EUROPEAN COMMISSION

Brussels, 05.02.2013
C(2013) 514 final

Subject: State aid SA.34611 (2012/N) – United Kingdom

Provision of public funds to a special purpose vehicle (SPV) in support of the UK Government's Green Deal policy (UK)

Sir,

1. PROCEDURE

1. By electronic notification dated 15 November 2012, registered on the same day, the UK authorities notified to the Commission, in accordance with Article 108(3) of the Treaty on the Functioning of the European Union (TFEU), their plans to provide public funds to a special purpose vehicle (SPV) in support of the UK government's "Green Deal" policy. The notification followed pre-notification contacts, initiated by the UK in April 2012. Following the notification, the UK authorities provided additional information on 20 November 2012, 28 November 2012, 4 December 2012, 5 December 2012, 7 December 2012, 21 December 2012 and 15 January 2013.

2. DESCRIPTION OF THE AID

2. One of the central UK government policies for improving the energy efficiency of buildings is the "Green Deal plan", an innovative financing mechanism which allows consumers to pay back funding for energy efficient investments through their energy bills. Subject to State aid approval, the UK government is minded to support the provision of low-cost finance for so called "Green Deals" in the early years. The national UK government is looking to support a single financial SPV in Great Britain with the aim to ensure coverage for Green Deals for all areas covered by the Green Deal legislation (i.e. Great Britain). The UK authorities explained that Northern Ireland is not covered by the Green Deal legislation and energy efficiency policy is fully devolved.

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3. The notified measure concerns State investment into a Green Deal finance SPV[1] offering finance to all Green Deal Providers (GDPs) on an equal and non-discriminatory basis (subject to reasonable anti-fraud and business viability checks). The State intervention will allow the SPV to provide financing on terms to the GDPs which are better than those available under market conditions. The GDPs are expected to pass the advantage of cheaper financing to the end-consumers, making the Green Deals more accessible to them.

4. The UK government considers that in principle the existence of several SPVs might enhance competition amongst them and does not exclude further notifications, covering further State investment(s) in other SPVs in line with the market economy investment principle ("MEIP") or including a component of aid (i.e. below market rates) . However, such investments are outside the scope of the current notification.

5. The Green Deal plan must comply with the Green Deal's Golden Rule principle, which is that the cost of the repayments should not be any higher than the energy saving produced over their lifetime by the energy efficiency measures installed. By paying through energy bills, consumers will be able to see the Green Deal charge alongside the reductions in energy use which generate savings on their bill. It also means that if they move out and cease to be the bill-payer at that property, the financial obligation will transfer to the next bill payer: the charge is only paid whilst the benefits are enjoyed. In that way, the Green Deal differs from existing lending – it is not a conventional loan since the bill-payer is not liable for the full capital cost of the measures but only for the charges due whilst they are the bill-payer. With that mechanism the UK aims to overcome the landlord/tenant problem that often hinders energy efficiency measures from being undertaken.

6. The Green Deal is based on a market mechanism, designed to be funded primarily by private capital. However, due to existing market failures and considering the extra advantages it could generate, the UK authorities consider that State investment is necessary in a first phase.

2.1. State intervention and form of aid

2.1.1. Market failures making State intervention necessary

7. According to the UK, there are several market failures and some transitional effects relating to the novelty of policy and current conditions of the credit market that do not allow the Green Deal to be implemented in a satisfactory manner without State support. Those market failures can be tackled through government intervention, and it can be particularly effective through financing solutions[2].

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[1] The SPV is expected to be constructed of a number of parts carrying out various functions, which may be legally separate. For the purposes of the notification all references to 'SPV' refer to the whole group of companies acting together.

[2] KfW Bankengruppe, 'Housing, home modernisation and energy conservation', http://www.kfw.de/kfw/en/Domestic_Promotion/Our_offers/Housing.jsp; House of Commons, Environment Audit Committee, 'The Green Investment Bank: Annex A: Note of visit to KfW,

8. The UK identified the following market failures (which are likely to continue to exist, but can be minimised through State intervention):

– Negative externalities – there is a disconnection between those who emit greenhouse gas emissions into the atmosphere and the cost to society of their actions meaning the price of energy does not always reflect the external costs. Cost effectiveness to society may not appear as cost effective to rational customers and demand is likely to be lower than socially optimal.

– Behavioural issues - economic research[3] demonstrates that customers are also likely to be influenced by behavioural failures including: inertia (favouring the status quo), bounded rationality (that customers will not be able to process all the information to make rational choices), the salience effect (that customers will give disproportionate weight to psychologically vivid factors like 'hassle') and the discounting of future benefits at a higher rate than is economically rational.

– Costs and benefits are likely to remain unclear to society as a whole, so further incentive is required to overcome them.

9. The transitional effects, relating to the novelty of policy and current conditions in the credit market mainly refer to the following:

– Missing markets and lack of a track record – the default rates on Green Deal plans are currently unknown and financiers do not yet have full confidence and understanding of the Green Deal proposition. Owing to the fact that Green Deal charges will be collected via electricity bills, the UK Department of Energy and Climate Change (DECC) expects default rates to be analogous to electricity default rates (which are historically low) – but that assumption is yet to be tested as the Green Deal is a new market. There is also uncertainty in the market around the role of government and how committed it is to the Green Deal policy, until the Green Deal has a track record.

– Lack of scale and positive externalities – economies of scale for some measures (particularly solid wall insulation) do not yet exist in the market and therefore the cost of the measures is likely to be prohibitively high where there is small scale and low demand.

10. Current market conditions – the current illiquidity in the credit markets following the financial crisis of 2008, and new regulations such as Basel III – means that there is less incentive for financial institutions to innovate at the present time.

Frankfurt, 27 January 2011', available at http://www.publications.parliament.uk/pa/cm201011/cmselect/cmenvaud/505/50510.htm

[3] A summary of studies having demonstrated that human decision-making is consistently affected by the issues listed can be found here: http://mcadams.posc.mu.edu/econ/W7948.pdf

11. According to the UK (and based on an analysis performed[4]), without further support being provided to overcome those market failures, fewer providers are likely to come forward as many will be unable to provide finance from their own balance sheet. It seems that only the large energy companies and one major retailer would be able to provide finance on-balance sheet.

12. An independent consultant estimated that without government intervention the resulting market size would be 49%-76% of that possible with government support over a ten-year period (£1 900 million compared to £2 500-3 900 million). Stakeholders' feedback suggests that many would not participate in the market at all if off-balance sheet financing is not possible. It should also be noted that even those large energy companies and the large retailer are unlikely to be able to finance the Green Deal on-balance sheet for a long period.

13. In the light of the above, the UK authorities consider that State support is necessary to allow the Green Deal to be implemented in a satisfactory manner. The UK government believes that competition in the market is critical to the success of the Green Deal, as it is essential to keep costs as low as possible and to ensure that the benefits of the Green Deal are realised by customers directly. That belief was decisive for establishing the form of State support to be provided.

2.1.2. Form of aid

14. Financing is likely to be primarily from the UK Green Investment Bank (GIB) but may also include local authorities, devolved administrations, the DECC and HM Treasury (HMT).

15. In the SPV envisaged in the notification under examination, the State will invest in the riskier tranches of capital – i.e. those hit by early losses and have less certainty around recovery of investment. By so doing, it will allow for adequate capital provision during the period of time necessary to build a track record of the underlying fundamentals, like demand and non-payments. However, the State will not provide the majority of those capital tranches. An indicative structure (currently under negotiation) is provided in the figure below, further detailed in Table 1.

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[4] Market soundings by Ernst & Young and conversations with organisations looking to become GDPs.

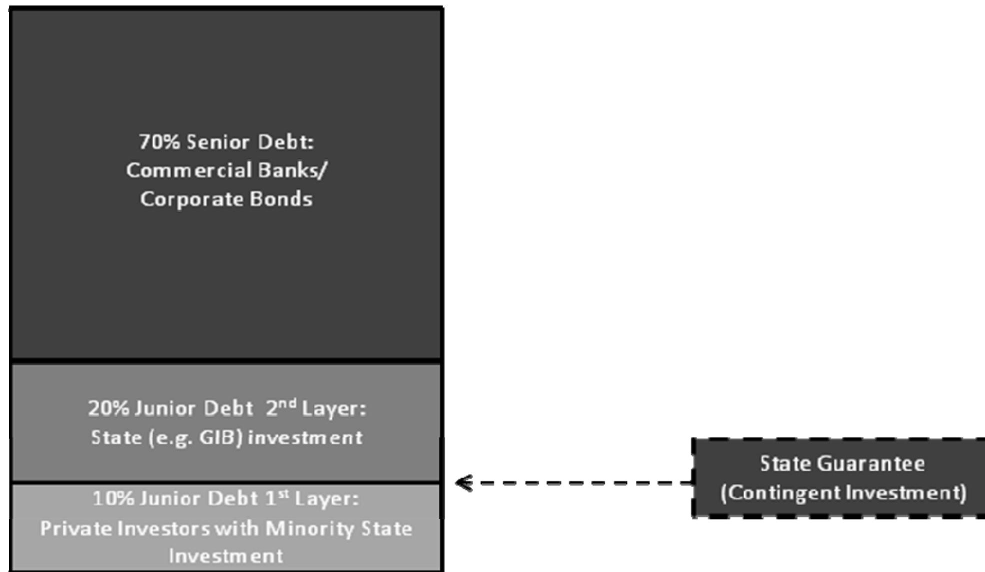

Figure 1: Long-term structure of SPV financing

Table 1- Key financial terms for the investments in the SPV

Capital Layer		Coupon	Key terms	Maximum state involvement requested	
1st Junior Layer*	Stakeholder Loan	c14%	Cash flows take both Asset and corporate risk (i.e. operational risks, providing working capital for operations with remaining funds used to finance Green Deal plans). Coupon Payable after all other capital is paid. Deferred coupon payments will roll-up and be subject to capitalised interest but will not give rise to a non-payment event of default.	49%	£49m
	Junior Asset Capital	c10%	Takes only Asset Risk. Coupon payable after payment of senior/Hybrid/Contingent. Deferred coupon payments will roll-up and be subject to capitalised interest but will not give rise to a non-payment event of default.	49%	
Contingent Capital (Guarantee)		c10% (once called)	Capital called in stress scenarios triggered from declining debt service cover ratio (DSCR) of the Senior Debt. Ranks senior to Junior Receives nominal fee of c.1% while uncalled.	100%	£100m
2nd Junior Layer (Hybrid Debt) (Hybrid capital will only be invested in the long term facility)		c[5%-7.5%]	Hybrid Capital will be repaid only to the extent that amounts payable to senior debt and senior expenses have been repaid in full but will be repaid senior to Junior Capital. The Hybrid Capital will have a target amortisation profile based on a cover ratio, but the final maturity will depend on available cash flow and its ability to meet target amortisation.	N/A (initial period – as hybrid won't exist) 100% (later phase)	N/A (initial period) £451m (later phase)

Senior Debt	c[4.5%-6%]	Benefits from first ranking security over all other Assets Assumed to be repaid on a cover ratio based profile. Drawn Subject to 30% junior capital being available.	50% (initial period) 0% (later phase)	£115m (initial period) £0 (later phase)
Total Asset base			**30%**	**£600m**

*1st Junior Layer will be split into two classes over time. Initial capital raised will fund the corporate costs and will provide junior asset finance to fund the loan book. As further capital is raised, the SPV will be able raise junior finance that only has exposure to the Green Deal Plan Assets as the corporate entity will be capitalised and reached sufficient demand to used retained earnings as working capital.

