The proportion of Operational Payments that is either adjusted or denominated in the foreign currency reflects the proportion of the Partner's costs that is incurred in the foreign currency.

#### **Eurostat's comments**

*Eurostat's view is that provisions through which the Authority takes the risk of exchange rate fluctuations (as described above) **do not influence the statistical treatment.***

## **14.8 Lenders' step-in rights**

Some EPCs include an agreement between the Authority and the lenders that the lenders have a right to step in and attempt to rectify Partner defaults that would otherwise trigger the Authority's right to terminate the EPC early.

On stepping-in the lenders are usually permitted to exercise the rights of the Partner under the EPC but are also required to take on the Partner's liabilities under the EPC.

Related to this:

- Some EPCs make provision for the Authority and lenders to agree the extent of the Partner's liabilities that have accrued before step-in, and in so doing crystallise the lenders' liabilities to the Authority;
- Some EPCs give non-financial relief for the consequences of breaches committed before step-in (e.g. deductions for unavailability before step-in are applied to the Operational Payments but the deductions do not count for the purposes of triggering early termination of the contract); and
- In some cases, liabilities that arise during the period of step-in are limited and/or capped.

The lenders' step-in rights usually include the right to appoint other entities as temporary or permanent substitutes for the defaulting Partner, subject to the Authority's approval.

In some jurisdictions, lenders' step-in rights exist under law. In all jurisdictions, even if step-in rights are provided for in the contract or law, the lenders typically have the ability to take over the Partner's business by enforcing "security rights" that they have over the Partner's shares.

### **Eurostat's comments**

*Eurostat's view is that provisions for lenders' step-in rights (in a contract between the Authority and the lenders, or in law, or in lenders' security arrangements over the Partner's shares) **do influence the statistical treatment if** the exercise of those lenders' rights restricts the Partner's liabilities and/or increases the Authority's liabilities under the EPC before, during or after step-in. Where this is the case, the issue is of MODERATE importance to the statistical treatment. Provisions that allow the Authority and lenders to agree and fix the pre-step-in liabilities **do not influence the statistical treatment.***

*Provisions that disregard, for the purpose of applying early termination triggers, the performance of the Partner before step-in but still preserve its financial liabilities **do not influence the statistical treatment.***

## **14.9 Factoring/forfeiting arrangements**

In some EU jurisdictions EPCs are often combined with factoring (or forfeiting) arrangements, in which the Partner assigns a percentage of its entitlement to the Operational Payments to a third party. This is usually accompanied by a commitment from the Authority to pay those amounts directly to the third party irrespective of the Partner's performance under the EPC in terms of service delivery and/or achievement of energy consumption and/or cost savings.

### **Eurostat's comments**

*Eurostat's view is that a factoring (or forfeiting) arrangement that involves an obligation on the Authority to pay a third party a percentage of the Operational Payments **does not influence the statistical treatment if** all of the following conditions are met:*

- *under the provisions of the EPC the Partner is liable to the Authority for the full amount of any savings shortfalls (i.e. the Partner's liability is not capped, for example by reference to a specific amount or to the percentage of Operational Payments that are payable by the Authority to the Partner);*
- *the EPC allows the Authority to set-off the Partner's liability for any savings shortfalls against the percentage of future Operational Payments that are payable by the Authority to the Partner;*

- *the EPC imposes a time limit on the carry-forward and set-off of savings shortfalls, meaning that the Authority must have appropriate recourse against the Partner if any amount of a savings shortfall has not been set-off within a maximum period of one year from when the savings shortfall is determined. That recourse might be through a demand for immediate payment from the Partner and/or a right for the Authority to terminate the EPC;*

*These conditions are consistent with Eurostat's views on the payment mechanism set out in Theme 5.6. Factoring (or forfeiting) arrangements that do not meet these conditions automatically lead to the EPC being ON BALANCE SHEET for government.*

*Any obligation on the Authority to make payments to the third party on or following early termination of the EPC for Partner default must be assessed against Theme 12 of the Guide.*

# Government influence

## 15.1 Authority (or government) share in the ownership of the Partner

Although not observed in the current EPC market, it is important to note a feature of the PPP market in some EU jurisdictions that could be applied similarly on EPCs.

On a minority of PPP projects, the Authority (and/or other government entities) has a share in the ownership of the Partner. Across these projects, the Authority (or government) ownership arrangements vary (e.g. including the size of ownership share and the rights that attach to that share). However, some common features include:

- The Authority (or government) takes a minority share (ranging from 10% to 30%);
- The Authority (or government) has a right to appoint a director to the Partner's board;
- The Authority (or government) has rights to vote/veto certain decisions of the Partner, either through specific rights in the shareholders' agreement and/or through general company law; and
- The Authority's (or government's) shares carry a right to receive dividends.

### **Eurostat's comments**

*Eurostat's views on this feature of some PPPs would apply similarly if this feature were to be used on EPCs. The impact on the statistical treatment of EPCs is explained below.*

*Eurostat's view is that if the Authority's (or government's) share in the ownership of the Partner leads to a statistical classification of the Partner to the general government sector, the arrangement is not be considered an EPC by Eurostat and is on balance sheet for government (see Chapter 2).*

*Even where it is not sufficient to lead to the statistical classification of the Partner to the general government sector, an Authority's (or government's) share in the ownership of the Partner **does influence the statistical treatment** in two ways described below.*

*Firstly, the amount invested by the Authority (or government) in the shares of the Partner is considered to be government financing (see Theme 14.1).*

*Secondly, any entitlement to the Partner's profits is considered to be Authority (or government) reward from the asset (see Chapter 1) and **does influence the statistical treatment** as follows:*

