

Minimizing Risks in Performance Contracting Projects: A Customer Checklist

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OVERVIEW

Performance contracting (PC) is the process of providing guaranteed facility improvements that typically require no up-front capital. Since the savings generated from this process pay for the costs of the improvements, these types of projects are fiscally attractive. This is especially true for owners or entities that have very little or no capital to finance much needed improvements. Ensuring success with a performance contract is, however, an ongoing process starting with the company selection, through project design, implementation and contract maintenance. As the number of companies offering these type of services is increasing everyday, and their approach, track record, and offerings vary, a client is challenged with asking a lot of questions en route to selecting and maintaining the right partner.

All aspects of a PC agreement are defined in a contract. Understanding this contract is the client's biggest challenge. A typical contract has five separate sections dealing with 1) Contract Terms & Conditions; 2) Scope of Work, 3) Performance Guarantee, 4) Baseline, Measurement & Verification, and 5) Financial Analysis. Complying with all the stated objectives of the contract and ensuring that the financial and performance guarantees are met requires considerable effort by both the Energy Service Company (ESCO) and the client.

This article will provide simple checklists for each aspect of the PC process starting with the qualification process. The checklist will detail questions that can provide tremendous insight on a company, their approach to the business, specific details about your project, and their long term commitment to your project. As the contract is the legal document

that binds the ESCO to a project, this article will provide detailed checklists for each of the five sections of the contract to ensure that all aspects of the contract are well understood and agreed by both parties. This is the only means to achieve a long-term successful partnership!

QUALIFICATION

The first step in a successful performance contract is selecting a company that is qualified and has the proven track record in performance contracts. This is critical, as you are just about to launch into an agreement that could be 10 to 25 years long. The following checklist is designed to help with the qualification process and should be filled out for every company that you are evaluating. A score card for each company will bring out their strengths and weaknesses. Keep in mind that this is only a sample of the questions you can ask, and a more specific list can be utilized for your particular facility or specific situation.

- √ Dedicated Business Unit
- √ Age of Company
- √ Total Annual Sales
- √ Annual Performance Contracting Sales
- √ # Years Offering Performance Contracting Services
- √ # Total Performance Contracts
- √ # Performance Contracts in Your Region
- √ # Performance Contracts in Your Vertical Market
- √ Accredited by NAESCO (National Association of Energy Service Companies)
- √ Location of Office to Manage Project
- √ Ability to Service Installed Equipment
- √ # PC Projects Canceled in the Last 5 Years and Their Reasons
- √ % of PC Projects Not Meeting Guarantee
- √ # Total Worldwide Employees
- √ # Employees Dedicated to PC
- √ # Certified Energy Managers
- √ # Professional Engineers
- √ Firm providing Guarantee, ESCO or 3rd party?
- √ Ability to Bond 100% of the Project
- √ Portfolio of Service Offerings

- √ Project References
- √ Ability to Implement Energy Awareness and Education Program
- √ Ability to Provide Supply Side Services

Contract Terms & Conditions

The most important aspect of any performance contract as with any legal contract is understanding the information contained in the contract. As a potential customer about to sign a multi-million dollar contract, it is imperative that the terms and conditions of the contract be clearly understood. As the information you need is described in various parts of the contract and not all on one page, it is important to take the time to read the contract in detail. It is always recommended to have your attorney review the contract. The following checklist will help simplify the details of the contract.

- √ Get the ESCO to explain the terms of the contract.
- √ What is the length of the performance contract?
- √ When does the contract start?
- √ What is the installation time frame?
- √ When does the guarantee start?
- √ When does the 1st payment occur?
- √ When does the service and/or monitoring contract start?
- √ What is the term of the annual service and/or monitoring contract?
- √ What happens when the project installation time frame is not met?
- √ Is the contract price guaranteed?
- √ Are taxes and all fees included in the contract price?
- √ What is the overall project warranty?
- √ Does the contract insurance coverage meet your requirements?
- √ Does the contract explain how possible disputes will be addressed?
- √ Has your attorney reviewed the contract?
- √ What are the responsibilities of the customer and the ESCO?

Scope of Work

The scope of work is the heart of the project. It must be well defined and clearly established so that all parties understand it. The following checklist will ensure that the scope is provided in detail and the work to be performed will be done in an efficient manner.

