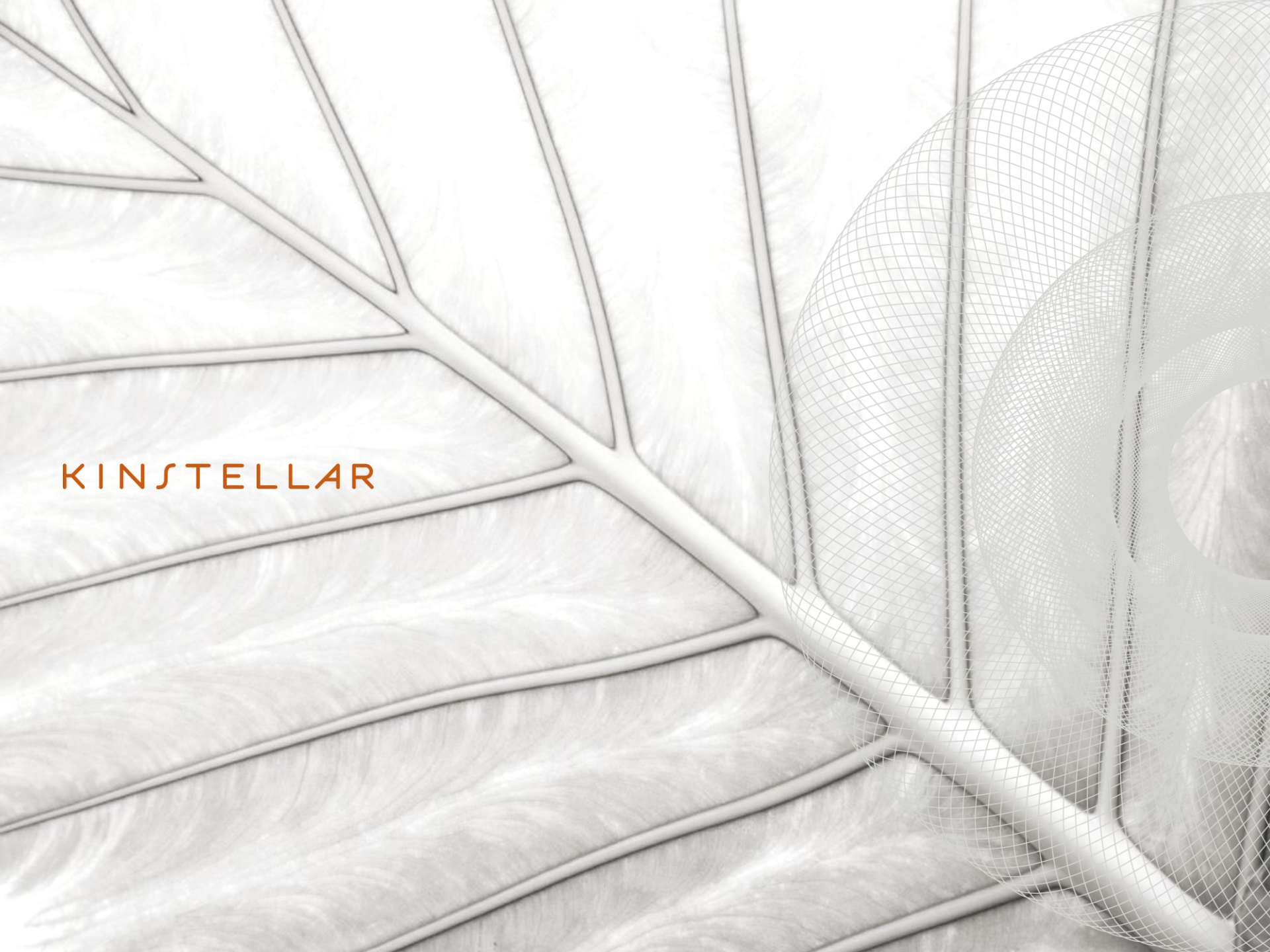
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Energy Efficiency – how efficient is the current regulatory framework?

