

ENERGY PERFORMANCE CONTRACTING IN PUBLIC SCHOOLS

Under an energy performance contract, an energy service company (ESCO) agrees to perform a variety of measures to reduce energy expenses and share the costs and savings with the school district. The energy performance contracting process can include some or all of the following services: comprehensive energy audit, design and specification of new equipment, installation and/or construction management, financing, on-going maintenance of the energy equipment installed, training of personnel and monitoring of performance. Payments are based in some fashion on the level of savings achieved.

Energy performance contracting offers several potential advantages over conventional procurement strategies for implementing energy efficiency improvements:

- little or no up-front expenditures required by the school district;
- consolidation of responsibility for project development, implementation, maintenance and monitoring with a single contractor;
- costs are ordinary contingent expenses not subject to a referendum;
- accelerated project implementation;
- increased incentives for persistence of savings; and
- opportunity to share risk that project will not earn projected savings.

The following is a brief overview of important subjects and issues school district personnel should be aware of in considering the use of an energy performance contract to save energy costs in school buildings. It is not meant to be comprehensive and does not address all the issues that could affect an energy performance contract. School districts should consult with the school district attorney, and with personnel in the State Education Department as this option is explored.

The New York State Energy Research and Development Authority (NYSERDA) can provide assistance in developing an energy performance contract, by helping to prepare a Request for Proposals (RFP) and other procurement activities and evaluations undertaken in connection with an energy performance contract. A list of energy service companies, a model RFP with evaluation criteria, and a model Agreement to Conduct a Comprehensive Energy Audit are available. To discuss the full range of assistance available through NYSERDA call (518) 862-1090, extension 3318.

Chapter 436 of the Laws of 1997 included four major provisions affecting energy performance contracts by school districts and Boards of Cooperative Educational Services:

- the amortization period shall not exceed the term of the energy performance

contract;

- building aid attributable to the project is excluded in determining the cost savings under the energy performance contract;
- the performance contractor must guarantee the recovery of contract costs from energy savings realized by the school district over the term of the energy performance contract, which shall not exceed 18 years; and
- the Commissioner of Education was directed to promulgate regulations, in consultation with NYSERDA, covering the development and approval of an energy performance contract in accordance with subdivision 8 of section 9-103 of the Energy Law.

The first provision was retroactive to July 1996; the second and third provisions were effective upon adoption of the legislation on August 20, 1997; and the regulations were published in the New York State Register on May 6, 1998 and adopted July 1, 1998. Relevant sections of the law and the regulations are included below as Sections V and VI.

I. Critical Path for Energy Performance Contracting by a School District

1. Organize the project team and assess project feasibility in your school district.
2. Draft a Request for Proposals (RFP). Include evaluation criteria.
3. Select evaluation panel for RFP. Have the panel review and revise the draft RFP before it is sent out.
4. Prepare a list of ESCOs believed capable and willing to submit proposals to perform an energy performance contract to ensure an adequate number of responses from qualified ESCOs.
5. Issue and advertise the written RFP in accordance with the school district's procurement policies and practices. It is strongly recommended that the RFP also be sent to the selected bidders.
6. Send letter of intent to the State Education Department identifying the building(s) in which work is planned and the general scope-of-work.
7. The evaluation panel reviews the proposals and ranks them in accordance with evaluation criteria.
8. Select an ESCO and negotiate the energy performance contract. See sections II and III below for typical forms of agreement and issues.

Usually a preliminary step occurs in which the selected ESCO conducts a comprehensive energy audit to confirm the estimates in the proposal, including project cost, energy savings, and cash flow. The "agreement to conduct a comprehensive energy audit," which may be either a separate contract or a preliminary step included in the energy performance contract itself, should specify the cost of the comprehensive energy audit and who bears those costs if the school district or ESCO should decide against proceeding with implementation. The ESCO typically guarantees that the comprehensive energy audit will meet a specified percentage of savings in the proposal within a stated percentage of the initial proposal costs.