16. The riskiest tranche of capital (the first layer) consists in the most junior debt and takes the form of a stakeholder loan[5]. That first tranche/stakeholder loan serves the purpose of equity in that it provides a financial cushion to project the other tranches of debt. However, there is no dividend payable, as it is structured as a loan. If the SPV were to cease to exist, any profits at that moment would not be distributed to the stakeholders, but will be given to a charity selected in line with the SPV's objectives of promoting energy efficiency.

17. Investment in the riskiest capital tranches is open to all. However, it is expected that the investors in the riskiest capital tranches in the early stages are most likely to be those with an interest in the SPV working, such as the members of the SPV (i.e. GDPs). In the view of the UK authorities, that profile of investors in the riskiest tranches also helps to ensure moral hazard issues are resolved because the members most likely to use the SPV are incentivised to ensure the Green Deal Plans they write are of a good quality.

18. The UK authorities explained that the members of the SPV will be presented with an Information Memorandum about the stakeholder loan to the SPV's loans administration body and they can choose whether or not to invest. The SPV members do not have to invest to use the SPV to source finance, but they will all have the opportunity of doing so and they can choose how much they invest. Any private investment from organisations who are not members of the SPV would be welcomed on an open basis.

19. The UK indicated that while the exact amounts and percentages are still to be agreed, the stakeholder loan is intended to be £76 million, and membership part in the stakeholder loan is likely to be around 80%, i.e. £63 million. The difference (i.e. £13 million) will be provided by DECC on the same terms as offered to the membership of SPV or other private investors who are not members of the SPV. The maturity of the stakeholder loan is expected to be ten years (but could be less or more – up to 18 years – depending on the demand). The stakeholder loan takes the first loss, and losses are taken *pari passu* between the private and the public providers of that loan. The UK explained that

[5] The SPV will be limited by guarantee and so there would not be any equity holding by its members or the State.

there might be other State investments in this first layer of capital (e.g. some local authorities might wish to invest) but confirmed that State investment will never increase to more than 49% of this capital layer.

20. DECC intends to provide a contingent capital guarantee (backed by HMT). The guarantee will be given to the SPV and could be up to £100 million or up to 10% of the asset base (without exceeding £100 million). The guarantee will cover the second junior (hybrid) debt tranche and the senior debt. Both are covered equally up to the 10% of total asset limit. The duration of the guarantee depends on how the Green Deal performs – it will be removed when three years have passed without the guarantee being called or when the total asset base of the SPV reaches £1 billion, whichever is sooner. The guarantee can be called in stress scenarios triggered from declining of DSCR ratios of the Senior Debt below a certain level. If the guarantee is called, the State will provide the amount of the guarantee as additional junior capital.

21. The initial senior debt is to be provided by the Green Investment Bank (GIB) and the European Investment Bank (EIB) on a *pari passu* basis. Terms are subject to confirmation, the investment is expected to be £95 million from the EIB and £95 million from the GIB at a proposed rate of 5.15%.

22. The stakeholder loan, the guarantee and the initial senior debt are expected to be provided at the same time, probably in January 2013. By mid-2014, the stakeholder loan is expected to increase to £100 million, and the GIB is expected to provide a second tranche of £200 million, with an increased coupon of 6.85%, representing hybrid debt (second layer of capital, in the table 1 above).

23. Additional senior debt is expected by mid-2014. That senior tranche is likely to be composed of a tranche of £500 million provided by the EIB at 5.15% and of private capital of £200 million which is projected by the UK authorities at LIBOR[6] plus 2 percentage points. However, that latter projection will be tested through competition. The UK confirmed that in this later phase senior debt is to be provided only by private investors (i.e. no other State investment is foreseen at the level of the senior debt, except for the initial £95 million provided by the GIB).

24. The UK indicated that once demand and default rates have a track record, the government intervention will be adjusted, so as to ensure that intervention is always at the minimum necessary as the market develops. The adjustment will concern future investment. For example, if default rates are lower than expected or demand is stronger than expected, it may be possible to attract a greater proportion of private sector investment. In that event, the level of government investment will be reduced accordingly.

[6] The London Interbank Offered Rate

25. The UK authorities have indicated that local authorities (or any other State body) may procure one or more delivery partners who act as or service GDPs directly based on contracts to deliver goods or services. Those GDPs will then operate in competition with other providers. According to the UK, that arrangement does not involve State aid. The UK authorities have indicated that local authorities and other State bodies are also free to work within the *de minimis* threshold or under the Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation)[7]. The UK made it clear that it is not seeking a State aid decision on those points. They are outside the scope of the current notification, and the Commission takes no position on them. In addition, the current decision will not prejudge any position the Commission might take on the existence of aid in cases where the delivery partners who act as or service GDPs are procured directly based on contracts to deliver goods or services[8].

26. There is also a rebate scheme available only to individuals (non-undertakings), directly from the Government. The total budget is £200 million and its duration is 18 months. It consists in an incentive amount being provided to individuals, on a 'first-come first-served' basis. It is meant to incentivise early up-take of the Green Deal and to catalyse the market at a faster rate. The rebate scheme is also open to individual landlords, but will be operated in line with the *de minimis* provisions and is therefore outside the scope of the current notification.

27. The UK has already provided funds to the SPV (£7 million), but it states that it has done so at market rates, determined through a combination of applying the Commission reference rates and through an independent report by Ernst&Young, which the UK considers was at a market rate. The interest rate applied was 15.74% per annum.

2.1.3. Green Investment Bank (GIB) involvement in the Green Deal

28. According to the UK, the most prominent amongst the potential sources of government support to the Green Deal is the GIB. The Green Deal is expected to be one of the GIB's key priority areas for investment.

29. The GIB received State aid approval from the Commission on 17 October 2012[9] (hereinafter referred as "the GIB decision"). The GIB decision approves the State aid granted to the GIB and for the creation of the GIB in view of its remit. It does not prejudge in any way the position to be taken by the Commission as regards the investments/interventions by the GIB and whether such investments involve State aid. In particular the GIB decision does not prejudge whether such aid would be considered compatible with the internal market.

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[7] OJ L 214 of 09.08.2008, p. 3

[8] The UK authorities provided some examples in that regard concerning Birmingham City Council, Newcastle City Council and the Scottish Government. However, they are not covered by the current decision.

[9] State Aid case SA.33984 (2012/N) – United Kingdom Green Investment Bank, C(2012) 7133. In the relevant notification the UK indicated that a separate State aid notification would cover any extension of the GIB's remit to cover investments in the Green Deal.

30. According to the GIB decision, the GIB can invest only in precisely identified environmental subsectors. While the non-domestic energy efficiency was acknowledged as a priority sector falling within the GIB's remit, investments for domestic energy efficiency are outside that remit. It follows that the GIB's participation in the Green Deal is not covered by the GIB decision and needs an extension of the GIB's remit, which otherwise would be in breach of that decision. Secondly, the GIB's intervention in the Green Deal needs to be assessed to verify existence of aid and its compatibility.

31. The UK acknowledges that the GIB's intervention in the Green Deal is not included in the GIB's original remit. It submits that the current notification covers investment by the GIB in the Green Deal (on both a market terms and an aided basis (i.e. at below market rates). The notification therefore seeks to expand the remit of GIB to invest in the Green Deal with respect to the SPV covered by that notification. Any further investment by the GIB in domestic energy efficiency (i.e. outside of the Green Deal) would be subject to a further notification.

32. The UK submits that there are market failures in the financial markets that justify the GIB's intervention in the Green Deal. According to the UK, they are temporary market failures related to the novelty of the market and lack of a track record (lack of information).

33. From the market failures described in section 2.1.1, the UK indicated that the following specific market failures relate to financial markets, and justify the intervention of the GIB: missing markets and the lack of a track record, lack of scale and positive externalities and the current market conditions. According to the UK, the nature of the financial market failures clearly indicates that the problems are only temporary, due to a lack of experience with the functioning of the Green Deal itself.

34. The Green Deal is an innovative financing framework supported by government legislation and policy designed to lower carbon emissions and promote energy efficiency. Although the energy efficiency measures themselves have been financed before (e.g. via personal loans) they have never been financed via the Green Deal framework, and the attachment of finance repayments to properties, via electricity meters, is an untested market mechanism.

35. The UK government, and potential Green Deal financiers, such as The Green Deal Finance Company, have explored debt funding options with many leading private sector lenders who have expressed an interest in providing senior debt in the future. However, it is unlikely that any private sector lender will provide the requisite senior finance for the early stage financing of the Green Deal. Nevertheless, after a track record is established there are indications that private financiers will be keen to take on a range of roles of debt financing. Beyond the initial 12 to 18 months of the Green Deal finance, it is expected that the GIB's senior finance may be refinanced by private sector senior finance, thus resolving that initial market failure. It seems unlikely that bank funding will be available to match the duration of the Green Deal plans but the UK indicated that after the initial 12 to 18 months it should be possible to secure short-term bridging

facilities from banks, which would refinance the initial GIB facilities and would provide a bridge to long-term capital market bonds.

36. Given the nature of the market failures and the GIB's market position, the UK views the GIB investment as an appropriate instrument to respond. Channelling UK government intervention through the GIB is likely to mean that State aid is lower and of shorter duration than would be achieved by intervention without the GIB.

37. The UK explained that there are three purposes served by investment through the GIB, rather than by the State in general:

- The financial engineering in the SPV is complex, and because of the skills and experience of its staff, the GIB is best placed to negotiate with the SPV to ensure that it is structured in a way that is financially efficient. The SPV can thereby achieve best value for taxpayers and be structured in such a way that it can be refinanced once the initial market failings are addressed. For example, the GIB is working to ensure that GDPs provide the majority of the most risky capital (and hence incentivise them so that they submit sufficiently robust plans).

- One purpose of the initial GIB investment is to demonstrate a track record of repayment from Green Deals that demonstrates the terms on which commercial financing can be achieved. The skills present in the GIB will ensure that the financial structure is framed in a way that will clearly demonstrate to other financiers the potential in the market. To the extent that the SPV has an interest in maintaining its own position in the future, that objective could not be assured as effectively if the UK government were to negotiate terms directly.

- Even in advance of the repayment track record, the presence of the GIB investment provides a signal of the potential of the area to be an interesting commercial opportunity, making it more likely that other investors will be drawn in, for example for senior debt in due course.

38. According to the UK, by participating in an initial capital structure and demonstrating the delivery of returns from the early Green Deal plans, the GIB can help close the market failure quicker than an investment by a government Department would, because the market would likely view a Department's intervention as a subsidy rather than an investment and it would not be encouraged to revisit their assumptions about what is investable.

Potential beneficiaries: actors involved in Green Deal

39. There are several actors involved in the Green Deal scheme (besides the State):

- the Special Purpose Vehicle (SPV) itself;
- operators of the SPV, who carry out the process of managing the Green Deal finance and issuing the bonds etc;
- investors in the SPV;
- GDPs;
- Green Deal Installers;
- Green Deal Advisors (Assessors in the Fig. below);
- end-consumers, including landlords (Customers in the Fig. below).