- An entitlement to a share of 50% or more of the Partner's profit automatically leads to the EPC being ON BALANCE SHEET for government;*
- An entitlement to a share of less than 50% but more than one third of the Partner's profit is of VERY HIGH importance to the statistical treatment;*
- An entitlement to a share one third or less but more than 20% of the Partner's profit is of HIGH importance to the statistical treatment; and*
- An entitlement to a share of 20% or less but more than 10% of the Partner's profit is of MODERATE importance to the statistical treatment.*

*An entitlement to a share of 10% or less of the Partner's profit **does not influence the statistical treatment.***

*As stated in Chapter 2, if a public entity classified outside general government, acting on behalf of or on an express or implied instruction of government, takes a share in the ownership of the Partner, its share will be considered to be held by government. Likewise, as stated in the introduction to this Chapter, if a public entity classified outside general government has a share in the ownership of the Partner and has a specific arrangement to transfer any profit it makes from that share to a government entity, that profit will be considered to be government reward from the EPC.*

## **15.2 Authority rights of approval**

Most EPCs specify various actions that the Partner cannot take without the Authority's approval. These actions typically include:

- changing its name, corporate constitution or tax domicile (where the Partner is an SPV);
- carrying out any business that is not related to the EPC (where the Partner is an SPV);
- changing key personnel involved in delivering the EPC;
- changing, terminating or entering into new key sub-contracts;

- granting the lenders “security rights” over the EPC assets;
- refinancing (see Theme 14.6);
- changing the terms and conditions of staff transferring from the Authority to the Partner; and
- selecting an insurer for the insurances required under the EPC.

Some EPCs also require the Partner to obtain the Authority’s approval if it wishes to make any changes to its owners/shareholders (typically where the Partner is an SPV). The strength of the Authority’s approval rights varies from contract to contract, and might be stronger in the early years of the EPC. For example, the Authority’s approval may be required for any proposed change in ownership during the Construction Phase and for a period of between two to five years after construction is complete, and thereafter only for:

- transfers of ownership from those that have another role in the EPC in addition to being owners/shareholders (e.g. as construction contractor or service provider); and/or
- transfers to third parties involved in businesses that raise public policy concerns.

In a minority of cases, the Authority’s approval is required for each and every change in ownership during the period of the contract.

#### **Eurostat’s comments**

*Eurostat’s view is that the Authority rights of approval described above **do not influence the statistical treatment**. However, for refinancing approvals, see Theme 14.6.*

### **15.3 Authority step-in rights**

EPCs will often include provisions that allow the Authority to step in and take over the delivery of the EPC from the Partner on a temporary basis in circumstances where:

- it is in the public interest for the Authority to do so (e.g. because of health and safety concerns, issues of national security, or other reasons connected to the Authority’s public duties); and/or
- the Partner is in default of its obligations under the EPC.

The Authority's rights are usually limited both in terms of the action it can take and the period for which it can take it. In other words, it has the right to do what is needed, for the time period that is needed, to address the underlying reason for the step-in and continue the performance of the EPC. The Authority has to give the Partner (and sometimes also the lenders) prior notice of its intention to step in.

Some EPCs require the Authority to continue to pay the Partner the full Operational Payments during the period of step-in, but allow the Authority to deduct any step-in costs that it incurs if it has stepped-in because of the Partner's poor performance.

In some jurisdictions (or in some specific sectors within jurisdictions) the Authority's right to intervene in the delivery of the EPC exists as a matter of law. The law will usually also address any claim that the Partner has for costs and/or losses that it incurs as a result of such intervention.

#### **Eurostat's comments**

*Eurostat's view is that provisions that allow the Authority to step in and take over delivery of the EPC from the Partner (either on specific grounds specified in the contract or general grounds specified in law) **do not influence the statistical treatment.***

*An obligation on the Authority to continue to pay the Operational Payments in full during the period of step-in **does not influence the statistical treatment if:***

- *deductions for unavailability and/or poor service performance up to the date that the Authority steps in and after the date that the Authority steps out are applied to the Operational Payments as envisaged for the normal operation of the EPC; and*
- *the Authority is entitled to recover its step-in costs from the Partner if the Authority has stepped in because of the Partner's poor performance.*

*Where either of these conditions is not met, the issue is of MODERATE importance to the statistical treatment.*

## 15.4 Caps on Partner profit or revenues

Some (rare) EPCs contain provisions that cap the amount of revenue or profit that the Partner can make from the EPC. The cap can be expressed, for example, as a monetary value or a percentage return on equity. The cap can also be expressed as an amount of energy consumption and/or cost savings generated under the EPC. These provisions might:

- require the Partner to pay the Authority (or wider government) the amount of any revenue or profit that exceeds the cap; and/or
- trigger expiry (or early termination) of the EPC (see Theme 13.1).

A cap on the Partner's revenue or profit might be set indirectly through linking the duration of the contract to the achievement of a certain level of energy consumption and/or cost savings (see comments at Theme 5.6.5 and Theme 13.1).

### **Eurostat's comments**

*Eurostat's view is that any provision that imposes a cap on the Partner's revenue or profit **does influence the statistical treatment** and automatically leads to the EPC being ON BALANCE SHEET for government.*

*Eurostat considers provisions that link the EPC's expiry to the Partner having generated a specific amount of revenue or profit (however that is expressed) to be akin to a cap on Partner revenue or profit, which **does influence the statistical treatment** and would automatically lead to the EPC being ON BALANCE SHEET for government.*



## Theme 16

# Miscellaneous provisions

## 16.1 Dispute resolution procedure

The approach taken to resolution of disputes between the Authority and the Partner varies from contract to contract, depending on the processes available in the relevant jurisdiction and the Authority's broader policies on public contracts. Typically, final determination of disputes will be referred to local and/or national courts or to arbitration.