If the comprehensive energy audit confirms the estimates in the original proposal, the contract can provide for a two-stage agreement for development of the plans and specifications with implementation of the capital improvements to follow State Education Department approval.

9. Design documents must be submitted to the State Education Department for review and approval prior to the school district authorizing implementation of the capital improvements.

II. Typical Forms of Energy Performance Contracts

1. There are two forms generally in use that focus on the type of financial arrangement used to share savings:
 - Under a **guaranteed savings agreement** payments are fixed for the term of the agreement based on the agreed-to estimate of energy savings. If measured savings are less than the guarantee, the ESCO makes up for the shortfall.
 - Under a **shared savings agreement** the ESCO puts up the money for the project and generally owns the equipment. Payments are a specified percentage of measured energy cost savings, and if there are no savings, the school district makes no payment.
2. In practice, both forms of agreement (contract) vary widely from the basic form. The available financing options for a guaranteed savings agreement are particularly varied. Financing can be provided by the ESCO (directly or through a third party) or by a third party directly to the school district.
5. Section 9-103(2) of the New York Energy Law requires an energy performance contract to include an "executory clause" under which payments are subject to annual appropriations. There are also other standard clauses typically included in school district and public contracting, such as insurance, including workers'

compensation and employers' liability insurance, prevailing wage rate requirements, clauses for appropriate bonds and guarantees, and other clauses that the school district attorney can usually supply.

6. There are several options for equipment ownership under a guaranteed savings agreement. (See item III.4 below for information on the impact equipment ownership has on the project's eligibility for building aid from the State Education Department.)

When structured as a **purchase**, title to equipment passes to the school district upon installation and acceptance. A security interest may be placed on the equipment by the ESCO or third party financier.

When structured as an **installment purchase** or **lease purchase**, the agreement can provide for a transfer of title to the school district at a specified time. A security interest will generally be placed on the equipment (collateral) by the ESCO or third party financier.

Under a **lease**, title does not transfer to the school district. Title could subsequently be transferred at the end of the lease period upon payment of the fair market value of the equipment.

7. Options available under a guaranteed savings agreement for equipment acquisition and installation:
 - Full responsibility assigned to the ESCO which may elect to subcontract portions of the work (selection of subcontractors should be subject to approval by the school district);
 - ESCO functions as the construction manager and as the school district's agent to competitively procure equipment and installation services.

III. Important Issues

1. New York Energy Law Section 9-102(4) defines an energy performance contract as "an agreement for the provision of energy services...in which a person agrees to install, maintain, or manage energy systems in exchange for a portion of the energy savings or revenues." As such, the contract must provide for some manner of sharing energy savings or revenues.
2. The recent amendments to the State Education Law enacted by Chapter 436 of the Laws of 1997 require the energy performance contractor to guarantee recovery of contract costs from savings realized by the school district during the term of the energy performance contract, which cannot exceed 18 years. Building Aid must be

excluded in determining the cost savings. See the attached draft regulations in Section VI for additional requirements.

3. There is no requirement for a referendum for an energy performance contract. In addition, the referendum requirements contained in General Municipal Law Section 109-b do not apply if the school district has issued an RFP in accordance with Section 9-103(6) of the Energy Law under a procurement policy adopted pursuant to Section 104-b of the General Municipal Law.

A third party financing agreement entered into in conjunction with an energy performance contract is exempt from voter approval. The solicitation for third party financing should be very clear as to how it is connected to other elements of the energy performance contract transaction.

