EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

October 3, 2012

M-12-21

MEMORANDUM FOR HEADS OF EXECUTIVE DEPARTMENTS AND AGENCIES

FROM: Jeffrey D. Zients
Deputy Director for Management

SUBJECT: Addendum to OMB Memorandum M-98-13 on Federal Use of Energy Savings Performance Contracts (ESPCs) and Utility Energy Service Contracts (UESCs)

This memorandum provides guidance to agencies regarding their entering into Energy Savings Performance Contracts (ESPCs) and Utility Energy Service Contracts (UESCs) for energy efficiency and new renewable power generation. In so doing, this memorandum supplements the OMB guidance in Memorandum M-98-13, *Federal Use of Energy Savings Performance Contracting*, which remains in effect and is enclosed. This guidance covers conditions of using ESPC and UESC authority and extends the budget scoring treatment prescribed in OMB Memorandum M-98-13 to include UESCs and onsite energy sources in ESPCs, if they meet the four criteria described below.

This memorandum sets forth, below, the conditions under which the budget costs of ESPCs and UESCs – including their total capital costs – may be scored (and obligated) on an annual basis during the term of the contract, rather than have these costs be fully scored (and obligated) "up front" to the first year of the contract, as would be the standard scoring under OMB Circular A-11. Under this scoring, an agency must obligate, at the time the contract is executed, sufficient discretionary budgetary resources to cover the agency's contract payments during the fiscal year in which the contract is signed. For each of the subsequent fiscal years during the contract period, the agency must obligate for such fiscal year the full amount of the contract payments that the agency is required to make during that year.

I. Conditions for Annual Scoring of ESPCs

The authority for ESPCs is established in the National Energy Conservation Policy Act, as amended. (*See* 42 U.S.C. § 8287 *et seq*.) The regulations implementing the ESPC statutory authority are located at 10 C.F.R. Part 436, subpart B.

An *energy conservation measure* (ECM) is a measure that is applied to a Federal building that improves energy efficiency, is life-cycle cost effective, and involves energy conservation, cogeneration facilities, renewable energy sources, improvements in operations and maintenance efficiencies, or retrofit activities. *See* 42 U.S.C. § 8259(4).

An ESPC is a contract that provides for the performance of services for the design, acquisition, installation, testing, and, where appropriate, operation, maintenance, and repair, of an identified energy conservation measure (ECM) or series of ECMs at one or more locations. 42 U.S.C. § 8287c(3).

For an *onsite energy source* to qualify as an ECM, it must meet the four criteria specified in the statutory definition. Under these criteria, the arrangement must –

(1) be "applied to a Federal building";

(2) "improve energy efficiency";

(3) be "life cycle cost effective"; and

(4) involve energy conservation, cogeneration facilities, renewable energy sources, improvements in operations and maintenance efficiencies, or retrofit activities.

The following is additional guidance with respect to these four criteria:

(1) *"Applied to a Federal Building"*

- The term "Federal building," as defined in the context of an ESPC, includes a "facility, or part thereof . . . , which consumes energy." 42 U.S.C. § 8259(6).

- Accordingly, an energy source that both supplies energy and is installed on the Federal site (but is not necessarily located on or in an actual structure) would be considered to be "applied to a Federal building."

(2) *"Improves Energy Efficiency"*

- An onsite energy source would be considered to "improve energy efficiency" if it would decrease the amount of energy required by a Federal building to maintain its same level of operation. That is, if the arrangement resulted in reduced energy consumption while allowing the same level of building performance, the arrangement would be considered to improve energy efficiency.

- In determining whether an ECM qualifies for the energy efficiency definition, calculations may be done on either a "site energy" basis or a "source energy" basis. Source energy is a more detailed means (than is site energy) for evaluating a building's resource-use efficiency performance, because "source energy" accounts for the embedded inefficiencies of transmission, distribution, and conversion.

- For example, when onsite renewable energy is substituted for conventional energy fuels, the substitution would in most cases reduce total system demand (due to

reduced line losses from transmission) and thus would "improve energy efficiency" in terms of system-wide energy used to perform work.