Most EPCs provide the opportunity for some form of alternative dispute resolution process (e.g. mediation) to be followed before resorting to a court or arbitration process.

### **Eurostat's comments**

*Eurostat's view is that the procedure for resolution of disputes between the parties **does not influence the statistical treatment.***

## 16.2 Information and confidentiality

Most EPCs contain provisions that deal with:

- information relating to the contract arrangements that the parties are required to share with each other;
- information relating to the contract arrangements that the parties are entitled to share with third parties; and
- information relating to the contract arrangements that must be kept confidential.

### **Eurostat's comments**

*Eurostat's view is that provisions in the EPC that deal with obligations relating to information and confidentiality **do not influence the statistical treatment.***

## 16.3 Compliance with law

Most EPCs impose an express obligation on each party to perform the contract in accordance with relevant laws, good industry practice, etc.

### **Eurostat's comments**

*Eurostat's view is that general provisions in the EPC that require the parties to comply with law, good industry practice, etc. **do not influence the statistical treatment.***

## 16.4 Restrictions on assignment (transfer) of the EPC

Most EPCs impose an absolute prohibition on the Partner assigning or transferring the contract to any third party without the Authority's prior agreement.

Some EPCs mirror this prohibition in the case of assignation or transfer of the EPC by the Authority (i.e. the Authority must obtain the Partner's prior agreement), but many EPCs give the Authority more flexibility (e.g. in the case of assignments or transfers to the Authority's successors or other public authorities in a re-structuring or reorganisation).

### **Eurostat's comments**

*Eurostat's view is that provisions that restrict (either absolutely or conditionally) the parties' rights to assign or transfer the EPC to third parties **do not influence the statistical treatment.***



## CHAPTER 4

# Concluding the Statistical Treatment Assessment

## Overview

Chapter 4 summarises the methodology that Eurostat uses in practice to reach a conclusion on the statistical treatment of an EPC, assuming that the EPC uses the typical provisions described in Chapter 3.<sup>40</sup>

It is important that Chapter 4 is not used on its own as a tool for concluding the statistical treatment assessment of a specific EPC. As Chapter 4 is based on the typical provisions described in Chapter 3, users must bear in mind the limitations and qualifications stated in the introduction to the Guide and at the beginning of Chapter 3.

Eurostat's methodology for the assessment of the statistical treatment of an EPC is based on three main steps:

- identifying the issues that typically influence the statistical treatment;
- analysing the significance of the issues that influence the statistical treatment; and
- concluding the statistical treatment assessment.

### Step 1: identifying the issues that typically influence the statistical treatment

The first step is to identify all the provisions of the relevant EPC (and related documents and underlying law) that influence the statistical treatment and to list these according to their category of importance (i.e. ON BALANCE SHEET, VERY HIGH, HIGH or MODERATE). For easy reference, the typical EPC provisions identified in Chapter 3 that influence the statistical treatment are listed and categorised in the table in Annex 1 to the Guide.

If this step identifies no provisions that influence the statistical treatment, it is reasonable to assume that the EPC is off balance sheet for government. In this case, steps 2 and 3 below do not apply.

If this step identifies one or more automatic ON BALANCE SHEET provisions, the EPC is on balance sheet for government and steps 2 and 3 below do not apply.

If this step identifies no automatic ON BALANCE SHEET provisions but one or more issues of VERY HIGH, HIGH, or MODERATE importance, steps 2 and 3 below apply.

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<sup>40</sup> Chapter 4 applies only if the arrangement falls within Eurostat's own definition of an EPC (see Chapter 2).

## Step 2: analysing the significance of the issues that influence the statistical treatment

The second step is to analyse the degree to which each of the influential provisions identified at step 1 has an impact on the economic substance of the arrangements.

The aim of this analysis is to “sense check” whether the categorisation of issues identified at step 1 is appropriate or whether an adjustment to the categorisation should be made given the facts and circumstances of the relevant arrangements. The analysis needs to be done in the spirit of the views expressed by Eurostat in Chapter 3. In some cases, a quantitative assessment of the actual or potential impact of a provision may be possible and may be considered by Eurostat to be relevant to this analysis. The outcome of this analysis might, for example, be to re-categorise a HIGH importance provision identified under step 1 as a MODERATE importance provision.

It is important to note that, under step 2:

- Eurostat will not re-categorise a VERY HIGH importance provision as HIGH or MODERATE or re-categorise a HIGH or MODERATE importance provision as VERY HIGH;
- Eurostat will not re-categorise a provision where its importance to the statistical treatment (as stated in Chapter 3) is based on a specified proportion or percentage;<sup>41</sup> and
- In extreme cases, Eurostat may re-categorise a HIGH<sup>42</sup> importance provision as ON BALANCE SHEET for government.

<sup>41</sup> Examples include: government financing that amounts to **10% or less** of the capital expenditure is of MODERATE importance; government equity with a right to a share of more than **one third** of the Partner’s profit is of VERY HIGH importance.

<sup>42</sup> Chapter 3 identifies only two VERY HIGH importance provisions (see Themes 14.1 and 15.1). Given that these are both based on specified proportions neither would be re-categorised as ON BALANCE SHEET for government.

