

**PAS 22/11**

**BRIEF ON THE DIRECTIVE RECOMMENDATION BY EUROPEAN  
PARLIAMENT AND COUNCIL ON ENERGY EFFICIENCY AND IN REPEAL  
OF DIRECTIVES 2004/8/EC AND 2006/32/EC (COM (2011) 370 FINAL)**

**Rome – 06<sup>th</sup> October 2011**

## **Premise**

The Regulatory Authority for Electricity and Gas (the Authority herein), exercising its signaling and advisory capacity for Parliament and the Government on matters of its competency, as per article 2, sub-paragraph 6 of law no. 481 of 14<sup>th</sup> November 1995, presents, in the form of this recommendation paper, its own observations on the European directive recommendations on energy efficiency.

With this brief, the Authority seeks to contribute to the Commission's work by focusing exclusively on the directive recommendation provisions that appear to be of direct interest to its own activities.

It should also be noted that the criticalities and related recommendations that are indicated as follows have already been incorporated in a *Position Paper* approved by the General Assembly of the Council of European Energy Regulators (CEER) on 05<sup>th</sup> September 2011.

The directive recommendation in question repeals and replaces the directive on cogeneration (2004/8/EC) and the directive on energy services (2006/32/EC), with the exception of the latter's provisions on the achievement of 9% energy savings in each Member State's final energy consumption by 2017.

In addition to the 2017 objective, Member States are also asked to establish non-binding national targets that are consistent with the general 2020 European Union target - a 20% reduction in primary energy consumption plus additional improvements after 2020.

Notwithstanding the non-binding nature of these particular national targets, the recommendation introduces Member States to various binding "measures" as well (i.e., specific legal and regulatory instruments that each Member State is required to introduce) as called for by the "European energy efficiency plan" of 08<sup>th</sup> March 2011<sup>1</sup>.

## **Main contents and issue profiles of the directive recommendation**

### **1. Compulsory energy efficiency regimes (art. 6 and Annex V)**

Our Country has been incorporating compulsory energy savings in the final uses of large electricity and gas distribution companies since January 2005 (the "energy efficiency credits" or "white certificates" mechanism introduced by ministerial decrees 24<sup>th</sup> April 2001, as replaced by ministerial decrees 20<sup>th</sup> July 2004, as modified).

Accumulated experience with the regulation and management of this mechanism and an ongoing comparison with similar experiences in other European and non-European contexts have convinced the Authority that the incorporation of joint obligations by the Member States should be accompanied by the identification and precise definition of

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<sup>1</sup> Commission Communication to European Parliament, the Council, the European economic and social committee and the Committee of the regions, dated 08<sup>th</sup> March 2011 and entitled "Energy efficiency plan 2011."

general criteria for harmonizing the definition of these obligations and quantifying and verifying the consequent energy savings achieved. Due to the complexity of the issue and the wide variety of different mechanisms already in place in certain Member States, this process could take place either in the context of the directive or through subsequent delegated acts.

The lack of general harmonized criteria for the quantification of energy savings would jeopardize the comparability of the obligations being imposed on energy companies in different national contexts as well as the results (energy savings) actually achieved, and could even weaken the *ratio* itself foreseen by art. 6.

To illustrate, imposing a 1.5% obligation on energy distributors or vendors based on the indications of the directive recommendation alone could result in a target that, in comparison to the obligations now imposed on large electricity and gas distributors by the white certificates mechanism, could be either fairly modest or extremely challenging, depending entirely on what specific criteria are used to define the target and calculate the energy savings achieved: as a net vs. gross of "non-additional" savings; as defined in incremental vs. cumulative terms; savings as measured *ex-post* vs. by computing the "current value" of the flow of energy savings that each intervention is expected to generate over the technical life span of the technologies installed; saving measured by counting this "current value" over the span of several years vs. a single solution.

With the general harmonized criteria defined in the directive, each Member State could define the specific criteria that best account for their own particular national situation.

One of the most significant criteria to be harmonized is known as "additionality," which the *Impact Assessment* of the directive recommendation calls for explicitly, and which addresses the need to limit the calculations to those interventions and energy savings that would not have occurred if the obligation had not been imposed on the distributors/vendors. This criterion has been applied in the context of the energy efficiency credits mechanism since it began, and has made it possible to limit the distribution of incentives (financed by electricity and gas tariffs) to interventions defined as "additional" in terms of legal obligations and developments in the markets for energy products (i.e., interventions designed to spread technologies whose level of energy efficiency is higher than legal standards and/or the level of technologies already widespread in the market).