Vienna Forum on European Energy Law, 2016

Kristóf Ferenczi

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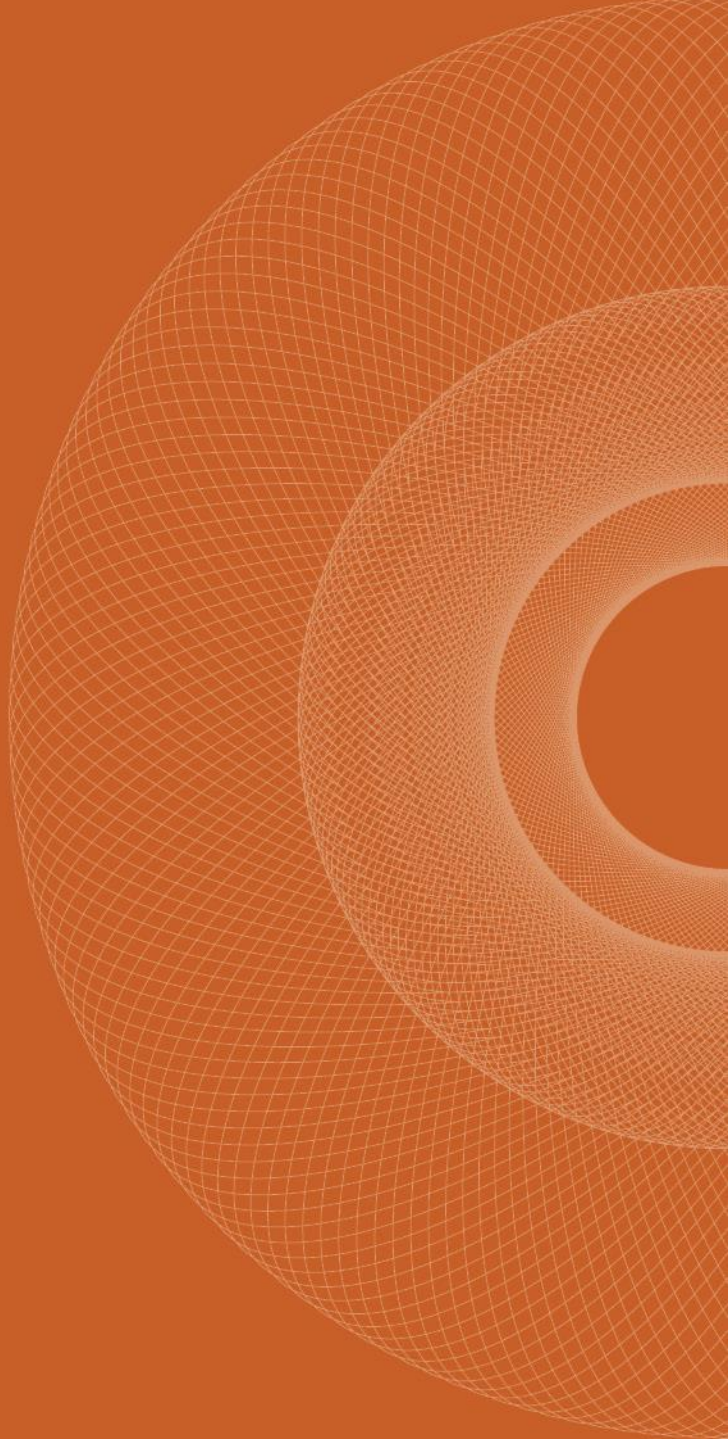
Short introduction to Kinstellar



