Déjà Vu for Chauffage

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Years ago, in distant memory for some and before many energy analysts were in kindergarten, there was an oil embargo. Supplies became scarce and prices soared. A routine part of the lives of most people became a significant concern.

All sorts of change took place as a result. People modified behaviors according to the principles of economics. Technologies were discovered in keeping with the principles of science. Governments imposed rules by the principals of politics.

New businesses were formed and different ways of doing business evolved. Arriving in the mid-70s, one of these new businesses was called Scallop Thermal. It was a sister company to Shell Oil. Actually, it was an import by Royal Dutch Shell from Europe to the U.S.

PERFORMANCE CONTRACTING

Scallop Thermal introduced a concept with a French name called chauffage (show-FAZH). Under the practice of chauffage, facility owners would outsource the operation and maintenance of their facilities. In addition, the chauffagist, to coin a term, would invest in upgrades to the physical plant such as lighting, air conditioning, and heating. These services would be provided for a fee which the facility manager expected to pay out of savings in energy bills.

The concept was slow to catch on in the U.S. In a few years Scallop Thermal abandoned the market, yet others came along and made a business out of what came to be performance contracting.

Under performance contracting, the facility owner pays for measured savings. The performance contractor in turn undertakes energy upgrades with the expectation that the returns will be profitable over time.

A variety of savings plans can be structured. A share of the energy bill savings may be negotiated, or the agreement may be for some level of guaranteed bill savings with surplus savings or shortfalls at risk for the performance contractor. The guarantee may be for energy as opposed to financial savings, since the long terms of most contracts can witness unexpected changes in utility costs.

Utilities became very active in the ESCO market. At one time over two-thirds of the utilities operated an ESCO as an unregulated affiliate or regulated business. Utilities now account for about 100 ESCOs in the U.S. However, they are quite varied in terms of target markets, types of customers, technology specialties, financial arrangements, and other business practices. One utility ESCO concentrates on refrigeration equipment for supermarkets and has purchased several contractors with expertise in those systems.

SUPER ESCOS

With the advent of utility deregulation, super ESCOs have arrived. The main difference is the addition of commodity services. Thus the super ESCO provides both energy infrastructure upgrades on a performance basis as well as manages the purchasing of energy to operate the facility.

The players in this market often have national or large regional enterprises. They also seek clients with multiple facilities to help spread the risks as well as increase the rewards. Size is important because the transaction costs can be high as the sales cycle is long,

TOTAL ENERGY MANAGEMENT

A further evolution is underway called total energy management or total environmental management. Under this arrangement, ESCOs offer added services to assume the total energy management of facilities.

In addition to maintaining and repairing equipment as is common with super ESCOs, the total energy management companies take over operations or energy consumption. It can also extend to paying bills on behalf of the facility owner. Given the expertise of the total energy manager, bill savings can be substantial through auditing and correction of rate misapplications, meter reading errors, and billing mistakes.

These billing services fit nicely with the commodity purchasing service since the agent may be able to aggregate loads from other clients and obtain better energy prices. In addition, robust energy information systems may be included in the package to allow the facility manager and the energy manager to better document performance and improve operations.

COMPLETE CHAUFFAGE

The next step in the evolution of energy management performance contracting is just starting to emerge. It is perhaps the most dramatic and intriguing development in recent years.

The next step is to completely outsource the energy management function including ownership of the infrastructure. The mechanical, electrical and other energy systems will be owned by a third party other than the facility owner and the energy supplier. Furthermore, it does not need to be limited to energy systems. Infrastructure ownership may include water and wastewater systems as well as telecommunications systems.

This outsourcing of utility infrastructure in being structured using the practice of mezzanine financing. As the term implies it is an intermediate type of financing between equity and debt. More particularly it allows a third party to own the energy infrastructure.

BENEFITS TO FACILITY OWNERS, ENERGY MANAGERS, INVESTORS

Facility managers can find such arrangements attractive for several reasons. First, it reduces their equity participation and the amount of debt required. Second, it allows them to focus on their core business of real estate and facility management, while others focus on their core strengths in energy management.

The facility owner can structure performance arrangements to insure that comfort conditions, operating schedules and other needs are met. In effect the facility manager is buying heating, lighting, cooling. and other utility services.

Several large ESCOs are linking up with financial experts to offer this complete outsourcing service. An attraction to the traditional ESCO is that a financial expert in mezzanine financing coupled with an understanding of real estate risks can find rates that are more attractive than otherwise available. And investors with a knowledge of real estate coupled with an expertise in energy management can provide facility owners with lower operating costs and higher returns on the investments for all parties.

Chauffage is a good term to apply to this concept of complete outsourcing of energy management, including ownership, of the utility infrastructure. Resurrecting chauffage, which is an elegant term, seems appropriate for such an elegant concept. Since the old usage of chauffage died with the exit of Scallop Thermal, it is time to reintroduce it here at the beginning of the millennium as a new and better concept. Try it, you'll like the sound. Chauffage!

ABOUT THE AUTHOR

Larry B. Barrett is president of Barrett Consulting Associates, Inc., Colorado Springs, Colorado, and consults on planning, implementing, marketing and evaluating programs for energy efficiency. He consults with utilities, research institutes, government agencies, and energy management businesses.

Prior to establishing his consulting practice in 1989, Mr. Barrett served for more than 10 years as the manager of Energy Management Programs for the Potomac Electric Power Company. Experience with the utility and since has encompassed residential, commercial, and industrial programs for energy efficiency and marketing including energy service companies.

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