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Prospects for and legal risks facing Poland's ESCo market

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Many energy-intensive industrial sectors, such as chemical, paper or cement, offer significant potential in energy savings. These can be achieved through thermo-modernisation, energy-saving construction, modification of technological processes and energy recovery. The construction, industrial, waste management, agricultural and transport sectors are among those that can benefit from the services of ESCos – Energy Savings (or Services) Companies.

These take on the risk of financing energy-efficient technologies in third-party premises in return for a share of the savings made. Cost-efficient investments financed by ESCos may lower energy costs by 10-40% ; in public buildings the savings can be up to 50%.

On top of Poland's 9% energy saving by 2016 target, the EU's 2012 Energy Efficiency Directive (EED) imposes an additional obligation to increase energy efficiency in the public sector. As of 1 January, 3% of Poland's public utility buildings will be subject to renovation and public procurement activities should be guided by principles of energy savings.

Experts have evaluated the investment plans of ESCos in Poland to be worth several hundred million zlotys each year.

Financial support for energy efficiency projects and ESCos

The application procedure for energy efficiency certificates (so-called **white certificates**) have proved to be of little encouragement to businesses from investing in energy-saving measures. During the 2013 tender procedure for efficiency certificates, half of all applications were rejected by the Energy Regulatory Office for formal reasons. And the procedure took an average of seven months. In such an environment, the appearance of national, EU and international sources of finance are of real encouragement.

Funds for measures that improve energy efficiency – energy audits, investment subsidies (such as thermo-modernisation), buying devices like photovoltaic panels, the replacement of obsolete energy sources or lighting – may be applied for by businesses from European Structural and Cohesion Funds, from the Norwegian Financial Mechanism, the Financial Mechanism of the European Economic Area, the Green Investment Scheme (GIS), and also from the Polish national fund for the environmental protection and water management (NFOŚiGW).

Discussions about the ESCo formula have gone on for at least a decade in Poland, but this model is not as popular as it should be. The EU today officially provides support to ESCos that finance and sell energy efficient solutions. EPCs can therefore be expected to be more often applied in Poland.

For the time being, a weakness of the Polish ESCo market is the lack of necessary statutory regulations. Neither the Bill amending the Act on Energy Efficiency (implementing the EED), nor an Act on the Energy Characteristics of Buildings have, to date, been officially published. A draft of the latter, however, is now publicly available. To enhance the development of the ESCo market, incentives, such as shorter waits for new investment permits, are needed. We also await adoption of uniform assumptions to standard EPCs on a national level.

ESCo investors should pay particular attention to the risk of not obtaining a return from the investment. To secure maximum returns for money spent on premises owned by a different entity, an investor should ensure the appropriate drafting of a contract that regulates the division of rights and obligations and risks shared between the partners. The contract should provide for a method of payment for services, and calculation, division and enforcement of the obtained energy savings; detailed principles for the operation of the development should be covered by the contract (e.g. the day-to-day maintenance of equipment); transfer of ownership rights of the installed energy-saving technologies to the beneficiary (whether at the beginning, or after the investment has been concluded); principles for hand-over and acceptance of the subject of the contract; assumption of risk for construction errors which may limit savings; the term of the contract; and the investor's security against the early termination by a beneficiary or its legal successor.

Contractual regulations regarding the method used for calculating the energy saving obtained (measurement, evaluation and verification), including a defined reference scenario for future energy consumption, may result in particular difficulties. When drafting an EPC, you can use the 2009 *International Energy Efficiency Financing Protocol – Consolidated Terms*, or the 2010 *International Performance, Measurement and Verification Protocol – Concepts and Options for Determining Energy Savings*, or the Polish Norm EN15900 *Services to the Extent of Energy Efficiency*.

All these sources of finance may concern investments undertaken in accordance with the ESCo formula. This is a mechanism for financing or co-financing an investment by increasing the energy efficiency of a building or plant through private funds from an ESCo. The ESCo assumes the risk by guaranteeing improvements; the beneficiary repays the ESCo from savings obtained through lower energy bills. As such, it is a self-financing venture.