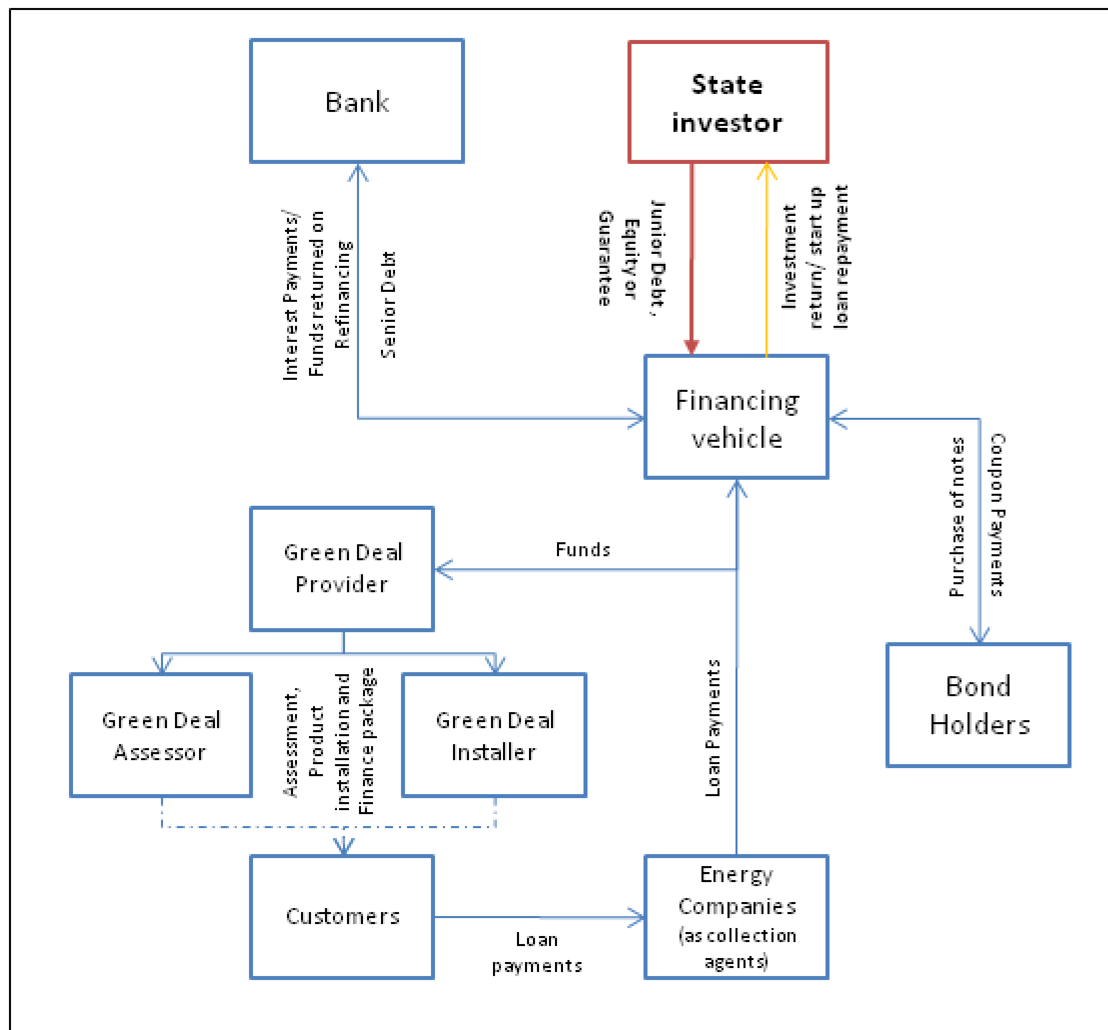

Fig.2 – Green Deal actors and interactions among them

40. The UK confirmed that companies in difficulty will be excluded from state aid support under the notified scheme.

2.1.4. The SPV and its operators

41. The SPV is a non-profit consortium. The UK indicated that at the time of the notification, the most developed SPV was The Green Deal Finance Company (TGDFC) – a consortium led by PricewaterhouseCoopers LLP with 16 original members and advisers. The 16 original members were PwC, British Gas, E.ON, EdF, Scottish and Southern Energy, Carillion, Kingfisher, Mark Group, Insta Group, npower, Linklaters, Clifford Chance, Lloyds Banking Group, RBC Capital Markets, HSBC and Goldman Sachs. By the time of the notification the number of its members increased to around 50. The UK authorities were expecting it to further increase to about 100.

42. The membership of TGDFC consortium is open to organisations with an interest in the Green Deal. Current members include companies from across the Green Deal supply chain, such as energy companies (acting as GDPs), local authorities, members of the energy efficiency product supply chain and other organisations looking to become GDPs. Its members are not required to provide financing to the SPV. The company is limited by guarantee of which each member must guarantee £1.

43. At present, TGDFC is the most likely company to be the SPV. However, it is not the only possible candidate. All the information provided by the UK on State intervention and the financial structure of the SPV are based on the on-going negotiations with TGDFC. However, the UK confirmed that any other candidate would be requested to work under the same conditions as TGDFC.

44. There might be other SPVs, but they are not covered by the current notification, as indicated in recital 4. If the market data will show the need to provide aid to another SPV, such aid will be notified separately.

45. In the medium- to long-term (once the value of the SPV's Green Deal portfolio has reached approximately £600 million[10]), the SPV is expected to aggregate the repayment streams from Green Deal customers and refinance the aggregated repayments through issuance of bonds to the capital markets, so as to access the lowest cost of finance available. At that stage, private investors will therefore be able to invest in the SPV bonds on market terms and obtain a return on their investment. The SPV will need to be able to obtain senior debt from private banks in order to build up the book to a sufficient size to be refinanced through the issuance of bonds.

46. The SPV will provide reports on its administrative charges and the UK authorities undertook to make copies of these reports on administrative charges available to the Commission. These reports will be regularly submitted to

[10] The UK authorities undertake that TGDFC will begin the placement of bonds once the asset base of TGDFC (both private and public funds) reaches £1billion at the latest. In the event that the UK authorities consider that further time is needed before refinancing can be achieved, the UK authorities undertake to notify the Commission in advance.

market testing, in order to ensure that the management of the SPV continues to be in line with market norms.

47. Under the scheme, the SPV must meet a number of conditions, which the UK believes will ensure that support is always the minimum amount necessary:

    – The SPV must be engaged purely in the financing and refinancing of Green Deals and no other business, It must be legally separate from other business. The SPV may interact (including financially) with a number of legally separate subsidiaries (such as loans administration bodies) but for the purpose of servicing, financing and refinancing Green Deals only.

    – The SPV can only provide finance for Green Deals for non-domestic properties if they only support energy efficiency measures that would be of interest to the broad generality of business occupants of the property in question (i.e. lighting, heating etc) and provide support on equal terms without any geographical limit for non-domestic properties (unless on their own estate), subject to the limitations for Northern Ireland. Those conditions are designed to ensure that there is no selective advantage to non-domestic occupants of improved properties in Great Britain.

    – The SPV must not be profit distributing; any profit made on the provision of finance is used to reduce the intensity of present or future state support or to support energy efficiency improvements in domestic properties.

    – The SPV must offer services to all GDPs meeting the required Government-specified standard offering solutions within that geographical area on equivalent terms and without discrimination, subject to reasonable anti-fraud and business viability checks.

    – Any capital required for the SPV from non-State sources (e.g. private banks) must be remunerated at a market rate determined through open competition.

48. The operators of the SPV are the staff of TGDFC (approximately 14-15) who will be recruited, and remunerated, through standard practices and have no investment in the SPV itself (TGDFC is a company limited by guarantee and so under its constitutional documents, it does not pay dividends; any profits must therefore be reinvested into the company). The operational personnel within the TDGFC loans administration body will be governed by a board of directors which will function in accordance with standard market corporate practice. TGDFC may also require expertise from outside the organisation such as professional services – legal and banking etc – which would be necessary for technical issues around loans administration and bond issuance. External organisations would be contracted on standard market contracts at standard market rates. The management of the SPV will be competitively procured where possible, or its costs will be subject to control by a group of independent private undertakings with clear incentives in the efficient operation of the SPV. These checks will ensure that market rates are applied and that the cost of finance to the Green Deal customer is as low as possible.

2.1.5. Investors in the SPV

49. As already indicated in section 2.1., there will be private investors in the riskier tranches of capital. The involvement of private investors is expected to increase, so that the senior lending, after the initial phase in which the GIB might be involved, is provided exclusively by private investors. The UK provided details on how the private investors – who will provide senior debt financing to the SPV – will be selected (described below).

50. In the initial financing phase, the GIB and the EIB will be the senior lenders. In the medium- to longer-term financing phase, private sector banks will act as senior lenders, probably through senior warehouse debt (those facilities would be in place until replaced by a final bond issuance).

51. According to the UK, TGDFC aims to obtain financing at pricing sufficiently low to realistically help support the latter's aim of offering Green Deals at a financing cost of 7-8% to its customers.

52. For the medium- to longer-term financing phase, in which it is proposed that private sector banks will participate, a full Information Memorandum will be issued by the TGDFC to a broad number of players in the market to ensure a thorough competitive process is undertaken. Like any competitive bank syndication, the TGDFC board will seek to balance the appropriate terms and pricing and will provide sufficient information and time so that banks can make informed and competitive offers of financing. The advisory banks (i.e. those banks who have advised TGDFC in its set-up stage to date) will be asked to tender through the same way as all third party banks. In the view of the UK, this senior lending does not involve aid, as it is secured through open competition.

2.1.6. GDPs, Green Deal Installers and Green Deal Advisors

53. GDPs will be the counterparty signatories for Green Deal plans with customers. They are the main participants in the Green Deal and will be responsible for ensuring the energy efficiency measures are installed to a high standard and for arranging the finance to support the installation. Green Deal Installers will carry out the practical work of the installation of energy efficiency measures. Green Deal Advisors will have the important task of assessing which measures are right for a particular premise.

54. Any organisation meeting the requirements set out in the national legislation[11] can become accredited and authorised as a GDP, Green Deal Installer or Green Deal Adviser. There is no limit to the number of organisations that may be accredited and authorised. Where possible, and where they exist, industry standards were kept for the accreditation standard, so that barriers to entry are as low as possible, whilst also ensuring that the market is credible and robust. The selection of the GDP, Green Deal Installer and Green Deal Adviser for a particular Green Deal is down to the customer in question.

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[11] Those requirements have now been published on the DECC website in the Green Deal Code of Practice, http://www.decc.gov.uk/assets/decc/11/tackling-climate-change/green-deal/6533-green-deal-code-of-practice.pdf

55. In a rental situation, the landlord must agree to Green Deal works if a reasonable request is made by a tenant and if there is a financing solution in place to support the works. A tenant, with the landlord's agreement, can choose any GDP in the same way as any other customers.

56. The fact that the consumer can choose any GDP is expected to drive prices down and limit the GDPs' return to a normal market return. The GDPs are not expected to make a profit on the provision of finance, which will be passed through from the financing organisation. Instead, GDPs will enjoy profit margins on the sale and installation of energy efficiency measures.