The following examples illustrate how step 2 may be applied by Eurostat in practice:

- Chapter 3 states that a grace period for deductions that exceeds three months on an EPC of 8 years duration is categorised as an issue of MODERATE importance (see Theme 4.3). The economic impact of a grace period of five months is, of course, very different from the impact of a grace period of one year. While, when applying step 2, it would likely be appropriate to maintain a MODERATE categorisation for an five-month grace period, it is likely that a one-year grace period would be re-categorised as HIGH; and
- Chapter 3 states that compensation event provisions that do not meet the conditions stated in Theme 6.1 are categorised as an issue of HIGH importance. It is possible that, in a specific EPC arrangement, provisions that do not meet these conditions could be re-categorised as MODERATE (e.g. in the case of compensation for an event that is foreseeable but that has a very low likelihood of occurrence and a very low likely economic impact). It is also possible that, in a specific EPC arrangement, provisions would not meet these conditions to such a significant degree that the issue would be re-categorised as leading to an ON BALANCE SHEET treatment. This could for example be the case of a compensation event that covers macro-economic conditions or is foreseeable or controllable by the Partner, to such extent that the Partner cannot be considered to be taking risk on the price/quality/timetable of the construction of the EPC assets.

### Step 3: concluding the statistical treatment assessment

Once all influential provisions have been identified (step 1) and their importance (i.e. VERY HIGH, HIGH, MODERATE) has been analysed (step 2), a conclusion on the statistical treatment of the relevant EPC can be reached.

Given that the individual facts and circumstances of EPCs vary widely, it would be inappropriate to use a purely quantitative/scoring approach to conclude the statistical treatment assessment. However, Eurostat is of the view that the following guidelines should help in reaching a conclusion.

According to Eurostat, there would be a strong presumption that the EPC is off balance sheet for government if, after step 2, it has:

- no more than one VERY HIGH importance provision, no HIGH importance provisions and no more than two MODERATE importance provisions; or
- no VERY HIGH importance provisions, no more than two HIGH importance provisions and no more than one MODERATE importance provision; or

- no VERY HIGH importance provisions, no more than one HIGH importance provision and no more than four MODERATE importance provisions; or
- no VERY HIGH importance provisions, no HIGH importance provisions and no more than seven MODERATE importance provisions.

Presenting this in another way, there is a strong presumption that an EPC is off balance sheet for government if, after step 2, it has:

	VERY HIGH	HIGH	MODERATE
Number of issues identified:	≤ 1	0	≤ 2
Number of issues identified:	0	≤ 2	≤ 1
Number of issues identified:	0	≤ 1	≤ 4
Number of issues identified:	0	0	≤ 7

If an EPC has a combination of VERY HIGH, HIGH and/or MODERATE provisions that does not fall within one of the thresholds listed above, there is a strong likelihood that Eurostat will conclude that it is on balance sheet for government.



## ANNEX 1

# Table of Typical EPC Provisions that Influence the Statistical Treatment

The table below lists the typical EPC provisions that, as stated in Chapter 3, do influence the statistical treatment. It also identifies whether a provision is one that automatically leads to the EPC being ON BALANCE SHEET for government or whether it is of VERY HIGH, HIGH or MODERATE importance to the statistical treatment. It can be used as a reference point for step 1 in the methodology for reaching a conclusion on the statistical treatment (see Chapter 4). However, it is important to note that applying step 2 of the methodology (see Chapter 4) may result in provisions being re-categorised from those specified in the table below.

This table should not be used on its own as a tool for determining the statistical treatment of an EPC. It must be read in conjunction with the text in Chapter 3 which explains the particular features of the typical EPC provisions that influence the statistical treatment. At the same time, it is important that users recognise the limitations inherent in Chapter 3 itself (i.e. that while Chapter 3 contains an overview of a comprehensive set of provisions in typical EPCs it cannot, by its nature, take into account all of the facts, circumstances and provisions of individual EPCs).

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 2: Specification, design, construction and installation of the EPC assets</b>					
Responsibility for specification and design: issues with Authority taking risk as described in Theme 2.1	2.1			✓	
Construction costs: issues with the Authority taking construction and/or installation cost savings as described in Theme 2.2	2.2	✓			
Construction and/or installation completion: issues with completion criteria as described in Theme 2.3	2.3			✓	
Construction and/or installation completion: issues with phased completion and phased Operational Payments as described in Theme 2.3	2.3			✓	

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Snagging works: issues described in Theme 2.4	2.4			✓	
Reimbursement of Authority costs: issues described in Theme 2.6	2.6			✓	
<b>Theme 3: Maintenance and operation of the EPC assets</b>					
Responsibility for operation and maintenance: issues with Authority responsibility for maintenance as described in Theme 3.1	3.1			✓	
Maintenance standards: issues described in Theme 3.2	3.2	✓			
Maintenance plan: issues with Authority approval reducing Partner risk as described in Theme 3.3	3.3			✓	
Maintenance plan: issues with requiring Partner to incur costs as described in Theme 3.3	3.3				✓
Maintenance funds: issues with the Authority taking risk on a maintenance fund as described in Theme 3.4	3.4			✓	
Maintenance fund: issues with the Authority taking reward on a maintenance fund as described in Theme 3.4	3.4	✓			
Maintenance: issues with the Authority taking benefit of maintenance cost savings as described in Theme 3.4	3.4	✓			

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 4: The Guaranteed Savings</b>					
Guaranteed savings: no guaranteed level of savings as described in Theme 4.	4	✓			
Defining the guarantee: issues in setting the level of guaranteed savings as described in Theme 4.1	4.1	✓			
Monitoring and measuring performance: lack of objective and robust regime as described in Theme 4.2	4.2	✓			
Monitoring and measuring performance: Authority approval reducing Partner risk as described in Theme 4.2	4.2			✓	
Testing performance: failure to test performance at least annually as described in Theme 4.3	4.3	✓			
Testing performance: provision for unreasonably long grace periods as described in Theme 4.3	4.3				✓
Testing performance: issues with calculating delivery of the guaranteed savings as described in Theme 4.3	4.3	✓			
Routine adjustments: scope and nature of provisions do not meet conditions described in Theme 4.5	4.5			✓	
Non-routine adjustments: scope and nature of provisions do not meet conditions as described in Theme 4.6	4.6			✓	

