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BILL ANALYSIS

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House Bill 5727 (Substitute H-3 as passed by the House)
Sponsor: Representative Joe Haveman
House Committee: Energy and Technology
Senate Committee: Energy and Technology

Date Completed: 12-3-12

CONTENT

The bill would create the "Cost-Effective Governmental Energy Use Act" to do the following:

-- Allow a governmental unit (a State department, agency, or authority) to enter into an energy performance contract to produce savings in utility or operation and maintenance costs.
-- Designate the Department of Technology, Management, and Budget (DTMB) as the lead agency for the development and promotion of a program of energy performance contracts in governmental units.
-- Allow a governmental unit to contract with a qualified provider if the DTMB determined that the anticipated savings would enable recovery of the costs of the work within 15 years or the average useful life of the measures.
-- Require the DTMB to assemble a list of qualified energy service providers, a list of standardized tools and contract templates, and a standardized energy performance contract process and documents.
-- Require the DTMB to make the lists available to local units of government and public entities.
-- Require the DTMB to report to the Legislature annually on total facility capital liability and dollar amount of energy performance contract work.
-- Require the DTMB to assist governmental units in identifying, evaluating, and implementing cost-savings measures; and allow the DTMB to charge reasonable fees for doing so.
-- Require a chosen qualified energy service provider to prepare an investment grade energy audit that included estimates of the anticipated utility and operation and maintenance cost savings.
-- Require an energy performance contract to require a qualified provider to give the governmental unit an annual reconciliation of the guaranteed energy savings, and specify that the provider would be liable for any shortfall.

Energy Performance Contract

Any governmental unit could enter into an energy performance contract with a qualified energy service provider to produce utility cost savings or operation and maintenance cost savings, except as otherwise provided in the Management and Budget Act.

Cost-savings measures implemented under an energy performance contract would have to comply with State or local building codes. Any governmental unit could implement other capital improvements in conjunction with a contract if the measures that were being implemented to achieve energy and operation and maintenance cost savings were a significant portion of an overall project. A governmental unit could not enter into an energy savings performance contract for a period of more than one year, unless it found that the amount it would spend on the cost-savings measures would

not exceed the amount to be saved in energy, water, wastewater, and operating costs over 15 years or the average useful life of the measures from the date of installation.

"Energy performance contract" would mean a contract between a governmental unit and a qualified energy service provider for evaluation, recommendation, and implementation of one or more cost-savings measures (described below). An energy performance contract could be structured as either a guaranteed energy savings contract or an energy savings performance contract.

"Guaranteed energy savings contract" would mean a contract that included all of the following: the design and installation of equipment; if applicable, operation and maintenance of any of the measures implemented; and guaranteed annual savings from reduced energy consumption and operating costs or increased operating efficiency that met or exceeded the total annual contract payments made by the governmental unit for the contract, including financing charges to be incurred by the governmental unit over the life of the contract.

"Energy savings performance contract" would mean a contract under which the rate of payments was based upon energy and operational cost savings and a stipulated maximum energy consumption level over the life of the contract.

"Operation and maintenance cost savings" would mean a quantifiable and governmental unit approved decrease in operation and maintenance costs or future replacement expenditures that was a direct result of the implementation of one or more utility cost-savings measures. The cost savings would have to be calculated in comparison with an established baseline of operation and maintenance costs.

"Utility cost savings" would mean any utility expenses that were eliminated or avoided on a long-term basis as a result of equipment installed or modified, or services performed, by a qualified energy provider. Utility cost savings would not include merely shifting personnel costs or similar short-term cost savings.

"Qualified energy service provider" would mean a person with a record of successful energy performance contract projects or a person who is experienced in the design, implementation, and installation of energy efficiency and facility improvement measures, the technical capabilities to ensure that the measures generate energy and operational cost savings, and accredited by the National Association of Energy Service Companies (NAESCO), prequalified for work through the U.S. Department of Energy for Federal facilities or the U.S. Department of Defense.

Cost-Savings Measures

"Cost-savings measures" would include any cost-effective facility improvement, repair, or alteration of, or any equipment, fixture or furnishing to be added to or used in, any facility that was designed to reduce energy consumption, utility costs, and costs associated with capital avoidance, capital improvement, maintenance, and operating; or to increase revenue or the operating efficiency of the facility for its appointed functions. Cost-savings measures would include all of the following:

-- Replacement or modification of lighting components, fixtures, or systems.
-- Renewable energy and alternate energy systems.
-- Cogeneration systems that produce steam or forms of energy, such as heat or electricity, for use primarily within a building or complex of buildings.
-- Changes in operation and maintenance practices.
-- Indoor air quality improvements that conform to applicable building code requirements.
-- Daylighting systems.
-- Insulating the building structure or systems in the building.
-- Storm windows or doors, caulking or weather stripping, multiglazed windows or door systems, heat-absorbing or heat reflective glazed and coated window and door systems, additional glazing, reductions in glass area, or other window and door system modifications that reduce energy consumption.
-- Automated or computerized energy control systems.
-- Heating, ventilation, or air conditioning system modifications or replacements.
-- Energy recovery systems.

