Bellona Europa

Recommendations on shaping ESCOs' development in Poland

Authors (In alphabetical order):
Andrzej Gula
Eivind Hoff
Joanna Ciesielska
Marek Zaborowski

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1. Introduction

While budget deficits and public debt are growing, saving energy can bring real benefits for the public finances and taxpayers - leading to a reduction in current expenditures of public budgets. Numerous opportunities exist to reduce power consumption by improving energy efficiency in buildings and thus saving energy in Poland. In the buildings sector implementing stricter efficiency controls for new buildings and better insulating existing ones could abate almost 30MtCO_2 by 2030 – 13% of the total potential (Figure 1). A very important factor in implementing energy efficiency obligations is the development of Energy Service Companies (ESCOs). The development of ESCO services among other features enables private financing of energy efficient investments in the public sector. Those investments could be repaid from savings resulting from lower energy costs.

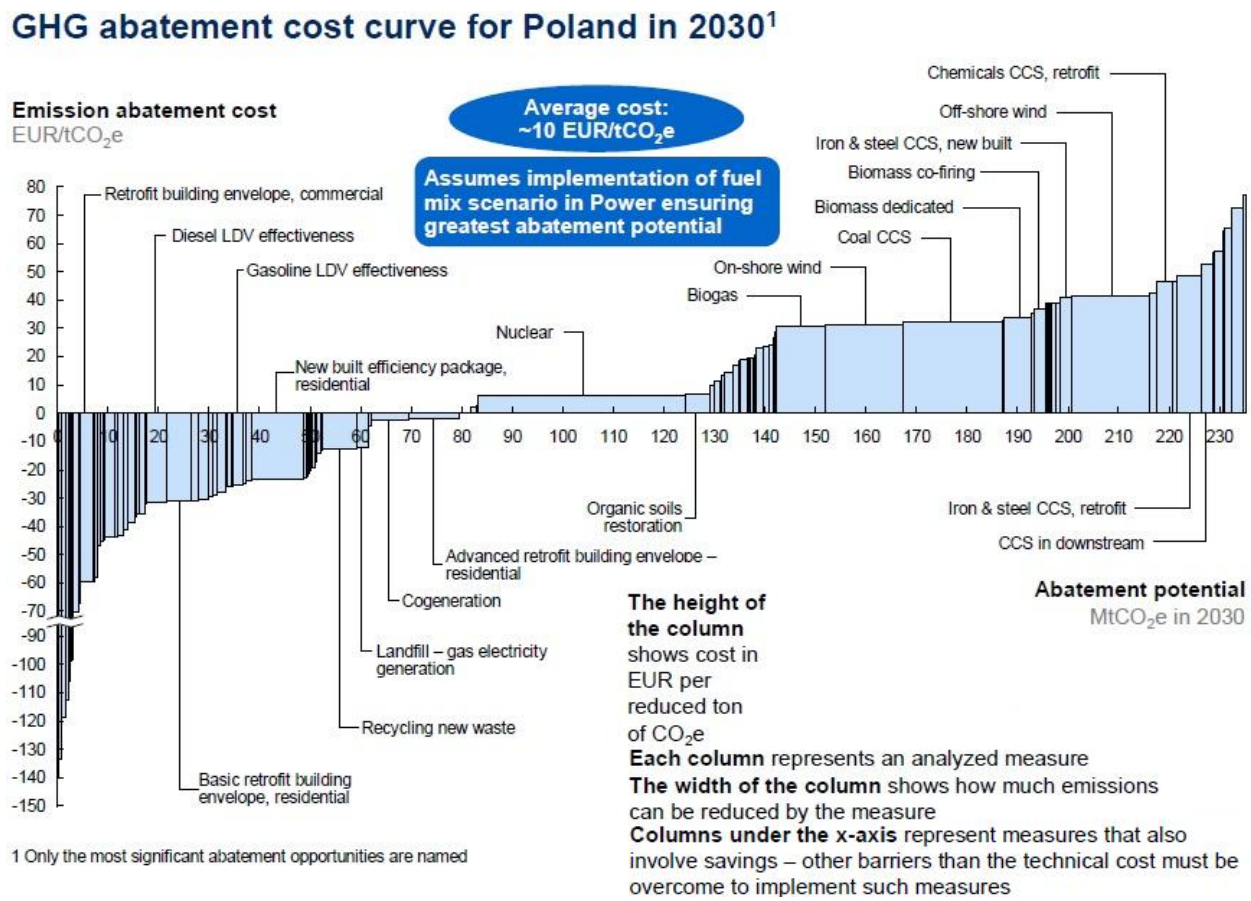

Figure 1 Assessment of Greenhouse Gas Emissions Abatement Potential in Poland by 2030, McKinsey & Co., Warsaw 2009