The directive recommendation already includes an important general criterion for quantifying the energy savings achieved that was incorporated in current directive 2006/32/EC. This criterion holds that "*the calculation of energy savings (...) needs to take into account the duration of the measures,*" i.e., the technical life span of the technologies installed (see par. 2 of Annex V of the Recommendation and par. 4 of Annex IV of directive 2006/32/EC). This diverges from the approach employed so far within the context of the white certificates mechanism<sup>2</sup>, but remains fully consistent

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<sup>2</sup> The current approach calculates and encourages the energy savings produced by any type of intervention for a "conventional" number of years ("useful life" of the intervention or duration of the right to the issue of white certificates), which is determined by law and, in most cases, shorter than the actual "duration" or "technical life span"

with the Authority's recommendation of last December - consultation document DCO 43/10 on the updating of the mechanism's technical regulation ("*Guidelines*" for the preparation, execution and assessment of energy savings projects, approved with resolution no. 103/03 of 18<sup>th</sup> September 2003, as modified). These recommendations were subject to further consultation by the technical task force established with resolution EEN 7/11 of 15<sup>th</sup> September 2001. The adoption of the new regulatory approach recommended by the Authority would, therefore, guarantee consistency with the current (directive 2006/32/EC) and future (Recommendation of the new directive) European regulatory framework in terms of the calculation of energy savings, at the same time making it possible to increase the stimulus level for interventions that are more "structural" (i.e., that generate energy savings over a longer time span than less structural interventions), at the same overall cost to the Nation.

Notwithstanding the need for a common framework of rules for defining the obligations and quantifying the energy savings achieved and the need to concur with the achievement of the 20-20-20 Climate and Energy Package targets for 2020, national specificities need to be taken into account (e.g., potential for energy savings, structure of the energy distribution and retail markets as well as those for energy products and services, regulatory framework of reference) while determining the extent of the obligations to be imposed on distributors and vendors, not to mention the identification of relevant subjects (distributors or vendors), as well as other elements (to be addressed more below) involved in a mechanism of this nature. From this perspective, the Authority hopes that the directive will provide for flexibility in terms of the specific *targets* that individual Member States may impose on the energy distributors and vendors, with the possible indication of a common minimal threshold target.

The definition of obligations also needs to ensure the hoped-for subsidiarity principle during the identification of the mechanism's field of application (eligible sectors and interventions, including the potential eligibility of the *short-term savings* addressed in session 1 of Annex V), the subjects that can contribute to achieving the target imposed on energy distributors and vendors, and the possibility of coupling the obligation with a market system for trading in white certificates (as happens in Italy, France and the UK, although to a limited extent, and in other mechanisms in the process of being defined in other Member States).

## **2. Obligations related to metering and billing (art. 8 and Annex VI)**

The future of this issue raises serious problems. Even if the objective of providing consumers with more about their own consumption patterns represents a common objective, in fact, the directive recommendation does not account for the costs this

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of the intervention itself (in specific, the conventional useful life is set at 5 years for most types of intervention, 8 years for interventions to reduce consumption through winter or summer climate control and 10 years for high-efficiency co-generation, and can reach up to 30 years for specific intervention types as gauged by the "effective durations of the measures"). Interventions with longer technical lives, as a result, are thus penalized to the extent that not all of the energy savings that they are capable of generating during their entire technical life span are accounted for.

entails for the system and the consumers or the uncertainty of the benefits (i.e., energy savings) that can actually be achieved by merely increasing the amount of information available on consumption. It should be emphasized, furthermore, that the implementation of such measures in the electricity and gas sector is made less realistic by certain technological constraints.

The adoption of these measures, therefore, needs to be made contingent upon a technical feasibility analysis and a cost-benefit analysis, which would also serve for assessing their impact on competition.

The proposed disclosure requirements, more specifically, cannot be fulfilled using the electronic meters that are currently installed (in the electricity sector) or in the process of being installed (in the gas sector) in Italy, and do not correspond with the provisions of the standardization bodies (CEN CENELEC, ETSI) which, in the context of European Commission Mandate M441, are developing an interoperable architecture of *utility meters* with related features (a.k.a. *additional functionalities* in respect to MID directive).

The adoption of these measures, therefore, needs to be made contingent upon a technical feasibility analysis and a cost-benefit analysis, which would also serve for assessing their impact on competition.

In general terms, it is worth keeping in mind that the information usually contained in billing documents can also be made available to consumers by other means. Obligations related to billing frequency as a function of customer type (compulsory monthly billing based on actual consumption of electricity and gas, for cases of independent heating, or bi-monthly for gas in cases of centralized heating) could pose obstacles to innovation and competition in addition to excessive costs. The following options, it is believed, need to be preserved: vendors should be allowed to promote offers based on specific types of consumers and customers should be allowed to obtain information at the frequency they prefer by choosing the offer best suited to their own particular style of consumption.

