

The Legal State of Energy Service Company Contracting

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What Is Performance Contracting?

- n Innovative financing technique that uses cost savings from reduced energy consumption to repay the cost of installing energy conservation measures.
- n Allows customers to achieve energy savings without up-front capital costs
- n All capital costs are borne by contractor and paid back out of energy savings.



Benefits

- n No up-front capital
- n Ability to use single contractor for audits and retrofit
- n Guarantee of savings
- n Can address more than just energy (i.e., water, air quality)
- n Creates an incentive for ESCO to develop a highly efficient project by linking profits to savings
- n Shifts all of the risk to the ESCO



Basic Steps

- n Assess project opportunity
- n Issue and RFP and select an ESCO
- n Complete a detailed engineering study
- n Negotiate an energy service agreement
- n Implement and commission the project
- n Monitor and verify the savings



The RFP

- n Request pricing for the detailed engineering study and ESCO qualifications to complete turnkey engineering, construction, training, and financial services
- n Get at least three responses
- n Require (and check) references for similar projects



The Investment Grade Audit

- n An Investment Grade Audit
 - n A detailed energy (and water) audit with an accompanying engineering analysis of proposed energy conservation measures (ECMs), their costs, and savings.
 - n The cost of the audit is financed as part of the project. If the customer decides not to enter into a contract after the audit is performed, the customer pays for the audit services and the contract is cancelled.



The Audit Contract

- n Should have a clearly defined schedule
- n List measures to be analyzed
- n Should have detailed reporting requirements
- n Should specify deliverables
- n **DO NOT COMMENCE AUDIT WITHOUT AN EXECUTED AUDIT CONTRACT!**



Project Development

- n The detailed audit should include:
 - n Facility description
 - n ECM recommendations
 - n Utility analysis methods
 - n Operating conditions and assumptions
 - n Utility consumption and baseline data, measured data and any other data used in analysis
 - n Utility rates used in savings calculations and their buildup
 - n Supporting engineering analysis for any baseline adjustments



The Energy Services Contract should include:

- n An M&V plan that covers each individual measure or group of measures, including measurements and calculation procedures, such as heating degree day adjustments.
- n Hard and soft costs for each ECM, broken down by ECM, including supporting documentation for all service fees, overhead, and profit.
- n Documentation of cost contributions (e.g., capital funds, grants, incentives) and associated requirements.
- n Preliminary amortization schedule and interest rate. If more than one financing source is used, information should be provided for each.
- n A template for construction invoices, which should use AIA or equivalent methods and be based on percent complete. Construction mobilization should be consistent with construction industry norms.
- n Commissioning plan.
- n Preventative maintenance plan.
- n Training plan, if applicable, for staff.
- n Other terms and conditions, including guarantee provisions and equipment warranties.



Don't Forget the Guarantee!

Energy and cost savings produced should be sufficient to cover all project and repayment period costs, including construction, commissioning, financing, maintenance, measurement and verification, and customer education.



Two Types of Guarantee:

Guaranteed minimum energy savings

- n ESCO guarantees a minimum energy savings adequate to cover the debt service and the ESCO's fee. Excess energy savings are either (1) split between the ESCO and the customer on a percentage basis, which gives the ESCO an incentive to achieve greater savings; or (2) all excess savings flow to the customer. If energy savings are inadequate to cover the debt service, the ESCO reimburses the customer to cover the debt service payments.



Two Types of Guarantee:

Guaranteed debt service

- n ESCO guarantees that the debt service is covered by energy savings. ESCO's fee is paid from the excess energy savings on either a fixed or percentage basis determined in negotiations with the customer. ESCO reimburses the customer to cover debt service payments if inadequate energy savings occur.



A Note on Rates:

- n Documentation should be provided to demonstrate that all “escalated” rates are reasonable.
- n If rates are escalated, the ESCO guarantee should also be escalated in order to minimize risk to the customer.



Ownership Options:

- n Customer assumes ownership of the energy improvements once they are installed by the contractor.
 - n If customer provides the financing, it would make conventional payments to its lending institution over the life of the loan. Can reduce the cost of the energy conservation measures if customer can obtain financing at a lower rate of interest than that offered by the contractor.
 - n If the contractor provides the financing, payments to the contractor would include a repayment of the loan over the period of the performance contract.
- n Contractor (ESCO) finances, installs and retains ownership of the energy conservation measures. At the end of the contract, customer can purchase the measures for a price negotiated with the contractor. Customers should be wary in such arrangements so that there will be a source of funding available to purchase the equipment at the end of the contract.



Types of Financing

- n ESCO;
- n Tax-exempt bonds;
- n Tax-exempt lease-purchase agreements;
- n Utility low-interest rate loans;
- n Loans from conventional lending institutions (i.e., banks);
- n Loans from state and local government agencies.



Measurement and Verification Steps

- n Define the baseline condition by establishing the existing design and operating conditions and correcting for any singular, non-standard, or deficient conditions
- n Determine the efficient condition by establishing the proposed design and operating conditions and calculate the projected savings
- n Develop an M&V plan (calculation methodologies for comparing baseline and actual consumption and any necessary adjustments)
- n Integrate the Commissioning Plan by establishing design intent, commission the installed equipment, verify assumptions and quantities in the M&V plan.



Measurement and Verification

RECOMMISSION PERIODICALLY TO
ENSURE SAVINGS PERSISTENCE!



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Review Performance Regularly

- n Routine performance reports should include:
 - n Monthly actual consumption, demand, and cost data
 - n Monthly heating and cooling degree day data for the nearest weather station and any other information required by adjustment methods in the M&V plan
 - n Evaluation of actual performance against the guarantee and documentation of any adjustments employed
 - n Certification of savings



When are Performance Contracts Not Appropriate?

- n Project size
 - n Annual utility costs should be at least \$200,000. Although smaller projects are usually not appropriate for performance contracting, they can be considered sometimes when ESCOs have shown an interest in a project.
- n Economic payback
 - n Projects with short term paybacks (less than 18 months) should not use performance contracts. (overall projects, not individual energy conservation opportunities).
- n Inability to enter into long-term contracts
- n Union maintenance contracts



Some Final Thoughts

- n Look for more than the low bid. Select an ESCO that can provide other necessary services such as project design, installation and maintenance. Get references!
- n Negotiate a contract that reasonably limits ESCO profit-making and provides financial benefit. Carefully weigh the pros and cons of shared savings versus fees for services and other contractual arrangements.
- n Require the ESCO to take a comprehensive approach to energy conservation rather than a "cream-skimming approach."



Some Final Thoughts

- n Ensure the agreement does not allow the ESCO to sacrifice quality for energy savings.
- n Organize an in-house project team to work with the ESCO to choose appropriate energy measures, prepare bid specs, prequalify prospective bidders, and perform other tasks when the contract is signed.
- n Don't be afraid to test new technologies in order to determine their performance and applicability.
- n Document both energy and non-energy benefits of your project and publicize its success to the community!



THANKS FOR LISTENING!

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