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 5: The payment mechanism</b>					
Commencement of Operational Payments: provision for payments to commence before completion of the EPC assets as described in Theme 5.2	5.2	✓			
Indexation: issues described in Theme 5.3	5.3				✓
Pass-through costs: issues with the scope/nature of pass-through costs as described in Theme 5.4	5.4	✓			
Savings shortfalls: failure to apply the principle of proportionality as described in Theme 5.6.2	5.6.2	✓			
Savings shortfalls: failure to comply with the conditions on the set-off and carry forward of shortfalls as described in Theme 5.6.2	5.6.2	✓			
Savings shortfalls: capping the Partner's liability for savings shortfalls as described in Theme 5.6.3	5.6.3	✓			
Savings excesses: provision for the Authority to share in savings excesses in a way that does not align with Theme 5.6.4	5.6.4	✓			
Savings excesses: provision for bonus payment not linked to savings as described in Theme 5.6.4	5.6.4	✓			
Savings excesses: capping the Partner's share of savings excesses as described in Theme 5.6.5	5.6.5	✓			

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Payment mechanism reviews: issues with reviews leading to guarantee adjustments as described in Theme 5.9	5.9	✓			
<b>Theme 6: Compensation, relief and force majeure events</b>					
Scope and nature of events: provisions that do not meet the conditions described in Theme 6.1	6.1			✓	
Quantifying compensation/relief: provisions that do not meet the conditions described in Theme 6.1.4	6.1.4			✓	
Compensation, relief and force majeure events that are dealt with through public law provisions as described in Theme 6.2	6.2	Specific analysis required			
<b>Theme 7: Changes to the EPC</b>					
Authority changes: issues with Partner compensation/relief as described in Theme 7.1	7.1			✓	
Partner changes: obligation on the Authority to accept changes as described in Theme 7.2	7.2			✓	
<b>Theme 8: Changes in law</b>					
Change in law: issues with Authority taking change in law risk as described in Theme 8	8				✓
<b>Theme 9: Insurance</b>					
Insurance requirements provision for the Authority to take out certain insurances as described in Theme 9.1	9.1			✓	

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Insurance costs: provisions for the Authority to take/share risk/benefit of insurance cost changes that do not meet the conditions described in Theme 9.3	9.3			✓	
Uninsurability: issues identified in Theme 9.4	9.4			✓	
<b>Theme 10: Warranties and indemnities</b>					
Warranties: warranties that relate to risks and rewards as described in Theme 10.1	10.1	Specific analysis required			
Indemnities given by the Partner: limits or exclusions on indemnities that do not meet the conditions described in Theme 10.2	10.2			✓	
Indemnities given by the Authority: indemnities for risks other than those described in Theme 10.3	10.3			✓	
<b>Theme 11: Early termination of the EPC</b>					
Authority default termination: issues with Authority default termination triggers as described in Theme 11.2	11.2			✓	
Rights of suspension: provisions that do not meet the condition described in Theme 11.6	11.6			✓	
<b>Theme 12: Compensation on early termination</b>					
Provisions that do not preserve pre-termination liabilities as described in Theme 12	12			✓	

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
No express provision on compensation amounts payable on early termination as described in Theme 12	12	<b>Specific analysis required</b>			
Partner default termination compensation: re-tendering provisions that do not take into account the Partner's performance of the project as described in Approach 1 in Theme 12.1.1 (first condition listed)	12.1.1	✓			
Partner default termination compensation: issues with the methodology for estimating the market value of the contract not meeting the conditions described in Approach 1 in Theme 12.1.1 (second condition listed)	12.1.1	✓			
Partner default compensation: provisions that do not meet the remaining conditions listed in Approach 1 in Theme 12.1.1	12.1.1			✓	
Partner default termination compensation: provisions that do not take into account the Partner's performance of the EPC as described in Approach 2 in Theme 12.1.2	12.1.2	✓			
Partner default termination compensation: provisions that compensate the Partner for loss of profit as described in Approach 2 in Theme 12.1.2	12.1.2	✓			

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Partner default termination compensation: provisions that only partially take into account the Partner's performance of the project as described in Approach 2 in Theme 12.1.2	12.1.2			✓	
Force majeure termination compensation: issue of compensation calculation as described in Theme 12.4	12.4				✓
Schedule of termination charges: provision of a pre-agreed amount payable on termination for Partner default as described in Theme 12.6	12.6	✓			
Schedule of termination charges: issue with the provision of a pre-agreed amount payable on force majeure termination as described in Theme 12.6	12.6				✓
<b>Theme 13: Expiry of the EPC</b>					
Expiry date: provisions that link expiry of EPC to a milestone as described in Theme 13.1	13.1	✓			
Condition of the EPC assets on expiry: issue described in Theme 13.3	13.3			✓	
<b>Theme 14: Financing arrangements</b>					
Authority/government financing at or above the 50% threshold as described in Theme 14.1	14.1	✓			
Authority/government financing above the one third threshold as described in Theme 14.1	14.1		✓		

