MEMORANDUM FOR THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

FROM: Jacob J. Lew
Acting Director

SUBJECT: Federal Use of Energy Savings Performance Contracting

PURPOSE: To increase Federal use of Energy Savings Performance Contracting (ESPC) in order to improve Federal energy management; and to provide guidance for developing and entering into these contracts.

BACKGROUND: ESPC is a technique to reduce energy costs and consumption at Federal facilities, without increasing budgetary outlays. Energy Savings Performance Contracts are awarded to private firms to reduce energy consumption in Federal facilities and guarantee savings. Additional benefits of ESPC can include new capital equipment, reduced maintenance costs, improved indoor environments and reduced pollution. Contractors, using private investment capital, design, purchase, install and maintain energy efficiency improvement projects at a facility. Contractors then receive a negotiated share of the value of the energy savings generated by their efforts, and since the contractor is required to guarantee the savings, payment is made only if actual savings result from reduced energy use. When a contractor is fully paid its negotiated share of the delivered energy savings, all additional savings accrue to the government.

On October 22, 1997, President Clinton announced proposals for the Climate Change Technology Initiative which included immediate actions that the United States would take. One of these was to affect Federal energy management by expanding the use of ESPC — using private investment capital and expertise to accomplish energy and cost saving projects in Federal facilities. The Departments of Defense (DOD) and Energy (DOE) have streamlined the contracting process by putting in place regional ESPC multiple award contracts, which are beginning to speed large investments in energy projects and are available for use by any agency. However, Federal agencies’ use of ESPC authority has been below anticipated levels. This memorandum is intended to encourage increased use of ESPC and improve Federal energy management.

Both the Energy Policy Act of 1992 (EPACT, P.L. 102-486) and Executive Order 12902, Energy Efficiency and Water Conservation at Federal Facilities contain requirements for Federal energy management and establish energy reduction goals. EPACT requires agencies to install energy conservation measures with payback periods of less than 10 years and to reduce energy consumption levels by 20 percent relative to 1985 levels by the year 2000. Executive Order
12902 requires comprehensive facility audits to be conducted and establishes a 30 percent energy reduction goal by 2005. Facility audits cover the size, type, energy use and performance of all energy-using systems, appropriate conservation maintenance and operating procedures, recommendations for installing conservation measures, and a strategy to implement the recommendations.

To help agencies meet the EPACT and Executive Order requirements, section 155 of EPACT authorizes and the Executive Order encourages ESPC as a means of alternative financing. Agencies are requested to review their facility audits and determine the appropriateness of ESPC for projects that exceed current fiscal year funding capabilities or that can be combined with expensive or long term payback projects for faster implementation and generation of savings.

GUIDANCE: Agencies are encouraged to use ESPC to achieve significant long-term energy and financial savings in their operations. Government-wide regulatory guidance on ESPC is contained at 10 CFR 436. In addition, the Department of Energy’s Federal Energy Management Program (FEMP) is available to provide assistance on facility audit reviews, investment decisions, technical issues, or general guidance on using ESPC. FEMP can be reached at (202) 586-5772. Additionally, the Defense Energy Support Center at Fort Belvoir, Virginia, and the U.S. Army Corps of Engineers, Engineering and Support Center, Huntsville, Alabama, can also offer ESPC support. They can be reached at (703) 767-8572 and (256) 895-1531, respectively.

The law authorizes agencies to enter into competitive, multi-year ESPC as long as funds are available and adequate for payment of the first fiscal year costs. Outyear costs or potential cancellation charges are not required to be financed up front. The statute also permits ESPC for a period of up to 25 years; but, requires a 30-day advance Congressional notification for any contract containing a cancellation ceiling in excess of $750,000. Agencies will be asked to report to OMB on a semi annual basis those ESPCs and task orders they have entered into during the year.