To do this, an Energy Performance Contract (EPC) is needed. An EPC is a contract for achieving energy savings. According to the EED, an EPC is the preferred model of contract used to achieve energy efficiency improvements. Various types of EPCs exist, but the ESCo always assumes the risk should savings not be achieved. The credit risk, however, may be borne by either the ESCo or the beneficiary. An investor may obtain savings from energy costs or, as in the case of a participation model – parties agree that from the outset that the beneficiary obtains a share (usually 10%) of the achieved savings of energy costs. This way, the beneficiary can decrease its expenditure in the budget (in this model, the term of the contract is extended). Combining EPCs with support programmes may multiply the profitability of an investment. An example of an EPC has been combined with an NFOŚiGW subsidy is the thermo-modernisation project for public utility buildings in Karczew (Mazowieckie voivodship), in which finance was obtained through the GIS programme.

When considering which subsidy source to select, you should check whether you would still be eligible to apply for a white certificate. This is because the Polish Energy Efficiency Act of 2011 states that a venture in which a thermo-modernisation bonus was granted on the basis of the Thermo-modernisation and Renovation Act, or where the funds were obtained from the EU or national budget , cannot participate in the tender for white certificates. It is advisable to obtain an interpretation from the Energy Regulatory Office or Ministry of Finance in such cases.

On top of funds currently available for improving energy efficiency, NFOŚiGW envisages that **preferential loans will be provided to ESCos**, probably up to 75% of the qualified costs of the project. The loan would be secured in the form of an assignment from the EPC. With regards the co-financing of an ESCo model by NFOŚiGW, a pilot scheme consists of a contract between the NFOŚiGW and an ESCo relating to the transfer of funds for an investment, and a contract relating to energy performance between an ESCo and the beneficiary.

Problems and risks associated with projects using the ESCo formula

Another legal problem relating to ESCo investments is the fact that the PPP model does not have any binding settlements as to how EPCs are to be treated with regards the local authority's balance sheet. In the model of a self-financing venture, it should not constitute a public debt.

Among legal problems relating to finance, we should also mention a lack of relevant provisions in programme documents which facilitate the subsidies of public entities to be joined within the overall ESCo formula.

The inappropriate preparation of tender documentation could also result in additional legal risk in an ESCo project where a public entity is a beneficiary.

An ESCo undertaking a large number of projects cannot obtain funds for all these investments within de minimis state aid (too small to cause distortion of competition within the internal market of the EU). The limit of de minimis support is no more than €200,000 over a three-year period for one business. Beyond this amount, ESCo can still receive state aid but no longer under the less restrictive de minimis rules.

A lack of experience with the ESCo formula, for investment companies, beneficiaries – including those from the public sector – and advisory companies, increases risk. Should the uniform assumptions of a standard EPC not be adopted on a national level, the parties themselves will have to take care of the appropriate construction of their own EPC.

One extraordinary legal risk worth mentioning relates to historic buildings. Energy-saving measures undertaken that could change the appearance of a listed buildings require a permit from the Voivodship Monument Conservator's office, issued at the request of the owner of building's legal title. It is worth applying early for the Conservator's recommendations regarding the work, asking them to specify the scope of admissible changes. The Conservator's recommendations constitute a public promise to protect the investor from incurring outlays for an intended project which has no chance of completion. Applying for recommendations should only hold up the planned investment by a month or two. Without them, the Conservator may refuse to issue a permit allowing the energy-saving works.

Despite the all the above-mentioned difficulties, the problems caused by a lack of relevant statutory provisions, and the lack of a standardised EPC, when considering the large investment potential and the available financial support for the improvement of energy efficiency, as well as the direct support which will be available to ESCos from the NFOŚiGW, investments within the ESCo formula in Poland should be encouraged.