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
Authority/government financing above the 10% threshold as described in Theme 14.1	14.1			✓	
Authority/government financing up to (and including) the 10% threshold as described in Theme 14.1	14.1				✓
Provisions that limit the Partner's liability for savings shortfalls as described in Theme 14.2	14.2	✓			
Interest rate adjustments: issues described in Theme 14.4	14.4			✓	
Refinancing: Authority's right to withhold approval for proposed refinancing on unlimited grounds as described in Theme 14.6.1	14.6.1			✓	
Refinancing: provisions that allow a refinancing to increase the Authority's liabilities under the EPC without its consent as described in Theme 14.6.1	14.6.1			✓	
Refinancing: a right for the Authority to require the Partner to proceed with a refinancing as described in Theme 14.6.1	14.6.1	✓			
Refinancing: gain-sharing provisions that do not align with either approach as described in Theme 14.6.2	14.6.2	✓			
Lenders' step-in rights: issues with liabilities as described in Theme 14.8	14.8				✓
Factoring/forfeiting: provisions that do not align with the conditions described in Theme 14.9	14.9	✓			

	Chapter 3 reference	Automatically ON BALANCE SHEET	VERY HIGH importance	HIGH importance	MODERATE importance
<b>Theme 15: Government influence</b>					
Authority/government entitlement to a share of profit at or above the 50% threshold as described in Theme 15.1	15.1	✓			
Authority/government entitlement to a share of profit above the one third threshold as described in Theme 15.1	15.1		✓		
Authority/government entitlement to a share of profit above the 20% threshold (up to and including a one third share) as described in Theme 15.1	15.1			✓	
Authority/government entitlement to a share of profit above the 10% threshold (up to and including 20%) as described in Theme 15.1	15.1				✓
Authority step-in rights: issues described in Theme 15.3	15.3				✓
Caps on Partner profit or revenue: provisions that cap Partner profit or revenue as described in Theme 15.4	15.4	✓			



## ANNEX 2

# Government and EU financing in EPCs (worked examples)

This Annex presents worked examples that illustrate the application of Eurostat's rules on:

- Government and/or EU financing (see Theme 14.1); and
- Guaranteed savings (see Theme 4.1).

## Government and/or EU financing

The rules on government financing look at the share of government financing<sup>43</sup> as a proportion of the capital expenditure (less EU grants) incurred:

$$\frac{\text{Government financing (grants, financial instruments)}}{\text{Capital expenditure – EU grants}} = \text{government share of financing}$$

If that share is:

- $\geq 50\%$  the EPC is ON BALANCE SHEET for government
- $> 1/3$  but  $< 50\%$  it is of VERY HIGH importance to the statistical treatment
- $> 10\%$  but  $\leq 1/3$  it is of HIGH importance to the statistical treatment
- $\leq 10\%$  it is of MODERATE importance to the statistical treatment.

Government financing is most often provided in the form of non-repayable capital grants or financial instruments (FIs) such as loans or guarantees.

Financing from the EU can come directly from EU programmes or instruments, or through European Structural and Investment Fund (ESIF) operational programmes, in the form of non-repayable capital grants or financial instruments such as loans or guarantees. EU support that comes through ESIF's operational programmes is provided on the basis that it is matched by a national contribution ("national co-financing"). The national co-financing might come from private sector or government resources. National co-financing of EU support from government resources is, for the purposes of Eurostat's rules, treated as government financing.

<sup>43</sup> As explained in Theme 14.1, government's contribution to the financing of a specific EPC looks in aggregate at the financing provided to the EPC by all entities classified to the general government sector.

## Guaranteed savings

The principal rule on guaranteed savings is that the level of guaranteed savings over the duration of the EPC is equal to or greater than the sum of:

- the Operational Payments forecast to be made by the Authority to the Partner over the duration of the EPC; and
- any amount of government financing that is not repayable by the Partner.

$$\sum \text{Guaranteed savings} \geq \sum \text{Operational Payments} + \text{government grants}$$

If this rule is not satisfied then the EPC is ON BALANCE SHEET for government.

The worked examples below demonstrate how, in practice, the interaction between Eurostat's rules on these two Themes might influence the extent of energy efficiency measures undertaken and the use of government and/or EU resources in an EPC arrangement where an off government balance sheet assessment is desired.

## Scenario

A regional health authority wants to undertake energy efficiency measures in all of its hospitals through an EPC. Its annual energy cost, before the measures, is EUR 8.5 million<sup>44</sup>. It considers two different renovation options:

- **Option A:** a basic refurbishment of heating, ventilation and air conditioning systems and the lighting systems. For a capital expenditure of EUR 10 million, these measures will achieve annual energy consumption savings of 20% (i.e. EUR 1.7 million). A contract duration of 10 years is assumed;
- **Option B:** a more comprehensive refurbishment that goes beyond the basic refurbishment in option A to include refurbishment of the building envelope (e.g. thermal insulation, new windows and doors). This option, with a capital expenditure of EUR 25 million, will achieve annual energy consumption savings of 40% (i.e. equivalent to EUR 3.4 million). Five financing solutions for option B are presented below and all of these assume a contract duration of 10 years.<sup>45</sup>

<sup>44</sup> The numbers used in this scenario are for illustrative purposes only and do not reflect any project or approach observed in the EPC market.

<sup>45</sup> A more comprehensive renovation would typically lead to a longer contract duration, but to simplify the comparison between the options and financing solutions a duration of 10 years is used in all of the examples presented.

For each option and financing solution, the examples below indicate how the EPC is assessed against Eurostat’s tests on government financing and the level of guaranteed savings (referred to above and described more fully in Themes 4.1 and 14.1). The examples focus only on these two tests and a full assessment of all of the EPC provisions against the whole Guide is needed in order to identify any other issues that influence the statistical treatment and point to the EPC being ON BALANCE SHEET for government.

**Option A: basic refurbishment; 20% guaranteed savings; no government or EU financing**

The Partner guarantees energy consumption savings of 20%, against annual Operational Payments of EUR 1.55 million. The net annual saving for the regional health authority (i.e. Operational Payments less guaranteed savings) is EUR 150,000. The capital expenditure is financed fully by the Partner (i.e. there is no government or EU financing).