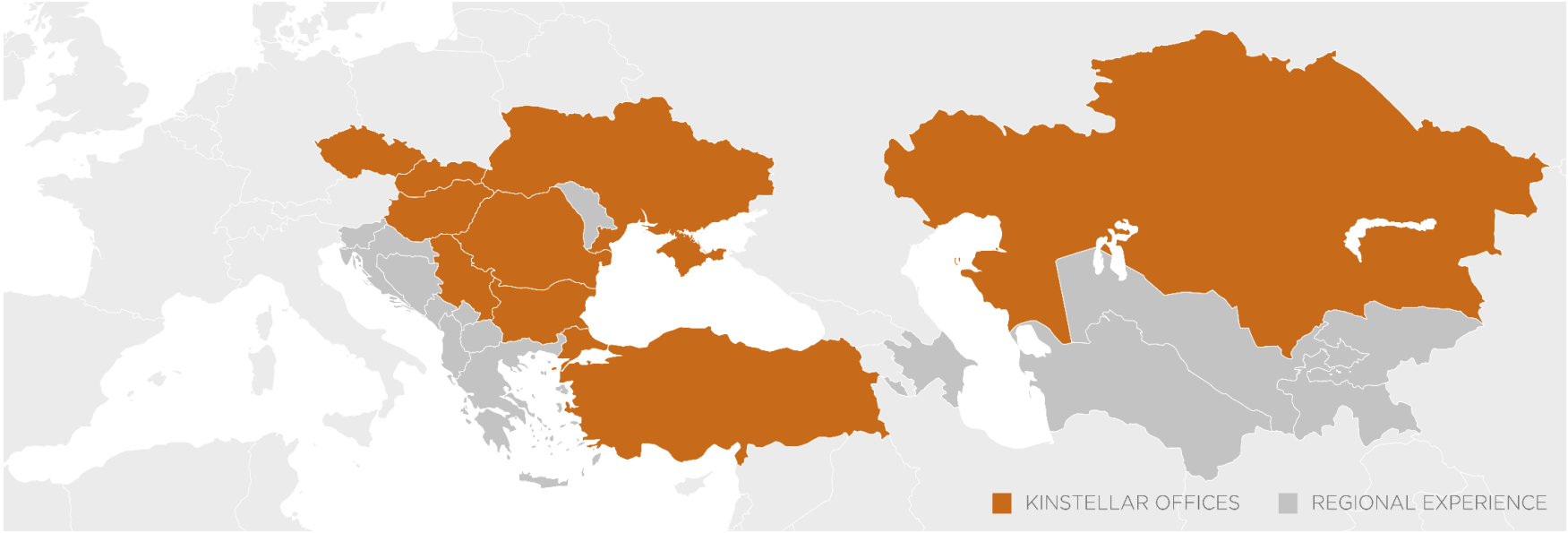
Emerging Europe and Central Asia's independent law firm

Kinstellar is a leading independent law firm in Emerging Europe, Turkey and Central Asia, with offices in Almaty (Kazakhstan), Belgrade (Serbia)*, Bratislava (Slovakia), Bucharest (Romania), Budapest (Hungary), Istanbul (Turkey), Kyiv (Ukraine), Prague (the Czech Republic) and Sofia (Bulgaria).

Operating as a single fully integrated firm, Kinstellar delivers consistently high quality services across all jurisdictions in an integrated and seamless style. We are particularly well suited to servicing complex transactions and advisory requirements spanning several jurisdictions.

We deliver:

- market experience and local knowledge across a wide range of sectors
- an in-depth understanding of the legal, regulatory and commercial issues surrounding any type of transaction or project in the region
- a dedicated team of local and internationally qualified lawyers
- a responsive, commercial approach and style
- value for money



* Kinstellar advises international and local clients in Serbia in cooperation with Zajednička advokatska kancelarija Marić & Mujezinović.

