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Subject: State Aid SA.43861 (2015/N) – United Kingdom – Electricity Demand Reduction Pilot Scheme

Sir, /Madam,

1. PROCEDURE

- (1) Pursuant to Article 108(3) of the Treaty on the Functioning of the European Union (hereinafter referred to as TFEU) the United Kingdom ("UK") notified the State aid scheme Electricity Demand Reduction (EDR) Pilot which aims to reduce electricity demand by undertakings on a lasting basis. The scheme was pre-notified to the European Commission (the "Commission") on 16 February 2015.
- (2) On 11 September 2015 the Commission required additional information from the UK. On 26 October and 26 November 2015 the UK provided the information required by the Commission.
- (3) On 11 December 2015 the UK notified the above mentioned measure.

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2. DESCRIPTION OF THE MEASURE

2.1. Background and objectives of the scheme

- (4) The EDR Pilot scheme aims at achieving a lasting reduction in electricity consumption as a result of replacing less efficient technologies with more efficient ones. Reducing electricity use by installing more efficient equipment can help cut energy bills for consumers, lower costs for businesses and bring down CO2 emissions.
- (5) The electricity reductions are achieved during times of peak demand, and they may therefore also have a positive effect on security of supply. The EDR Pilot scheme has been designed as a technology neutral pay-as-bid auction open to all households and undertakings in any sector of the economy that can deliver electricity demand reduction at peak, subject to meeting eligibility criteria. The EDR Pilot rewards successful participants for electricity savings (in terms of kW) during the winter peak hours between 4pm and 8pm on business days from November to February.
- (6) The notified measure is conceived as a pilot scheme, which in case of successful deployment, may be scaled up and applied on a larger budgetary base. The present decision only concerns the notified Pilot scheme and is without prejudice to the assessment of any future successor scheme.¹

2.2. The scheme

2.2.1. Beneficiaries

- (7) The policy (see point 2.5) has been designed to be open to all electricity consumers willing to participate. Organisations and individuals from all sectors and locations are encouraged to apply to take part in the EDR Pilot; this includes both public and private organisations and the participation takes place on a voluntary basis. Projects however must be located in the UK and be connected to the UK electricity grid in order to fulfil the objective of the measure.
- (8) In order to better administer the scheme the minimum size of the electricity reduction per EDR Pilot scheme applicant is set at 50kW. However, it is estimated that, as currently designed, the EDR Pilot may attract a minimum bid size of around 100kW. In any case, potential undertakings in the EDR Pilot (including households) that cannot meet the minimum level of electricity demand reduction during the winter peak period will not be automatically excluded from participating because aggregators will be allowed to participate in the bid. An aggregator is defined as a person or organisation that combines projects from different organisations or households to put forward a single application for EDR

¹ The notified measure represents the second phase of a pilot initiative, the first phase of which was designed by the UK authorities to operate as a general measure open to all households and undertakings within the limit of the budgetary allocation. As the UK considered that this first phase did not involve State aid, they considered unnecessary to notify it to the Commission. Therefore, the present decision only concerns the second phase of such a pilot initiative.

Pilot support. Therefore, the aggregator will be responsible for meeting the commitments of the Participant Agreement².

2.2.2. *Pre-qualifications requirements*

- (9) The first requirement on potential beneficiaries is their confirmation that they are able to enter into a contract with the Department of Energy and Climate Change (DECC)³ via a declaration proving that they meet the standard DECC requirements⁴. If they are successful at this stage then potential recipients of funding will be required to outline in their full application information regarding:
- i) Energy efficiency measures they intend to implement (i.e. technological equipment they intend to install);
 - ii) Capital cost of such energy efficiency measures;
 - iii) Total costs of installation of the related equipment (including delivery costs);
 - iv) Estimated annual electricity savings;
 - v) Measurement and verification details to enable savings calculation based on the current electricity use;⁵
 - vi) Time of use during the winter peak period and equipment to be replaced; and
 - vii) An average peak time estimated kW savings per project across the winter peak period.
- (10) All energy efficiency measures will be eligible for the auction if they are able to meet the EDR Pilot's minimum quality requirements, as well as the relevant monitoring and verification requirements which will be set out in the monitoring and verification manual⁶.
- (11) The EDR Pilot will require beneficiaries to provide evidence that the measures outlined in their application deliver a payback period of two years or greater at the site level without any aid from the scheme. Commercial and industrial sectors energy efficiency projects with a payback period⁷ of two years or less are much more likely to be funded by the beneficiaries themselves. Therefore, measures with a lifecycle of less than two years will be excluded from the EDR Pilot (short lifecycle exclusion).
- (12) Participants have to determine at least 60% of their capacity savings at the application stage and have the option to determine up to a further 40% at a later

² Participant Agreement is the document that the winners of the auction will be required to sign in order to undertake the obligations under the measure

³ Department of Energy and Climate Change (DECC) is in charge with the implementation of the scheme.