Lastly, it should be pointed out how the directive recommendation's proposals deviate from the provisions of the "Third Energy Package"<sup>3</sup> with respect to the electronic meter *roll out* schedules (100% coverage of end users by 2015 according to the recommendation, *versus* 80% coverage of end users by 2020, according to the outcome of cost-benefit analysis).

### **3. Promoting efficiency via heating and cooling facilities (art. 10 and related Annexes)**

The directive recommendation provides for an obligation to outfit all new thermo-electric generation plants (with over 20 MW in total thermal power) with high-

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<sup>3</sup> Directive 2009/72/EC of the European Parliament and Council of 13<sup>th</sup> July 2009, on joint requirements for the domestic electricity market, and Directive 2009/73/EC of the European Parliament and Council of 13<sup>th</sup> July 2009, on joint requirements for the domestic gas market.

efficiency co-generation units to be positioned where excess heat can be used to meet the heat demand. An analogous obligation is planned for the refurbishment/reinforcement of existing plants.

Since the different economic, climatic and geographic characteristics of specific Countries have not been taken into consideration, this proposal could entail excessive costs relative to the expected benefits.

Although the directive recommendation provides for the possibility of requesting exemptions, their eligibility is contingent upon highly-restrictive conditions, such as the preparation of a specific cost-benefit analysis, the methodology for which is to be established by a delegated act of the Commission itself by 2012.

#### **4. Energy distribution and transmission activities (art. 12, Annex XI and XIII)**

The provisions on the tariff regulation of transport and distribution activities are less restrictive than the ones described above. They consist of general principles, in fact, whose application is still subordinate to case-by-case assessment (for example: the elimination of regulatory provisions that "unnecessarily" encourage increases in the volumes transported; the introduction of incentives for promoting *demand response*, including the *dynamic pricing*).

It shares the need for transport tariff regulation to contribute to the promotion of energy efficiency and *demand response* (peak demand management) by eliminating useless incentives designed to increase transported volumes and introducing positive incentives, notwithstanding the need to safeguard the *cost-reflective* and stimulatory tariff-setting in relation to network development and service quality, including metering activities.

The directive recommendation is also oriented towards fostering an active role for distributors in the promotion of *demand response* by introducing appropriate regulatory stimulus mechanisms. Notwithstanding how important it is for network service regulation to avoid encouraging increased consumption and to help promote the rational use of energy, and considering the role that distributors play in identifying the network problems associated with different consumption profiles, the Authority finds that the supply-side of products and services for the demand-side of energy management need to be allowed to develop under competitive conditions by ensuring equal access to this market for non-distributor subjects who perform as *load serving entities* (for example: vendors, energy services companies, aggregators). This same position was expressed by the CEER in the cited *Position Paper* that addresses the directive recommendation.

#### **5. Roles and competencies of regulatory authorities**

Energy efficiency and the management of energy demand more generally is taking on a more and more important role in the functioning of energy markets as they confront the need to contain greenhouse gas emissions, to facilitate the integration of non-programmable renewable energy resources, the emergence of new consumption models

(e.g., electric cars) and technological developments in the sectors of domotics, bio-construction and *smart grids*.

The promotion of energy efficiency and *demand response* overlaps with many areas where energy regulators already enjoy specific competencies, such as competition in the *retail* market, the tariff regulation of network services and smart meters. The Authority also plays a direct role in the regulation and management of the energy efficiency credit/white certificate mechanisms with the support of other subjects (GME, Enea, GSE).

In consideration of the types of interaction suggested above, the Authority maintains that the new directive should endow the regulators with new responsibilities, which would be homogeneous across the Member States, related to demand management and the promotion of energy efficiency.

More specifically, the Authority maintains that regulators should play a direct role in designing the overall regulation of support regimes financed by electricity and gas tariffs, including both technical (quantification criteria for energy savings achieved) and economic (tariff contributions, market regulation for mechanisms such as white certificates, definition of sanctions for failure to comply) regulation. This is the regulation that will determine the economic effectiveness and efficiency of these regimes and therefore, in the end, their impact on tariffs and final consumers.

## **6. Definitions that serve for implementation of the directive (art. 1)**

The last suggestion is that the directive recommendation should be integrated with some of the current directive's (2006/32/EC) pre-existing definitions, which could enhance its proper and effective application (for example, the definition of: energy services companies-ESCO, which is limited to legal persons to the exclusion of natural persons; energy services suppliers-EPSCO; energy efficiency contracts; third-party financing).