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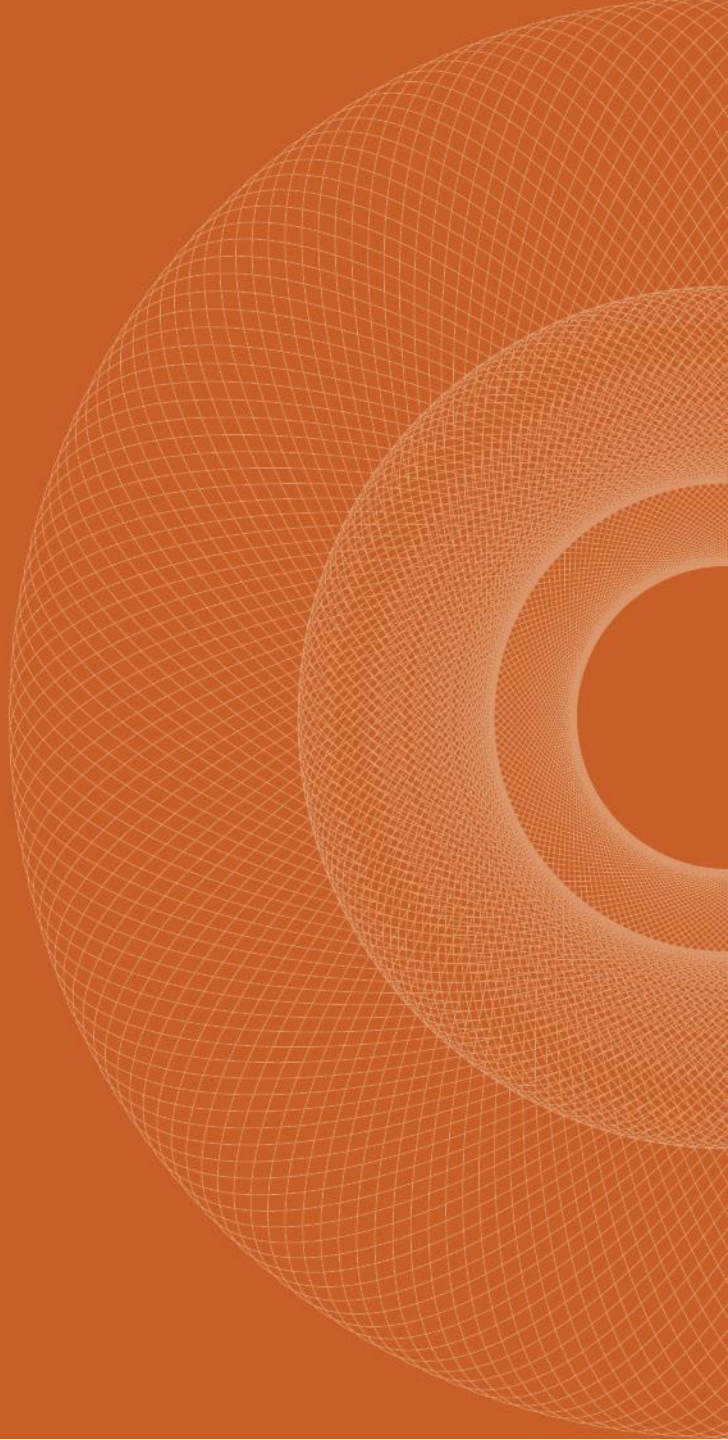
Energy efficiency within the context of current EU energy policy