An ESCO proposes contracts to enhance energy efficiency of the customer's assets – generally buildings. The ESCO takes the investment cost for energy savings on its balance sheet. In return, the ESCO is paid back over time by the customer, who covers this from the energy cost savings achieved as a result of the modernization. During the repayment period the customer does not bear larger overall costs than before the 'upgrade' and often (depending on the conditions of the investment) immediately partially benefits from the savings achieved. After the repayment period the customer starts managing the modernized facility on his or her own account.

Contracts in the ESCO field can be divided into two basic groups:

a. Delivery contracting (Contract for delivery of energy/heat)[1]

A contract for the supply of energy makes the ESCO obliged to modernize energy generating equipment in or for the facility. The service also includes operation and maintenance of installed systems. Accounting for those investments is done based on the amount of energy supplied and its calculated fee, covering mostly two components:

- Fixed component (cost of investment and other fixed costs)

[1] Krajowa Agencja Poszanowania Energii S.A.: 'ESCO - USŁUGI ENERGETYCZNE; KONTRAKTOWANIE EFEKTYWNOSCI ENERGETYCZNEJ. Materiał informacyjny' Source (viewed on 10.11.2011): *http://change.kig.pl/pliki/ESCO_i_kontrakting.pdf*

- Variable component for energy supplied (and depending on fuel prices)

b. Energy Performance Contracting (Contract for guaranteed energy savings)

While the contract for energy delivery is focused exclusively on the purchase of energy for e.g. buildings, the energy performance contract is to lead to a reduction in energy demand. Savings are achieved through the use of any methods to improve efficiency. In this case, the remuneration of the ESCO is based on the savings achieved. Over the duration of the contract the repayment of costs of investment is made from the savings achieved. Contracts where the cost savings are used to cover the costs of management plus financial costs are also possible.

While ESCOs are developing significantly in other EU member states (e.g. Czech Republic, Hungary and Germany), in Poland this sector is almost non-existent. The European Union clearly indicates the need for development of ESCOs in Article 6 of Directive 2006/32/EC on energy end-use efficiency and energy services:

Member States shall ensure that there are sufficient incentives, equal competition and level playing fields for market factors other than energy distributors, distribution system operators and retail energy sales companies, such as ESCOs, installers, energy advisors and energy consultants, to independently offer and implement the energy services, energy audits and energy efficiency improvement measures.

2. Barriers to ESCO market development in Poland

Due to all the above mentioned reasons, Bellona invited the most important Polish ESCO stakeholders to share their views and come up with constructive recommendations on how to shape the ESCOs development in Poland.

The players involved were:

- KAPE
- FEWE – Fundacja Efektywnego Wykorzystania Energii (Foundation for Energy Efficiency)
- MIWO – Stowarzyszenie Producentów Wełny Mineralnej i Szklanej (Mineral and Glass Wool Manufacturers Association)
- SIEMENS - Energy & Environmental Solutions Unit, Warsaw, Poland
- Build Desk Polska – Private company
- Śnieżyk – Private company
- EE System – Private company
- City Lighting – Private Company

The respondents were interviewed in the first half of 2011. In the course of those discussions they identified various obstacles to the general development of ESCOs in Poland (Table 1). Some of the defined problems are more diffuse – like the insufficient understanding and knowledge of ESCO mechanism. The major practical hurdles are to be found in this report and were classified as follows:

- Lack of understandable regulation,
- Exclusion of ESCOs from projects financed by public subsidies[2]
- Administrative barriers
- Discrepancies and contradictions in Polish law
- Low competitiveness of ESCOs in relation to other forms of financing the investment
- Lack of incentive for public bodies to save energy
- Possibilities of vertical integration between energy distributors and those owning energy using facilities