57. The consumers do not pay upfront, but via charges (through electricity bills), for a certain duration, capped by the lifetime of the investment/work. Under the Golden Rule, the annual charges should not be higher than the annual expected energy savings generated by the investment/work.

58. The remittance of payments by end customers to GDPs is governed by the Green Deal Arrangements Agreement (GDAA). The GDAA obliges energy companies to pass on payments to the originating GDP, or a financier nominated by the GDP. A GDP that is also an energy company has to use the same databases and remittance processes as an organisation that is not an energy company due to account separation and insolvency requirements. As such, the Green Deal confers no advantage on any participating energy company from a remittance point of view. The GDAA was finalised on 1 October 2012. The risks of default remain the same regardless of what background the GDP has because the same processes need to be followed regardless of the type of organisation acting as the GDP.

59. The charges (capped by the Golden Rule) must include the capital cost of the measure, any administration costs and any profit margins being applied by the GDP, as well as the financing costs. The GDPs' profit margins will not be visible to the end-consumers (who only get a price proposal from the GDPs), but the interest rate will be disclosed to domestic and small businesses due to consumer protection regulations under the Consumer Credit Act 1974. The State will have access to information on the interest charged to consumers and will monitor the competitiveness of the GDP market to see whether the cost of capital is indeed passed on to consumers.

60. The SPV will provide equivalent financing and support to all GDPs for Green Deal projects, subject to reasonable anti-fraud and business viability checks, so as to avoid the danger of supporting GDPs which are firms in difficulty. The GDPs can obtain financing from the SPV for the works covered by Green Deal plans signed with customers (up to the level of the price of those works). The terms of the financing will be decided by the SPV, with reference to its own cost of financing.

61. The UK authorities have explained that it is possible for GDPs to fully or partly fund their Green Deal plan offers to customers using other sources of finance. However, it is expected that the majority of GDPs will use the SPV for 100% of funding, as it is likely to be offering the lowest cost form of finance available on the market until the repayment track record is established.

62. GDPs will sell Green Deal loans to the SPV, which will purchase them at a rate that assumes the normal default rate for electricity bills. As the track record for default on bills which include Green Deals emerges, the financing rate that GDPs will be charged with will also change. As a result, the financing rate will progressively reflect the default rate in practice. The financing will be on better terms than that obtained from the market and the GDPs are expected to pass on that advantage to the end-consumer.

63. The UK authorities explained that there are a number of safeguards in the Green Deal that should ensure that good quality Green Deal plans are written. The Golden Rule limits the amount of finance that can be offered (as the cost of financing is included in the charges). Standardised software must be used for Green Deal assessments. The accreditation for GDPs and other operators in the Green Deal market should provide further assurance. Under the Consumer Credit Act 1974, the GDP will retain the responsibility for compliance with the Act and ensure that Green Deal Plans are affordable. The Green Deal measures themselves must also have standard industry warranties. In addition, the SPV will make sure that if Green Deals are mis-sold, the GDPs responsible must buy back the respective Green Deal Plans from the SPV, so that they bear the financial consequences of any mis-selling.

64. The GDP's functions might be done in-house by the provider, or shared amongst other organisations on a sub-contractor basis for installation works. However, the customer's contractual relationship will be with the GDP. Installers are likely to be small scale builders and small and medium-sized enterprises, but may also be employed within a larger GDP organisation. The UK authorities have not specified whether the roles should be split or grouped; they only stated that the Green Deal Adviser role must be impartial and use standardised software calculation tools (so that any Green Deal Adviser should produce the same assessment of a property, regardless of who they are). The UK authorities' position is that the market should form whatever suitable structuring is most efficient.

65. The UK authorities consider that GDPs do not benefit from State aid since they are subject to enough competition and all of them will have access to the financing of the SPV. Therefore, in the view of the UK authorities, the GDPs will only benefit from an increased market size.

66. The registration process is operated by the Green Deal Oversight and Registration Body (which reports to the DECC directly). At the stage of the Commission's assessment, the UK authorities were aware of 23 organisations who intend to be GDPs, but the number is expected to increase to 40-60. They indicated that 11 organisations have completed the GDP registration process as of 6 November 2012 with other 36 being at the 'fitness test' stage. Other 91 organisations manifested their interest in the program and some of them are at the early stage of approval.

2.1.7. End-consumers (including landlords)

67. The Green Deal is available for occupants of buildings (both individuals and undertakings). They benefit from lower interest rates on the Green Deal than would have prevailed under pure market conditions

68. The Green Deal is available for the non-domestic sector when the measures are in the interest of all the occupants of a building and there is no territorial selectivity. Green Deal is not available for making production processes more energy efficient.

69. The measures supported by the Green Deal and its supporting financing are carefully framed to be of general application to all sectors and areas, and therefore in the UK's view there is no State aid involved at the level of the end-consumers.

70. The UK government's policy is that all customers, domestic and non-domestic, are eligible for the same support, regardless of whether or not they share a building with other customers. According to the UK, supported measures will be of interest to all types of businesses and the measures are non-selective by sector or business-type in Great Britain. Customers can therefore be considered in the same way whether they are domestic or non-domestic and consequently, the UK believes that there will be no State aid to any customer.

71. In relation to those end-consumers who are landlords, the UK authorities consider there is no evidence of an advantage to landlords in improvement's to their property's energy efficiency. The UK argues that landlords will not be able to charge higher rental charges for properties with Green Deal measures than for those that are poorly insulated, as other factors (such as location and floor space) are significantly more important than energy efficiency in the rental market. Several consumer studies were provided in the notification to support these arguments.

72. Based on a recent study by the Royal Institute of Chartered Surveyors (RICS)[12], the UK concluded that currently tenants and purchasers of properties in the UK do not value energy efficiency measures as high as might be expected. A Quadrangle report commissioned by DECC[13] also concluded that tenants do not even ask to see the Energy Performance Certificate (EPC) of a property before agreeing terms with a landlord. Consumer Focus have also authored a report[14] which concluded that location was the main factor in determining price of rents and property and although 14% of prospective buyers and tenants surveyed considered energy issues to be important, the EPC has little impact at present and only 6% of EPC recipients used the information when negotiating on price.

73. Furthermore, as indicated in recital 55, the landlord must agree to Green Deal works if a reasonable request is made by a tenant and if there is a financing solution in place to support the works. However, as this might change in time, the UK undertakes to perform a regular review: if by 2016 there is evidence of benefits to landlords, UK will exclude the provision of finance to landlords under this scheme (or notify it separately).

2.2. Budget and duration of the scheme

74. Total maximum budget for State investment in the Green Deal, under the current notification, is £600 million. The amount estimated to remain with the SPV (to cover administrative expenses) is a maximum of £100 million. The benefit of lower interest rates on financing is expected to primarily flow through to the end-consumers and as such, in the view of the UK authorities, it will not constitute aid to GDPs. According to the UK authorities, only a very small percentage of the £100 million is expected to constitute aid, in order to ensure that the organisation is run as efficiently as possible in its early years.

75. The UK explained that the administrative costs of the SPV are made up of the following components: First, the SPV will outsource its loans administration function to an outsourcing organisation specialising in the provision of these types of services. This organisation will administer the loans, issue statements, ensure that collections of repayments are made, and provide data for the SPV. TGDFC carried out some initial market sounding, which indicated that the loans administration function would cost £18 per loan as a set-up fee and £8 annually thereafter (which have now been revised to £19.45 per loan as a set up fee and £4.65 annually). The SPV will run a competitive tender process, which will ensure that the market price will be obtained for this service. Second, there will be further overheads for the company such as office space and facilities to cater for around 15 members of staff, as well as fixed assets such as IT equipment for

[12] Royal Institute of Chartered Surveyors (RICS), 'Energy Efficiency and Value Project', http://www.rics.org/site/download_feed.aspx?fileID=6271&fileExtension=PDF

[13] Quadrangle (commissioned by DECC), 'Green Deal and the Private Rented Sector: Consumer research amongst tenants and landlords', DECC website, November 2011 http://www.decc.gov.uk/assets/decc/11/consultation/green-deal/3506-green-deal-consumer-research-prs.pdf - particularly pages 4, 13, 16 and 29.

[14] Consumer Focus, 'Room for improvement: the impact of EPCs on consumer decision-making', Consumer Focus website, February 2011, http://www.consumerfocus.org.uk/files/2011/02/Room-for-improvement.pdf - particularly pages 4 and 7.

those staff. In addition, the SPV will need to run its own treasury function, for which it will need a number of treasury professionals.

76. The aid scheme was notified for 5 years, as this is the duration expected for State involvement in the SPV. The scheme can be re-notified if the market data shows evidence that aid is still necessary after the respective 5 years (e.g. if the State is not able to withdraw by then from the SPV).

2.3. Results expected

77. According to the UK authorities, the Green Deal should catalyse £14 billion over 10 years, providing energy efficiency measures in up to 15 million homes and is expected to save 128 MtCO2e of lifetime savings (44 traded, 84 non-traded).

78. The State intervention should provide an interest rate subsidy, attract extra private sector investment and increase the numbers of Green Deals to be delivered. Without the subsidy, the market is estimated at only 49-76% of the size that can be reached with the subsidy.

79. The expected results were estimated based on the following assumptions:

   - The aim of Government support is to reduce the cost of finance to the end customer provided in terms of a percentage interest rate;
   - The total level of financial benefit in the support for any given Green Deal financing intervention may be calculated by comparing the Net Present Value (NPV) of state intervention with an assessment of the market without Government intervention ("the counterfactual");
   - This intervention will be in addition to the effect of the Energy Company Obligation (ECO) as well as other Government interventions such as the rebate;
   - The financial benefit will be shared between the SPV and the end beneficiaries of the scheme (the UK considers that the operation of competition will ensure that other undertakings in the delivery chain – GDPs, Green Deal Installers, Green Deal Advisors etc. – will not get a direct financial benefit, but will only benefit from having a larger market in which to operate)
   - The interest rate that the end customer is charged (7-8%) is considered by the UK to be at the appropriate level (it is a competitive rate for unsecured lending, particularly for those on low incomes or with a poor credit history and evidence suggests that consumers will not take up Green Deals that have finance attached at higher rates, regardless of the Golden Rule limit; anecdotal evidence suggests some potential GDPs would not participate in the Green Deal if they could not offer Green Deals below 8%; finally, the rate is the level at which Government should be able to divest at a later date once a track record in the market has been proven).

- The level of the financial benefit that will remain with the SPV cannot be projected with certainty, but it is assumed to be a proportion of its administrative costs.

80. Without State intervention, for the whole market over a 10 year period, in addition to any financing coming from ECO and the rebate scheme, the interest rate charged to the end consumer would be around 11.8% at the very lowest. About £1 900 million could be invested by the private sector in Green Deal finance. The number of Green Deals delivered would be aprox. 465 000 for measures not requiring any ECO funding and approx. 1 488 000 where part-funding is required from ECO (giving approx. 1 953 000 Green Deals in total).

81. With State investment, over a 10 year period, in addition to any financing coming from ECO and the rebate scheme, the interest rate charged to the end consumer would be around 7-8%. Approx. £300-600 million would be invested by the State in the SPV and around £4 400-6 200 million could be invested by the private sector. The number of Green Deals delivered would be approx. 823 000 for measures not requiring any ECO funding and approx. 1 581 000 where part-funding is required from ECO (giving approx. 2 404 060 Green Deals in total).

