

QUICK STUDY

Federal Energy Management Program

Savings and Performance Guarantees That Work for You

Fine Tuning for Best-Value Super ESPC Deals Using the Responsibility Matrix

Super Energy Savings Performance Contracts (Super ESPCs) are a practical and flexible tool for obtaining energy improvements for federal facilities. While the overarching Super ESPC establishes general terms and conditions of the agreement between the agency and the energy service company (ESCO), the contract leaves broad latitude to custom-tailor a deal to suit the agency's own particular needs, priorities, and circumstances.

The agency can precisely define the nature of the savings guarantee and how optimum performance of the energy conservation measures (ECMs) will be ensured throughout the life of the contract. A full awareness of all the options and associated costs can help the agency negotiate a deal that uses the agency's resources effectively, makes good business sense, and yields optimum value.

WHAT'S IN A GUARANTEE?

At the heart of a performance contract is a guarantee of a specified level of cost savings and performance. The customer is not obligated to pay for an unmet guarantee. The question is, what exactly is being guaranteed? Who is responsible for factors that affect performance and savings? And who pays for what?

A "Responsibility Matrix" in the Super ESPC (www.eere.energy.gov/femp/docs/r_r_matrix.doc) describes three categories of responsibilities or factors at work in the contract — operational, performance, and financial. The allocation of responsibilities between the agency and the ESCO defines the specifics of the guarantee, who does what, and who pays for what during the term of the contract. Early in the process of developing the project, the ESCO and the agency review the matrix and evaluate how to allocate these responsibilities, taking into consideration the agency's resources and preferences.

A few fundamental principles can be applied to the allocation of responsibilities in Super ESPC agreements:

- Logic and cost-effectiveness drive responsibility allocation.
- The responsible party then predicts its likely tasks and associated costs to

fulfill its responsibility, and makes sure they're covered in the ESPC or the agency's budget (the government pays foreseeable costs).

- Unforeseen costs are paid by the party who caused the costs, or by the party who is responsible for that risk area.

FINANCIAL FACTORS: Energy Prices, Construction Costs, M&V Costs, Delays, Changes in Facilities, Interest Rates

Energy Prices

Energy prices, along with usage, determine the dollar value of the energy-cost savings guaranteed by the ESCO. Since neither party has any control over energy prices, agencies and ESCOs generally opt for simple and practical ways to arrive at prices to use in savings calculations. A common practice is to stipulate current energy prices for the first year of the contract and use the energy price escalators published by DOE's Energy Information Administration for succeeding years (www.eia.doe.gov/oiaf/aeo/index.html).

The chances that this approach will have serious financial consequences for the agency are very small. If prices turn out to be lower than expected, "savings" may be smaller on paper than projected, but the agency benefits from the lower prices and will be able to pay its bills. If energy prices are higher than projected, savings will exceed expectations, and the problem of higher prices will be easier to manage because the agency will be buying less energy than before the Super ESPC project. Keep in mind that the primary purpose of the guarantee is to ensure that the agency will be able to pay all its bills — to the ESCO and for energy and related operations and maintenance (O&M) — from its annual energy and related O&M appropriations.

Construction Costs

The ESCO can control construction costs and generally guarantees a firm, fixed price for the project, typically taking bids and locking in subcontractor prices before

submitting the final proposal. Contract and price modifications are rare in Super ESPC projects.

M&V Costs

In considering the wide range of measurement and verification (M&V) options and costs, the key questions are:

- (1) How much do I want to spend?
- (2) What degree of accuracy do I need?
- (3) What are the tradeoffs?

Some agencies want more detailed data to verify savings to a very high degree of confidence and are willing to pay the price. Those intent on getting as many improvements as possible (to generate more savings) can take a practical, but less elaborate, less expensive approach. M&V costs in Super ESPC projects have averaged 3.86% of first-year guaranteed cost savings, with half of these projects keeping costs below 2.5%.

Major Changes in Facilities

Agencies who are certain that major changes are planned for some of their facilities should not pursue Super ESPC projects in those buildings, and buildings of questionable longevity should obviously not be included in improvement projects. However, agencies must work with the information available to them, and valuable opportunities for achieving energy savings and improvements in government facilities shouldn't be missed for lack of a crystal ball.

Even if a facility were closed during the Super ESPC term, the government's financial obligations would be only the usual ones associated with closing facilities. To keep financiers comfortable (and interest rates as low as possible), the contract should include pre-negotiated terms for retirement of debt upon termination for convenience.

Interest Rates

Neither the ESCO, the agency, nor the financier controls interest rates. However, financing transaction costs can be affected by the agency's choices. Understanding the structuring, costs, and logic of private-sector financing for Super ESPC projects will help agency acquisition teams accelerate the negotiation and approval of delivery orders and keep financing costs as low as possible.