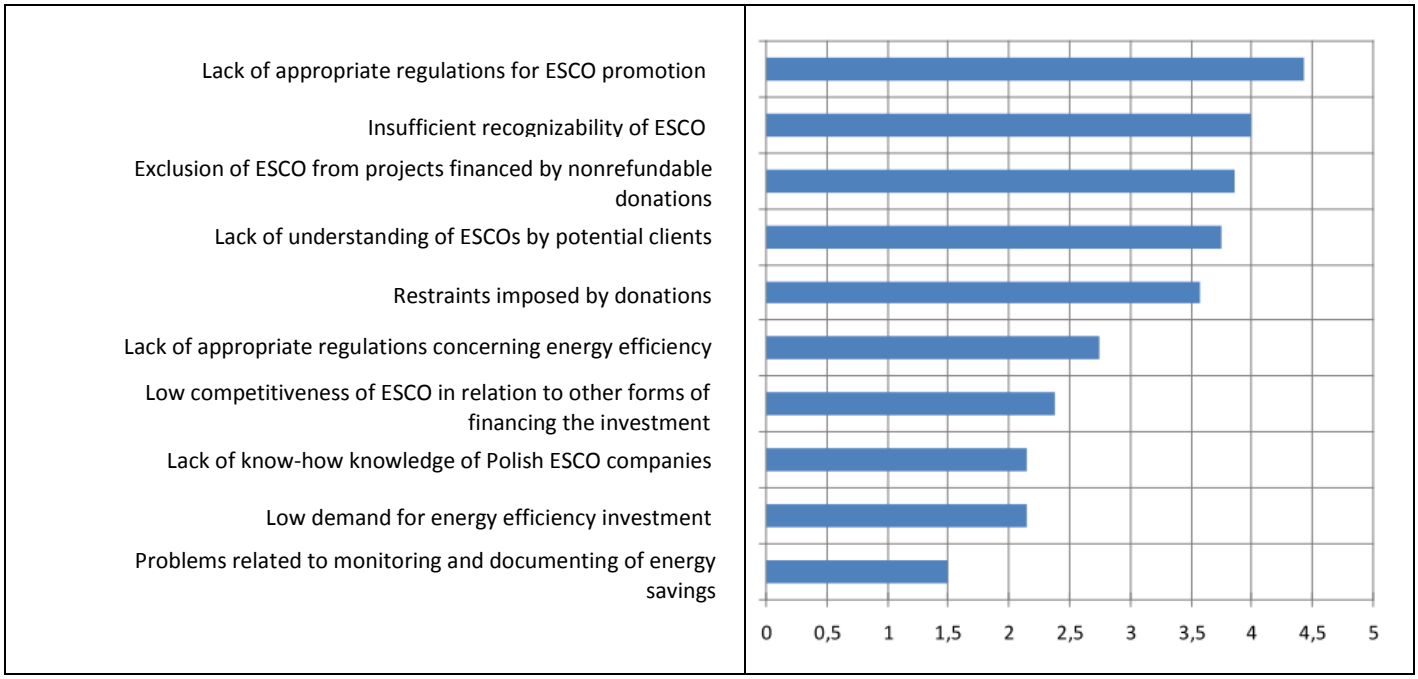

Table 1 Significance of given barriers to ESCO development in Poland (where 1 is no barrier and 5 is a very significant barrier).

[2] Governmental subsidies, such as EU funds, EEA and Norway Grants, the National Fund for Environmental Protection and Water Management and its regional equivalents.

3. Challenges to ESCO development in Poland and recommendations for how to overcome them

a. Lack of proper legal regulations promoting ESCO markets

The majority of respondents (7 out of 8) pointed out that the lack of proper legal regulations promoting ESCO markets is the major barrier preventing the development of such services in Poland. There is no reference regarding ESCOs in Polish law. This should be changed by introducing references to ESCOs in the Public Procurement Law, Public-Private Partnership Act, Public Finance law, Energy law, Energy Efficiency Act, Balance Sheet Law and Tax Law.

b. Exclusion of ESCOs from projects financed by public subsidies.