⁴ E.g. None of the undertaking's directors have a conviction for fraud.

⁵ There are two broad types of measurement and verification in the Pilot, deemed savings and metered approaches. In the deemed approach participants will use technology specific spreadsheets to calculate savings (restricted to technologies where performance is well known and replicable across contexts). In the metered approach participants will need to take meter readings before and after implementation to baseline demand and calculate savings. This double approach does not create discrimination between the measurement systems; meter approach relying on less known technologies, will be supported with aid for acquisition of the additional equipment required for verification. The UK authorities confirmed that the metering will be technology neutral.

⁶ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/435266/M_and_V_manual.pdf

⁷ Payback is a reference to how long it takes for the measures to be paid for by the electricity savings they lead to. It is calculated by dividing the cost to purchase, deliver and install the EDR measure(s) by the avoided cost of the annual electricity savings the measure(s) will deliver.

stage. This flexibility aims to cater for possible changes to projects after the auction, including for business needs, and encourage wider participation. However, no payment will be made until after operational verification – when participants have properly installed all energy saving equipment.

2.2.3. *Selection of successful applicants - Auction arrangements*

- (13) In order to select the qualifying beneficiaries, DECC will implement a pay-as-bid auction mechanism. The pre-qualified beneficiaries (see point 2.2.2) will be invited to submit a bid for each approved application into the auction⁸, i.e. their proposals of what energy efficiency measures they intend to implement to reduce the amount of power they consume during peak times between February and November.
- (14) Bids will be placed in ascending order from lowest bid price to highest bid price per kW savings. The price per kW and number of kW of capacity savings determine best value for money and therefore the successful bids. Aid is granted on the basis of the submitted bid by the bidder and DECC will fund as many projects as can be afforded within the specified budget (i.e. £6 million) with those that are cheapest, on a £/kW basis, being selected first. If two or more participants bid the same price (£/kW) then the participant offering the highest amount of savings at each price will be ranked first. If two or more participants bid both the same price and volume of kW savings then the rank order between these bids will be determined randomly (a random number will be assigned to each bid received and the bid with the highest random number will be ranked ahead of the other bids).
- (15) Bidders will not be able to change their original bid after the auction, and the award to successful bidders is capped at the bid price (£/kW) multiplied by the offered savings (kW). In addition, the maximum bidding price per kW saved will be capped at £300. According to the UK authorities the overall budget constraint for the EDR Pilot scheme in combination with the competitive pressure created by the auction system will mean that aid is distributed most efficiently to those projects providing highest energy efficiency savings for least cost, leading to an optimal balance between costs and benefits.
- (16) The winning bids will be funded until the whole available budget is consumed. Participants will be paid the price that they bid for the kW savings offered. Only those participants' projects that can be fully funded within the auction budget constraint will be offered funding under the EDR Pilot scheme. If the remaining budget is insufficient to completely cover a participant's bid then no funding will be awarded to that participant at all.

⁸ Bids are submitted via the EDR portal and are held sealed on the portal until after the bidding window has closed.

