Explanatory Note for SEAI EXEED Grant Scheme Approach to ESCOs – April 2022

Background:

The overall objective is for SEAI to support the uptake of ESCO project delivery in Ireland and to provide, where necessary, investment-aid to incentivise capital investment decision of energy users. SEAI's aim is to provide a standard solution that could be applied to accommodate market engagement, within the constraints of State aid regulations.

What is State aid and why must it be complied with by the SEAI?

State aid is the name given in the EU to a subsidy or any other aid provided by a government (including State bodies such as the SEAI) to an undertaking that may distort competition. An "undertaking" is defined as any entity engaged in an economic activity (i.e., offering goods or services on a given market). Any proposed granting of State aid requires mandatory prior notification and clearance by the European Commission before any decision to grant the aid is made. No mandatory notification to the European Commission is necessary, however, where aid is granted under the General Block Exemption Regulation ("GBER")[1]. SEAI must comply with EU State aid obligations as any finding of unlawful State aid by the European Commission would otherwise result in a requirement for the SEAI to recover aid from the beneficiaries receiving such assistance.

SEAI's grant supports to businesses therefore need to comply with State aid rules set at the European level. As these grant funds generally relate to Energy Efficiency and Renewable Energy the SEAI's grant schemes are generally designed to operate under Section 7 of GBER, "Aid for environmental protection", with Articles 36 (Investment aid enabling undertakings to go beyond Union standards for environmental protection or to increase the level of environmental protection in the absence of Union standards) and Article 38 (Investment aid for energy efficiency measures) being commonly applied. This is the case with SEAI's EXEED grant scheme, SEAI's Community Energy Grant Scheme, and SEAI's SSRH Grant (Heat Pump).

When operating a grant programme under State aid, SEAI have a series of obligations that will form part of an application evaluation process to ensure that the application evaluation process complies with Articles 36 and 38 of GBER, e.g. establishing that the grant will have an incentive effect, ascertaining the counterfactual to the proposed investment (i.e. the hypothetical scenario that would occur in the absence of the grant) and assessing that the conditions required under GBER Articles 36 and 38 are fulfilled.

SEAI, and from our understanding other Member States, have faced numerous challenges in providing grant support where there is involvement of ESCOs in the context of meeting their obligations under GBER. State aid rules recognise that there may be indirect advantages conferred on businesses other than those to which State resources are directly transferred which must be addressed from a State aid perspective.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0651&from=EN

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SEAI decided to evaluate this issue further when it was proposed to involve ESCOs in the EXEED programme and expended considerable effort in 2021 to understand and adopt a compliant approach to this issue for the EXEED programme. This included obtaining external legal advice related to the application of State aid rules for the proposed inclusion of ESCOs in the EXEED programme. This approach is likely to be adopted in other programmes should it prove acceptable and manageable for SEAI and grant counterparties. SEAI are seeking feedback on the proposed approach during a consultation period, and will consider all feedback in the drafting of the final approach to be adopted.

EXEED Grant and ESCO Contracts – Key State Aid Constraints

The considerations undertaken and legal advice received by SEAI are extensive, but three key constraints are detailed below which SEAI have sought to address in the proposed approach

1. Clear requirement for site/building owner to be the grant beneficiary

There was initially some ambiguity around which party to an ESCO contract SEAI could pay the grant, as GBER and other European Commission State aid guidance was largely silent on the specifics of who could and should be the beneficiary of assistance when an ESCO is involved. This has been clarified by additional guidance provided by the European Commission in 2021[2]. This clearly states for the purposes of grant schemes seeking to relying on GBER's Article 38 that "*if the grant or the cheaper loan or guarantee is not provided to the building owner or tenant as the final beneficiary but the energy service company, such support is not covered by Article 38 GBER*"**. On this basis, an ESCO may not be a direct recipient of funding under an SEAI scheme in the context of an efficiency project, rather the underlying building/asset owner or tenant has to be the recipient.**

SEAI sought clarity on the specific guidance which related to energy efficiency in buildings and Article 38 of GBER. The advice given is that the building/asset owner or tenant would also have to be the direct recipient of State aid funding should the other articles under Section 7 of GBER be applied instead in the context of SEAI schemes.

In the case of an ESCO type contract, as the beneficiary (being the building/asset owner) may not be making any initial investment, the incentive effect needs to be demonstrated in the application. Demonstration of the incentive effect will depend on the nature of project but will take into account matters such as the reason behind the investment decision, the risk burden that the client will take under the arrangement along with the future transfer of ownership to the building/asset owner of the equipment installed by the ESCO. The burden sharing can be demonstrated where the client takes some performance risk, and therefore SEAI have proposed that a shared savings type EPC contract will facilitate this, and that the incentive effect via this form of contract (versus, e.g. a guaranteed savings EPC contract) could be credibly assessed.