As a major hurdle most of the respondents (5 out of 7) identified the lack of possibility to take into account ESCO investments as the required co-financing for projects receiving government subsidies. This applies to EU funds, EEA and Norway Grants, the National Fund for Environmental Protection and Water Management and its regional equivalents. Therefore some respondents identify such subsidies as competition for ESCOs. The State should ensure, instead, that ESCO financing is recognized as co-funding for publicly funded energy efficiency projects (e.g. as the 20% co-funding required for Cohesion Funds). This would encourage the potential ESCO customers to use ESCOs in order to make fuel and electricity consumption more efficient.

c. Lack of a solid demand for white certificates.

To create a demand for ESCOs, it will be crucial to create solid demand for white certificates notably from deep renovation in buildings.

d. Lack of energy savings ownership.

Public institutions that achieve energy savings must be able to keep at least a sufficient portion of the saved costs. Today, energy consumption cuts (and subsequently costs cuts) will cause budget cuts the following years. Regulation should be adopted ensuring savings from the reduction of energy use, water, fuel and other media savings is kept by the public bodies concerned in order to reimburse ESCOs, based on energy performance contracts.[3]

e. Lack of supportive position on the administrative side.

One of the respondents emphasized the fact that officials are against ESCOs due to the formal and legal problems related to preparation and organization of such enterprise. He stressed that the government and the Regional Chambers of Auditors should have an official, supportive position on energy performance contracts.

[3] i.e. contracts guaranteeing both financial savings and methodology for calculating them

f. Discrepancies between Public Procurement Law[4] and the Public Finance Law.

There are some discrepancies between Public Procurement Law[5] and the Public Finance Law[6]**.** According to the Public Procurement Law, fixed term contracts for four years or less can be signed. This fixed time can be extended if all the conditions imposed by the art. 142, Paragraph 2 of the Public Procurement Law are fulfilled. Exceptionally, contracts may be concluded for an indefinite duration. According to the Public Finance Law, on the other hand, only contracts regarding the budget year are included (equal to the calendar year), what is often interpreted as an official ban on concluding long-period contracts. It is essential to clarify this, allowing contracts for a period longer than 4 years (ca. 8-10 years). Appropriate changes in law may improve the demand for ESCOs in buildings of the public finance sector. Other Member States' experience proves that simplification of law concerning thermo-modernization and electro-modernization of public buildings generates considerable energy savings.

g. Restrictions for ESCO services imposed by regulations under the new Public Finance Act.

Some respondents pointed at restrictions for ESCO services imposed by regulations under the new Public Finance Act[7]. According to this Act, ESCO contracts will be included as a component of public debt. This reflects an insufficient understanding of investments of this type, which may be neutral or even positive for public bodies' budgets. Therefore, the use of ESCOs should be compatible with public finance legislation: budget neutral ESCO contracts related to financing of service, delivery and construction works should not be a component of public debt.

h. Existing vertical integration between energy distributors and those owning energy using facilities.

Another complex problem identified is preventing investments reducing energy use in public lighting. In many cases, public lighting infrastructure in Poland is owned by utilities also owning power plants. That means an increase in energy efficiency is not in their interest. Vertical integration between energy distributors and those owning energy using facilities (such as street lighting) should be banned.

i. Lack of an entity responsible for coordination of ESCOs' development and their recognition.

To ensure that the above-mentioned changes are put in place a national body for ESCOs should be created. Such an entity should develop or gather exemplary ESCO contracts of different kinds as guidelines for interested parties. It should also ensure that information about possible benefits of using ESCOs is included in all relevant public documents. The body should build on international institutions' know-how and resources (e.g. the European Bank of Reconstruction and Development, European Investment Bank and World Bank).

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[4] Prawo zamówień publicznych
[5] Prawo zamówień publicznych
[6] Ustawa o finansach publicznych
[7] Znowelizowana ustawa o finansach publicznych

Such a national body should also form an 'ESCO National Contact Point', which would provide the mentioned know-how to ESCO companies and ESCO beneficiaries as well as assist the local government and public finance units planning to use ESCO services. Last but not at least – a national campaign for energy efficiency should be launched to broaden public awareness of the subject.

4. Conclusion

None of the above mentioned actions requires complicated or cost intensive actions/planning. With the exception of the information campaign, all of the proposed measures have zero or negative net costs and will be highly valuable in the process of boosting the energy service companies sector in Poland.