2.2.4. *Average electricity demand reduction*

- (17) Prior to the winter peak period participants will be required to provide evidence that the equipment in their project as set out in their plan has been installed. This will typically be a commissioning certificate confirming the type and number of units installed. The average reduction achieved will be calculated as a function of the total kW savings of all the equipment included in a project and how long it is operational during the winter peak period. Following the winter peak all participants will be required to submit to DECC a "winter peak capacity savings report" to confirm their actual time of use over the winter peak period and baseline data if they are using a metered approach.
- (18) The manual⁹ sets out the processes by which participants can measure and verify the savings that their projects deliver and payments will be linked to the verified reductions that are achieved. In their measurement and verification documents participants have to provide information about their project both before and after implementation (i.e. what technologies are being installed and replaced, appropriate baselines and expected time of use during the winter peak). All applications have to complete a declaration stating the accuracy of the information provided and all applications will be scrutinised by technical experts to ensure they meet the requirements (i.e. eligibility). In addition DECC has the right to inspect projects at any stage (both before and after implementation) should that be considered necessary.
- (19) As another safeguard, the UK has also implemented a phased approach to payments, which means that projects will not be receiving funds unless they demonstrate they have properly installed EDR measures and they prove the extent to which their savings target has been met in the Winter Capacity Savings Report (WCSR) and Final Report and Participation in evaluation.¹⁰
- (20) DECC is responsible for designing, administering, monitoring and evaluating the EDR Pilot. DECC will provide funding directly to successful beneficiaries in the form of a grant payable in instalments and based on whether beneficiaries meet their commitments. These instalments are 20% following installation and operational verification, 60% following the Winter Capacity Savings Report (WCSR) and another 20% following the Final Report and Participation in the evaluation.

2.2.5. *Additional requirements*

- (21) Only households and undertakings that can provide lasting savings are eligible to participate in the EDR Pilot scheme. These criteria include being able to prove projects were operational during the times of the day in question. Measures that reduce demand by reducing economic output, or shift demand to non-peak times (i.e. Demand Side Response), and measures that are expansion projects or new build projects (i.e. where there is no replacement of existing equipment and

⁹ See footnote 6 supra

¹⁰ WCSR is the report with data evidencing savings made over winter peak for 60% payment.
Final Report is the report evidencing savings made over winter peak for the remaining 20% payment.

therefore no baseline to compare future electricity demand with previous electricity demand) will not be eligible.

2.2.6. *Aid amounts*

- (22) DECC will pay winning beneficiaries their auction bid price multiplied by the average capacity savings committed to in their successful application if all the capacity savings committed to in their Measurement and Verification (M&V) Plan have been delivered. If beneficiaries deliver less capacity reduction than estimated then their total grant will be reduced by 2% for every 1% of missing capacity reduction.
- (23) The total grant (after any adjustment for under delivery) will be split into three instalments, as described above (see point (20)) and will be capped at the eligible costs represented by the costs of procuring and installing the energy efficient equipment to deliver the electricity savings. Therefore, should the auction bid price multiplied by the average capacity saving result in an amount exceeding the eligible costs, the aid amount will be automatically limited to the amount corresponding to the eligible costs.

2.2.7. *Technological neutrality*

- (24) Any equipment provider can become a provider to any EDR Pilot participant. The EDR Pilot scheme will be open to all EDR technologies and will be competitive and non-discriminatory. A wide variety of technologies/measures will be within the scope of the scheme. This will include any product or system that can be demonstrated to reduce electricity use at a site on a lasting basis provided it has a minimum of two years payback time.

2.3. Financing mechanism and budget

- (25) The EDR Pilot is a government grant scheme. The scheme will be funded via the budget of the UK's Department of Energy and Climate Change. The estimated budget is £6 million.

2.4. Duration

- (26) The EDR Pilot scheme is of limited duration (one year). A single auction will be held in January 2016. Successful beneficiaries must measure and report their capacity savings achieved over the winter peak period¹¹. There is a choice between two winter periods, 2016-17 or 2017-18: beneficiaries can be rewarded for only one of the two winters. Beneficiaries must submit a final report with up to twelve months data and information from completed evaluation tasks.

¹¹ The winter peak period is defined as non-Great Britain public holiday weekdays from 1 November until 28 February.

2.5. National legal basis

- (27) Aid would be granted under the EDR Pilot scheme pursuant to section 43 of the UK Energy Act 2013.¹²

2.6. Cumulation

- (28) The UK Government has decided that beneficiaries will not receive other specified incentives or binding commitments for any of the measures included in their project under the EDR Pilot scheme. Projects that receive support under the Capacity Market scheme¹³ (i.e. a Capacity Market and Demand Side Response contract) will be excluded from the EDR Pilot because both schemes will potentially be operating at the same time¹⁴.