(3) *"Life-Cycle Cost Effective"*

- The term "life-cycle cost," as defined in the context of an ECM, means the total costs of owning, operating, and maintaining a building over its useful life (including such costs as fuel, energy, labor, and replacement components) determined on the basis of a systematic evaluation and comparison of alternative building systems.

- Savings that result from the life-cycle cost effectiveness of ECMs must be guaranteed in the ESPC and must cover the full cost of Federal investment for improvements.

- Accordingly, an *onsite energy source* would be considered life-cycle cost effective if it results in the reduction in the total cost of owning, operating, and maintaining a Federal building, as compared to a baseline in which the existing energy source and related energy support structure is maintained, including any marginal disposal costs.

(4) *Permissible Types of Activities*

The fourth element of the ECM definition is that an arrangement must involve energy conservation, and may include cogeneration facilities, renewable energy sources, improvements in operations and maintenance efficiencies, or retrofit activities.

II. Conditions for Annual Scoring of UESCs

A UESC is a contract between a Federal agency and a local utility providing energy, water, or sewage services, as well as provision of technical services and/or upfront project financing for energy efficiency, water conservation, and renewable energy investments, allowing Federal agencies to pay for the services over time, either on their utility bill, or through a separate agreement.

UESCs that meet the criteria prescribed in this memorandum, and follow the guidance prescribed in M-98-13, can receive the same budget scoring treatment as ESPCs. Through this authority, a UESC may be scored on an annual basis if the UESC requires:

(1) energy savings performance assurances or guarantees of the savings to be generated by improvements, which must cover the full cost of the Federal investment for the improvements;

(2) measurement and verification (M&V) of savings through commissioning and retro-commissioning; and

(3) competition or an alternatives analysis as part of the selection process prior to entering into a UESC.

III. Procurement

When entering into ESPC and UESC procurements, unless otherwise exempt, agencies shall adhere to the Federal Acquisition Regulation (FAR), including appropriate application of FAR Part 8, Required Sources of Supplies and Services and Subpart 23.2, Energy and Water Efficiency and Renewable Energy.

For an ESPC or UESC that includes *onsite energy generation* to be scored on an annual basis under this memorandum and M-98-13, the Federal government must retain title to the installed capital goods at the conclusion of the contract. (Lease arrangements, where the Federal government does not retain title, will be scored under the standard leasing scoring rules described in OMB Circular A-11 Appendix B, which for capital leases requires that agencies have sufficient resources to cover the full cost of the contract when the contract is signed, rather than applying the scoring exceptions in M-98-13.)

IV. Off-Site Generation or other Arrangements

This memorandum does not specifically and separately address power purchase agreements (PPAs), and they are not independently covered by the guidance in M-98-13. ESPCs and UESCs are solely for the purpose of achieving energy savings and benefits ancillary to that purpose. To qualify for the scoring on an annual basis covered under this memorandum and M-98-13, ESPC and UESC authority may <u>not</u> be used for the long-term purchase of off-site new renewable generation or to build merchant scale power generating facilities on federal land. In advance of award, summaries of all lease arrangements related to power purchase agreements should be submitted to OMB and the Department of Energy Federal Energy Management Program (FEMP), as noted in the OMB-CEQ Memorandum of August 16, 2011, on *Supporting, Energy and Sustainability Goal Achievement Through Efficiency and Deployment of Clean Energy Technology* (also enclosed).

V. Coordination and Reporting

FEMP's mission is to assist agencies to maximize federal energy efficiency and to provide assistance on the use of these tools by providing education and training, best practices and model contracts. FEMP will also assist OMB in providing oversight to ensure that the guidance is followed, and that agencies are on track to achieve their targets toward the President's $2 billion performance-based contracting goal for energy savings.

Agencies should take advantage of FEMP expertise, ensure compliance with this and other guidance, and use the OMB MAX Collect reporting tool to streamline the reporting process and reduce the burden of duplicative reporting. Agencies are required to provide monthly updates to agency implementation plans and track milestones for individual projects underway to meet the President's goal.

Agencies should keep FEMP updated and apprised of all contract actions and awards, regardless of the contracting agency, that are part of the $2 billion commitment.