<b>Baseline energy costs (annual; EUR)</b>	8.5m	<b>Capital expenditure (EUR)</b>	10m	
<b>Guaranteed savings (%)</b>	20%		<b>Financed by:</b>	
<b>Guaranteed savings (annual; EUR)</b>	1.7m		<b>Partner</b>	10m
<b>Contract duration</b>	10 years		<b>Grant (government)</b>	0
<b>Operational Payment (annual)</b>	1.55m		<b>Grant (EU)</b>	0
			<b>FI (government)</b>	0
			<b>FI (EU)</b>	0
<b>Eurostat tests:</b>				
<b>1. Government financing (%)</b>				→ 0
<b>2. <math>\Sigma</math> guaranteed savings <math>\geq</math> <math>\Sigma</math> Operational Payments + (non-repayable) government financing (grant)</b>				→ YES

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is satisfied:** there is no government financing;
- **Test 2 is satisfied:** the guaranteed savings (EUR 17 million over 10 years) exceed the sum of the Operational Payments (EUR 15.5 million over 10 years) and non-repayable government financing (EUR 0).

### Option B.1: Comprehensive refurbishment; 40% guaranteed savings; no government or EU financing

The Partner guarantees energy consumption savings of 40% against annual Operational Payments of EUR 3.65 million. Overall, the regional health authority's annual costs increase (the annual Operational Payments exceed the guaranteed savings). The EPC is financed fully by the Partner (i.e. there is no government or EU financing).

<b>Baseline energy costs (annual; EUR)</b>	8.5m	<b>Capital expenditure (EUR)</b>	25m	
<b>Guaranteed savings (%)</b>	40%		<b>Financed by:</b>	
<b>Guaranteed savings (annual; EUR)</b>	3.4m		<b>Partner</b>	25m
<b>Contract duration</b>	10 years		<b>Grant (government)</b>	0
<b>Operational Payment (annual)</b>	3.65m		<b>Grant (EU)</b>	0
			<b>FI (government)</b>	0
			<b>FI (EU)</b>	0
<b>Eurostat tests:</b>				
1. <b>Government financing (%)</b>			→ 0	
2. <b><math>\Sigma</math> guaranteed savings <math>\geq</math> <math>\Sigma</math> Operational Payments + (non-repayable) government financing (grant)</b>			→ NO	

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is satisfied:** (there is no government financing);
- **Test 2 is not satisfied:** the guaranteed savings (EUR 34 million over 10 years) is lower than the sum of the Operational Payments (EUR 36.5 million over 10 years) and non-repayable government financing (EUR 0). Failure to satisfy this test means that the EPC is ON BALANCE SHEET for government.

## Option B.2: Comprehensive refurbishment; 40% guaranteed savings; government capital grant

The regional health authority is able to secure a national government capital grant of EUR 5 million which is paid to the Partner to subsidise the capital investment. This results in the Partner reducing its annual Operational Payments to EUR 2.95 million. The net annual saving for the regional health authority is EUR 450,000.

<b>Baseline energy costs (annual; EUR)</b>	8.5m	<b>Capital expenditure (EUR)</b>	25 m	
<b>Guaranteed savings (%)</b>	40%		<b>Financed by:</b>	
<b>Guaranteed savings (annual; EUR)</b>	3.4m		<b>Partner</b>	20m
<b>Contract duration</b>	10 years		<b>Grant (government)</b>	5m
<b>Operational Payment (annual)</b>	2.95m		<b>Grant (EU)</b>	0
			<b>FI (government)</b>	0
			<b>FI (EU)</b>	0
<b>Eurostat tests:</b>				
<b>1. Government financing (%)</b>			→ 20% (HIGH importance)	
<b>2. <math>\Sigma</math> guaranteed savings <math>\geq</math> <math>\Sigma</math> Operational Payments + (non-repayable) government financing (grant)</b>			→ NO	

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is satisfied:** the national government grant constitutes government financing. Representing 20% of the capital expenditure, this is an issue of HIGH importance in assessing the statistical treatment;<sup>46</sup>

<sup>46</sup> As explained in Chapter 4, the combination of an issue of HIGH importance with other issues that influence the statistical treatment (as referred to in Chapter 3) can lead to the EPC being ON BALANCE SHEET for government.

- **Test 2 is not satisfied:** the sum of the guaranteed savings (EUR 34 million over 10 years) is lower than the sum of the Operational Payments (EUR 29.5 million over 10 years) and the government grant (EUR 5 million). Failure to satisfy this test means that the EPC is ON BALANCE SHEET for government.

### Option B.3: Comprehensive refurbishment; 40% guaranteed savings; ESIF grant

A capital grant of EUR 5 million is available from an ESIF operational programme as an alternative to the national government capital grant in option B.2. The ESIF grant consists of 50% EU funding and 50% national government sector co-financing. As in option B.2, the capital grant subsidises the capital expenditure and enables the Partner to set the Operational Payments at EUR 2.95 million, resulting in annual cost savings of EUR 450,000 for the regional health authority.