-- Steam trap improvement programs that reduce operating costs.
-- Building operation programs that reduce utility and operating costs, including computerized energy management and consumption tracking programs, advanced metering, metering and sub-metering, and staff and occupant training.
-- Any life safety measures that provide long-term operating cost reductions and are in compliance with State and local codes.
-- Any other installation, modification of installation, or remodeling of building infrastructure improvements that produce utility or operational cost savings for their appointed functions in compliance with applicable State and local building codes.
-- Recommissioning.
-- Retro-commissioning.
-- Continuous commission.
-- Behavior modification and energy policies.
-- Measurement and verification.
-- Reporting tools.
-- Geothermal.
-- Carbon footprint monitoring.

The term also would include devices that reduce water consumption or sewer charges, including the following:

-- Water-conserving fixtures, appliances, and equipment, including water-conserving landscape irrigation equipment, or the substitution of nonwater-using fixtures, appliances, and equipment.
-- Landscaping measures that reduce watering demands and capture and hold applied water and rainfall.
-- Equipment for recycling or reusing water originating on the premises or from other sources, including treated municipal effluent.
-- Equipment to capture water from nonconventional, alternate sources, including air conditioning condensate or graywater, for nonpotable uses.
-- Metering equipment to segregate water use in order to identify water conservation opportunities or verify water savings.

"Cost-savings measure" also would include a program to reduce energy costs through rate adjustments and load shifting to reduce peak demand, including changes to more favorable rate schedules and auditing of energy service billing and meters.

"Cost-effective" would mean that the present value to a governmental unit of the energy, utility, capital cost avoidance, capital improvement, and operational costs and revenue reasonably expected to be saved or produced by a facility, activity, measure, equipment, or system over its useful life, including any compensation received from a utility, was greater than the net present value of the costs of implementing, maintaining, and operating the facility, activity, measure, equipment, or system over its useful life, if discounted at the cost of public borrowing.

DTMB Responsibilities

The Department of Technology, Management, and Budget would be the lead agency for the development and promotion of a program of energy performance contracts in governmental units. With respect to the program, the DTMB would have to assemble a list of qualified energy service providers through a request for qualifications process and a list of standardized tools and contract templates. The DTMB also would have to develop a standardized contract process and documents, including all of the following:

-- A request for qualifications.
-- An investment grade audit and energy services contract.
-- Guidelines and an approval process for awarding energy performance contracts that allowed the governmental unit to contract with a qualified energy service provider for an audit to be performed at any building, structure, or facility.

("Investment grade audit" would mean a study by the qualified energy service provider selected for a particular energy performance contract project that included detailed descriptions of the improvements recommended for the project, their estimated costs, and the operations and maintenance cost savings and utility cost savings projected to result from the recommended improvements.)

Under the contract, the energy service company would have to prepare a report containing a description of the physical

modifications to be performed to the building, structure, or facility that were required to effect specific future energy savings within a specified period and a determination of the minimum savings in energy use that the governmental unit would realize from making these modifications within that period.

After review of the investment grade audit report and subject to approval, the governmental unit could contract with the energy service provider for construction work to be performed at the building, structure, or facility for the purpose of realizing potential savings of future energy costs identified in the audit, if the DTMB determined that the anticipated savings to the governmental unit after completion of the work would enable recovery of the costs of the work within a maximum of 15 years or the average useful life of the measures.

In addition, the Department would have to promote the energy performance contract program to all governmental units, and make the list of qualified providers, standardized tools, and contract templates available to local units of government and public entities.

The DTMB's criteria for the evaluation of qualified providers could include all of the following substantive factors to assess the provider's capability in the areas of design, engineering, installation, maintenance, and repairs associated with energy performance contracts:

-- Experience in conversions to a different energy or fuel source associated with a comprehensive energy efficiency retrofit.
-- Experience and capabilities in postinstallation project monitoring, data collection, and reporting of savings.
-- Overall project experience and qualifications.
-- Management capability.
-- Experience with projects of similar size and scope.
-- The financial ability to cover energy guarantees, the procurement of bonds or insurance, and the financial ability to cover energy guarantees as demonstrated by audited financial statements.
-- Other factors proposed by a governmental unit and determined by the DTMB to be relevant, appropriate, and related to the ability to perform the project.

The DTMB would have to develop an annual report of total facility capital liability and total dollar amount of completed and substantially completed energy performance contract work. Before December 31 of each calendar year, the Department would have to present the report to the members of the House and Senate Appropriations Committees.

