

Legislative Auditor's Review of Operation and Maintenance Savings in Energy Efficiency Contracts

This document provides a brief background and criteria for determining whether an operation and maintenance savings guarantee in a state or local performance-based energy efficiency contract is valid.

I. Background – Legal Authority:

Energy efficiency contracts may be entered into by state agencies ([R.S. 39:1496.1](#)) and political subdivisions ([R.S. 33:4547.1](#), [R.S. 33:4547.2](#), [R.S. 33:4547.3](#)). Energy efficiency contracts are statutory exemptions under the Public Bid Law ([R.S. 38:2211-2296](#)) and, therefore, must be strictly followed. Although state and local energy efficiency contracts are governed by different statutes, all statutes require a guarantee encompassing energy savings and operation and maintenance savings. The savings achieved may come from one or the other of these guarantees or a combination of both. The payment obligation for energy efficiency contracts is either set as percentage of savings or:

“Guaranteed by the person under contract to be less than the annual energy cost savings attributable to the services or equipment under the contract.” (See [R.S. 39:1484](#) (14) and [R.S. 33:4547.1](#) B (1).) (Emphasis added.)

Therefore, annual energy cost savings, as defined by statute, must include actual energy savings as evidenced by a lower utility bill and savings on maintenance and operation costs related to the project once the contract is executed. In addition, the local law says that the savings guaranteed in the contract must be measurable and verifiable.

The transactions between the energy service company (ESCO) and the public entity are exempt from the public bid law because the ESCO guarantees the energy savings and the operational/maintenance savings ensuring that no public dollars will be needed in the future to cover any shortfall with regard to the cost of energy or operational/maintenance related to the project. Thus, verification is critical to ensure that savings are actually realized. If the guarantee is unmet as proven through measurement and verification, the ESCO is required to reimburse the public entity the difference, that difference being based on amounts actually guaranteed and the amounts actually achieved. Guaranteed is defined in [R.S. 33:4547.1](#) B (1)(b).

II. History – Problems with Contracts:

The guarantee of operation and maintenance savings component was the focal point of a lawsuit filed by Siemens Business Technologies, Inc. (Siemens) against the Iberville Parish School Board (Iberville) in 2007. See *Siemens Building Technologies, Inc. v. Iberville Parish School Board*, 978 So.2d 328, 2008 WL 1765598 (La.), 2008-0336 (La. 4/4/08). Siemens and Iberville had executed an energy efficiency contract that contained a stipulated savings clause. It stated:

“The Customer and the Contractor agree to stipulate that the Operational Stipulated Savings will be deemed to be achieved upon execution of this Agreement. Neither the Customer nor the Contractor will have any right to object to the use of such amounts as the Operational Stipulated Savings in the calculation of Actual Annual Savings.”

Stipulated savings were to substitute for verified and guaranteed operation and maintenance savings.

The Attorney General (AG) examined the contract and its amendments to determine whether the stipulated savings clause for operation and maintenance savings was tantamount to the guarantees required by [R.S. 33:4547.1](#), *et seq.* In Opinion No. 07-0002, the AG stated that “in order for the operational savings to be guaranteed, the Contract would have to provide for some type of measurement and/or verification of the operational savings, and require Siemens to reimburse Iberville for any deficiency.” Iberville argued to the court that because stipulated savings are not verified they are merely estimates or projected savings.

Prior to the filing of the lawsuit, the LLA’s Advisory Services Division had concluded in a 2006 report examining the contract between Iberville and Siemens that the financial data did not support the required statutory guarantee, [R.S. 33:4547.1](#), *et seq.* The contract and amendment executed between Iberville and Siemens totaled approximately \$4.7 Million. Some of the improvements Siemens was contracted to provide that would yield operation and maintenance savings on an annual basis included the retrofitting of lighting in all facilities, installing an energy management computer system throughout the district, replacing/retrofitting/adding mechanical equipment at certain schools to provide more efficient and reliable HVAC (heating, ventilation, and air conditioning) systems, and providing technical support services.

Although there appeared to be a total guaranteed savings of approximately \$5.5 Million, approximately \$3.4 Million (or 61.4%) of the savings was stipulated and not actually being guaranteed by Siemens. A majority of those stipulated savings were operation and maintenance savings.