Thorough analysis through a capital planning and budgeting or equally disciplined process should be conducted in advance of entering into all ESPC agreements. Agencies should be aware of the budgetary implications of using ESPC -- the fact that they are financing an investment and creating obligations for future year funding that could impact the future funding of other programs. When an agency is considering ESPC, the following issues should be considered as part of acquisition planning:

- **Most Appropriate Mechanism:** Agencies should determine whether an ESPC agreement is appropriate for the work required. Although ESPC can be a valuable tool for obtaining energy conservation investments in an expeditious manner, these contracts may not be appropriate for buildings or facilities where usage may be reduced considerably or where operations may be terminated. Alternatives to consider include use of appropriated funds and Demand Side Management/Area-Wide agreements with local utilities.
• **Competition and Contracting:** Competitive selection among qualified firms for ESPC work is important to ensure that the government is receiving the best value possible, in terms of the expected savings realized by the government, quality of the installed material and equipment, and risk. This may be accomplished with commercial style procedures such as streamlined evaluation of approaches received from multiple award contract holders, or other processes. The goal is to enable the government to obtain the best deal possible by encouraging vendors to exercise due diligence to investigate and solve an agency's particular energy use problems and by making cost-effective, merit-based selections.

• **Termination or Cancellation:** ESPC must specifically address the rights and obligations of each party in the case of a termination or cancellation. Recognizing that it may be necessary for the government to terminate or cancel an ESPC agreement, the contract should contain provisions for determining equitable adjustments if the agreement is terminated or canceled during the term of the contract. There may be circumstances where the government should terminate or cancel the agreement due to a deficiency in the contractor's performance. Such deficiencies may include not achieving the savings projected by the contractor in its proposal or violating security agreements where the contract requires system maintenance on a government installation.

• **Ownership Retention:** Agencies must also consider issues of ownership of energy saving investments (materials and equipment) the contractor installs in government buildings and facilities. Through appropriate contract clauses, agencies need to ensure that contractors and their lenders do not have the right to remove items, which could interrupt government operations if anticipated savings have not been realized. Ownership is especially important when the contractor uses third party financing that may subject the material or equipment to liens or other types of security interests. In such cases, the government must ensure that it has an interest paramount to any lien or other types of security interest.

• **Energy Costs and Savings:** ESPC agreements must contain a guarantee of minimum savings to be generated by improvements, which must cover the full cost of Federal investment for improvements, if any. Agencies should consider providing for adjustments due to significant changes in the price of energy. For example, electricity industry restructuring may cause a significant change in power rates which would impact energy cost savings without necessarily impacting actual energy usage.

**BUDGET TREATMENT:** Obligations, budget authority, and outlays will be recognized on an annual basis. There must be sufficient discretionary budgetary resources to complete the first fiscal year's contract costs. For each of the subsequent fiscal years, discretionary budget authority and outlays will be recognized annually to the extent that payments are made on the contract. It is expected that energy costs will be reduced, reflecting ESPC savings and retained savings. All budget authority and outlays associated with ESPC will be classified as discretionary and will be subject to the discretionary caps under the Balanced Budget Agreement (BBA).
RETENTION OF SAVINGS: All agencies have been granted statutory authority to retain half of the government's portion of ESPC savings generated (DOD and the General Services Administration (GSA) have specific retention authorities, and EPACT grants it to all other agencies). The Office of Management and Budget (OMB) encourages agencies to permit the retention of some or all of the savings at the facility or site where they occur in order to provide incentive for facility and site managers to undertake more Federal energy management initiatives and to offset other operation and maintenance costs.

COORDINATION AND REPORTING: Within 60 days, OMB will convene an interagency policy group to address Federal energy management initiatives, including the increased use of ESPC. This group, which will include both energy and procurement program officials, will convene to report on the status of agencies' efforts in response to this memo, address other energy policy concerns and help spread successful energy program efforts more quickly among agencies.

Also, in accordance with the National Energy Conservation and Policy Act (NECPA), EPACT, Executive Order 13031 on Alternative Fuel Vehicle Leadership, and guidance published in OMB Circular A-11, each agency is required to submit information on energy use and energy efficiency improvements to both OMB and FEMP. OMB and DOE are working to coordinate that data collection and minimize agencies' reporting burden, while still meeting the intent of the overall reporting requirements.