<b>Baseline energy costs (annual; EUR)</b>	8.5m	<b>Capital expenditure (EUR)</b>	25m	
<b>Guaranteed savings (%)</b>	40%		<b>Financed by:</b>	
<b>Guaranteed savings (annual; EUR)</b>	3.4m		<b>Partner</b>	20m
<b>Contract duration</b>	10 years		<b>Grant (government)</b>	2.5m
<b>Operational Payment (annual)</b>	2.95m		<b>Grant (EU)</b>	2.5m
			<b>FI (government)</b>	0
			<b>FI (EU)</b>	0
<b>Eurostat tests:</b>				
1. <b>Government financing (%)</b>			→ 11% (HIGH importance)	
2. <b><math>\Sigma</math> guaranteed savings <math>\geq</math> <math>\Sigma</math> Operational Payments + (non-repayable) government financing (grant)</b>			→ YES	

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is satisfied:** the national government sector co-financing element of the grant (EUR 2.5 million) constitutes government financing. In calculating this as a share of capital expenditure, the EU grant of EUR 2.5 million is deducted from the total capital expenditure. The government financing is therefore 11%, which is an issue of HIGH importance in assessing the statistical treatment.
- **Test 2: is satisfied:** the sum of the guaranteed savings (EUR 34 million over 10 years) is higher than the sum of the Operational Payments (EUR 29.5 million over 10 years) and the government grant (EUR 2.5 million).

#### **Option B.4: Comprehensive refurbishment; 40% guaranteed savings; EU grant and government loan**

In this scenario, the Partner receives an EU capital grant of 5 million that does not require any national co-financing.<sup>47</sup> In addition, the Partner receives a preferential loan of EUR 10 million from a government agency, which is a public entity classified as inside the general government sector. Adding the preferential loan enables the Partner to set the annual Operational Payments at EUR 2.8 million (i.e. lower than in scenarios B.2 and B.3 which involved a grant only). The regional health authority's annual net savings are EUR 600,000.

<b>Baseline energy costs (annual; EUR)</b>	8.5m	<b>Capital expenditure (EUR)</b>	25m	
<b>Guaranteed savings (%)</b>	40%		<b>Financed by:</b>	
<b>Guaranteed savings (annual; EUR)</b>	3.4m		<b>Partner</b>	20m
<b>Contract duration</b>	10 years		<b>Grant (government)</b>	0
<b>Operational Payment (annual)</b>	2.8m		<b>Grant (EU)</b>	5m

<sup>47</sup> This could include a grant from an ESIF Operational Programme where the Partner's own financing contribution counts as national private co-financing.

			FI (government)	10
			FI (EU)	0
<b>Eurostat tests:</b>				
1.	<b>Government financing (%)</b>		→ 50% (ON BALANCE SHEET)	
2.	<b><math>\Sigma</math> guaranteed savings <math>\geq</math> <math>\Sigma</math> Operational Payments + (non-repayable) government financing (grant)</b>		→ YES	

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is not satisfied:** the preferential loan constitutes government financing<sup>48</sup>. In calculating this as a share of capital expenditure, the EU grant of EUR 5 million is deducted from the total capital expenditure. This results in a government financing share of 50% and the EPC is ON BALANCE SHEET for government;
- **Test 2 is satisfied:** the sum of the guaranteed savings (EUR 34 million over 10 years) is higher than the sum of the Operational Payments (EUR 28 million over 10 years) and the government grant (EUR 0 million).

### **Option B.5: Comprehensive refurbishment; 40% guaranteed savings; EU grant and ESIF loan**

As with option B.4, this solution involves a preferential loan of EUR 10 million provided by the government agency to the Partner. However, here the preferential loan is funded by an ESIF Operational Programme, consisting of 50% EU funding and 50% of national public (government-sector) co-financing<sup>49</sup>. As in option B.4, the combination of the EU grant and the guarantee result in the Partner setting the annual Operational Payments at EUR 2.8 million. The regional health authority's annual cost savings are EUR 600,000.

<sup>48</sup> By contrast, if the guarantee were granted by a public entity that is not classified in the general government sector (e.g. a national bank) then it would not be considered government financing unless that entity was acting on behalf of or on an express or implied instruction of government (see Chapter 2).

<sup>49</sup> If an ESIF Operational Programme guarantee or other financial instrument (loan, sub-ordinated loan or equity) were provided by the EIB Group, other IFI or a national public entity classified outside the general government sector it would not count as government financing.

Baseline energy costs (annual; EUR)	8.5m	Capital expenditure (EUR)	25m	
Guaranteed savings (%)	40%		Financed by:	
Guaranteed savings (annual; EUR)	3.4m		Partner	20m
Contract duration	10 years		Grant (government)	0
Operational Payment (annual)	2.8m		Grant (EU)	5m
			FI (government)	5m
			FI (EU)	5m
<b>Eurostat tests:</b>				
1. Government financing (%)			→ 25% (HIGH importance)	
2. $\Sigma$ guaranteed savings $\geq$ $\Sigma$ Operational Payments + (non-repayable) government financing (grant)			→ YES	

For the purposes of achieving an OFF BALANCE SHEET assessment:

- **Test 1 is satisfied:** in contrast to option B.4, only half of the preferential loan (i.e. the national co-financing share) constitutes government financing (i.e. the EU share of the preferential loan does not count as government financing). In calculating government's financing as a share of capital expenditure, the EU grant (EUR 5 million) is deducted from the total capital expenditure. This results in a government financing share of 25% which is an issue of HIGH importance in assessing the statistical treatment;
- **Test 2 is satisfied:** the sum of the guaranteed savings (EUR 34 million over 10 years) is higher than the sum of the Operational Payments (EUR 28 million over 10 years) and the government grant (EUR 0 million).



**eurostat** 

**European Commission**

**EUROSTAT**

BECH Building

5, rue Alphonse Weicker

L-2721 Luxembourg

Eurostat user support

<http://ec.europa.eu/eurostat/help/support>

**European Investment Bank**

98-100, boulevard Konrad Adenauer

L-2950 Luxembourg

 +352 4379-22000

 +352 4379-62000

[www.eib.org](http://www.eib.org) –  [info@eib.org](mailto:info@eib.org)