The DTMB also would have to assist governmental units in identifying, evaluating, and implementing cost-savings measures at their facilities. The assistance could include the following:

-- Apprising governmental units of opportunities to develop and finance energy performance contract projects.
-- Providing technical and analytical support, including procuring energy performance contract services.
-- Reviewing verification procedures for energy savings.
-- Assisting in the structuring and arranging of financing for energy performance contract projects.

The Department could charge reasonable fees for any administrative support and resources or other services it provided from the governmental units that used its technical support services. The fees could not exceed the lesser of $300,000 or 2% of the total cost of the contract project. A governmental unit could add the costs of the fees to the total cost of a contract.

Investment Grade Energy Audit

The qualified energy service provider chosen as a result of the process set forth in the bill would have to prepare an investment grade energy audit, which, upon acceptance, would be part of the final contract. The audit would have to include estimates of the amounts by which utility cost savings and operation and maintenance cost savings would increase, and itemized estimates of all costs of the utility cost-savings or energy-savings measures, including all of the following: design, engineering, equipment, materials, installation, maintenance, repairs, and debt service.

Financing

A governmental unit could use designated funds, bonds, or master lease for any energy performance contract, including purchases using installment payment contracts or lease purchase agreements, if that use were consistent with the purpose of the appropriation.

Unless otherwise provided by law or ordinance, a governmental unit could use funds designated for operating and capital expenditures or utilities for any energy performance contract.

A guaranteed energy savings contract could provide for financing, including tax-exempt financing, by a third party. The contract for third-party financing could be separate from the guaranteed energy savings contract.

Contract Requirements

Each energy performance contract would have to provide both of the following:

-- All payments between the parties, except obligations on termination of the contract before its expiration, would be made over time.
-- The objective of the contract was implementation of cost-savings measures and achievement of both utility and operation and maintenance cost savings.

A contract and payments under it could extend beyond the fiscal year in which it became effective, subject to appropriation of money, if required by law, for costs incurred in future fiscal years.

In addition, a contract could provide for payments over a period of time not to exceed deadlines specified in the contract from the date of the final installation of the cost-savings measures.

The term of a contract could not exceed 15 years or the average useful life of the measures. The term also could reflect the useful life of the cost-savings measures.

An energy performance contract would have to require the qualified energy service provider to provide the governmental unit with an annual reconciliation of the guaranteed energy savings based on industry standards. The contract would have to state that the provider would be liable for any shortfall in annual energy cost savings revealed by the reconciliation.

During the term of a contract, at the governmental unit's discretion, the qualified provider or an independent third party would have to monitor the reductions in energy consumption and the cost savings attributable to the cost-savings measures installed pursuant to the contract, and would have to provide a report at least annually to the governmental unit documenting the performance of the measures. The report would have to comply with adopted industry standards as published at the date of the contract.

Scope of Act

The bill provides that nothing in the proposed Act would mandate or could be construed to mandate either of the following:

-- That government units join or pay membership dues to organizations involved in energy efficiency, sustainable development, or similar practices.
-- That government units abide by or otherwise follow international standards related to performance measurement and verification protocol.

Legislative Analyst: Julie Cassidy

FISCAL IMPACT

The Department of Technology, Management, and Budget has stated that it is already in compliance with most of the provisions in the bill regarding energy performance contracts (EPCs). Under Public Act 122 of 1987, the State of Michigan has implemented multiyear, performance contracts to accomplish energy efficiency measures in State-owned buildings. The Michigan Energy Office and DTMB Acquisition Services have assisted State agencies with performance contracting processes. Since the passage of the legislation, the State of Michigan has realized approximately $5.0 million in net savings.

Additional savings to governmental units under the bill cannot be estimated, but likely would be positive compared to the current

baseline over the long term. The savings would be realized from reduced utility costs as well as reduced operation and maintenance costs outweighing the cost of the energy saving measures implemented. The bill's provisions would attempt to ensure that authorized projects realized overall savings, and would require an EPC to provide that the qualified energy service provider would be liable for any shortfall if the annual reconciliation revealed a shortfall in annual energy cost savings determined in the contract. Conversely, if the reconciliation showed an excess in annual energy cost savings, the excess savings could be used to cover potential energy cost-savings shortages in subsequent contract years. The bill also states that a governmental unit could not enter into an EPC for a period of more than one year unless the governmental unit found that the amount it would spend on the cost-saving measures would not exceed the amount to be saved over 15 years from the date of installation.

Finally, the DTMB also has indicated that it does not expect there would be any additional administrative costs under the provisions of the bill. (Department responsibilities are described in the summary above.) Additionally, many of the costs associated with the bill would be offset by the provision allowing the DTMB to charge a reasonable fee that could not exceed the lesser of $300,000 or 2% of the total cost of the EPC.

Fiscal Analyst: Joe Carrasco