4. State school building aid is unavailable if the performance contractor or third party financier retains ownership of the equipment.
5. The proposed energy baseline and mechanisms to measure savings should be reviewed carefully to determine their limitations. Particular care should be taken to ensure the accuracy of hours of operation and run times of equipment.
6. The contract should contain provisions governing approval of equipment specifications, energy conditions to be maintained and changes in use of buildings.
7. The plans and specifications must generally be signed and stamped by an independent architect or engineer licensed in New York State. (See Education Law Sections 7209(3) and 7307.) ESCOs and school districts must exercise care to assure that they are in compliance with the Education Law's requirement for plans and designs to be prepared by independent architects or engineers licensed to practice in New York State.
8. The scope of any guarantee should be carefully evaluated to consider the protection it provides upon the possible default, financial adversity, or equipment failure and the remedies available to the school district.
9. The risk that the executory clause exposes an ESCO to is offset by Section 9-103(3) of the Energy Law which instructs school districts to treat payments under an energy performance contract as an ordinary contingent expense.
10. The State Environmental Quality Review (SEQR) Act applies to an energy performance contract transaction.

IV. NEW YORK STATE ENERGY LAW
ARTICLE 9 - ENERGY PERFORMANCE CONTRACTS
IN CONNECTION WITH PUBLIC BUILDINGS AND FACILITIES

§ 9-101. Purpose

The purpose of this article is to obtain long-term energy and cost savings for agencies and municipalities by facilitating prompt incorporation of energy conservation improvements or energy production equipment, or both, in connection with buildings or facilities owned, operated or under the supervision and control of agencies or municipalities, in cooperation with providers of such services and associated materials from the private sector. Such arrangements will improve and protect the health, safety, security, and welfare of the people of the state by promoting energy conservation and independence, developing alternate sources of energy, and fostering business activity.

§ 9-102. Definitions

For the purposes of this article, the following words and phrases shall have the following meanings unless a different meaning is plainly required by the context.

1. "Agency" means any state department, agency, board, commission, office, or division.
2. "Municipality" means a municipal corporation, as defined in section two of the general municipal law, school district, board of cooperative educational services, fire district, district corporation or special improvement district governed by a separate board of commissioners.
3. "Public authority" means any public authority, public benefit corporation, or the port authority of New York and New Jersey, to the extent its facilities are located within the state of New York.
4. "Energy performance contract" means an agreement for the provision of energy services, including but not limited to electricity, heating, ventilation, cooling, steam or hot water, in which a person agrees to install, maintain or manage energy systems or equipment to improve the energy efficiency of, or produce energy in connection with, a building or facility in exchange for a portion of the energy savings or revenues.

§ 9-103. Energy performance contracts

1. Notwithstanding any other provision of law, any agency, municipality, or public authority, in addition to existing powers, is authorized to enter into energy performance contracts of up to thirty-five years duration, provided, that the duration of any such contract shall not exceed the reasonably expected useful life of the energy facilities or equipment subject to such contract.
2. Any energy performance contract entered into by any agency or municipality shall contain the following clause: "This contract shall be deemed executory only to the extent of the monies appropriated and available for the purpose of the contract, and no liability on account therefor shall be incurred beyond the amount of such monies. It is understood that neither this contract nor any representation by any public employee or officer creates any legal or moral obligation to request, appropriate or make available monies for the purpose of the contract."
3. In the case of a school district or a board of cooperative educational services, an energy performance contract shall be an ordinary contingent expense, and shall in no event be construed as or deemed a lease or lease-purchase of a building or facility, for purposes of the education law.
4. Agencies, municipalities, and public authorities are encouraged to consult with and seek advice and assistance from the New York state energy research and development authority concerning energy performance contracts.
5. Notwithstanding any other provision of law, in order to convey an interest in real property necessary for the construction of facilities or the operation of equipment provided for in an energy performance contract, any agency, municipality or public authority may enter into a lease of such real property to which it holds title or

which is under its administrative jurisdiction as is necessary for such construction or operation, with an energy performance contractor, for the same length of time as the term of such energy performance contract, and on such terms and conditions as may be agreeable to the parties thereto and are not otherwise inconsistent with law, and notwithstanding that such real property may remain useful to such agency, municipality or public authority for the purpose for which such real property was originally acquired or devoted or for which such real property is being used.