III. Legal Guidance:

A. Resolution of Contract Problems – Court Decisions:

The District Court decided in favor of Iberville and found that the contract was invalid because stipulated savings do not satisfy the statutory requirement of a guarantee for operation and maintenance savings. The failure to strictly comply with this statutory exemption invalidates the contract and mandates compliance with the Public Bid Law. [R.S. 38:2220](#) A provides that any contract for public works that is contrary to the law is “null and void.” Siemens’ requests for review and reversal by the First Circuit Court of Appeal and the Supreme Court were rejected.

The challenge posed by verifying operation and maintenance savings is showing costs that have been avoided. For example, such avoided costs may include equipment costs, labor costs, outside contractors and capital expenditures.

State agencies and political subdivisions must carefully construct their energy efficiency contracts to ensure that each savings component is verifiable and that the guaranteed savings have been realized. All energy efficiency contracts should include a version of the following provisions:

B. Measurement and Verification Clause

The contract must include a provision that requires the measurement and verification of both energy savings and operation and maintenance savings. For example,

“Energy-related cost savings and operation and maintenance savings shall be measured and verified on an annual basis.”

Because the public entity will possess much of the information used to determine whether operation and maintenance savings were actually achieved, the contract should require the timely exchange of information between the public entity and the ESCO.

C. Reconciliation and Deficiency Clause:

The contract should include a provision that requires the payment of any deficiency owed in the event the guaranteed savings are not realized. For example,

“In the event the energy-related cost savings and/or operation and maintenance savings achieved during the twelve-month guarantee period is less than the guaranteed energy and operation and maintenance savings, ESCO shall pay to the agency an amount equal to the deficiency within a specified period of time following the annual reconciliation.”

D. Suggested Solutions:

It should be noted that the Legislature made significant changes to the energy efficiency law in the 2008 Regular Session. Among other important requirements, local entities are now required to have a third-party consultant to evaluate submitted proposals. The Commissioner of Administration may also select such consultants on behalf of state entities. The advantage of a third-party consultant is their ability to provide objective standards and measurements to ensure that the savings in the contract are guaranteed, rather than stipulated. With this in mind, here are some suggested solutions to the noted problems with certain energy efficiency contracts:

1. As noted in Section B. and C. above, amend the current contract to remove the stipulated language, and replace said language with objective, measurable savings that are guaranteed, with a restitution clause should the savings not be met;
2. Using objective standards, measure and verify any stipulated savings in past years of the contract;

3. If the contract has already expired, or has been substantially fulfilled, or the stipulated savings of past years cannot be verified by objective and measurable criteria, take an average of the years of guaranteed savings in the contract that can be verified as a benchmark for years that cannot be verified and estimate guaranteed savings you should have received when stipulated savings were a part of the contract;
4. Select an independent third party to verify the guaranteed savings of past and future years; and
5. Submit any contract amendments, or any other action taken, to your attorney for assistance.

IV. Summary

In summary, an energy efficiency contract must contain a guarantee inclusive of energy savings and operation and maintenance savings. Therefore, the components of operation and maintenance savings must be identified and agreed to by the parties prior to the execution of the contract. The costs of these components must be noted at the beginning of and throughout the contract period with some acceptable formula/criteria so that the public entity and the ESCO can determine the amount of annual savings in order that the amount of deficiency to be remitted by the ESCO can also be determined.

In other words, these components must be measurable and verifiable in order for the guarantee to be valid and, therefore, an acceptable legal alternative to the Public Bid Law. Stipulated savings clauses that are mere estimates or projections of savings do not serve as valid guarantees. The contract should require the timely exchange of information between the public entity and the ESCO to determine whether the guarantee has been achieved. Further, although the lawsuit dealt with an energy efficiency contract executed by a political subdivision, it is appropriate to apply the Court's decision to state agencies because of similar language in the statutes as mentioned above.

A further understanding of these issues can be achieved by reading AG Opinion No. 99-0280; AG Opinion No. 07-0002; the Performance Audit Division Information Report on State Energy Efficiency Contracts issued on December 12, 2007, and the Advisory Services Report on Iberville Parish School Board issued on October 18, 2006.

The latest Attorney General Opinion on performance-based energy efficiency contracts, [No. 10-0138](#), opines that the requirements to form a valid performance-based energy efficiency contract are set by statute. Pursuant to statute, the annual energy cost savings must be guaranteed. There is no prohibition against having stipulated savings. However, these stipulated savings must be measured and verified and the contract must contain a mechanism to require a reimbursement for any deficiency and/or default.

The AG also says in [No. 10-0138](#) that the parties of the contract are free to include their understanding as to the measurement and verification of any savings not previously measured or verified in the contract.