3. ASSESSMENT OF THE MEASURE

3.1. Existence of aid

- (29) A measure constitutes State aid in the meaning of Article 107 (1) TFEU if it is "*granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods [...] in so far as it affects trade between Member States.*"
- (30) The aid will be granted by the UK and through State resources within the meaning of Article 107(1) TFEU because the scheme will be financed through resources from the UK Government.
- (31) To the extent that the EDR Pilot scheme beneficiaries are undertakings performing economic activities, the measure may also give such undertakings (that decide to install energy efficiency equipment in order to benefit from EDR Pilot support) a direct selective advantage over other undertakings, as it reduces the electricity costs for such beneficiaries.
- (32) By reducing the beneficiaries' electricity costs, the notified measure threatens to distort competition as it will enhance the beneficiaries' competitive position on the downstream markets in which they operate.
- (33) The Commission notes that the measure is likely to affect the trade between Member States because the electricity is traded in an integrated European market.
- (34) Taking the above into consideration the Commission concludes that, to the extent that the beneficiaries are undertakings performing economic activities, the measure constitutes State aid within the meaning of Article 107 (1) TFEU.

¹² <http://www.legislation.gov.uk/ukpga/2013/32/section/43>

¹³ State aid SA.35980 (2014/N-2) – United Kingdom Electricity market reform – Capacity market - OJ C 348/2014

¹⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480548/EDR_Participant_Handbook_vpublication_30_November.pdf

3.2. Lawfulness of the aid

- (35) By notifying the scheme before any grant of the aid takes place, the UK authorities have fulfilled their obligation pursuant to Article 108(3) of the TFEU.

3.3. Compatibility under the Guidelines on State aid for environmental protection and energy 2014-2020

- (36) The Commission notes that the notified measure aims at improving the energy efficiency of undertakings that install equipment increasing the level of environmental protection.
- (37) The scheme's compatibility with Article 107(3)(c) TFEU must be assessed on the basis of the Guidelines on State aid for environmental protection and energy 2014-2020 (hereinafter EEAG or Guidelines)¹⁵, namely Section 3.1 of the Guidelines (i.e. Common assessment principles), Section 3.2 (i.e. General compatibility provisions) and Section 3.4 (i.e. Energy efficiency measures).
- (38) According to point 27 of the EEAG the Commission will consider a State aid measure compatible with the internal market only if it satisfies each of the following criteria:
- a) Contribution to a well-defined objective of common interest;
 - b) Need for State intervention;
 - c) Appropriateness of the aid measure;
 - d) Incentive effect;
 - e) Proportionality of the aid (aid kept to the minimum);
 - f) Avoidance of undue negative effects on competition and trade between Member States;
 - g) Transparency of aid.

3.3.1. Contribution to a well-defined objective of common interest

- (39) Firstly, the EDR Pilot scheme is designed to test whether measures that reduce electricity demand at peak demand can contribute to improve security of supply. Therefore the scheme contributes to the achievement of the objective of common interest related to security of energy supply.
- (40) Secondly, the EDR Pilot scheme contributes to the UK's achievement of its Energy Efficiency Directive¹⁶ targets because the security of supply achieved by the EDR Pilot is delivered via the installation of more efficient electrical measures or additional measures to reduce electricity demand¹⁷. The scheme incentivises electricity efficiency thereby contributing to the Union's objective of saving 20% of the Union's primary energy consumption by 2020. Reducing energy consumption contributes to a higher level of environmental protection as

¹⁵ OJ C 200 of 28.06.2014.

¹⁶ OJ L 315/1 of 14.11.2012 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

¹⁷ Evidence shows that there is a lot of potential for this kind of demand reduction in the UK — estimates suggested up to 9% or 32TWh of total projected electricity demand by 2030 could be reduced (EDR Impact Assessment – May 2013)

required by Section 3.4.1 of the EEAG (paragraph 138 and 141) and could also reduce consumer bills by making energy more affordable.

- (41) Thirdly the EDR Pilot scheme supports households and undertakings to reduce their electricity demand during the winter peak period. Currently, peak demand in the UK is typically met with increased electricity generation from fossil fuel generation plants; with associated increases in emissions. Whilst existing emissions policies including the Union's Emissions Trading Scheme and the UK's Carbon Price Floor have introduced carbon pricing into the electricity market, the total environmental impact of the emissions is not fully reflected in the price of electricity. If the costs associated with the use of fossil fuels were adequately priced in the electricity market then the cost of electricity would be higher. Firms/individuals would then take this into account when making energy efficiency investment decisions and therefore they would increase their deployment of energy efficiency measures. This increase in energy efficiency would typically lead to lower electricity demand during the peak and therefore lower greenhouse gas emissions. This is because it is likely the demand for electricity that is displaced by EDR Pilot participants would have been produced by fossil fuel plants.
- (42) The Commission concludes, therefore that the EDR Pilot scheme contributes to an objective of common interest.

