



## **Energy Efficiency Obligation schemes – the exit plan**

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*The EU's updated Energy Efficiency Directive (EED) retains Article 7, which requires Member States to implement an [Energy Efficiency Obligation \(EEO\) scheme](#), or eligible Alternative Measures, capable of delivering a set quantity of energy savings via energy efficiency measures.*

*The [EC's Impact Assessment](#) cites the cost effectiveness of EEO schemes and the large outstanding economic potential for future savings as key justifications for the extension that takes new targets out to 2030. This seems logical but does raise the question – does the policy encourage the development of a market in energy services on a commercial footing, which may enable a future 'exit plan'?*

### **Addressing market failure**

The EC sees EEO schemes as addressing a number of market failures – eg lack of information among end consumers, barriers to households accessing capital, transactions costs - and encouraging the development of an [ESCO market](#).

But despite the cost-effectiveness of EEO schemes, the expected transition of utilities to become energy service firms as well as the development of an efficient ESCO market serving all sectors of the economy, has largely failed to transpire.

As noted by [Fawcett et al](#) such a transition represents a potential exit

plan from the EEO policy, by placing the sector on a commercial footing able to operate without top-down obligations. The stunted progress on this front and how it may be improved should therefore be a key concern for EEO scheme design as they move into the next phase.

### **EEOs and energy services**

EEO schemes were first formed in the United States in an environment of largely integrated utilities being encouraged by policy makers to take an “integrated resource” approach to planning that considers energy supply and energy efficiency on an equal basis.

The current European environment differs substantially from these origins with competitive retail tariffs and unbundled suppliers. Holding or building market share in their core business has remained the focus of retailers, while distribution utilities lack a direct relationship with consumers. The EEO schemes therefore seek to provide the framework for catalysing energy efficiency measures.

Provision of energy services in the EU as demanded by EEO schemes has been undertaken largely through third parties. Where done partially in-house, as in the case of British Gas, the delivery unit has been set up and

operated specifically for meeting the scheme targets, as opposed to greater long-term integration in the overall business model.

Third party provision (eg via ESCOs) makes sense. The skills and capacity required to deliver energy efficiency via appliances and construction work differ substantially from that of electricity retail (or distribution). But such ESCOs rely on demand for their services from the obligated retailers and distribution firms.

### Residential sector remains the key sticking point

EEO-driven development of the ESCO market has been most clearly seen in Italy, possibly assisted by the open trading of energy saving credits in that market. However, despite this success, ESCOs in the country remain predominantly focused on the industrial, public and large commercial sectors. This reflects the UK experience where the ESCO market in these sectors was deemed sufficiently efficient and active that the EEO scheme has been exclusively focused on the residential sector.

Development of ESCO offerings within the residential sector across Europe [remains slow](#), with the market failures more prominent (particularly information and access to capital). As the most simple and straightforward domestic energy efficiency improvements are

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saturated, dealing with this deficiency becomes more pressing.

### Route forward

For mature EEO markets, this suggests a refocus of scheme design towards assisting the development of the residential ESCO market. This may be particularly necessary as EEOs move into more complex measures such as full refurbishments.

In addition, technology may help achieve what policy has not and encourage energy retailers to move towards the original “integrated resource” ideal. The roll-out of smart meters, smart appliances, corresponding tariff offerings, and diffusion of battery technology at the household level, bring the full electricity value chain into the home. Energy retailers may have little choice but to re-develop their business models to fit this new paradigm.

Policies do not necessarily require an expiry date but encouraging an active commercial market is more sustainable in the long-run than a “second-best” intervention. The goal of developing an active and robust market in energy services for all sectors of the economy, able to outlast the life of EEO schemes, is an ambition worth focusing on.

### Economic Consulting Associates

41 Lonsdale Road  
 London NW6 6RA  
 Tel: +44 (0) 20 7604 4546  
[www.eca-uk.com](http://www.eca-uk.com)