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## SCHOOL ENERGY CONTRACTS

House Bill 4634 as introduced  
First Analysis (5-19-93)

Sponsor: Rep. William R. Keith  
Committee: Education

### *THE APPARENT PROBLEM:*

The concept of performance-based contracting is being promoted as a way of improving the energy efficiency and comfort levels of school buildings. Many of the state's public school buildings are said to be outmoded in design and inefficient energy users. Bringing them up-to-date is expensive, but the costs of modernization reportedly can be more than offset in a relatively short time by greatly increasing energy efficiency. New heating, ventilation, and cooling equipment; modern lighting; computerized energy control systems; improved doors and windows; insulation -- all of these can reduce future operational costs for school districts. What performance-based contracting does, say its proponents, is to provide a promise that the cost of making improvements will be covered by the amount of future savings (and that certain other aims, such as temperature levels, will be achieved). This means, say proponents, school districts can upgrade their energy systems without increasing current expenses; future savings pay the cost of today's modifications. This is particularly important in these days of scarce school budget dollars. The contractors who make the improvements, moreover, typically must monitor their work to see that the comfort and cost guarantees are carried out.

Those who favor this approach to improving the energy efficiency of school buildings say that the current competitive bidding requirements of the School Code are an obstacle. (Generally speaking, purchases and projects costing \$12,500 or more must be competitively bid.) This, they say, is because energy conservation proposals typically are not "pre-engineered" but are designed from the ground up by those making proposals. Companies engaged in this business may favor one approach over another; for example, one company may promote weatherization and insulation, another may promote new heating and cooling systems, a third may endorse yet other solutions. In a sense, contractors in the field compete on the basis of the solutions they propose to solve specific problems (and even over how those problems are to be

understood). A school district may prefer one approach over another rather than look for the proposal with the lowest immediate cost. Or, a district might want to negotiate with companies making proposals to achieve certain ends. Further, advocates say, a district might not want to obtain competitive proposals but accept the proposal and approach of a company that has solicited them or that they have otherwise been made aware of. A related problem, reportedly, is that these performance-based contract proposals, since they are not based on pre-engineered specifications, are expensive to put together, and smaller school districts have difficulty finding people to compete for the business. According to information provided last session by Honeywell, Inc., performance-based contracting of this kind has been permitted in Ohio and Minnesota. In Ohio, the company says, savings of \$75 million over seven years were promised to 130 school districts and actual savings are 30 to 50 percent higher. (Reportedly, 9 states now allow non-competitive performance-based contracting.) Legislation has been proposed to allow "sole source" and negotiated performance-based contracts for school energy conservation projects in Michigan.

### *THE CONTENT OF THE BILL:*

The bill would amend the School Code to govern the use by school districts of performance-based contracts for energy conservation projects. Districts, including intermediate districts and consortiums of districts, would be able to enter into such contracts or packages of contracts without obtaining competitive proposals if they chose to. If they did obtain competitive proposals, they would be permitted to negotiate with those making proposals after the proposals were opened, and changes could be made to a proposal before a contract was awarded. The provisions of the bill would supersede those in the School Code that require competitive bidding for projects above certain dollar amounts. (Districts could still choose to use

traditional competitive bidding methods in awarding energy conservation contracts.)

The bill would apply to performance-based contracts for energy conservation measures. The term "energy conservation measures" would mean goods and services to reduce energy consumption or operating costs of school facilities and includes insulation; window and door modifications; automatic energy control systems, including licenses for computer software; heating, ventilation, and air-conditioning systems, modifications, or replacements; energy-efficient lighting systems; energy recovery systems; and cogeneration systems that produce energy for the private use of a school district or consortium. The term "performance-based contract" would refer to an agreement under which energy conservation measures are provided to a school district or consortium of districts and the provider guarantees specific levels of comfort and guarantees that the total costs for project design, equipment, servicing, and financing will not exceed the savings realized over the term of the agreement. The board of a school district, intermediate school district, local act school district, or a consortium consisting of any of those could enter into such contracts. The board of an intermediate district could enter into such a contract on its own behalf or on the behalf of one or more of its constituent school districts at their request.

**Contract Requirements.** If a district wanted to be able to enter into an energy conservation contract without obtaining competitive proposals it would first have to obtain from the Michigan Public Service Commission (PSC), no earlier than a year before entering the contract, a list of potential energy service providers developed by the PSC. Whether competitive proposals were sought or not, a contract would have to meet the following criteria:

-- The contract would have to cover a period that did not extend beyond ten years after the completion of installation.