82. It results that the extra benefit that is derived from State investment in the market will be an interest rate reduction to the end consumer of 3.8-4.8%, while the track record of repayment is being established[15], extra private sector investment of around £2 500-4 300 million and approx. 451 000 more Green Deals in total (approx. 358 000 extra Green Deals for measures not requiring any ECO funding and approx. 93 000 extra green deals where part-funding is required from ECO). The extra number of Green Deals delivered are estimated to produce more than £1 100 million of net benefits. This is calculated by monetising the energy savings, carbon savings and air quality improvements and taking away the costs of those measures. These net benefits compare favourably with the Government investment of £300-600 million.

83. According to the UK, the State intervention is aimed at minimising the cost of capital to GDPs in order to ensure that the Green Deal proposition is sufficiently attractive to customers and this should lead to higher demand and increased probability that environmental benefits will be realised. This will also mean the ECO can reach further. Additionally, the State intervention should ensure a sufficient supply of capital to support the delivery of the Green Deal from its launch and a comprehensive national coverage (without public support, financing is likely to be insufficient in the first years and there may be a concentration of Green Deals in certain geographical locations where scale can be achieved, while many other parts of Great Britain could be excluded).

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15 If the Government assessment of default rates is correct, the apparent subsidy will progressively reduce to nothing as private finance for Green Deal refinancing becomes available on better terms.

2.4. Cumulation – Green Deal and ECO

84. The UK indicated that State support for Green Deal finance could be present alongside with other forms of state intervention, and considers that all these interventions are required for keeping the UK on its route for meeting the 2020 commitments.

85. The UK authorities confirmed that where policies could cumulate there will not be any overcompensation, as they will build into the modelling for the Green Deal the effect of other policies (in a similar way to ECO and the rebate scheme being pre-built into the Green Deal modelling).

86. More generally, if other policies emerge which would cumulate with Green Deal finance, these schemes will avoid overcompensation by taking into account in their baseline the amount of support that has been given through the Green Deal, or vice versa, if Green Deal finance were to be provided after the support from other policies has been received.

87. The UK provided some examples, concerning potential cumulation with the Renewable Heat Incentive (RHI), Feed in Tariffs (FITs) and Local Energy Assessment Fund (LEAF).

88. It submitted that there is a potential overlap between RHI and Green Deal as RHI-eligible measures are also theoretically eligible for Green Deal finance, although, in general, RHI-eligible measures would not meet the Golden Rule. The UK made it clear that the subsidy element of the RHI cannot be included in the Golden Rule calculation for the purpose of the Green Deal. The UK undertakes to keep this under review and if necessary, to avoid overcompensation, to incorporate measures within the design of the domestic RHI scheme to ensure that there is no overcompensation. Options may include requiring repayment of any overcompensation in order to receive the RHI or making a change to the level of the RHI payment.

89. There is also a potential overlap between FITs and Green Deal as FITs-eligible measures are also theoretically eligible for Green Deal finance, and it will be treated the same way as for the RHI. The UK undertakes to keep this under review and check for any potential overcompensation that might arise.

90. LEAF has been established by DECC to support communities in understanding their potential for improvements in energy efficiency and local deployment of renewable energy, alongside demonstrations of solid wall insulation. It operates under cover of the *de minimis* regulation. It is a grant fund to help communities prepare for new opportunities in sustainable energy and climate change arising from the Green Deal, Renewable Heat Incentive and Feed in Tariffs. There is, therefore, no direct overlap between LEAF and Green Deal.

91. The Green Deal will be operated in parallel with ECO.

92. The European Energy Efficiency Directive (EED)[16] requires Member States to set an indicative national energy efficiency target, based on either primary or final energy consumption, primary or final energy savings, or energy intensity. For building efficiency, it requires Member States to establish a long-term strategy for mobilising investment in the renovation of the national stock of residential and commercial buildings, both public and private.

93. The EED requires each Member State to set up an energy efficiency obligation scheme for energy distributors and/or retail energy sales companies to achieve a cumulative end-use energy savings target by 31 December 2020. As an alternative to setting up an energy efficiency obligation scheme, Member States may opt to take other policy measures to achieve energy savings among final customers, provided those policy measures meet the criteria set out in the Directive and the annual amount of new energy savings achieved through this approach is equivalent to the amount of new energy savings required. Provided that equivalence is maintained, Member States may combine obligation schemes with alternative policy measures, including national energy efficiency programmes. Such policy measures may include financing schemes and instruments or fiscal incentives that lead to the application of energy-efficient technology or techniques and have the effect of reducing end-use energy consumption.

94. The UK has legislated (through the Climate Change Act 2008) to require emission cuts of at least 34% by 2020 and 80% by 2050 – below the 1990 baseline, and setting out carbon budgets for at least three forthcoming carbon budget periods of 5 years each. The UK Government published in December 2011 the steps that it will take to meet the first four carbon budgets to 2027, in 'The Carbon Plan', highlighting that energy efficiency must be a key part of the policy response to tackling climate change, as carbon budgets cannot be met without reductions in emissions from the built environment. In March 2011 the Hill's Fuel Poverty Review was published, on the level of Fuel Poverty in the UK and on how this might be addressed. On 26 July 2012 the UK Government published guidance for Local Authorities in England under the Home Energy Conservation Act 1995 on reporting the status of home energy efficiency in their local areas.

95. The UK imposed an Energy Company Obligation (ECO) on energy suppliers. ECO is a successor to the existing Carbon Emission Reduction Target (CERT) (for the carbon saving element) and Warm Front (for supporting vulnerable customers) schemes and it is an obligation on energy companies to achieve among their final customers the requisite level of energy savings specified by Article 6(1) of the EED. Although ECO is a legally binding obligation on energy companies, it is expected that the costs will be passed through onto all energy consumers (socialised across all energy bills). Non-domestic customers will not be eligible for ECO.

[16] Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC, OJ L315, 14.11.2012, p.1

96. The ECO obligation is legally binding and designed to support energy efficiency measures that would not meet the Golden Rule even if funding was available at a low cost (i.e. solid wall insulation) or situations where the pure Green Deal would not be appropriate (i.e. households in fuel poverty and areas of low income).

97. The Green Deal is meant to support measures that are not supported by ECO, notably simple cost-effective measures like loft insulation and cavity wall insulation in households that are not fuel poor. Such measures should readily meet the Golden Rule, and householders should be able to pay for the measures themselves.

98. The UK Government considers the Green Deal to be necessary in addition to the ECO obligation because the combination of the two measures will result in a greater volume of energy efficiency measures installed and energy savings achieved than would be the case through ECO alone and a fairer distribution of costs with householders able to pay more of the cost of measures for their own property. The UK authorities consider that it is fair that households should contribute towards costs of measures for which they benefit up to the level permitted by the Golden Rule.

99. Operating ECO without Green Deal would mean that costs for energy efficiency measures would be shared across all energy bill payers and this socialised cost would be significant, disproportionately burdening fuel poor households.

100. Operating the Green Deal without ECO would not be sufficient to enable the UK to meet its objectives in terms of reducing emissions because ECO provides support for example to the fuel poor who would not be eligible for the Green Deal and because the Green Deal by itself would not achieve a significant roll-out of the more expensive measures that cannot by themselves meet the Golden Rule.

101. The UK submits that the Green Deal and ECO are key parts of the UK Government's delivery of its commitments under the EED. The UK authorities believe that action by the state (including the provision of approved state aid) to achieve energy efficiency savings is an acceptable part of meeting the Directive and submit that any actions that are mandatory under the EED (i.e. where the State does not have a choice about how it meets the Directive) would not be supported by this investment in the Green Deal SPV.

102. The ECO is outside the scope of the current notification. According to the UK, ECO does not constitute state aid because it does not involve state resources. Energy companies must prove to the UK Government's regulatory body, Ofgem (Office for Gas and Energy Markets), that they have delivered their legal obligation, but financial flows remain entirely in the private sphere between energy companies and their contractors in delivering the energy saving measures. Energy companies are free to decide how to deliver the carbon savings most effectively. The activities they undertake to meet the Carbon Target must result in demonstrable carbon savings, but this can involve paying for measures directly, but may equally involve working with others or even by

seeking to persuade consumers to pay for measures themselves without any significant financial contribution as long as they promote the uptake of the measures. Energy companies are able to pass costs onto their customers through energy bills so that costs and savings are ultimately borne by energy consumers, but they are not obliged to recover costs and may choose not to do so at all. They have complete choice on how much or how little they pass onto consumers. While it may be profit maximising to pass on full costs to consumers, they may decide to bear some costs themselves and pass less onto consumers.

103. Consumers are able to enter into the Green Deal as they wish without reference to ECO, as long as measures meet the Golden Rule, and the UK expects this to be the case for most simple measures with short payback periods, such as loft insulation and cavity wall insulation.

104. Energy companies will be able to deliver their ECO obligations without reference to the Green Deal, if they wish to do so. This might be the case for example where there are individuals with ready capital (and who may therefore not wish to take up the Green Deal) to whom the energy company might offer a complex measure at a reduced price. It may also be the case where, for example, there is an individual from a vulnerable group who is cautious about lending.

105. In some cases, however, an energy company might wish to meet ECO requirements by making a financial contribution to a Green Deal package so as to reduce the repayments required by the beneficiary of the Green Deal package to the point that the Golden Rule could be met and the Green Deal could be implemented. The financial flows in such a case are shown below.

106. The UK authorities explained that at no point can Green Deal finance flow from the state aided-SPV to energy companies to meet their ECO targets by funding ECO measures. Energy companies must meet ECO obligation by using their own resources and are expected to pass the costs onto all energy customers.

