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ESCO - A new opportunity for the Serbian Energy Market

Serbia is currently one of the countries in the CEE region with the lowest rates of energy efficiency. Prospective savings in energy could result in a significant reduction of public expenditure, stabilisation of the overall energy supply and further development of the energy sector, thus fostering development of the entire economy to a noteworthy extent.

The Law on Efficient Use of Energy ("**EE Law**"), the first coherent and wide-ranging piece of legislation regulating the area of energy efficiency in Serbia, was adopted in 2013 but has practically become applicable only in May 2015, as only then was the most important by-law setting out the model agreements between the public and private partners in energy efficiency projects adopted.

The EE Law, for the first time in Serbia, explicitly defines the energy services company ("**ESCO**") and sets out the rules for energy performance contracting generally in line with the EU *acquis*, aiming at providing the overall legal framework for energy efficiency arrangements.

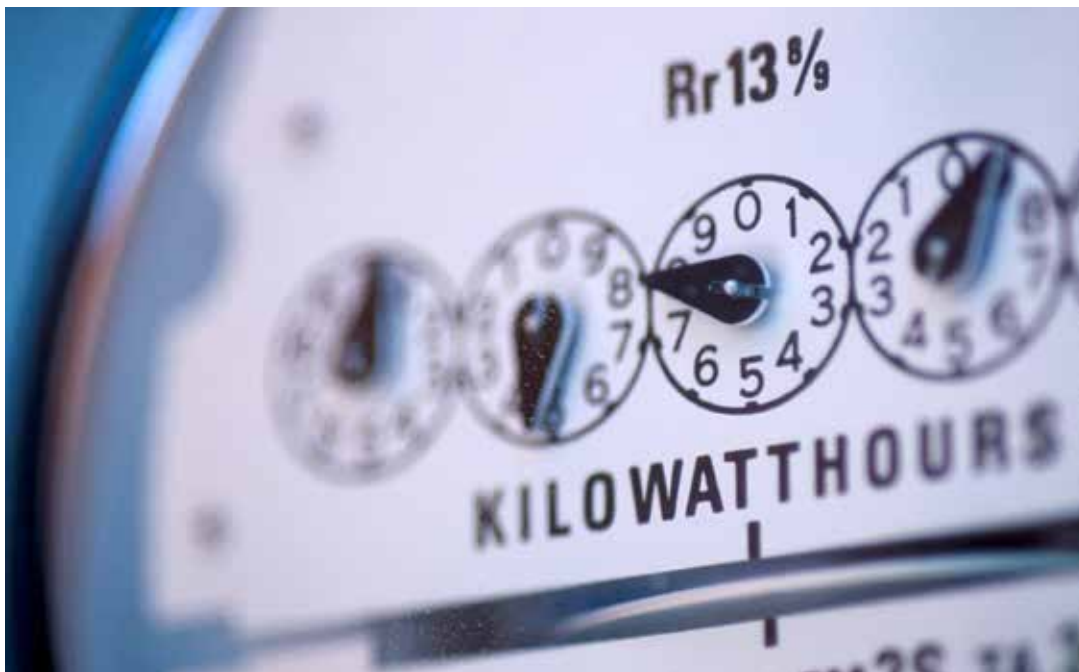
On the whole, the EE Law:

- defines energy services as services which, under normal circumstances, result in a verifiable and measurable or assessable increase in the energy efficiency of building, technical system, production process, public and private services and/or savings of primary energy;
- defines ESCOs as entities registered for the provision of energy services which assume a certain degree of financial risk in doing so, because the payment for the services provided is based – either wholly or in part – on the achievement of energy efficiency improvements and on compliance with the other agreed performance criteria;
- principally provides for ESCO, third party and energy-user financing schemes;
- stipulates that the provision of energy services is to be governed by the Energy Services Agreement concluded between ESCO and the relevant energy user. Mandatory elements of this agreement, *inter alia*, shall include the relevant efficiency criteria, measures for increasing energy efficiency, manner of financing of the project, energy consumption within the reference period, fees for the provided energy services, and the like;
- sets the system of the energy management, the subjects of which are the Government, the Ministry of Mining and Energy, the licensed energy managers and the authorised energy consultants as well as the so-called 'obligors of the energy management system', those being: (i) companies predominantly

engaged in the production sector and/or trade and services sector, if they consume energy in excess of respective thresholds prescribed by the Government; (ii) companies predominantly engaged in production not exceeding the threshold applicable to such companies but owning facilities the aggregate consumption of which exceeds the thresholds set for companies engaged in trade/services; and (iii) public authorities and other public services using the publicly owned facilities;