Key elements of the current regulatory framework

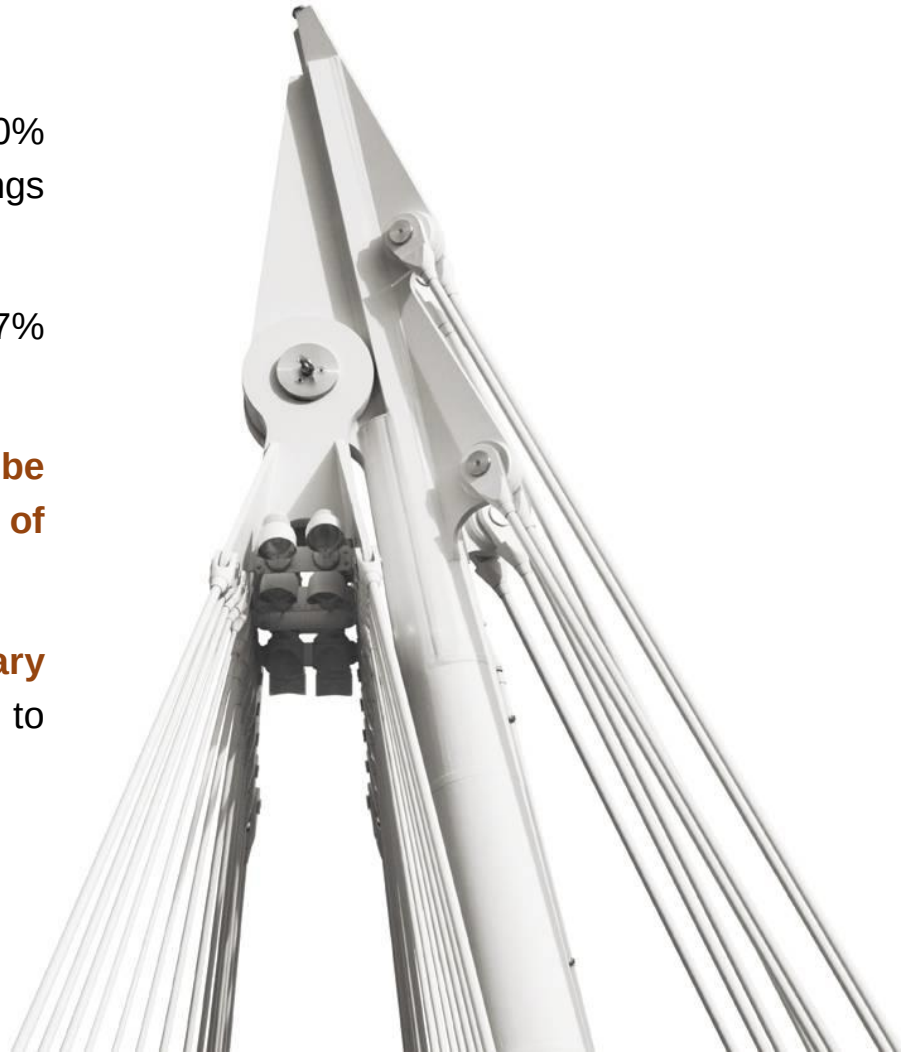
- Energy Efficiency Directive (EED)
- Energy Performance of Buidlings Directive (EPBD)
- Ecodesign Directive on minimum energy performance standards
- Energy Labelling Directive on energy performance information on labels
- EU Regulations on CO_2 performance standards for cars and vans
- Electricity Directive on the roll-out of smart meters

Energy efficiency as part of the European Energy Union

- Energy efficiency has been a policy objective for quite some time
- New impetus from launching the Energy Union
  - „[…] *necessary to **fundamentally rethink energy efficiency** and treat it as an **energy source in its own right***"
- Key areas:
  - Energy efficiency to become primary consideration in Member States' policies
  - As part of energy market design review, energy efficiency to compete on equal terms with power generation capacity
  - 3 focus points: buildings stock / transport / heating and cooling
  - One of the European energy R&I priorities: developing efficient energy systems and energy neutral buildings
  - Smart Financing for Smart Buildings initiative

Recent evolution of EU energy efficiency targets

- 20/20/20 target: 20% energy savings by 2020
- New 2020 – 2030 framework (2014 January): 40% GHG emission reduction target + 25% energy savings by 2030
- European Council conclusions in October 2014: 27% improvement of energy efficiency by 2030
- New **2030 energy efficiency target of 27% to be reviewed in 2020, having in mind an EU-target of 30%**
- Reality in November 2015: **only 17.6% primary energy savings to-be-achieved** as compared to 2020 projections



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2015 November status of implementation of EED

- Meeting June 2014 deadline for EED's implementation was not a success story
- Admittedly, EED's implementation is still work in progress
- Areas where progress is incomplete:
  - MS to take additional / new measures and set more ambitious national targets
  - Several MS must reduce primary energy consumption at a higher rate than prior to 2014
  - Large differences between MS in terms of energy intensity in industry
  - Increase share of high efficiency CHP and district heating / cooling

Results from the public consultation on EED review (2016)