Energy Company Obligation | *Green Deal finance*

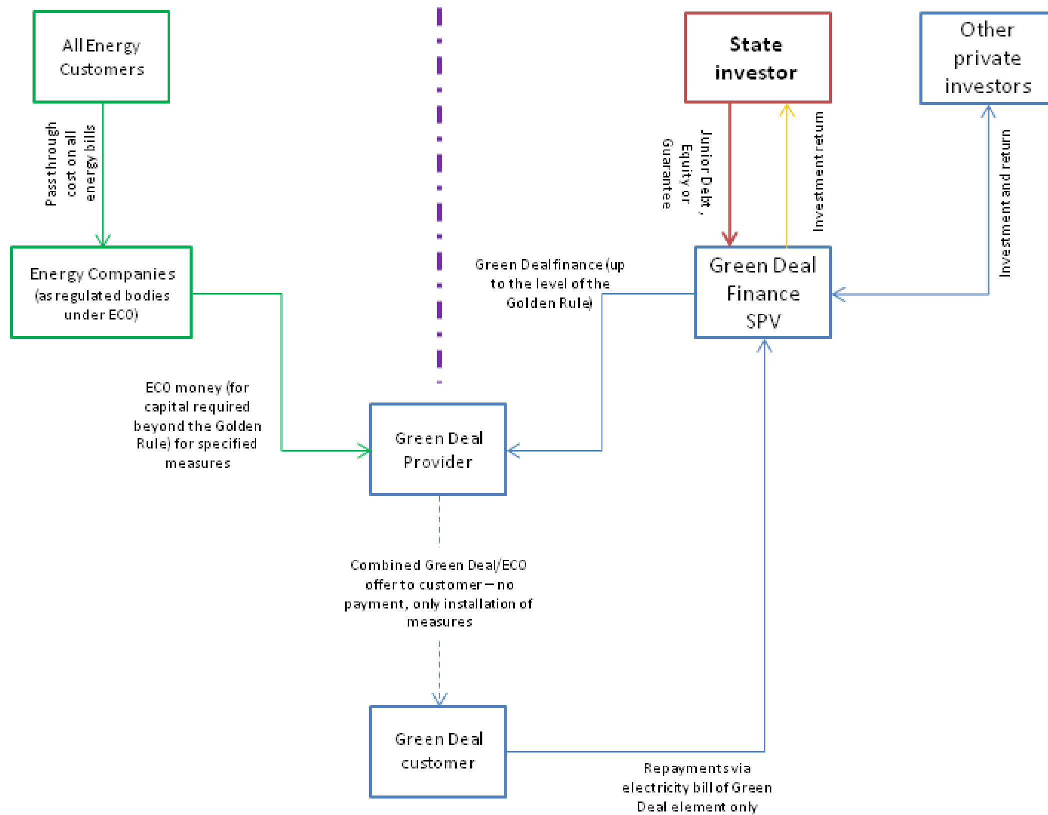

Fig.3 – Financial flows in case of a measure where the Green Deal is combined with the ECO obligation

Example 1: Green Deal only – easy measure in a well-off household

Easy to Treat Cavity Wall Insulation in Large Semi-Detached House	
Capital cost of measure (including labour)	£796 (c.€1,001)
*Expected **savings** produced by the measure **per year** (Maximum amount of Green Deal finance attachable due to Golden Rule)*	*£135 p.a (c.€170 p.a.)*
Expected savings over **10 years** and therefore the maximum **Green Deal finance** size over **10 years** with interest rate of 7.5% (based on maximum £135 per year)	£927 (c. €1,166)
ECO **subsidy** required to cover capital costs (This is the difference between the maximum amount of Green Deal finance and the actual capital costs, if Green Deal finance is not sufficient)	£0 (€0)

Example 2: Green Deal in combination with ECO

Internal Solid Wall Insulation in Large Semi-Detached House	
Capital cost of measure (including labour)	£8,470 (c.€10,655)
*Expected **savings** produced by the measure **per year** (Maximum amount of Green Deal finance attachable due to Golden Rule)*	*£547 p.a. (c.€688)*
Expected savings over **20 years** and therefore the maximum **Green Deal finance** size over **20 years** with interest rate of 7.5% (based on maximum £547 per year)	£5,576 (c.€7,015)
ECO **subsidy** required to cover capital costs (This is the difference between the maximum amount of Green Deal finance and the actual capital costs, if Green Deal finance is not sufficient)	£2,894 (c.€3,641)

107. The UK provided some examples to illustrate the measures that could be covered by Green Deal alone and the measures for which the ECO obligation might be combined with the Green Deal. The first example is a scenario in which a measure can be fully supported under the Green Deal. The second one is the specific situation for a more expensive measure. In this case the Golden Rule cannot be met on its own through a pure Green Deal. The installer of the measure is paid through a combination of two sources of capital. Capital up to the maximum permitted by the Golden Rule, given projected energy bill savings, is provided under the Green Deal plan. The remaining capital is provided directly from the energy company wishing to secure the credit towards their ECO obligation. Energy companies will not be able to benefit from cheap finance from Green Deal financing mechanisms to directly meet ECO obligations – as one of the conditions set out for the Green Deal finance SPV is legal separation from other business including funding of ECO.

2.5. National Legal Basis

108. The relevant national legislation includes the Enterprise and Regulatory Reform Bill or Industrial Development Act 1982, Infrastructure (Financial Assistance) Act 2012 Localism Act 2011 Scotland Act 1998 Government of Wales Act 1998; Government of Wales Act 2006 and the Competition and Enterprise Bill (expected in UK Parliament during 2012).

2.6. Monitoring

109. The UK undertakes to monitor performance of the SPV on an annual basis for the whole duration of the notified scheme (e.g. 5 years), examining in particular the costs of finance offered. This should enable the UK to assess whether there is evidence that the benefits of cheaper finance are being passed through to end users. The UK will include this information in annual reports that will be sent to the Commission. In the UK's view this will provide on-going assurance that there is no aid at the level of the GDPs.

110. In case the monitoring shows in some cases (e.g. for some GDPs) cheaper finance is not being passed through to end users, the UK will take actions to remedy the situation and ensure that safeguards are in place, for example through contractual agreements between the SPV and GDPs (e.g. by suspending the access of the respective GDP to cheaper financing via the SPV for a certain duration, or adding an additional margin to the finance for that respective GDP).

111. In addition to that annual monitoring, the UK will undertake a review of its investments in the SPV benefiting from State aid mid-way through the five-year approval period. That review will take into account the results achieved to that date and ensure that, if necessary, suitable amendments are made to the scheme to address any risk of future overcompensation, including in the Green Deal supply chain. The UK will inform the Commission of the results of this review.

112. The review will examine the question of aid to the GDPs by checking once again the costs of finance being offered to end users, so that it is ensured that benefits of cheaper financing are being passed on. In addition, the review will consider in particular whether there is evidence of overcompensation in respect of other undertakings as follows:

– to the SPV (by examining administration costs against projections and benchmarks);

– to the advisors to the SPV (by examining costs of services against market benchmarks); and

– to finance providers (by examining costs of finance provided against market benchmarks).

113. The UK also undertakes to commission an independent report at the two and a half year review regarding the overall competitiveness of the market at the GDP. The report is expected to be written either by an independent regulatory body or an independent private sector organisation who has experience and expertise in this area and can write a sufficiently detailed report. The report will be shared with the Commission.

114. In case the review shows that there is a general overcompensation, the scheme will be suspended to new business and proposed amendments notified to the Commission in advance of implementation.

115. The amendments will concern the terms for future investments by public bodies in the SPV, rather than a retrospective clawback of contracts made in the initial period.

116. The review will also examine the emerging repayment rate on Green Deals, whether these rates are effectively matching those of historic electricity bills (so that financing for future investments can be adjusted accordingly) as well as whether there are market players who might be prepared to establish financing vehicles with less or no State aid in the light of progress made.

3. ASSESSMENT

3.1. Presence of State Aid Pursuant to Article 107 (1) TFEU

117. The Commission has assessed the notified aid on the basis of Article 107(1) TFEU. A measure constitutes State aid under Article 107(1) TFEU if it fulfils four conditions. Firstly, the measure is funded by the State or through State resources. Secondly, the measure confers an advantage to the recipients. Thirdly, the measure favours selected undertakings or economic activities. And fourthly, the measure has the potential to affect the trade between Member States and to distort competition in the internal market.

118. In the case at hand, due to the complex design of the scheme and to the multitude of actors involved, the existence of aid needs to be checked at different levels.

119. The notified measure concerns State investment in one Green Deal financial SPV, and it involves State resources within the meaning of Article 107(1) of the TFEU. As regards the presence of an economic advantage to that undertaking, the Commission notes that the SPV is unable to obtain financing on similar terms on the market. By providing financing on better than market terms, the State is conferring an economic advantage on the SPV. The SPV will provide financing to GDPs, for Green Deal plans. The aid allows the SPV to offer better financing terms to the GDPs than other financial companies are able to offer, therefore distorting the competition on the funding market. As regards effect on trade, the Commission notes that while the SPV's interventions are restricted to projects physically implemented in the UK, the funding market of such projects might be international. Indeed, most green markets are international. It therefore considers that aid granted under the notified measure has the potential to affect the trade between Member States and distort competition in the internal market.

120. The UK indicated that the GIB is the most prominent amongst the potential sources of Government support and it is likely to invest in the riskier tranches of financing (e.g. by providing junior debt to the SPV). It is therefore clear that the terms under which the GIB will provide funding would not be acceptable for a market economy investor. Similarly, any direct State support in the riskier tranches constitutes aid, since the market would not provide such financing without the involvement of the State. Finally, the proposed remuneration for the GIB's intervention, planned in the range of 5-6% is clearly below market levels.

121. The Commission therefore considers that both direct investment from the State and the investment provided by the State via the GIB qualify as aid.

122. The public funding of the SPV will allow the SPV to provide financing on better than market terms to the GDPs. GDPs are expected to pass on the advantage to the end-consumers and the UK argued that there is no aid at the level of the GDPs. According to the UK, GDPs would pass on fully the advantage to the end-consumers, because of the competition among them, and because interest rates applied are public. Furthermore, the UK submits that the GDPs will not have any financial benefit; instead they will benefit from a bigger market.

123. The Commission does not share that view. First of all, the Commission notes that the GDPs will receive financing from the SPV at better than market terms, which they would not be able to receive otherwise. Such preferential financing constitutes an advantage to the GDPs, even if part of the advantage is passed on to the end-consumers. Furthermore, the Commission notes that GDPs will offer a price to end-consumers based on which the charges for the respective consumer will be calculated. According to the UK authorities those charges must include the capital cost of the measure, any administration costs and any profit margins being applied by the GDP) and the financing costs. While the financial costs are public, the GDPs can find alternative ways to retain part of the advantage, such as applying higher profit margins for Green Deals. Finally, while the Commission agrees that competition among the GDPs will reduce the risk of aid being retained at that level, it considers that it is not sufficient for excluding the existence of aid at the level of GDPs (even more so knowing that it is a new market and at least in the beginning the competition level will not be very high).

124. In so far as the end-consumers (including landlords) are concerned, the Commission notes that the end-consumers can be divided into 2 categories: individuals and undertakings. There can only be aid at the level of the undertakings. The Green Deal is designed as a general measure: Green Deals are available to all types of undertakings, regardless of their size, sector of activity or location (in Great Britain[17]). Furthermore, the measures are of general interest and concern the energy efficiency of buildings – the UK explicitly confirmed that the Green Deal is not available for making production processes more energy efficient.

125. The Commission notes that the notified measure was designed as a general measure for all end-consumers, including landlords, as it is available to all landlords in Great Britain. However, the measure seems to be de facto selective, as it would favour more the landlords, especially those undertakings owning several properties, such as companies active in real estate sector. The Commission therefore considers that aid cannot be completely excluded at the level of landlords. Nevertheless, based on the evidence and commitment provided by the UK, any aid granted to landlords will comply with the *de minimis* rules[18]. It is possible that the situation might change in the future[19]. Under the circumstances the Commission welcomes the proposed regular

[17] Based on the explanation of the UK, on why Northern Ireland is not covered by the Green Deal legislation, since energy efficiency policy is fully devolved, the Commission agrees that limiting the measure to the territory of Great Britain should not be considered as regional selectivity. There seem to be significant structural differences between how the energy market operates in Great Britain and Northern Ireland, but the Commission notes that according to the information submitted by the UK, nothing stops the Northern Ireland government from introducing the Green Deal for Northern Ireland. Also, there seem to be nothing to stop the installation and financing of energy efficiency measures in both domestic and non-domestic properties outside of the Green Deal in Northern Ireland from accessing a special purpose vehicle that serves the same purpose as for the rest of the United Kingdom.

[18] The UK authorities undertook to comply with the *de minimis* regulations to prevent significant levels of aid to pass onto landlords.