-- The contract would have to contain a written guarantee of a specific minimum amount of money to be saved in energy costs, including electrical, gas, and other utility costs, and a written guarantee by the provider to perform necessary services to ensure that at least those savings were realized. A similar guarantee would be required for operating costs.

-- The provider would have to file with the board or consortium a performance bond, insurance policy, or other acceptable guaranty instrument guaranteeing the faithful execution of the contract in an amount at least equal to the savings guarantee plus ten percent and to be effective at least for the term of the guarantee. An additional instrument could be required for the installation of energy conservation measures.

-- The provider would have to agree to monitor the results of conservation measures.

A board or consortium, before it could enter into a contract, would have to make a finding that the amount spent on the measures would not exceed the amount guaranteed to be saved and that the district's or consortium's contractual obligation in any one year of the contract would not exceed 95 percent of the annual savings guarantee specified in the contracts. In making these findings, a board or consortium would have to consider all costs of the energy conservation measures, including costs of design, engineering, installation, maintenance, repairs, operations, and debt service. A contract or package of contracts could include a lease with an option to buy if the lease term did not exceed ten years and the contract met federal tax requirements for tax-exempt municipal leasing or long-term financing.

Regardless of whether competitive proposals were sought, contracts would have to comply with the prevailing wage provisions of Public Act 166 of 1965 as if the provider were selected by competitive bidding (for contracts exceeding the \$12,500 competitive bidding threshold). For a first class school district (i.e., Detroit), if the district entered into a performance-based contract for which it obtained competitive proposals, the contract would have to comply with prevailing wage requirements of P.A. 166 as if the provider were selected by competitive bidding.

**Competitive Proposals.** If a school board or consortium chose to obtain competitive proposals, it would be required to advertise and specify in the notice the relative importance of guaranteed savings, price, financial performance and stability, quality, technical ability, experience, and other factors to be used in evaluating proposals and those making the proposals. The notice would have to state whether or not the proposals were subject to negotiation. (Only if the notice said the proposals would be

subject to negotiation could they be subject to negotiation.) The contract would have to be awarded based on savings guarantees and the evaluation factors specified in the proposal notice.

A board or consortium could, with the proper notice, negotiate with those making proposals after the proposals had been opened and could allow proposal revisions before a contract was awarded. If provided for in the notice, proposals would be opened so as to avoid disclosure of trade secrets to competitors during negotiations. All proposals would be open for public inspection after the contract was awarded, although districts could enter into software licensing agreements and nondisclosure agreements to protect a provider's computer software or trade secrets. Then such software or trade secrets would not be open for public inspection and would be exempt from the Freedom of Information Act. The term "trade secret" is defined in the bill as a confidential formula, pattern, device, or compilation of information used in the provider's business that gives the provider an opportunity to obtain advantage over competitors who do not know or use it.

Similar provisions would apply to cases where competitive bids were not obtained (so-called sole sourcing). All information provided to the board or consortium would be open for public inspection after the contract had been awarded, but as above, there could be software and nondisclosure agreements.

The bill says a board or consortium could pay for energy conservation contracts from operating funds of the district or districts or from the proceeds of bonds or notes issued for energy conservation measures. Bonds issued for purposes authorized by the bill would be considered as issued for capital expenditures for all purposes, including for purposes of the state-loans-to-school-district provisions in the state constitution.

**Public Service Commission List.** The bill would require the Public Service Commission (PSC) to develop and maintain a list of potential providers that would be made available to school districts that desired to enter into energy conservation contracts without seeking competitive proposals. The bill specifies that the list would be intended for use only for informational purposes and would have to contain a disclaimer that a provider's appearance on

the list was not an indication of competence. The PSC would not be liable for inaccuracies in the list. The PSC would have to determine the specific energy conservation measures that were part of performance-based contracts and indicate for each measure which providers were willing to provide it. The commission would also be required to establish and implement procedures for including in the list all potential providers who want to be in the list; for adding providers to the list and amending the list to update which services providers can perform; and for making the list available to anyone upon request. A provider who did not request at least once every 24 months to be kept on the list would be automatically removed.

MCL 380.623a et al.