3.3.2. *Need for State intervention*

- (43) The Commission is of the view that the measure will address the following market failures.

3.3.2.1. Positive externalities

- (44) The reliability of electricity supply is a public good. Customers cannot choose their desired level of reliability because the system operator cannot selectively disconnect customers and most customers cannot respond to real-time changes in the wholesale price. The costs and consequences of outages are also not exclusively faced by any particular market participant. Therefore reliability has some of the properties of a public good in the sense that it is non-excludable: most consumers cannot, with the current metering technologies, buy reliability of electricity supply for themselves without providing it for everyone else. As a consequence, electricity users do not fully price in the security of supply benefits derived from a reduction in their demand for electricity when making an investment decision. The EDR Pilot scheme provides a financial incentive that will compensate undertakings (i.e. successful applicants, to the extent they perform economic activities and are therefore undertakings for State aid purposes) for the security of supply benefits the reduction in electricity demand delivers; it therefore partially addresses this market failure through incentivising capacity savings during the winter evening peak. In addition, EDR Pilot scheme will allow the UK authorities to rely on a measure able to offer additional input on the capabilities of the market to reduce consumption at pick hours.

3.3.2.2. Coordination failures

- (45) A “principle-agent” problem that is recognised as leading to under-investment in energy efficiency is the landlord-tenant relationship. This creates split incentives. Factors which drive this coordination failure include, for example, where tenants may have an incentive to promote energy efficiency to reduce their electricity bill but they are unlikely to invest in items that become permanent fixtures in buildings they do not own and may only occupy for only a limited period of time. Landlords by contrast have little incentive to invest in energy-savings measures to reduce their tenant’s bills – except to the extent that this would enable them to charge sufficiently higher rents to recoup their investment.
- (46) Many commercial businesses use facility management companies (a third party) and in this situation the management company has no incentive to reduce consumption because any reduction in electricity demand achieved by the management company accrues to the tenant. The EDR Pilot scheme will provide a financial incentive for undertakings to overcome coordination failures, for example by potentially providing a facility management company with a financial incentive that reflects the electricity demand reduction achieved in the buildings they manage. Third party aggregators are an important part of the EDR Pilot design as they help addressing this failure by allowing undertakings that cannot meet the minimum bid size to participate and also allowing coordination of savings from a range of parties.

3.3.2.3. Incomplete information

- (47) Lack of information is a barrier to the deployment of the socially optimal level of energy efficiency. Undertakings are often unaware of the opportunities or the impact of energy efficiency measures, particularly lack of information on the performance of energy efficiency options and technologies. There is also a general lack of energy efficiency experience within commercial institutions. The EDR Pilot scheme will provide a financial incentive for the installation of electricity efficiency measures that reduce demand at peak thereby raising awareness of EDR measures and potentially incentivising undertakings to overcome the lack of information.

3.3.2.4. Other externalities

- (48) Positive externalities create insufficient incentives to promote innovation in new energy efficiency technologies resulting in higher technology and energy costs. The market for energy efficiency measures is overall not fully developed, although sub-sectors are more developed than others. The energy efficiency sector needs to grow to fully realise the potential innovation benefits. The introduction of the EDR Pilot will create a signal to incentivise investments in innovation for energy efficiency. If this occurs, then this is likely to lead to a larger market for energy efficiency measures and therefore help the realisation of greater environmental benefits from innovation.

- (49) On the basis of the evidence above, the Commission concludes that the scheme is in line with the provisions of the Section 3.2.2 and paragraph 142 of the EEAG.

3.3.3. *Appropriateness of the aid*

- (50) The Commission notes that, in order to tackle these market failures, several options (i.e. financial and non-financial) were considered by the UK government:

Non-financial options

- Information hub: This would consist of a web-based resource that would bring together the best available expertise in industrial energy efficiency, such as recent research, energy efficiency solutions and tools, best practice training material etc.
 - Disaggregated metering: support to help organisations install additional meters to give a more detailed understanding of their electricity use and so overcome information barriers.
 - Additional labelling for non-household appliances and products: this could include the inclusion of information about lifetime electricity running costs to help inform decisions at the point of purchase.
 - Buyer's commitment: This would recognise organisations that commit to only buy appliances or electronics with a high level of efficiency.
- (51) The Commission notes that none of the above mentioned non-financial options are able to address the market failures identified in Section 3.3.2 above because they do not fully address the type of externalities, asymmetry of information and coordination problems which are specifically hindering the achievement of the energy efficiency objectives.