- Present regulatory framework is so complex that Member States require additional guidance
- Energy savings calculations to be based more on observed data and less on projected estimations
- EU Commission to focus more on the transport sector, monitor Member States' progress and, if necessary, indeed sanction non-compliance
- Main barriers identified by participants
  - Limited timeframe (2014-2020) makes it hard to attract investment for long term measures
  - High administrative burden associated with certain measures
  - Ensuring sound and independent monitoring and verification of energy savings
- Rules needed aiming at specific sectors such as: building renovation, district heating and cooling network development and city infrastructures for transport, waste heat recovery, and waste-to-energy
- Accounting rules biased against energy efficiency investments, e.g. when calculating the balance of public budgets – public authorities should base public procurement decisions on lifecycle cost analyses

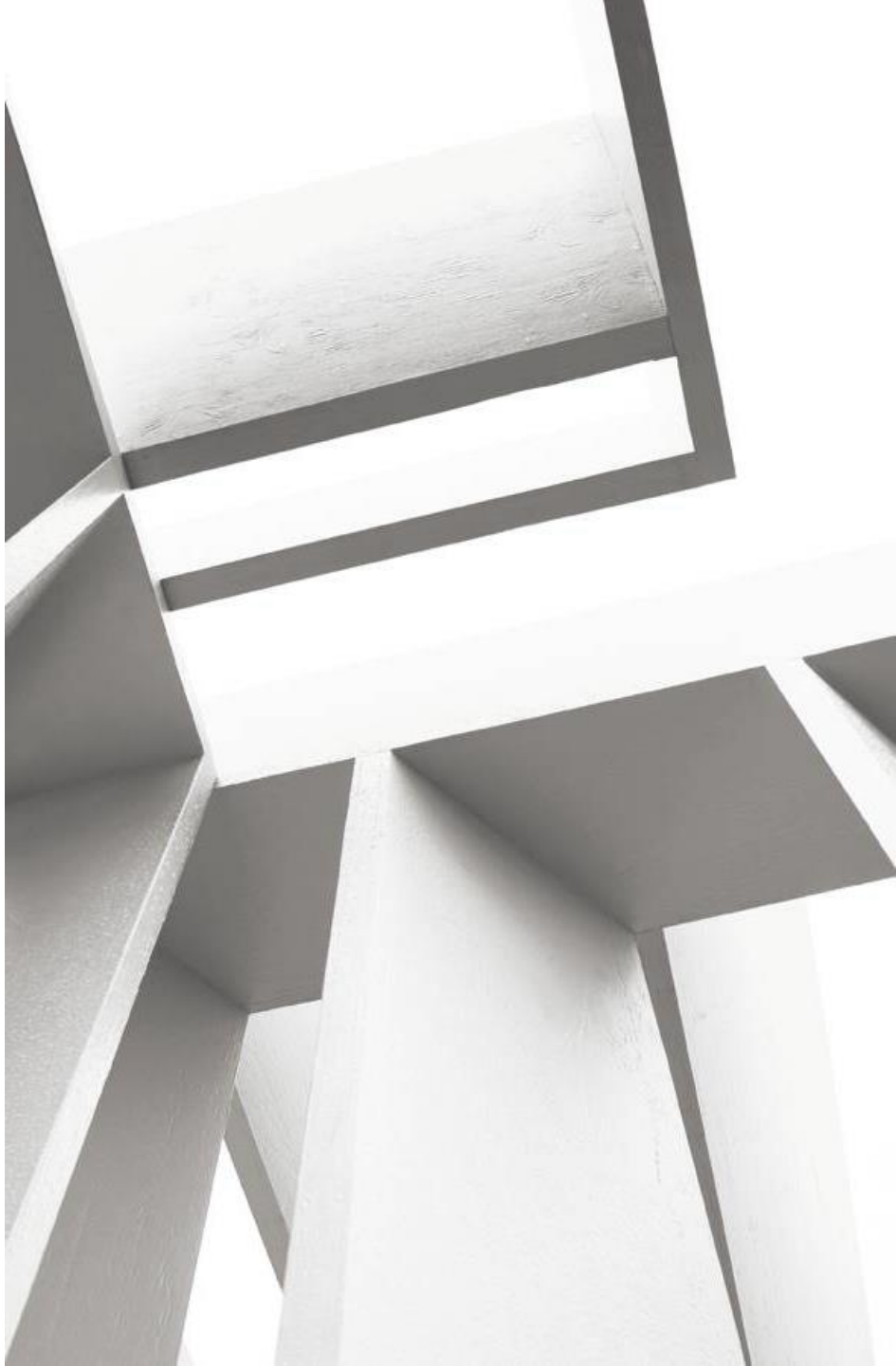
Energy Union – revision of EED / EPBD under way

