

Beware of the Fine Print in Performance Contracts

Lawsuits lurk in these 5 areas of contract language

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Buildings Magazine June 2016

You think you're about to be a hero by entering into an Energy Savings Agreement, (which is supposed to fund improvement projects based on savings). Your long-time law firm reviewed the contracts, and your engineers have signed off. Everything seems positive. So what can go wrong? Actually, quite a bit... and your knowledge can be the difference between having a glowing success or abject failure that could cost you a job, reputation or worse.

In many cases, unless you have spent years in performance contracting, you are not prepared. In fact, very few law firms or engineering firms have handled enough performance contracts to provide useful and efficient advice to avoid "pitfalls". Let's face it- if you are a building owner/manager, it's unlikely you have made a career focus to study performance contracting legal language. In addition- you are at a disadvantage compared to the folks on the other side of the contract, who develop and execute performance contracts all year long.

This article will put you more on an "equal footing" with those that might be offering you a "deal". I have served as an expert witness for energy performance contracts that have gone wrong. I have seen the multi-million dollar consequences when performance contracts are not developed correctly. Besides not achieving the savings claims, paying lawyers is expensive, and there is uncertainty regarding what will happen in the courtroom.

What I am about to tell you was inspired by a recent performance contract that I was asked to review before the contract was signed. Upon review, I could not believe the amount of unclear "boiler-plate" language, which would surely lead to confusion/lawsuit in the future. However, the sad fact is that because few



people are “experts”, the use of outdated and unfair contract templates happens every day. I will point out some of these specific clauses and help you to avoid what could be painful litigation.

FYI- there are state laws, international [standards](#), “best practices” and [certification courses](#) for developing and measuring performance contracts. There are also important things to know about how to interpret the protocols, savings calculations and statistics. However, many municipal and institutional facility managers don’t have the time to master guidelines such as the International Performance Measurement and Verification Protocol (IPMVP). I have organized the key problem-causing issues into the following 5 categories:

- A. Politics and Attention Spans
- B. Equipment / Installation
- C. Estimated Savings
- D. Additional Maintenance/Training Required to Maintain Savings
- E. Measurement and Verification Plan & Procedures

A. Politics and Attention Spans

Achieving energy savings is a “long-term” focus, (analogous to staying physically fit). Because many elected officials may not be in office 7 years into a performance contract, they naturally will not pay much attention to long-term details. This is a widespread problem that applies in municipalities, military bases and even college campuses, where leadership may change hands every few years and mistakes “down the road”, will become a problem for the next manager. For example, in a recent contract, the ESCO proposed to install LED lighting, which will last about 7 years without need for re-lamping. However, when the LEDs do fail, the whole fixture will need to be replaced, which is much more expensive than just putting in new lamps... and someone is going to have to pay for it. This cost represented about \$350,000 during a 20-year contract, replacing the failed LEDs would occur at least twice to maintain the savings. The ESCO had zero dollars budgeted for this, but



claimed all of the energy and maintenance savings (from not having to replace fluorescent lamps and ballasts), which was unfair. These types of misleading “savings estimates” are actually hurting the reputation of the ESCO industry... but the ESCO will do this to remain competitive with another ESCO’s savings claims... and most facility managers will never recognize the problem until it is too late.

B. Equipment and Installation

This really surprises me, but I have recently seen a few Performance Based contracts that were signed BEFORE a detailed cost breakdown was provided. The facility was going to receive “a chiller” and no additional details were provided about the size, operating efficiency, warranty, etc.. *Yes- this actually does happen because the ESCO was pressuring the facility manager for a “commitment” and no one was reviewing the details.* I can understand that everyone appreciates a “fast track” process for performance contracting... however- as an alternative to signing a final performance contract, your facility could show “commitment” by signing a “project development agreement” that would protect the ESCO’s intellectual property as well as the facility’s interest to develop the details. [A sample project development agreement template is provided here.](#)

C. Estimated Savings

“Stipulated Savings” / “Avoided Capital Expenditures”: These are other terms worth understanding within a performance contract. In a recent review, I found that about 50% of the savings were “stipulated avoided capital expenditures” and would not be measured. While I agree that it may not be worthwhile to measure every single piece of equipment within an energy conservation measure, the facility manager should review all stipulated savings and be comfortable with the assumptions...



because some assumed savings might never actually happen! In addition, the language/calculations should be clear enough so that 10 years into a performance contract, a new employee (or ESCO representative) can read and understand (or defend) the calculations. Failure to do so is an opening for a lawsuit. Also- make sure you understand the “escalation rates” that ESCOs typically assign to utility, maintenance and labor costs.

D. Additional Maintenance/Training Required to Maintain Savings

I have seen contracts implying that once the savings are achieved, the savings will continue for the next 20 years. However, (like a diet) savings will only continue if the facility puts some effort/focus on maintaining the savings. Annual training as well as a budget to replace more complex parts is critical to the long-term achievement of savings. If you are installing more sophisticated systems (VSDs, Controls, etc.), you will need to spend more than you are currently spending on maintenance. From my experience- you should plan on re-investing 10-20% of savings towards a budget line item to “maintain” those savings, and the distinction needs to be made between what is “Maintenance” and “M&V”. *The ESCO usually is happy to provide M&V and a “pre-requisite” for the guaranteed savings is that the facility is maintaining the equipment “properly” (a description that lawyers find to be vague).*

E. Measurement and Verification Plan and Procedures

Several “guidelines” or protocols exist to help the facility manager and ESCO navigate deviations from estimated savings due to variances in weather, facility uses, or other changes that always occur. However, because the protocols are constantly improving (for example- IPMVP just launched a 2016 version), it is important to be “up-to-date”. Having a clear instructions and “step by step” methods to calculate savings is



critical to success. There are several organizations that offer training with respect to M&V.

In a recent contract, I thought it was interesting that as a pre-requisite for the guaranteed savings, the ESCO had required the facility pay for M&V as well as preventive maintenance services for the duration of the 20-year contract. However the ESCO's own financial model only accounted for 5 years of such services, and what was missing was worth about \$500,000 in un-budgeted costs to the facility and would result in a voided guarantee (which was the whole reason this municipality was doing the PC)! Fortunately- we got that corrected, but what a mess it would have been.

As I mentioned at the beginning, entering performance contracts can be risky if not done correctly. The above information may help you avoid a mistake when setting up a performance contract, but I also encourage you to review the contracts that you have in place and look for improvement opportunities, which can be worth millions. Ultimately, it makes sense to have someone on your team that has been through a number of energy related performance contracts.

If you want to “learn” and “do it yourself”- take a class on performance contracts. If you are not willing to invest time/focus or pay attention to details, then hire an expert to review your performance contract. *I admit I am biased on this issue, but it would be a greater weight on my conscience if I didn't “shout from the rooftops”... because the industry needs to improve its credibility!*