Financial options

- (52) The Commission understands that the UK Government examined also financial incentives including a scrappage scheme where a payment would be made to an undertaking to reduce the cost of replacing an existing piece of equipment with a new more electricity efficient version.
- (53) A scrappage scheme is simple and savings would be straightforward. In addition, this type of scheme could also be implemented relatively quickly and be simple for undertakings to understand. However, the Commission understands that a scrappage scheme was rejected because it lacked a strong mechanism to drive competitive price setting for EDR measures and therefore it could provide poor value for money. In addition, a further disadvantage of a scrappage scheme was that it requires the disposal of an existing piece of equipment and this rules out payments for new equipment to optimise the performance of existing equipment, e.g. the installation of light sensors.
- (54) The Commission understands that the EDR Pilot scheme has also been designed to ensure that it provides robust evidence to help inform the UK Government's

decision on the long-term future of any financial incentive to undertakings to reduce electricity demand and provide learning about EDR projects.

- (55) The Commission also notes that alternative State aid interventions (i.e. repayable advances or financial instruments) will have a limited impact in addressing the market failures. At this stage, the lack of experience in understanding the best practices to reduce the electricity consumption will make such interventions more costly and will mitigate the aim of the intervention. In addition, because of the market failures (see point 3.3.2) such alternative interventions are not fully adequate to deliver the best balance between the savings of electricity and the costs of installation, in order to deliver the reduction in electricity consumption.
- (56) The Commission takes the view that all these measures alone would not generate a significant volume of electricity demand reduction and therefore they would fail to adequately address the market failures listed above.
- (57) On the basis of the evidence above, the Commission concludes that the scheme is in line with the provisions of the Section 3.2.3 and paragraph 145 of the EEAG.

3.3.4. Incentive effect

- (58) The UK confirmed that projects where work/ installation of EDR measures have started prior to the date of application to the EDR Pilot scheme are not eligible to participate and would be rejected at application stage. Therefore, the scheme meets the formal incentive effect requirement.
- (59) According to point 49 of the EEAG an incentive effect occurs when the aid induces the beneficiary to change its behaviour to increase the level of environmental protection and the aid does not subsidise the costs of an activity that an undertaking would anyhow incur.
- (60) The measure at hand aims to support the acquisition of electricity reduction equipment so as to achieve a higher level environmental protection. Such investments are not mandatory at the level of households and undertakings and the investor would not undertake them without the aid due to the market failures pointed out above and the relatively long pay-back period (more than 2 years).
- (61) The Commission notes that eligible undertakings will be selected on the basis of a competitive tendering process and that DECC will implement several safeguards in order to avoid aid at the level of the equipment providers [as described in recital (24)]. Accordingly, it is not required to meet the conditions of paragraphs (50) and (51) of the EEAG.
- (62) On the basis of the evidence above, the Commission concludes that the scheme is in line with the provisions of the Section 3.2.4 of the EEAG.

3.3.5. Proportionality of the aid

- (63) DECC has designed the EDR Pilot to include a number of features which ensure the proportionality of the aid that will be granted.

3.3.5.1. Eligible costs

- (64) Point 148 of the EEAG (by referring to Point 73 of the EEAG) sets out the eligible costs for aid for energy efficiency measures. In addition, Point 148 of the EEAG recognise the difficulty in setting a counterfactual for energy efficiency measures.
- (65) The counterfactual scenario in the project at issue is that any project with a payback of more than two years would generally be expected not to happen at all without Government funding. This is based on evidence¹⁸ covering a range of energy efficiency projects across the UK economy.
- (66) The eligible costs will be therefore the investments costs of procuring and installing the energy efficient equipment to deliver the electricity savings compared to the counterfactual (i.e. no investment in such equipment).