- Review of the 2030 energy efficiency target
- Improving the implementation and effectiveness of EED
- Review of EED Article 6 on purchasing by public bodies (public procurement)
- Extension of EED Article 7 beyond 2020 on energy efficiency obligation schemes
- Review of EED Articles 9 -11 on information and metering for consumers and Article 15 on efficiency in transmission and distribution
- Review of various EED Articles on financing / energy performance contracting

Promoting energy efficiency – a market based approach

2014 Energy Efficiency Communication

- ”*Particular attention should be given to the* ***emerging market for energy services*** *(including Energy Performance Contracting and Energy Service Agreements)”*
- *”[…] work has to be done to clearly* ***demonstrate the business case for investors and financiers****”*
- *”[…]* ***Transparency, scalability and standardisation are required*** *to create a secondary market for energy efficiency financial products and unlock the potential for the* ***refinancing of energy efficiency investments via capital market products*** *and structures*”



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Market-based approach: energy services market and EPC

- Short recap:
  - EPC: Energy Performance Contracting
  - ESCO: Energy Services Company
  - Underlying principles of EPCs
- Key characteristics of EPCs in practice
  - Turn-key services
  - Guaranteed energy savings
  - Focused around risk allocation
  - Long-term cooperation
  - Different financing models
  - Long-term pay-back mechanism

Market-based approach: energy services market and EPC (cont.)

- EPC project contractual framework
  - Complex contractual setup
  - Structured risk allocation
  - External financing adds to complexity
- Typically, EPC contracts are unregulated agreements
  - Outside of the scope of many Civil Codes
  - Annex 13 of EED provides minimum elements for EPCs with public sector

Experience with and some conclusions regarding EPC structures in practice

- Typical examples
- Complexity of contractual framework is a major challenge
  - Significant legal issues with poorly prepared contractual framework
  - Compliance with local regulatory framework is not self-evident
  - Details do matter
- Lack of expertise and misconception of the need for external advice hinder success

Experience with and some conclusions regarding EPC structures in practice (cont.)

- Usual hot spots of EPC contractual frameworks:
  - Measurement and verification of energy savings
  - Allocating risk of regulatory changes, including e.g. price regulation
  - Future changes to the financing of public bodies
  - Dispute resolution clauses
  - Accommodating financing banks' requirements in the project documentation and addressing bankability concerns

Experience with and some conclusions regarding EPC structures in practice (cont.)

- Recommendations
  - Enhance work on removing market barriers
  - Raise awareness of possible benefits
  - Still further information-sharing and training of stakeholders is needed
  - Publicize and explain success stories
  - Elaborate model contractual framework and sample contracts, bearing in mind national law specifics

Promoting energy efficiency – through State intervention

State intervention: imposing legal obligations

- Direct legal obligations
  - On the public sector – renovation of 3% of total floor area of heated/cooled buildings
  - On the private sector – setting up energy efficiency obligation schemes
- Indirect legal obligations
  - Energy audit requirements
  - Energy efficient public procurements
  - National Energy Efficiency Action Plans
- State aid aspects