[19] Especially since under the Energy Act 2011 there are regulations due to come into force in 2018 that will put an obligation on landlords to improve the energy efficiency level of their properties.

review proposed by the UK (mentioned in recital 73). On that basis, the Commission considers that there is no aid at the level of the end-consumers.

126. Based on the description provided by the UK on the operators and their role (see recital 48 above) the Commission agrees that, in principle, while there is aid for the SPV itself, there is no aid to the operators of the SPV.

127. The membership to the SPV involves a £1 guarantee. As indicated in recital 42, it was decided to replace the equity by a Stakeholder Loan. Therefore the SPV will be limited by guarantee and there would not be any equity holding by its members. The UK confirmed that there can be members of the SPV who do not provide financing to the SPV (except for the £1 guarantee) and who have an observatory role. In view of the above, the Commission agrees that there is no aid to the member of the SPV.

128. However, many of the SPV's members are also GDPs. The members of the SPV will also have the opportunity to invest in the SPV – in the riskiest tranche of capital (investment open to all members, but not mandatory) or in providing senior debt (in the case of advisory banks). If the members of the SPV act as GDPs or as investors in the SPV, the assessment concerning the respective actors (GDPs and investors) would then be applicable to them.

129. The Commission also notes that the assessment of the aid for the notified measure is based on the information provided by the UK, including the information on TGDFC as potential SPV. In case another SPV is selected, the UK explained that such a SPV will be requested to operate under similar conditions. Should the selected SPV (TGDFC or another) operate under different conditions than the ones described in this decision, it will not be covered by the current decision and it must be subject to another notification.

130. Regarding the investors in the SPV, the Commission considers that aid cannot be excluded at the level of the private investors providing financing along the State in the riskier tranches of capital, unless they invest on exactly the same terms (*pari passu*) with the State. The UK explained that for the riskier tranches of capital the private investors will provide loans on exactly the same terms as the State. However, the State is also providing a contingent capital guarantee. The guarantee will cover the second and third layer of capital (not the stakeholders' loan). However, the guarantee is provided at the same time as the stakeholder loan and allows the SPV to obtain also the initial senior lending from the GIB and the EIB. The Commission considers that the guarantee also reduces the risk for the investors in the stakeholders' loan, as without it the funding available to the SPV might have been significantly reduced, which may potentially affect the ability of the SPV to function properly. Based on the above, the Commission considers that aid cannot be excluded at the level of private investors in the first capital tranche.

131. For the senior debt, however, the Commission notes that the initial senior debt is to be provided by the GIB and the EIB on *pari passu* terms. In a latter phase, senior debt will be procured through an open competitive selection process open to all bidders without restriction by nationality. The Commission takes note of

the commitment provided by the UK, according to which for the open competition process for attracting senior investment in TGDFC, the opportunity to invest will be published and an Information Memorandum will be published. The respective Information Memorandum will set out the full extent of state involvement so that market participants can price their offering on the basis of full knowledge of that involvement. The competition will be open to all bidders without restriction by nationality. The UK authorities are already aware of a number of interested parties looking to make a senior investment and therefore expect to have a strong competitive process.

132. If the expectations of the UK authorities are confirmed and the senior lending will be provided exclusively by private investors, the Commission considers that the selection process described in recital 52 will ensure that financing is obtained on market terms, and as such considers that there will be no aid for banks providing such senior lending. Finally the Commission agrees that the bond holders will not receive aid, since the bonds will be issued on market terms and will be available to any interested investor. Based on the above the Commission considers that there is no aid to the private investors providing senior debt to the SPV.

Conclusion on existence of the aid

133. Taking the above into consideration the Commission concludes that the measure involves State aid within the meaning of Article 107(1) the TFEU, at the level of the SPV (direct investment from the State and the investment provided by the State via the GIB), and potentially at the level of GDPs and private investors in the SPV.

3.2. Legality of the Aid

134. By notifying the measure before its implementation, the UK authorities have fulfilled their obligation according to Article 108(3) TFEU. Any disbursements will only be made after the authorisation of the notified measure by the Commission.

3.3. Compatibility of the Aid with Article 107(3)(c) TFEU

135. Although the ultimate purpose of the scheme is the increase of energy efficiency, taking into account the different levels of potential beneficiaries (who are not *stricto sensu* undertaking carrying out investments resulting in energy saving) and the design of the measure, the Commission considers that it falls outside the scope of the Environmental Aid Guidelines[20].

136. The Commission notes that the measure does not fall under any other of the existing frameworks and guidelines setting out the rules for implementing the Article 107 (3) (c) TFEU.

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[20] OJ C 82 of 01.04.2008

137. The Commission therefore considers that the assessment of the compatibility of the measure with the internal market needs to be based directly on Article 107(3)(c) TFEU which states that: "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*" may be considered to be compatible with the common market.

138. It is established Commission practice[21] that aid measures may be declared compatible with the internal market directly under Art. 107(3)(c) TFEU, if they are necessary and proportionate and if the positive effects for the common objective outbalance the negative effects on competition and trade. In this regard, the Commission considers it appropriate to assess the following three questions:

(1) Is the aid measure aimed at a well-defined objective of common interest[22]?

(2) Is the aid well designed to deliver the objective of common interest? In particular:

(a) Is the aid measure an appropriate and necessary instrument, i.e. are there other, better-placed instruments[23]?

(b) Is there an incentive effect, i.e. does the aid change the behaviour of firms?

(c) Is the aid measure proportional, i.e. could the same change in behaviour be obtained with less aid?

(3) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

3.3.1. Objective of Common Interest

139. An objective of common interest is an objective which has been recognised by the EU as being in the common interest of the EU Member States.

140. The Conclusions of the European Council of 17 June 2010 confirmed the energy efficiency target as one of the headline targets of the Union's new strategy for jobs and smart, sustainable and inclusive growth.

141. The Commission Communication of 10 November 2010 on Energy 2020 places energy efficiency at the core of the Union energy strategy for 2020 and outlines

[21] Community framework for state aid for research and development and innovation OJ C 323, 30.12.2006, p. 1., point 1.3; Community guidelines on State aid for environmental protection, OJ C 82, 1.4.2008, p. 1., point 1.3.

[22] Judgement of the court of 14 January 2009, Kronoply v. Commission (T-162/06, Rec. p. II-1; especially points 65, 66, 74, 75)

[23] Judgement of the Court of 7 June 2001, Agrana Zucker und Stärke / Commission (T-187/99, Rec._p._II-1587) (cf. point 74); Judgement of the Court of 14 May 2002, Graphischer Maschinenbau / Commission (T-126/99, Rec._p._II-2427) (cf. points 41-43); Judgement of the Court of 15 April 2008, Nuova Agricast (C-390/06, Rec._p._I-2577) (cf. points 68-69).

the need for a new energy efficiency strategy that will enable all Member States to decouple energy use from economic growth.

142. The Conclusions of the European Council of 4 February 2011 acknowledged that the Union energy efficiency target is not on track and that determined action is required to tap the considerable potential for higher energy savings in buildings, transport, products and processes.

143. On 8 March 2011, the Commission adopted its Communication on an Energy Efficiency Plan 2011. The Communication confirmed that the Union is not on track to achieve its energy efficiency target. On 8 March 2011, the Commission also adopted a Roadmap for moving to a competitive low carbon economy in 2050, identifying the need from this perspective for more focus on energy efficiency.

144. The recently adopted EED confirmed once more that energy efficiency is an objective of common interest.

145. The Green Deal is a key part of the UK Government's delivery of its commitments under the EED, essential for the UK in view of meeting its targets in terms of energy efficiency.

146. Therefore the aid measure aims at a well-defined objective of common interest recognised by the EU.

3.3.2. Aid well designed to deliver the objective of common interest

3.3.2.1. Appropriate Instrument

147. The Commission notes that the UK authorities have demonstrated that there are market failures which make State support necessary for the Green Deal (as shown in section 2.1. above)

148. Moreover, the Commission notes that the UK had considered other instruments; and has imposed the ECO obligation on energy suppliers. However, the operation of ECO alone would not be able to generate the same results in terms of increased energy efficiency. The UK demonstrated that the notified measure is expected to significantly increase the results in terms of energy efficiency, as compared to the counterfactual, of operation of Green Deal without State support. Furthermore, the expected results are estimated at over £ 1 100 million, largely exceeding the maximum budget of the notified measure (of maximum £600 million).

149. Consequently, the Commission considers that, under the circumstances and given the nature of the investments concerned, State aid (provided directly by the State or though the GIB) is an appropriate instrument that will help the UK achieve its targets in terms of energy efficiency.

3.3.2.2. Incentive Effect

150. As indicated in recitals 81-82, the State support will generate significant positive results, which would have not been achieved without the aid. It would allow more organisations looking to become GDPs to access financing and be active on this market. The Commission notes that State investment in the market should reduce the interest rate to the end-consumers. Consequently, it would allow more end-consumers to finance measures increasing the energy efficiency of the building they occupy. The UK indicated that with State intervention there will be approximately 450 000 more Green Deals in total.

151. It follows that in order to achieve the expected positive effects in term of contribution to a common EU objective, public support to Green Deal is necessary. Therefore it can be concluded that the scheme will provide for the necessary incentive effect.

3.3.2.3. Proportionality

152. First of all, the Commission notes that the maximum budget notified is £600 million, but the State investment is expected to be between £300 million and £600 million. Based on the most recent information, provided by the UK on 4 and 5 December 2012, the State investment should not exceed £422 million, out of which only £27 million are in quasi-equity investments and £100 million are under the form of a guarantee. The remaining £295 million will be provided by the GIB as loans. While the financial terms of the GIB's loans are not necessarily market conform, the aid element for this part of the investment is significantly below the nominal value, being determined by the difference between the market terms and the agreed terms of the loans. The Commission further notes that the advantage of cheaper financing is largely passed on to the end-consumers, where there is no aid, further reducing the aid amount involved in the scheme.

153. The Commission notes that due to the novelty of the proposed aid measure, the level of uncertainty is necessarily high. Considering the high level of uncertainty surrounding the scheme, the UK agreed to reduce the State intervention to only one SPV and the duration of the notified measure from the initially planned 10 years to only 5 years. Therefore the notified scheme could be seen as a pilot project, limited in time and aid amount.

154. Moreover, the Commission notes that State investment in the riskiest tranche of capital would be limited, as most investment in this tranche (currently estimated at 80%) would come from private investors. Therefore the risks are shared by the State and the private investors having an interest in the good functioning of the Green Deal. In the total financing of the SPV, as indicated in figure 1 and table 1, State investment is expected to be less than 30%.

155. Furthermore, the Commission notes that the UK agreed to extensive monitoring and reporting, as indicated in section 2.7. above.

156. According to the UK authorities, the notified measure was designed so as the aid is kept to the minimum necessary and the economic advantage is largely passed on to the end-consumer – except for a part of the administrative costs of the SPV, which would represent aid at the level of the SPV. The Commission agrees that the measure is designed in such a way that that a large part of the economic advantage is passed on to the end-consumer, but it does not agree that aid can be found only at the level of the SPV.

