STATE PROGRAMS TO PROMOTE PERFORMANCE CONTRACTING OF ENERGY PROJECTS

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In recent years, performance contracting[1] programs for energy efficiency, cogeneration and alternative energy projects have been undertaken by governments throughout the country, with states appearing to take a leading role in demonstration programs. Michigan, North Carolina, Massachusetts, New York, Florida, Mississippi, California, Washington, Indiana, Connecticut, New Jersey and Delaware have each sponsored demonstrations of performance contracting in public and/or private buildings. The availability of funds from settlements of oil-overcharge cases is certain to increase state activity in this area. As states continue their performance contracting activities, it is important to reflect on the lessons of prior experiences and consider ways to improve future efforts. This paper outlines a few of the key lessons learned from existing programs and suggests a few strategies for future efforts.

LESSONS LEARNED FROM PRIOR EFFORTS

1. Types of Solicitation Documents: Most of the lessons stemming from prior efforts relate to the newness and relative complexity of the procurement of energy services and performance contracts, relative to other types of government procurements. Whereas most procurements involve the acquisition of a tangible good or the provision of a service that does not include the acquisition of a good, performance contracting involves a combination of services and tangible goods designed to save energy, with the tangible good considered incidental to the service. For this and other reasons, standard procurement procedures design to accommodate the acquisition of a service or a tangible good are inappropriate. In structuring new forms of procurement procedures for performance contracting the following ideas have surfaced:

A. Any form of negotiation that does not involve competition will not insure that the building owner receives the greatest level of benefits (e.g. energy savings) at the lowest price.

B. A Request for Bids[2] is an inappropriate method of solicitation, since ESCos reserve the right to select the measures and services they will provide and, therefore, not all proposers will be bidding on the same items of equipment. In addition, fixed price bids are inappropriate for contracts that include service components (the scope of which may also vary from bidder to bidder).

C. A Request for Proposals[3] allows building owners to consider cost as well as other factors, without requiring the selection of a lowest bidder, and may therefore be the preferred method of solicitation.

D. For relatively small projects, where the cost of preparing a technical bid will be low, a one-stage RFP is a suitable solicitation style; for projects where the cost of preparing a technical bid will be significant, a two-stage

RFP that first narrows the number of bidders through a Request for Qualifications, is preferable. The cost involved in preparing a proposal and probability of being selected are two of the most important factors affecting the decision to respond to an RFP. Most companies will not propose on a project where the cost of bidding is high and the probability of being selected is low or uncertain.

2. Technical Guidance in Project Selection and Proposal Review: There are two points in the solicitation and selection process at which the assistance of an engineer (either on the building owner's staff or a contractor independent from the energy service company) familiar with conservation projects is essential. First, an engineer should be involved in the initial identification of buildings to be included in the project to determine whether adequate energy savings opportunities are available. The second point is during the review of proposals submitted by energy service companies. Since proposals for energy services are not responding to fixed specifications, the merit of the technical portion of the proposals attains greater significance during the evaluation of proposals.

3. Soliciting a Performance Contract Takes Time: For most governments, it takes at least a full year from the time a solicitation is first issued until the day a contract with an energy service company is signed. This time frame is no longer than other similarly complex solicitations. However, many government representatives fail to realistically plan for the timing of these projects and are too stringent in the time they provide for RFP responses or evaluation of the responses.

4. Evaluating Proposals: Evaluation of proposals can be simplified dramatically by following two steps:

A. Provide standardized economic assumptions to so that proposals are based on consistent information. Assumptions should be provided regarding inflation, the discount factor, current energy consumption and especially energy prices (inflation or deflation!).

B. Direct bidders to put specific pieces of information in specific sections of the proposal and use standardized response forms wherever possible. Proposals should differ in terms of specific answers, but not in general content or format.

5. Contracts and Negotiations: There are three important, and very costly lessons that some governments have learned during the contracting process. First, it is extremely important to understand every word in an energy services agreement before signing it. Payment and guarantee schedules can be particularly complex, but they are the heart of the financial obligations of the building owner and the energy service company. Contracts should not be signed until these provisions and all other parts of the contract are clear to the building owner. Second, ESCos have displayed incredible flexibility during the negotiation process and have been willing to structure and restructure the deal to meet the needs of the building owner. Building owners should learn to take advantage of this flexibility. Finally, each performance contract is different. Companies vary in their use of service agreements, leases,

installment sales, etc. Governments should avoid mandated models that specify a particular type of agreement or list detailed contract clauses (unless government grants are involved).

6. Assistance to Local Governments and Buildings Owners: Many people thought that demonstrations alone would be enough to facilitate the ongoing use of performance contracting; this may be true for federal, state or large municipal governments and large private building owners, but not for most small local governments or small private businesses. The staff of most small governments and businesses have limited spare time to initiate new projects and will, in many instances, avoid particularly innovative programs unless assistance is available. Independent replication of demonstrations will probably only be initiated by large private and public entities. Handholding by State Energy Office staffs (or their contractors) is likely to be required on an ongoing basis by small public and private building managers.

7. Performance Contracting is not Right for Every Government: Performance contracting may not be appropriate for governments that have funding available and engineering staffs capable of operating and maintaining projects and an ability to absorb the risk of loss of measures do not work or governments with projects that are too small to interest ESCos or justify elaborate financing plans.

8. Performance Contracting Legislation: Some governments find that legislation is needed to overcome legal barriers to performance contracting. If such legislation is drafted, it should not be overly restrictive (by mandating very specific procedures or the use of specific documents) or overly vague (by failing to address key issues such as contract length or bidding procedures).

STRATEGIES FOR STATE GOVERNMENTS

To encourage the ongoing use of performance contracting states may wish to consider some of the following ideas:

1. Determine which form of solicitation is legally permissible and most appropriate for different types of projects; include standardized assumptions and forms for responses; provide sample solicitation documents.

2. Use engineers at appropriate points in the project.

3. Tailor programs to the size and types of public or private building owner being targeted. Performance contracting may be best for large building owners or where technical assistance is available to assist medium sized building owners. Grant programs should be reserved for small building owners that may not fit into either of the above categories.

4. Designate one or more staff as performance contracting specialists to provide ongoing assistance to building owners. It may be possible to charge a fee to cover salary and administrative costs of this service.

[1]In a performance contract, an energy service company (ESCo) performs energy saving services and installs energy saving measures at no upfront cost to the building owner. The building owner's reimbursement to the ESCo is linked to energy savings.

[2]A Request for Bids is a solicitation where selection of a contractor is dependent upon which company submits the lowest cost bid on a specified piece of equipment.

[3]A Request for Proposals is a solicitation where selection of a contractor is dependent upon a variety of factors, including cost, used to determine the worthiness of a respondent's proposal.