### **BACKGROUND INFORMATION:**

A virtually identical bill passed both houses of the legislature in the 1991-92 session but was vetoed by Governor Engler. The governor cited four reasons: (1) a reluctance to exempt any public contract from competitive bidding; (2) the bill's exemption of certain information in performance-based contracts from the Freedom of Information Act by amending the School Code, an impermissible amendment by reference; (3) the expansion of responsibilities of the PSC contrary to his vision of a downsized state government; and (4) the expansion of the application of the state's Prevailing Wage Act, a policy change that "should be required to stand alone on its merit."

### **FISCAL IMPLICATIONS:**

The Senate Fiscal Agency described a similar bill last session as having no fiscal impact on state or local government. (3-20-92)

### **ARGUMENTS:**

#### **For:**

The aim of the bill is to provide an alternate method for school districts to use future energy savings to finance the cost of modifications to school energy systems. The use of performance-based contracting without competitive bidding is said to have been successful in other states in reducing school system costs and funding school energy projects. The performance-based contracting approach, moreover, provides school districts with the ongoing expertise of energy experts through the



monitoring of energy projects, expertise that many districts would be hard put to obtain otherwise. The contracts would have to contain guarantees that the cost of a project could not exceed the energy savings and guarantees of comfort levels. Permitting the districts to use sole sourcing, rather than obtaining competitive proposals, and to negotiate with contractors when competitive proposals were obtained, grants districts the flexibility that is desirable in attempting to solve complicated energy problems that have multiple possible solutions. It also gives them the flexibility of determining how best to use their available funds. Districts could still use competitive bidding if they wanted to. The bill requires that if school districts are to forgo competitive proposals, they at least obtain from the Public Service Commission a list of those engaged in the energy conservation business, so that they will know what is available in the marketplace. By enabling districts to engage in energy management projects that otherwise could not have afforded them, the bill will create jobs and will provide a more comfortable environment to more students and teachers.

***Against:***

Some contractors are concerned about permitting schools to enter into energy management contracts without using a competitive bidding process. They fear it could be a first step in eliminating the use of competitive bidding and fair competition in construction. School districts can already do much of what this bill proposes: use performance-based contracts that allow energy savings to pay for energy management projects. Contractors are already engaged in this work. It does not seem good public policy to allow school districts to deal with a single company without any competitive bidding. There is also concern among smaller contractors that this bill primarily would benefit one large major corporation or at least could lead to energy management projects monopolized by a few, large, hardware-specific vendors. There is also concern that utility companies could use this process to compete unfairly against local contractors.

***Response:***

It should be noted that the bill requires school districts to get a list of eligible contractors from the Public Service Commission. The PSC already maintains such a list, and many local contractors are on it. This helps to ensure access to the contractor selection process to all qualified contractors. (It should also be noted that, contrary to the governor's view in his veto message last session, the bill does

not significantly expand PSC duties, since they already keep the required list of available contractors and make it available.)

***Against:***

Some people are concerned about what they interpret as an expansion of "prevailing wage" requirements by making non-competitive performance contracts subject to the prevailing wage statute when typically the requirements apply to competitively bid projects. This will lead to higher labor costs. If this issue is to be addressed, it ought to be in separate legislation. This is one of the reasons Governor Engler gave for vetoing an identical bill last session.

***Response:***

The intent is not to extend the reach of the prevailing wage requirements, but to make them apply to performance-based contracts that they would have applied to in any case without this bill. It simply maintains the status quo. Currently, a project costing over \$12,500 would require competitive bidding and would have to comply with prevailing wage requirements. This bill would allow some energy-related projects that currently would have to comply with both competitive bidding requirements and prevailing wage requirements to be exempt from competitive bidding but not from prevailing wage.

***POSITIONS:***

A representative of Honeywell, Inc., testified in support of the bill. (5-18-93)

The Michigan Association of School Boards supports the bill. (5-18-93)

The AFL-CIO testified in support of the bill in its current form, but said it would oppose the bill if the current prevailing wage language was removed. (5-18-93)

The Michigan State Building and Trades Council testified in support of the bill in its current form. (5-18-93)

A representative of the Metro Detroit Sheet Metal and Air Conditioning Contractors Association testified generally in support of the bill and in favor of amendments to protect small businesses and limit contracting work by utility companies. (5-18-93)

**The Michigan Plumbing and Mechanical Contractors Association opposes the bill. (5-18-93)**

**The Michigan Chapter of the Air Conditioning Contractors of America testified in opposition to the bill. (5-18-93)**

**A representative of the Western Michigan Heating, Ventilation, And Air Conditioning Contractors testified in opposition to the bill. (5-18-93)**