Enclosures:

Memorandum M-98-13:
http://www.whitehouse.gov/sites/default/files/omb/assets/omb/memoranda/m98-13.pdf

Memorandum of August 16, 2011:
http://www.whitehouse.gov/sites/default/files/omb/procurement/memo/supporting-energy-and-sustainability-goal-achievement-through-efficiency-and-deployment-of-clean-energy-technology.pdf

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

July 25, 1998

M-98-13

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.

MEMORANDUM FOR AGENCY SENIOR SUSTAINABILITY OFFICERS

FROM: Nancy Sutley, Chair, Council on Environmental Quality

Sally Ericsson, Associate Director for Natural Resources, Energy and Science Programs, Office of Management and Budget

DATE: August 16, 2011

SUBJECT: Supporting Energy and Sustainability Goal Achievement Through Efficiency and Deployment of Clean Energy Technology

The Administration is committed to making the Federal government a leader in energy efficiency and sustainability, including making the Federal Government itself cleaner, greener, and more efficient. That is why we want to make it clear that the Obama Administration continues to support implementation of OMB Memorandum M-98-13, *Federal Use of Energy Savings Performance Contracting*, issued on July 25, 1998, to increase Federal use of Energy Savings and Performance Contracts (ESPCs).

Executive agencies have been asked to lead by example to increase energy efficiency, reduce greenhouse gas emissions, and promote sustainability, consistent with Executive Order 13514, "Federal Leadership in Environmental, Energy, and Economic Performance," issued on October 5, 2009. Upgrading the energy performance of Federal buildings can be one of the fastest and most cost-effective ways to reduce energy costs, combat pollution, and create local jobs.

To meet our stated goals, Executive agencies should prioritize building upgrades with the highest return on investment, and responsibly fund capital improvements and services that will yield future savings and sustainability performance improvements. While the best return on these investments is often a result of carefully planned projects funded directly with agency dollars, effective and responsible use of available statutory authorities and contracting tools can leverage private investment. ESPCs and Utility Energy Services Contracts (UESCs) are important tools to help meet identified energy management goals while deploying clean energy technology. These contracts use qualified private sector firms and utilities to design and construct energy upgrade projects, which are financed based on the energy and water and other cost savings they will generate. OMB Memorandum M-98-13 provides guidance for developing and entering into these contracts. That guidance remains in effect, and agencies are encouraged to consider the responsible use of performance-based contracts that offer private-sector investment in energy and water conservation and renewable energy projects as part of their portfolio of tools to implement their Strategic Sustainability Performance Plans.

The Federal Government is the world's largest single consumer of energy, incurring approximately $20 billion in energy costs in FY 2010 alone. Of that, $7 billion was for energy consumption in Federal buildings. As directed in Executive Order 13514, Executive agencies should lead in employing strategies to improve energy management.

Effective management and coordination is necessary to ensure that the various tools for energy performance improvements are employed effectively and deliver on long-term energy cost savings to the benefit of the American taxpayer. ESPCs can incorporate purchase of on-site renewable energy, if the result is lower energy consumption and costs to the Government, but the complexity of power purchase agreements (PPAs) deserve special consideration. Agencies should therefore submit to OMB for review all proposals for PPAs entered into under ESPC authority, or that would otherwise require review as a non-routine financing proposal under OMB Circular A-11, Appendix B. OMB will review existing practices for PPAs and consider whether additional guidance is necessary to ensure maximum efficiency in the use of Federal funds.

To increase transparency and accountability, OMB is asking the Department of Energy's Federal Energy Management Program (FEMP) to report annually on Government-wide use of ESPCs and UESCs, including aggregate energy performance improvement, increased renewable energy production at Federal facilities, and cost savings achieved through the use of these tools. These tools have already been proven effective in many circumstances. Since 2003, almost half of Federal facility investment in energy efficiency has been made through ESPC and UESC use, covering projects in 49 States and US facilities overseas, and representing every Federal agency that owns and operates buildings. In their sustainability plans, agencies are encouraged to explore leading-edge technologies in order to leverage this opportunity to drive American innovation, support entrepreneurship, and demonstrate the benefits of these new practices and technologies. Agencies should consider consulting with FEMP at the planning stages of their projects to both take advantage of FEMP expertise and to reduce the burden of meeting the reporting requirements.