157. The SPV must comply with a set of conditions (indicated in recital 47). According to the UK, these conditions will ensure that the level and nature of State support is the minimum needed. Additionally, the Commission notes that the SPV will be operated by organisations having a strong interest in the development of the Green Deal market (as many members of the SPV are GDPs, interested in receiving financing from the SPV on the best possible terms and therefore reducing the amount that can be retained at the level of the SPV). Considering the above, the Commission considers that the proportionality criterion is fulfilled, for the aid provided to the SPV.

158. The main safeguard ensuring that aid flowing to GDPs is limited to the minimum is the fact that there will be competition among them. The profit margins on the capital costs of the measures will be subject to the competition in the market. The UK authorities insisted that since this is a new market, no estimations of profit margins can be provided.

159. According to the UK, the operation of the SPV also provides protection against aid flowing to the GDPs. The SPV will provide an interest rate quote to the GDPs so that they are able to agree on Green Deal plans and install the measures. The SPV will then purchase the receivable at the agreed rate. Under the Consumer Credit Act, the interest rate of the Green Deal to the end user will be publicly available, and can be compared with the cost of finance offered to the GDP. The UK will then be able to determine whether the interest rate is being passed onto the consumer (taking into account administrative charges). The UK undertook to monitor annually whether cheaper finance is being passed on to consumers, so that it can act if there is evidence of aid being retained by GDPs.

160. The Commission agrees that competition among GDPs (considering the high number of organisations who already initiated the registration process[24]) and the transparency concerning the interest rates received and offered by GDPs contribute to reducing the aid that might be kept by the GDPs. The extensive monitoring proposed by the UK further reduces the risk of having important amounts of aid at the level of the GDPs, and the UK undertook to take corrective actions, should the monitoring show any overcompensation at the level of the GDPs. Therefore the Commission considers that the proportionality criterion is fulfilled, for the aid that might be provided to the GDPs.

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[24] See recital 66.

161. According to the UK, the main safeguard against aid flowing to private investors is the fact that private investors will only receive a market return and will invest on *pari passu* terms with the State. While the Commission does not share the view of the UK authorities that aid can be totally excluded at the level of private investors providing the junior debt (mainly because of the guarantee provided by the State), it considers that the aid to such investors is limited.

162. In fact, excluding the guarantee, private investors invest on *pari passu* terms with the State in the riskiest tranche of capital, and are providing the majority of the funds needed. Those investments are not covered by the State guarantee. The second layer of capital is provided by the GIB and the EIB, initially on *pari passu* terms and in the equal amounts. Subsequently the GIB will provide a second tranche of capital, while the EIB and other private investors will provide senior debt. The UK confirmed that the senior debt (except the one provided by EIB) will be procured by competitive tender and that the State will not intervene in the senior debt tranche of capital. The second and the third layer of capital are covered by a State guarantee, but the guarantee will not exceed 10% of the asset base. The guarantee can be called only in stress scenarios triggered from declining DSCRs of the Senior Debt below certain levels (still to be agreed), it ranks senior to junior debt (i.e. first layer of capital) and receives nominal fee of 1% while uncalled. Based on that information, the Commission considers that while aid cannot be excluded at the level of private investors in the SPV, the potential aid to them is limited and proportional.

163. The UK confirmed that if the Government can withdraw from the market earlier than estimated because private investors have confidence in the track record produced, the Government would do so, as long as it was clear the market could be sustained without Government support.

164. The UK government undertook to review progress towards exit at the mid point of the five year approval period. It will include examining the emerging repayment rate on Green Deals, as well as whether there are market players who might be prepared to establish financing vehicles with less or no State aid in the light of progress made. If it is possible to establish financing vehicles which achieve the same policy aims with no State aid, the Government will be able to remove State aid from the SPV for future investments.

165. The UK provided a commitment that if the amount of private investment is higher than projected, at an appropriate level to sustain the Green Deal market, the amount of aid will be reduced accordingly, to avoid any crowding out effects.

166. Considering the above, the Commission concludes that the aid is kept to the minimum necessary.

167. As explained in section 2.5. above, support given under the notified scheme can be cumulated with support received under several other schemes, but the UK explained that support granted under one scheme will be taken into account when calculating the support that the beneficiary might get under the other schemes, so that any overcompensation is avoided. In the light of detailed

information provided by the UK on the interaction between the notified scheme and different other support schemes the Commission considers that the cumulation rules applied by the UK will ensure the lack of overcompensation.

3.3.3. Distortions of competition and the effect on trade

168. As already mentioned in recital 119, the Commission considers that the notified aid measure has the potential to affect the trade among the Member States and to distort the competition on the funding market. To the extent that aid is present at the level of GDPs, the notified measure could also distort the competition between companies providing and installing measures aimed at increasing buildings' energy efficiency.

169. The Commission notes that the State aid support to the SPV will be transitional, and the government will withdraw once the market is ready to take over. GDPs have equal access to financing from the supported SPV. The SPV supported will not be a company in difficulty and all other participants in the scheme will be subject to normal market checks to ensure they are viable and robust against fraudulent activity.

170. The Commission further notes that aid amount is limited and that it is reduced to the minimum necessary for reaching the proposed objectives. The scheme is widely accessible (for investors in the SPV and GDPs), which further limits the distortions of competition.

171. The distortions of competition and effects on trade are therefore limited, especially when compared with the positive effects in terms of increasing the energy efficiency.

3.4. Extension of the remit of the Green Investment Bank, to cover its intervention in the Green Deal

172. As indicated in recital 29, the set-up of the GIB received State aid approval, for a specific remit. That remit includes as priority sector non-domestic energy efficiency, but does not cover domestic energy efficiency measures. Therefore the remit of the GIB needs to be extended in order to allow the GIB to participate in the Green Deal. Under the current notification, the UK requested Commission's approval for expanding the remit of GIB to invest in the Green Deal with respect to a notified SPV.

173. The Commission notes that the domestic energy efficiency measures were not included in GIB's remit. The Green Deal seeks to improve buildings' efficiency in both the domestic and the non-domestic sector. To a certain extent the Green Deal is similar to non-domestic energy efficiency measures, as they both contribute to reducing overall energy consumption and contribute to the same objective of common interest, notably the achievement of the 20-20-20 package by contributing to creating a low carbon emissions economy.

174. The UK has provided information showing that there are market failures justifying the intervention of the GIB in the Green Deal (as presented in section 2.1.3.). The UK explained that they are temporary failures caused by the novelty of the Green Deal plan. The UK also explained that without State support the market size would be significantly smaller than with State support (as indicated in recital 12). Without State support, the market would also be less competitive and dynamic, since apparently only a few large energy companies and one large retailer would be able to finance the Green Deal on-balance sheet, but not for a long period. The State support in general is likely to have a crowding-in effect. According to the UK that effect would be even stronger if the intervention is made via the GIB (as the market perceives the GIB more as an investor and is therefore likely to revisit faster its assumptions on investment opportunities in the Green Deal).

175. The Commission agrees with the UK, on that the implementation of the Green Deal relies on the presence of commercial financing at reasonable rates; the presence of commercial financing at reasonable rates depends on the establishment of a track record of repayment in a vehicle that will be recognised and respected by commercial financiers, and the GIB is well suited to negotiate arrangements that do that.

176. The Commission takes note of the confirmation provided by the UK that all the principles of operation of the GIB (the double bottom line, additionality, last resort lending, due diligence and instruments) will be respected for the proposed GIB investment in the SPV, as further detailed below.

177. Double bottom line: The GIB will structure its proposed investment in a way that maximises environmental effect as well as maximising financial returns – at a minimum achieving the GIB's minimum overall nominal return target of 3.5%. Based on the proposals put to the GIB so far (which are still subject to negotiations), the GIB's indicative estimates of the interest rate it would require on senior secured Green Deal lending is around 5-6%, while if the GIB were asked to consider a further hybrid investment it would seek an interest rate in the region of 7%.

178. Additionality: The SPV has been structured so that the GIB investment takes place alongside other private co-investors, who are investing both in the riskier tranches of capital and in the senior debt. The presence of the GIB in the junior capital should act to crowd in investors at that level, creating interest in finance for the Green Deal. Furthermore, the exit of the State investment once a track record has been established will provide a second opportunity to bring in new commercial investment.

179. Last resort lending: The UK explained that there is no private investor prepared to invest on MEIP terms in junior capital on a basis that would ensure acceptable interest rates to end users for Green Deals so as to deliver the policy objective. The UK confirmed that the GIB would be willing to sell its stake in the Green Deal as soon as this option became available at acceptable commercial terms. The conditions that GIB would expect to see in order to halt or otherwise reduce the level of its new investment would be a clear indication

from private sector investors that they have an appetite to invest in TGDFC on or close to the terms of the GIB or that it is demonstrated that a significant proportion of the Green Deal market can be supported without state support through financial models that are not dependent on TGDFC.

180. Instruments of intervention: The GIB intervention is consistent with the instruments of intervention described in the GIB decision.

181. The Commission notes that the UK is not proposing any additional aid to the GIB, but requests only the extension of the remit of GIB to the proposed investment in the Green Deal. The UK explained that the total investment by the GIB in the SPV will be dependent on the specific capital structure of the SPV and on the uptake of Green Deal finance, but will be no greater than £300 million, which represents 10% of the bank's total capital.

182. The Commission agrees that in the case at hand, considering the complexity of the financing mechanism and financial structure of the SPV, channelling the aid largely through the GIB is likely to result in a lower amount of aid and a shorter duration of State intervention.

183. Based on the above the Commission agrees that the remit of the GIB can be extended, as proposed by the UK authorities, to cover GIB's investment if the Green Deal SPV, as notified by the UK.

3.5. Conclusion

184. It can be concluded from the above that the measure is aimed at a well-defined objective of common interest, is well designed for this purpose and the distortions of competition and the effect on trade limited, so that the overall balance is positive.

185. However, the Commission notes that it is an innovative project, for which no similar precedent exists. All the above reasoning is based on an ex-ante assessment of the notified measure and not on experience based on the observations of the effect of similar projects. Under the circumstances, the Commission welcomes the extensive monitoring and reporting proposed by the UK.

186. In so far as the GIB is concerned, the Commission considers that the extension of GIB's remit to include GIB's involvement in the Green Deal is justified and in line with GIB's objectives.

187. The Commission considers that aid provided directly by the State, as well as through GIB to support the notified scheme, and any aid at the level of GDPs and private investors in the SPV, is compatible with the internal market.

4. DECISION

188. The Commission has accordingly decided not to raise objections to the notified measure, because the aid can be found compatible with the internal market in accordance with Article 107(3)(c) TFEU.

189. The Commission approves GIB's remit extension so as to include GIB's investment in the Green Deal, as described in the current notification.

190. The Commission reminds the UK authorities that, in accordance with Article 108(3) TFEU, plans to refinance, alter or change this aid have to be notified to the Commission pursuant to provisions of the Commission Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (now Article 108 TFEU)[25].

191. The Commission would also like to draw the UK authorities' attention to the fact that aid measure at hand was notified for a five-year period, while the Commission approved the GIB only for four years. It follows that the involvement of the GIB in the Green Deal in the fifth year (if necessary) would need to be subject to a re-notification.

192. If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

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Directorate-General for Competition
Directorate for State Aid
State Aid Greffe
1049 Brussels
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Fax No: (0032) 2-296.12.42

For the Commission

Joaquín ALMUNIA
Vice-President

[25] OJ L 140, 30.4.2004, p. 1.