6. In lieu of any other competitive procurement or acquisition process that may apply pursuant to any other provision of law, an agency, municipality, or public authority may procure an energy performance contractor by issuing and advertising a written request for proposals in accordance with procurement or internal control policies, procedures, or guidelines that the agency, municipality, or public authority has adopted pursuant to applicable provisions of the state finance law, the executive law, the general municipal law, or the public authorities law, as the case may be.

7. Sections one hundred three and one hundred nine-b of the general municipal law shall not apply to an energy performance contract for which a written request for proposals is issued pursuant to subdivision six of this section.

8. In the case of a school district or a board of cooperative educational services, an energy performance contract shall be developed and approved pursuant to the requirements of this section and pursuant to regulations promulgated by the commissioner of education in consultation with the New York state energy research and development authority. Such regulations shall include, but shall not be limited to: a list of the appropriate type of projects that qualify as energy performance contracts; an approval process that includes review of the type and nature of the proposed project, the scope and nature of the work to be performed, and a detailed breakdown of the energy savings to be derived each year and for the duration of the energy performance contract; and a process for ensuring that districts have obtained financing at the lowest cost possible. Such regulations shall require that all energy performance contracts which contain maintenance and monitoring charges as part of the energy performance contract price state such maintenance and monitoring charges separately in the contract in a clear and conspicuous manner. Such regulations shall not apply to energy performance contracts entered into prior to the effective date of such regulations, nor shall they apply to energy performance contracts for which a request for proposals was issued prior to such effective date.

Added L. 1985, c. 733, § 2; amended L. 1989, c. 638, §§ 1,2; amended L. 1994, c. 368, §§ 1,2; amended L. 1995, c.83, §47; amended L. 1997, c. 436, §78.

V. Chapter 436 of the Laws of 1997

Sections Relevant to School Districts and BOCES Energy Performance Contracts from 1997 Senate bill 5788 signed by Governor Pataki on August 20, 1997

AN ACT to amend the education law, in relation to the calculation and payment of state aid to school districts and boards of cooperative educational services * * *, to amend the energy law, in relation to energy performance contracts * * *

PART A

Section 1. Section 305 of the education law is amended by adding a new subdivision 27 to read as follows:

27. The commissioner shall promulgate regulations in consultation with the New York state energy research and development authority concerning the development and approval of energy performance contracts for school districts and boards of cooperative educational services in accordance with subdivision eight of section 9-103 of the energy law.

* * *

§40. Paragraph i of subdivision 6 of section 3602 of the education law, as added by chapter 474 of the laws of 1996, is amended to read as follows:

i. Approved expenditures for debt service. (1) * * *

(2) * * *

(3) * * *

(4) * * *

(5) Notwithstanding any inconsistent provisions of this paragraph, for the purpose of calculating an apportionment pursuant to this subdivision:

(i) current approved expenditures for debt service for energy performance contracts authorized pursuant to section 9-102 of the energy law shall mean approved debt service incurred by a school district under such contract during the current school year related to the financing of such construction, acquisition, reconstruction, rehabilitation or improvement of any school building, provided that as a condition of eligibility for aid:

A. The amortization period shall not exceed the term of the energy performance contract.

(ii) * * *

(iii) * * *

§ 41. Clause (i) of subparagraph 5 of paragraph i of subdivision 6 of section 3602 of the education law, as added by section forty of this act, is amended by adding two new subclauses B and C to read as follows:

B. Any state building aid attributable to such project shall be excluded in determining the cost savings under the energy performance contract.

C. The energy performance contractor shall guarantee recovery of contract costs from energy savings realized by the school district during the term of the energy performance contract, which shall not exceed eighteen years.