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OPERATIONAL FACTORS:

Operating Hours, Plug Load, Weather, User Participation

Operating hours, plug load, weather, and user participation (or occupancy effects) may all affect energy usage and cost. In Super ESPC delivery orders, savings are calculated in relation to a baseline that represents the energy and related costs that would have occurred if the status quo had been maintained and no new ECMs had been installed. The agency and the ESCO agree on the baseline (or how the baseline will be determined) and how savings will be calculated and compared to the guarantee for verification. The guarantee and the method for verifying savings must be documented in the contract in a way that accounts for potential impacts of operational factors.

Over the term of the contract, if building occupants acquire no new electrical equipment that increases plug load, if the weather is not extreme, and if operating hours remain the same, the ESCO's estimates of energy savings will likely prove accurate and the guarantee will be met. However, if extreme weather occurs, if occupants increase the number of computers or other office equipment in use, or if a plant adds a second shift, energy usage will increase and savings may appear smaller than expected. Who is responsible for this increase in energy use under the contract? The agency, as the party with the greatest ability to cost-effectively control operational factors, generally takes financial responsibility. Even when the project doesn't totally eliminate potential cost increases from operational factors, it does minimize cost increases and make them more manageable than before.

Operating Hours and Plug Load

The agency generally assumes financial responsibility for operating hours and load in one of two ways:

1. Baseline adjustments. The contract can allow specified baseline adjustments for changes in operational factors so that savings calculated in relation to the higher baseline will better reflect the savings attributable to the new ECMs. Baseline adjustments must be supported by measurements.
2. Stipulation. Both parties can accept stipulated operational factors and estimated savings based on engineering calculations and measurements as a fair representation of savings. If related requirements are met (i.e., satisfactory commissioning results and maintenance tasks performed), the guarantee is considered to be met.

Operating hours and plug loads are often stipulated. With well-proven, predictable technologies, stipulation is often the most practical choice. The alternative is for the agency to spend money on measurements and monitoring just to check up on itself.

Weather

No one but Mother Nature controls the weather, but it can be a major factor in energy usage. A sensible approach is to normalize calculations of the baseline and yearly energy savings to a typical weather year. In mild weather years, savings will seem small, but the energy bill will also be smaller than normal and the ESCO payment manageable, with funds to spare. In extreme weather, savings will exceed expectations, and it will be easier for the agency to manage and pay all its bills than before the project.

User Participation

The behavior of building occupants is subject to only minimal control by anyone. One strategy for handling occupancy effects is to stipulate comfort settings to use in calculations and document the baseline.

PERFORMANCE FACTORS/ RESPONSIBILITIES:

Equipment Performance, O&M, R&R

Performance of the ECMs is the foundation of the guarantee and the value of the project. The ESCO is ultimately responsible for selection, application design, installation, and performance of the equipment, and must maintain specified standards of service (temperature, humidity, lighting levels, etc.). To be negotiated and spelled out in the contract are:

- (1) whether the ESCO will carry this responsibility just through project acceptance by the agency, for a limited period to prove performance and standards of service, or for the entire term of the contract;
- (2) how performance and standards of service will be verified; and
- (3) what the consequences for unacceptable performance and standards of service will be.

Responsibility for O&M and equipment repair and replacement (R&R) is negotiable and may be assumed by the ESCO, agency staff, or subcontractors. In any case, it is critical to spell out how proper performance of these functions will be ensured.

Typically the agency operates the equipment with ESCO oversight. Maintenance can go either way, but the ESCO is always

responsible for defining the maintenance program and verifying execution. Generally the ESCO is responsible for R&R through extended equipment warranties. However, individual agencies should negotiate whatever arrangement best addresses their needs. Some choose to keep all of these functions in-house to minimize the cost of the project; others lack the in-house capability or prefer to pay more for the "insurance" of having one responsible party for all these functions.

CONCLUSIONS

FEMP's experience with Super ESPCs is proving them to be a flexible and practical vehicle for custom-tailoring energy projects to agencies' site-specific needs. Agencies can optimize the value of their projects by taking advantage of the broad latitude in the contracts to fine-tune the guarantee, specify ESCO services, and allocate responsibilities to suit their own in-house resources, capabilities, and priorities.

The wide range of M&V options available also allows agencies to "build to suit." M&V plans can call for complex, detailed verification schemes with correspondingly high costs, but can also provide for acceptable verification through less expensive means. M&V costs for half of all Super ESPC projects have been a reasonable 2.5% of first-year cost savings. Interest rates for Super ESPC projects have been reasonable as well and are no obstacle to structuring solid pay-from-savings projects.

The responsibility matrix is a convenient, useful format for agencies to use to study and understand all aspects of the Super ESPC deal. Using the matrix to consider the options and balance corresponding costs and benefits will help agencies build best-value energy projects and meet federal energy goals.

Program Contact

Tatiana Strajnic
DOE FEMP Finance
Acquisition Support Team Leader

Please forward your ESPC information requests to the EERE Information Center at eeeric@ee.doe.gov or call 1-877-337-3463.

June 2006

This publication and other guidance and tools pertaining to Super ESPCs are available on FEMP's ESPC Contract Tools pages: www.eere.energy.gov/femp/financing/superespcs.html