2. Clear requirement not to provide indirect aid to ESCOs

[2] https://ec.europa.eu/competition-policy/system/files/2021-12/template_RRF_energy_efficiency_in_buildings.pdf

The same guidance provided an obligation to consider indirect aid to ESCOs under the application of State Aid, stating that *"it is important [for State entities] to verify that **potential indirect support** to those intermediaries complies with the applicable State aid framework"* **As such, it is also important for SEAI to consider whether an ESCO is receiving an indirect advantage from a State aid perspective in the context of any scheme.**

SEAI, therefore, must demonstrate that it is engaging with the ESCO in line with market conditions, i.e. SEAI must consider whether the funding being provided by the SEAI, and any potential (indirect) advantage accruing to intermediaries such as, in this instance, ESCOs, is in line with market conditions and are addressed from a State aid perspective (meaning that the ESCOs will not be indirectly advantaged as a result of the grant funding).

Put simply, SEAI cannot provide State Aid in such a manner that would indirectly advantage the ESCO engaged by the building owner which would lead to a distortion in competition amongst other ESCOs in the market not in receipt of SEAI assistance. SEAI also must consider the proportionality of risk to the client within the EPC contract to justify that the SEAI grant is providing an incentive effect to the building/asset owner.

3. **Requirement to ensure that key matters related to the grant are managed in a replicable and consistent manner and that other state aid obligations are considered**

On the basis of point 1 and 2 above, SEAI have developed the proposed approach outlined in the next section. As a consequence of both the site/building owner being the grant payee, the required incentive effect, and the requirement to ensure no indirect advantages are being conferred on the ESCO, SEAI are proposing that a standard form of shared savings EPC contract, based on the National Form of EPC Contract, is utilised. This manages the constraints in point 1 and 2 above, but also allows all key matters related to the grant and ensures that this can be replicable and scalable for SEAI, e.g. the key Terms and Conditions of the EXEED scheme can be met by the applicant, and aspects such as the incentive effect for the building owner can be addressed and assessed appropriately.

EXEED Grant and ESCO Contracts – Proposed Approach

Based on the legal advice taken by SEAI and the key State aid aspects outlined above, SEAI have developed a proposed approach for consideration by key stakeholders. SEAI expect to engage in a market consultation on this approach over the coming weeks and will address any key concerns as far as practicable and within the legal advice and state aid obligations as summarised above.

Clear requirement for site/building owner to be the grant beneficiary

It is absolutely evident that in all cases the site/building owner must be the grant applicant, and the grant beneficiary. Therefore, SEAI will not accept applications from ESCOs on behalf of site/building owners, and will not directly pay ESCOs

As the incentive effect will need to be tested on the grant beneficiary, who may not have any financial hurdle for an ESCO type contract, SEAI propose that a shared savings type EPC contract would allow this incentive effect to be satisfactorily assessed given the risk burden on the site/building owner.

Clear requirement not to provide indirect aid to ESCOs

In order to ensure that no indirect aid is provided to a particular ESCO, SEAI propose that a standard form of contract is utilised for all potential applications and that specific clauses are included in this contract to demonstrate, *inter alia*, that the ESCO is being engaged by the building owner/tenant in line with normal market conditions. This ensures that SEAI are not distorting the ESCO market, are engaging with the market in line with market conditions, and that grant aid is available to site/building owners contracting with any existing or new-entrant ESCO at any given time.

Requirement to ensure that key matters related to the grant are managed in a replicable and consistent manner and that other state aid obligations are considered

As the grant recipient will be the site/building owner, and the ESCO will be making the investment, a clear chain of responsibility must be established to ensure that the grant recipient can discharge all their responsibilities in relation to the grant, SEAI can discharge their responsibilities in relation to governance, State aid and transparency of the grant aid, and the ESCO will provide the necessary information and documentation to facilitate this. By utilising a standard form of shared saving EPC contract, this can be done in a standardised and replicable manner, ensuring that there is no ambiguity or uncertainty on the disbursement of grant funding in this manner. Matters such as the incentive effect, counterfactual costs, risk burden, ownership and transfer can all be managed appropriately via a standard form shared savings EPC contract.

How will this work in practice

This approach will facilitate grant support for ESCO funded projects in a transparent and consistent manner, and ensure that SEAI are compliant with their State aid obligations. SEAI will seek to take account of any relevant consultation responses before finalising the approach. The alternative to the proposed approach is that SEAI will not be in a position to provide grant funding to ESCO type contracts.

The broad approach to be taken in practice will be;

1. Site/building owners applies for grant funding, indicating the expected use of an ESCO approach, and include all information typical of any grant, however for the investment delivered through the ESCO.
2. SEAI review application and provide letter of offer to Site/building owner
3. Site/building owner enters into standard form of contract with ESCO (noting this could happen before the application)
4. ESCO completes investment project
5. Site/building owner applies for payment, providing necessary evidence and documentation which ESCO will be obligated to provide under the standard form of contract

6. SEAI pays Site/building owner grant funding
7. Site/building owner pays ESCO grant funding
8. Retention provided through grant applicant following receipt of M&V required data via ESCO.

Next Steps

SEAI will now consult with key interested stakeholders on the proposed approach, consider any submissions on this consultation, and provide a final guidance document to be utilised in the grant scheme.

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