3.3.5.2. Maximum aid intensity

- (67) The Commission notes that the aid is granted on the basis of a process consisting of an invitation to tender in accordance with points 78 and 80 of the EEAG.
- (68) According with the point 80 of the above mentioned guidelines, "*where aid to the beneficiary is granted in a competitive bidding process on the basis of clear, transparent and non-discriminatory criteria, the aid amount may reach 100 % of the eligible costs. Such a bidding process must be non-discriminatory and provide for the participation of a sufficient number of undertakings.*"
- (69) The UK authorities confirmed that the grant will be awarded on the basis of a tender and that objective criteria (i.e. unambiguous, transparent and non-discriminatory) will be used to assess the applications of undertakings.
- (70) The Participant Agreement will ensure that funding from the EDR Pilot will be capped at 100% of eligible costs. The aid amount after the tender will be checked against the investment costs and the lowest amount is applied. The Commission notes that the scheme fulfils the conditions set in the Annex 1 of the EEAG.
- (71) In light of the above mentioned arguments, the Commission takes the view that the notified measure fulfils the proportionality requirement under the EEAG.

3.3.5.3. Cumulation of aid

- (72) The Commission notes that the UK committed to respect the cumulation rules (see point 2.6 above)
- (73) On the basis of the evidence above, the Commission concludes that the scheme is in line with the provisions of the Section 3.2.5 of the EEAG.

3.3.6. Avoidance of undue negative effects on competition and trade

- (74) The UK authorities intend to implement the scheme along with several safeguards which are meant to avoid any undue distortion of competition.

¹⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/66566/7028-design-policies-efficiency-elec-edr.pdf

- (75) Whilst the EDR Pilot scheme will allow undertakings to reduce their costs because their demand for electricity will decrease as a result of the purchase of the subsidised equipment (and this may allow the beneficiaries to either increase their profits and/or lower prices and increase their market share) the measure is nonetheless open to all undertakings. Also the price discovery mechanism is a pay-as-bid auction that selects beneficiaries on a "least-cost" basis and incentivises undertakings not to inflate their bid price. The EDR Pilot scheme is also time-limited because it will only pay back investments costs in electricity saving projects achieved during one winter peak period and therefore the effect on competition and trade is highly likely to be extremely limited.
- (76) One additional safeguard is represented by the fact that the scheme is only benefiting projects with a 2 year minimum pay-back period and limits to £300/kW the maximum price an undertaking can bid. This ensures that the aid does not support business as usual investments and confines the economic advantage within reasonable limits.
- (77) Moreover, the EDR Pilot scheme does not specify a list of equipment or technologies and the choice is left up to the market. The EDR Pilot scheme will be open to all technologies which are chosen in a competitive and non-discriminatory fashion. The downward pressure to compete as low as possible (i.e. participants are bidding on the basis of the savings delivered), and the cap of £300/kW on the auction prices, means that the purchase of more expensive energy efficiency measures to deliver the same savings would lead to the successful bidder receiving a relatively smaller proportion of costs.
- (78) Finally the relatively small budget of the scheme (up to £6 million) further limits any potential distortion of markets and trade.
- (79) On the basis of the evidence above, the Commission concludes that the scheme is in line with the provisions of the Section 3.2.6 of the EEAG.

3.3.7. *Transparency*

- (80) The Commission notes that the UK committed to comply with the requirements of the EEAG, points 104 and 106 on the transparency of aid.
- (81) The EDR Pilot scheme was designed based on open consultation on the options to encourage Electricity Demand Reduction. Interested parties will have access to legislation related to the EDR Pilot scheme, which can be found at: <http://www.legislation.gov.uk/ukpga/2013/32/section/43/enacted>. A detailed Handbook and Measurement & Verification Manual, which details the scheme and explains how to participate in the pilot are available to the public on the EDR website (<https://www.gov.uk/government/publications/electricity-demand-reduction-pilot-phase-ii-participant-handbook-and-additional-guidance>).
- (82) Once the Pilot auction has taken place, information regarding the results of the auction, including information on successful bidders will be made available online, on the UK Government website (www.gov.uk). The UK authorities

committed that the publication of the above mentioned information will be compliant with the requirements of point 106 of the EEAG.

4. CONCLUSION

The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) TFEU.

If any parts of this letter are covered by the obligation of professional secrecy according to the Commission communication on professional secrecy and should not be published, please inform the Commission within fifteen working days of notification of this letter. If the Commission does not receive a reasoned request by that deadline United Kingdom will be deemed to agree to the publication of the full text of this letter. If United Kingdom wishes certain information to be covered by the obligation of professional secrecy please indicate the parts and provide a justification in respect of each part for which non-disclosure is requested.

Your request should be sent electronically in accordance with Article 3(4) of Commission Regulation (EC) No 794/2004,

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