- defines activities subject to public financing or co-financing under the EE Law that are related to the improvement of energy efficiency, which include: (i) implementation of technical measures in the production, transmission, distribution and consumption of energy; (ii) encouragement of the development of energy management for entities that are not the aforesaid 'obligors of the energy management system'; (iii) promotion/implementation of energy inspections/audits of facilities, production processes and services; (iv) stimulation of energy services' development on the Serbian market; (v) encouragement of the usage of renewables for own use; and (vi) other activities aimed at the more efficient use of energy. The EE Law prescribes that said activities are to be financed from the central budget and the budgets of the local units as well as from the financial means provided via EU funds and other international funds, credits of international institutions, donations and other sources;
- provides for establishment of the Budget Fund for Energy Efficiency Improvement ("**EE Fund**") for the purpose of registration of financial means envisaged for the public financing of activities related to energy efficiency. The EE Fund is funded for an indefinite period and is governed by the Ministry of Mining and Energy. The EE Fund's funds are to be provided from the central budget's appropriations for the current year as well as from the credits and donations – in line with applicable public policy acts – and disbursed to the EE Fund's users for the purpose of financing the aforesaid energy efficiency activities on the basis of public tenders announced by the said Ministry. This is especially so if the financing of services as per the third-party financing agreement is to be done using the EE Fund's funds; the EE Law prescribes that in such cases the relevant funds are to be disbursed under the applicable public procurement law;
- expressly entitles the competent authority of the autonomous province or local municipal units to: (i) determine specific financial and other incentives; (ii) establish specific budgetary funds; and/or (iii) use existing funds of their own for projects and other activities related to efficient use of energy in their respective territory;

- prescribes the criteria and manner of labelling of energy efficiency of products affecting energy consumption, as well as the rules relating to products' eco-design;
- makes an energy audit mandatory in respect to: (i) facilities used by the public 'obligors of the energy management system' (having more than 500 sqm of usable area); (ii) facilities, i.e. their respective parts that are classified within the prescribed energy classes; and (iii) facilities, i.e. their respective parts in case of change of their purpose or owner or if they are intended for renting;
- obliges entities applying for issuance of: (i) energy permits for construction or reconstruction of facilities for production of electricity and/or heating as well as for transmission of electricity or transport/distribution of natural gas; and/or (ii) construction permits for construction or reconstruction of distribution of electricity or heating energy, to provide an elaboration of energy efficiency of such facilities proving that the criteria setting the minimum energy efficiency of the system are complied with; and
- specifically prescribes that production of electricity or heating energy via renewables is to be deemed a measure of energy efficiency, provided that the energy is produced for own use.



Model ESCO agreements

To enable implementation of these principal possibilities introduced by the EE Law, the Rulebook on Model Energy Service Contracts for the Implementation of Energy Efficiency when Users are from Public Sector ("**ESCO By-Law**") was finally adopted in May 2015, following the completion of the year-long work of the national working group within the Ministry of Mining and Energy (with the support of the European Bank for Reconstruction and Development, involving GFA Consulting Group and CMS as their external consultants).

The ESCO By-Law sets out two models of ESCO agreements, one for public buildings and another one for public lighting, and generally allows for public-private partnerships to be established between the relevant public partner (e.g. a municipality, a public company, a State) and the relevant private partner (i.e. ESCO company) on a long-term basis wherein the installation and management of the energy efficiency measures by a private partner are to be financed from the savings achieved, thereby not involving public debt.

Importantly, the receivables attributable to a private partner from the savings thereunder are to be further transferable to third parties, which will hopefully boost the overall bankability of ESCO projects in Serbia.

The two model agreements set out by the ESCO By-Law envisage three main periods of the ESCO agreement:

1. Preparatory Period, mainly consisting of planning and design activities pertaining to the relevant project;
2. Implementation Period, in which activities related to the implementation of the respective energy savings measures by a private partner in cooperation with a public partner are to be undertaken;
3. Guarantee Period, being a period of utilizing the energy savings potentials of the contracted facility, in the course of which energy savings, i.e. financial savings are achieved as a result of the implemented measures.

The ESCO By-Law further contains amply sophisticated provisions relating to collateral packages, warranties regarding the performance, the insurance of the project, the force majeure clauses and detailed rules regarding the aforesaid three main contractual periods.

It also contains a comprehensive set of appendices where the necessary details relevant for a particular project are to be set, such as the details of the contracted facility, the instructions for achieving energy savings, as well as the guidelines for verification of the quality of maintenance and performance levels.

Challenges ahead

The remaining challenges regarding the overall operability of the EE Law include the need to introduce particular sector-specific incentives for energy efficiency in the relevant legislation (notably, the real estate legislation and the tax-related one) and, moreover, the gradual raising of financiers' perceptions of the actual feasibility of the ESCO projects. While some of the banks and other market players in the Serbian financial sector have most recently become acquainted with the overall concept, the remaining challenge is that the said players often assess the creditworthiness of the client instead of the project itself.

Yet, similarly to other countries where such concepts were introduced for the first time, it may still be expected that, gradually – and with very first projects becoming (successfully) implemented – financiers may become more and more receptive for engaging in the financing of these projects.



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