

# Client Alert.

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## European Union's Major Refocus on Energy Efficiency

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On June 22, 2011, the European Union ("EU") proposed a new Energy Services Directive ("Proposed Directive")<sup>1</sup> for energy efficiency. The Proposed Directive expands the obligations of EU Member States, transforms previous voluntary actions into compulsory ones, and sets the stage for additional legally binding measures. The Proposed Directive is under review and targeted for implementation late next year or in early 2013. Its adoption will have a widespread impact on energy companies, businesses, and consumers.

### BACKGROUND

The EU has long understood the role that energy efficiency can play in building jobs, saving money, and reducing greenhouse gas ("GHG") emissions. Indeed, in 2000, the European Commission ("EC") first developed an action plan to promote energy efficiency within the EU.<sup>2</sup> Subsequently, the EU has adopted directives on the energy performance of buildings (2002), the promotion of combined generation of heat and electricity (2004), energy savings increases from domestic appliances (2005), and end-use use efficiency and energy services (2006).

### 2006 ENERGY SERVICES DIRECTIVE

In April 2006, the EU issued its Energy End-Use and Energy Services Directive, known as the "Energy Services Directive" ("2006 ESD").<sup>3</sup> The 2006 ESD defined and set savings targets on a national level and each EU Member State was directed to achieve a minimum annual energy savings target of 9% over nine years (or 1% cumulative per annum) in the period 2008-2016. In addition to its larger energy efficiency objectives, the 2006 ESD also addressed issues such as financing, metering, billing, promotion of energy services, and public sector obligations. For the first time, Member States were given the option to make it compulsory for energy distributors and retailers to provide energy efficient end-use services and to participate in such measures. However, since the targets were not legally binding, the EU had no enforcement authority for noncompliance, and EU Member States were allowed to determine how the energy savings would be achieved.

On October 19, 2006, the EC launched a new Energy Efficiency Action Plan ("2006 EEAP") focused on energy savings of 20% by 2020 with ten proposals for action.<sup>4</sup> The 2006 EEAP was intended to be a cornerstone in the EU's policy for energy efficiency. The EU energy ministers supported the energy proposals put forth in the 2006 EEAP, but they did not support binding national targets for increases in energy efficiency.

Many Member States declined to implement the targets suggested in the 2006 ESD and instead developed action plans with lower goals. As a result, the actual trend in reduced energy consumption within the EU is currently only expected to

<sup>1</sup> COM(2011) 370 final.

<sup>2</sup> Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions – Action Plan to improve energy efficiency in the European Community COM/2000/0247 final.

<sup>3</sup> Directive 2006/32/EC of the European Parliament and of the Council of April 5, 2006, on energy end-use efficiency and energy services and repealing Council Directive 93/76/EEC.

<sup>4</sup> COM(2006) 545 final.

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reach 9% by 2020, far below the EU's aim of a 20% reduction.

## 2011 PROPOSED ENERGY SERVICES DIRECTIVE

The EC released a new EEAP on March 8, 2011,<sup>5</sup> which introduced measures that would increase savings in energy supply and use. Shortly thereafter, on June 22, 2011, the EU issued a new Proposed Directive to replace the expiring 2006 ESD and the 2004 Cogeneration Directive<sup>6</sup> in response to many calls from the European Council,<sup>7</sup> Energy Council,<sup>8</sup> and European Parliament to accelerate efforts to achieve the 20% reduction by 2020 goal.<sup>9</sup>

The Proposed Directive is subject to negotiation and voting by representatives of the 27 EU Member States and by the European Parliament over the course of 2011-2012. The final Directive is expected to enter into force by the end of 2012 or the beginning of 2013. If the Proposed Directive is approved, Member States will have one year from the date of adoption to transfer the rules into national law.

Once the Proposed Directive goes into force, EU Member States will be obligated to implement all of its provisions, but will have flexibility in setting the level of national energy efficiency targets. Companies may also have an option of funding voluntary agreements or programs that produce the same result but are not based on obligations by energy companies, depending on how their domestic government implements the Proposed Directive. The EU will review progress made towards the 20% energy savings target in 2014, and mandatory national energy efficiency targets will be proposed at that time if progress is insufficient.

The measures in the Proposed Directive are expected to reduce primary energy demand in 2020 to between 19.7% to 20.9%, with additional tangible benefits that will continue beyond 2020. The Proposed Directive applies to end-use efficiency and cogeneration. The savings from measures directed at public and private buildings—which represent 40% of overall EU energy consumption—are forecast to produce 60% of the energy savings needed to achieve the 2020 goal. The energy savings from building retrofit measures alone will avoid the construction of 17 new coal power units.

The Proposed Directive includes the following binding measures:

- **Energy Efficiency Targets**

Member States would be required to set a national energy efficiency target, taking into account the EU overall target of 20% by 2020, but each state would have flexibility in determining the ultimate level of its target. The EC would review progress in 2014 and propose binding targets if necessary.

- **Legal Obligations on All Member States and Retail Service Companies**

All Member States would be required to establish energy savings schemes. Energy distributors or retail energy sales companies would be required to achieve a very ambitious energy savings goal of 1.5% annually by encouraging end users to reduce their energy consumption by implementing efficiency improvements, such as replacing old water

<sup>5</sup> COM(2011) 109 final.

<sup>6</sup> Directive 2004/B/EC.