* * *

§ 78. Section 9-103 of the energy law is amended by adding a new subdivision 8 to read as follows:

8. In the case of a school district or a board of cooperative educational services, an energy performance contract shall be developed and approved pursuant to the requirements of this section and pursuant to regulations promulgated by the commissioner of education in consultation with the New York state energy research and development authority. Such regulations shall include, but shall not be limited to: a list of the appropriate type of projects that qualify as energy performance contracts; an approval process that includes review of the type and nature of the proposed project, the scope and nature of the work to be performed, and a detailed breakdown of the energy savings to be derived each year and for the duration of the energy performance contract; and a process for ensuring that districts have obtained financing at the lowest cost possible. Such regulations shall require that all energy performance contracts which contain maintenance and monitoring charges as part of the energy performance contract price state such maintenance and monitoring charges separately in the contract in a clear and conspicuous manner. Such regulations shall not apply to energy performance contracts entered into prior to the effective date of such regulations, nor shall they apply to energy performance contracts for which a request for proposals was issued prior to such effective date.

* * *

§ 119. This act shall take effect immediately and shall be deemed to have been in full force and effect on and after July 1, 1997, except that:

(1) sections one and seventy-eight of this act shall take effect immediately, and the commissioner of education is authorized and directed to promulgate the regulations necessary to implement the provisions of such sections within 180 days of such effective date;

(2) * * *

(3) * * *

(4) * * *

(5) section forty of this act shall take effect immediately and shall be deemed to have been in full force

and effect on and after the effective date of section 41 of chapter 474 of the laws of 1996;
(6) section forty-one of this act shall take effect immediately;

VI. REGULATIONS OF THE COMMISSIONER OF EDUCATION
(8 NYCRR §155.16)

Pursuant to sections 101, 207 and 305 of the Education Law, section 9-103(8) of the Energy Law and Chapter 436 of the Laws of 1997, Section 155.16 of the Regulations of the Commissioner of Education is added, effective July 1, 1998, to read as follows:

155.16 Energy Performance contracts. (a) The following procedures consistent with Energy Law section 9-103(8), and Education Law sections 305(27), and 3062 (6)(i)(5)(i)(b) and (c) shall apply to energy performance contracts entered into by a school district or a board of cooperative educational services (BOCES) on or after July 1, 1998, provided that this section shall not apply to energy performance contracts for which a request for proposals was entered into prior to July 1, 1998.

(b) Definitions: For the purposes of this section:

(1) Energy Performance Contract shall mean an agreement for the provision of energy services, including but not limited to electricity, heating, ventilation, cooling, steam or hot water, in which a person agrees to install, maintain or manage energy systems or equipment to improve the energy efficiency of, or produce energy in connection with, a building or facility in exchange for a portion of the energy savings or revenues.

(2) Simple payback period shall mean a measure of the length of time required for the cumulative cost savings, net of cumulative future costs, from an investment in an energy conservation project to pay back the investment cost, without taking into account the time value of money, or the Differential Energy Price Escalation Rate, or the State building aid payable for the project.

(3) Energy Savings shall mean the positive difference between the energy and associated cost before the retrofit and its estimated cost after the retrofit of a proposed alternative building system, taking into account all types of energy effected.

(4) Cost savings shall mean the positive difference between the operation and maintenance cost before the retrofit and its established operation and maintenance cost after the retrofit.

(5) Co-generation shall mean the simultaneous production of electricity and thermal energy. Typical systems utilize natural gas engines to turn electric generators thereby producing electricity, which reduces utility costs. Waste heat captured from the natural gas combustion process can be used to produce domestic hot water, provide space heat in winter or air conditioning in summer when used in conjunction with absorption chillers.

(c) The appropriate type of projects that qualify to be completed under an energy performance contract may include, but are not limited to:

(1) replacement of lighting fixtures;

(2) installation of energy efficient boiler/furnace, heating, ventilating, air conditioning (HVAC) equipment;

(3) installation of vestibules:

(4) installation of automatic setback thermostat;

(5) energy management system;

- (6) upgrade domestic hot water system;
- (7) roof insulation;
- (8) installation of energy efficient window/doors;
- (9) co-generation; or
- (10) the installation, maintenance or management of other energy systems or equipment to improve the energy efficiency of, or produce energy in connection with, a building or facility.