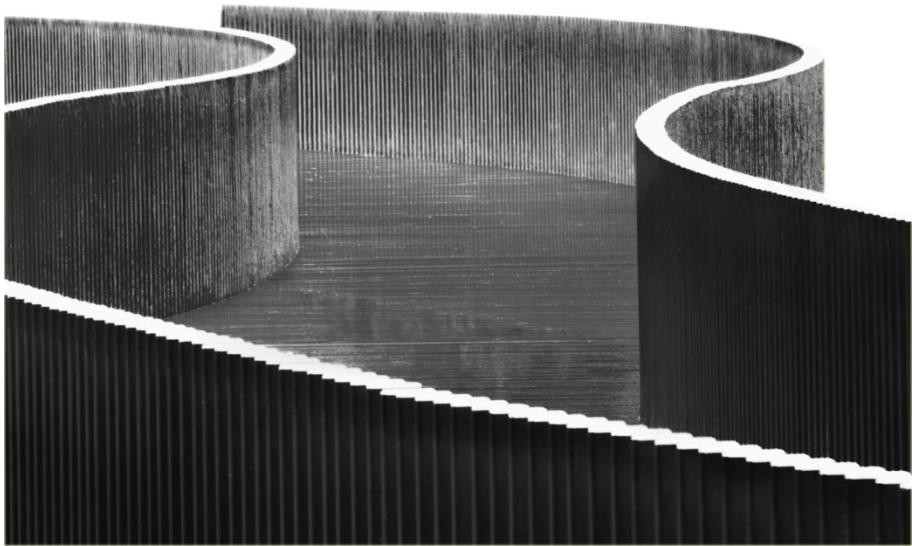
Energy audit: a practical example for differences in national implementation

- CEE/SEE survey of energy audit obligations by Kinstellar (and in Europe by Linklaters)
- Key findings (for the CEE/SEE)
  - Inconsistent treatment of partner and linked enterprises
  - Inconsistent application of consumption thresholds
  - Inconsistent treatment of holding companies and companies with no economic activity or energy consumption
  - Different attitude towards the acceptance of internal and external audits
  - Significant differences in the sanction regimes

Takeaways

Conclusions

- Energy efficiency investments can be realised through market-based mechanisms (EPC)
  - Direct regulation plays a lesser role, BUT
  - Significant role for EU Commission, MS Governments, market players in promoting transparency and enhancing confidence
  - Role of experienced professional advisors should not be underestimated
- Energy efficiency investments can also be realised by State intervention
  - Lack of clarity, coupled with complexity of regulation, is an issue
  - Differences in national implementation should be minimised



Questions?

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Thank you for your attention!

Kristóf Ferenczi
Partner
Head of Energy
T: +36 1 428 4471
E: kristof.ferenczi@kinstellar.com

Your contacts

HEAD OF ENERGY PRACTICE

Kristóf Ferenczi
T: +36 1 428 4471
E: kristof.ferenczi@kinstellar.com

Almaty, Kazakhstan

Joel Benjamin
T: +7 727 355 0530
E: joel.benjamin@kinstellar.com

Belgrade, Serbia

Branislav Marić
T: +381 11 3210 201
E: branislav.maric@kinstellar.com

Bucharest, Romania

Razvan Popa
T: +40213071618
E: razvan.popa@kinstellar.com

Budapest, Hungary

Kristóf Ferenczi
T: +36 1 428 4471
E: kristof.ferenczi@kinstellar.com

Bratislava, Slovakia

Roman Oleksik
T: + 421 2 5929 1113
E: patrik.bolf@kinstellar.com

Istanbul, Turkey

Halide Cetinkaya Yılmaz
T: +90 2123495022
E: halide.cetinkaya@ccaolaw.com

Kyiv, Ukraine

Kostiantyn Likarchuk
T: +38 044 394 9040
E: konstiantyn.likarchuk@kinstellar.com

Prague, Czech Republic

Kamil Blazek
T: +420 221 622 258
E: kamil.blazek@kinstellar.com

Sofia, Bulgaria

Diana Dimova
T: +359 2 9048 331
E: diana.dimova@kinstellar.com

Firm Managing Partner

Jason Mogg
T: +420 221 622 111
E: jason.mogg@kinstellar.com