<sup>7</sup> EU CO 2/11 (the European Council focused on two sectors—energy and innovation—and agreed on a number of priority actions whose implementation will contribute to enhancing growth and job creation as well as promoting Europe's competitiveness).

<sup>8</sup> Revision of the Energy Efficiency Action Plan ("EEAP"), 2010/2107(INI) (the resolution called for a revision of the Energy Services Directive ("ESD") in 2011 that includes an expanded time framework until 2020, a critical assessment of National Energy Efficiency Action Plans and their implementation).

<sup>9</sup> In addition, the new measures should help realize the EU's 2050 vision as summarized in the Low Carbon Roadmap 2050, an initiative of the European Climate Foundation that aims to analyze pathways for achieving a low-carbon economy in Europe.

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heaters or insulting their homes. The EU anticipates that establishing energy savings programs will reduce the EU's energy consumption by 6.4% in 2020 (the current combined consumption of Poland and Portugal).

- **Public Sector to Lead by Example**

In order to stimulate market transformation, the public sector would be required to buy energy-efficient buildings, products and services and, as of January 2014, retrofit at least 3% of total existing floor area annually.

- **Smart Meters and Access to Customer Usage Information**

The roll-out of smart meters is already required by EU legislation but the Proposed Directive would address shortcomings in the program. For example, new meters for electricity and gas are usually provided without adequate interface with mobile or other electronic devices and billing is often based on forecasts and not actual consumption. Additionally, some Member States only require billing based on annual consumption once a year. The Proposed Directive would remedy these limitations. It would also require that minimum customer usage information from metering is provided on a regular basis, free of charge, to individual consumers.

- **Industry**

Large industries would be required to conduct energy audits every three years to create more awareness of energy savings possibilities.

- **Efficiency in Energy Generation, Transmission, and Distribution**

Regulatory measures would require that surplus heat from power generation and industrial processes and other sources are used to address heat demand in buildings. These measures include equipping new generation capacity and high-heat demand industries with heat recovery (or cogeneration of heat and power ("CHP")) units. Member States would also be required to ensure that national energy regulatory authorities take energy efficiency into account when making decisions on gas and electricity infrastructure and determining how and at what costs to distribute energy to end users.

- **Energy Services Markets**

The Proposed Directive addresses the significant market barrier of upfront investment in the implementation of energy efficient improvements by requiring energy services companies ("ESCOs") to use performance contracts whereby the ESCOs pay for initial investments and are paid from the savings on energy bills. The EU energy services market currently accounts for €6 billion; the potential for the market is estimated at €25 billion.<sup>10</sup>

## PUBLIC REACTION

The Proposed Directive has received praise and criticism—often from the very same people. The European Building Automation and Controls Association ("eu.bac") strongly welcomes the adoption of the Proposed Directive but also calls it a "missed opportunity" to improve Europe's efficiency. Specifically, the eu.bac states that the Proposed Directive risks taking away focus on energy efficiency at the end-user level. The Union of the Electricity Industry ("EURELECTRIC") firmly supports a market-based approach to energy efficiency but highlights some preliminary areas of concern and ambiguity in the Proposed Directive, such as administrative burdens in permitting and authorization procedures and the need for more flexibility for Member States in meeting obligations. Finally, the European Federation of Energy Efficiency

<sup>10</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/440&format=HTML&aged=0&language=en&guiLanguage=en>

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Services Companies ("EFIEES") publicly supports the Proposed Directive but states that some improvements have to be made, including clarifying energy obligation schemes and removing existing barriers to energy efficiency.

Some critics claim that the Proposed Directive is "set up to fail" since it does not require binding targets, similar to the EU directives for renewable energy, and EC review of the indicative targets will not occur until 2014. Given that the EU is already off track in meeting its non-binding energy efficiency goals, they argue that this delay may only exacerbate the problem.

Generally, supporters and opponents alike are cautious in the short term and recognize the importance of ensuring that the Proposed Directive's impact on, and potential conflict with, other EU policies be monitored, and that potential ambiguities in the Proposed Directive language discussed above are clarified.

## LOOKING AHEAD

Although the Proposed Directive transforms elements of the 2006 EEAP into compulsory actions and replaces the 2006 ESD's recommendations with legally binding measures, the jury is still out as to whether the Proposed Directive can be transferred successfully into the many Member State laws and policies and private actions and investments necessary to meet the EU's 20% energy savings goal by 2020.

Energy efficiency is certainly critical for meeting EU goals, building economic growth, and addressing climate change. However, large-scale successful energy efficiency depends upon the often voluntary actions of hundreds if not thousands of individuals and companies. It also requires extensive governmental resources to establish laws and policies, provide financial support and leadership and, most importantly, measure savings and performance. Opportunities for private sector companies involved in the demand-side will be substantial under the Proposed Directive but it will also present many challenges for those businesses subject to the new requirements.

Morrison & Foerster is widely recognized as a leader among law firms on issues related to energy efficiency and green buildings, and maintains a full-service environmental law practice. Dian Grueneich is a former Commissioner for the California Public Utilities Commission (2005-2011) overseeing California's utility energy efficiency and demand response programs. She led development of the California Long-Term Energy Efficiency Strategic Plan, serves on the U.S. Department of Energy's Electricity Advisory Committee, and has participated in numerous international energy discussions, including with the European Union and European Commission, European utilities, and major European businesses.

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