(d) Every energy performance contract entered into by a school district or BOCES to which this section applies and every amendment to an energy performance contract entered into on or after July 1, 1998 by a board of education or a BOCES shall be subject to approval by the Commissioner of Education and shall contain a provision that such contract shall not be executory until approval of the Commissioner is obtained. In order to obtain approval by the Commissioner of Education to enter into an energy performance contract, the school district or BOCES shall:

- (1) demonstrate that the project complies with all applicable provisions of section 155.2 of this Part;
- (2) describe the scope and nature of the work to be performed;
- (3) demonstrate that the types of projects included in the energy performance contract are appropriate in accordance with subdivision (c) of this section.;
- (4) provide a detailed breakdown of the energy performance savings to be derived each year and for the duration of the energy performance contract in the project summary form, which shall include:
 - (i) a description of each energy conservation measure included in the energy performance contract;
 - (ii) the cost of each energy conservation measure;
 - (iii) the project energy savings and cost savings;
 - (iv) the useful life of each energy conservation measure; and
 - (v) the simple payback period;
- (5) state any maintenance and monitoring charges that are part of the energy performance contract in a clear and conspicuous manner separately in the contract;
- (6) provide the interest rate applicable to the energy performance contract and length of borrowing. The interest rate will be compared to the U.S. Treasury rate for like terms as published in the Wall Street Journal and must be comparable;
- (7) provide the following certifications:

(i) The sole trustee, the president of the board of trustees or board of education, or the president of the BOCES shall certify that in lieu of competitive bidding, the energy performance contract was procured pursuant to a request for proposal (RFP) process in accordance with the school district's or BOCES' procurement policies and procedures adopted pursuant to applicable provisions of General Municipal Law section 104-b;

(ii) The energy performance contractor shall certify that such energy performance contractor has guaranteed recovery of contract costs from energy savings realized by the school district during the term of the energy performance contract, which shall not exceed 18 years, or the useful life of the equipment being installed, whichever is less. This certification shall be based on an analysis of energy costs and savings, which shall not include any cost savings attributable to state building aid. If a simple payback calculation is used to demonstrate compliance with the 18 year payback limitation, it shall be calculated by dividing the initial contract

cost by the first year cost savings. If another analysis is used to support the certification, it should be submitted with the certification;

(iii) The energy performance contractor shall certify that measurement and verification techniques for determining cost savings will be performed in accordance with the North American Energy Measurement and Verification Protocol, March 1996, (U.S. Department of Energy, Washington, D.C. 20585: available at the Office of Facilities Planning, Room 1060 State Education Building Annex, Albany, NY 12234);

(iv) The energy performance contractor shall certify that any state building aid attributable to such project has been excluded in determining the cost savings and payback period under the energy performance contract; and

(v) The architect and/or engineer of record shall certify that he or she is free from financial interest in the energy performance contractor which conflicts with the proper completion of the audit and any design work associated with the energy performance contract and that full disclosure has been made to the school district and/or BOCES detailing all financial compensation received from the energy performance contractor.

(e) The administrative and technical review by the State Education Department shall include:

- (1) review of project scope and its appropriateness to be done under an energy performance contract and its eligibility for building aid;
- (2) review of the project's compliance with applicable provisions of section 155.2 of this Part;
- (3) review of detailed breakdown of the energy savings to ensure compliance with Education Law section 3602 (6)(i)(5)(1);
- (4) review of certifications by the president of the board of education, energy performance contractor and architect/engineer as specified in regulations;
- (5) review of interest rate and comparison to the U.S. Treasury Rate for like terms;
- (6) review of technical specifications for compliance with the Uniform Fire Prevention and Building Code, State Education Department standards and other applicable standards,

(f) Capital construction costs and associated incidental costs such as architect/engineer fees, administrative costs and feasibility costs may be eligible for building aid. Costs associated with operation and maintenance, repairs, extended warranties and service agreements are not eligible for building aid and should be separated in a clear and conspicuous manner from those eligible expenses.