- √ Is the scope of work provided in detail?
- √ Does the scope follow all pertinent codes and regulations?
- √ Is the scope of the project in line with your facility goals and objectives?
- √ Has the project been fully designed?
- √ Will stamped drawings be provided for the project?
- √ Is a dedicated project manager assigned to the job?
- √ When will the work be performed?
- √ Has a detailed project work schedule been provided?
- √ What interruptions will it cause your facility?
- √ Is a performance and payment bond included in the project?
- √ Who will issue the permits on the project?
- √ What are the access and space requirements of the project?
- √ How many subcontractors will be used on the job?
- √ Will any part of the work require customer to shift or stop normal business activity?
- √ Does the scope include cleanup of hazardous materials such as PCBs?
- √ What training will be provided as part of the performance contract?
- √ Is a customer employee required on-site during project installation?
- √ Is an energy awareness or education program included as part of this project?
- √ What are the owner's operation and maintenance requirements?

Performance (Savings) Guarantee

As the savings or performance is guaranteed as a result of a performance contract, the terms of the guarantee should be clearly spelled out, including what is guaranteed, clauses for shortfalls, and excess savings. The checklist below is designed to provide clarifications on guarantees.

- √ Who provides the guarantee? ESCO or 3rd party?
- √ What is the length of the guarantee?

- √ Is there a guaranteed savings bond on the project?
- √ What is the projected total annual savings?
- √ What is the guaranteed total annual savings?
- √ What is the breakdown of energy and nonenergy (operational) cost savings?
- √ What is the breakdown of savings by energy and unit type?
- √ Are the non-energy savings guaranteed?
- √ Are installation savings guaranteed?
- √ What happens when a savings shortfall occurs in any year?
- √ What happens when excess savings occur?
- √ Can excess savings be carried forward?
- √ Can excess savings in future years be used to offset past shortfalls?
- √ Is there a clause for shared savings? If so, what is the breakdown?
- √ Do the shared savings occur when the savings exceed projected or guaranteed savings?
- √ What conditions will void the guarantee?

Measurement & Verification (M&V)

Savings cannot be verified without first identifying a baseline for comparison. Although there are different ways of measuring and verifying savings and performance, it is important to use the method that is best understood and accepted by the involved parties. The checklist below will aid in asking the right questions when dealing with baselines and M&V.

- √ What is the baseline year for comparison?
- √ How was the baseline derived?
- √ What parameters were utilized to arrive at the baseline—sq. ft., hours of operation, number of occupants, weather, production output, etc.
- √ How will savings be verified and what methodology will be utilized?

- √ Will the M&V methods comply with the International Measurement & Verification Protocol?
- √ What changes to the facility constitute an adjustment to the baseline?
- √ How will adjustments be made?
- √ What utility rates will be used to calculate savings?
- √ What happens if utility rates increase or decrease?
- √ How were operational cost savings derived?
- √ Is an annual escalation utilized for savings?
- √ How often will savings be reported and reconciled?
- √ Is a 3rd party verification included in the contract?

Financial Analysis

This section typically details the contract amount and payment terms, but does not always include a cash flow which details the yearly payment and savings profile. This is a vital component of a performance contract, as the savings generated each year should offset the payment and service costs. Even if the details of the financial analysis are not all included in the contract, an owner should obtain the following information for the particular project, as it will have a net economic impact on the project.

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|---------------------------------|-------------------------------|
| √ Total Project Cost | √ Equal or Graduated Payments |
| √ Term of the Agreement | √ Date of 1st Payment |
| √ Nominal Interest Rate | √ Total Project Savings |
| √ Effective Interest Rate | √ Total Project Payments |
| √ Length of Construction Period | √ Net Project Cash Flow |
| √ Loan Buydown Amount | √ Project Payback |
| √ Amount of Project Rebate | √ Net Present Value |
| √ Type of Financing | √ Return on Investment |
| √ Payment Frequency | √ Internal Rate of Return |
| √ Payment in Advance or Arrears | |

SUMMARY

Performance contracting is an excellent means of achieving both energy efficiency and much needed facility improvements through guaranteed results.

Though the performance contractor assumes the majority of the risks associated with a project, a customer is tasked with several critical components in implementing a successful project. This starts with selecting the right long-term partner with whom the customer achieves its facility goals and objectives through a team approach. A good relationship is critical as this partnership is built on trust and understanding and unless the parties are comfortable with each other, the long-term success of the project could be in jeopardy.

The contract is the legal binding agreement between a customer and a performance contractor. A thorough understanding of the various terms and conditions, along with details of project scope, performance or savings guaranteed, method of establishing and verifying these savings, and financial impact can be obtained by asking the right questions. As you are in the process of signing or endorsing a multi-year, potentially multi-million performance contract, asking the right questions can help you minimize risks, and select and maintain the right long term partner to achieve your facilities' objectives through the implementation of a performance contract. Guaranteed!

ABOUT THE AUTHOR

Mahesh Tharoor is a consultant with Johnson Controls specializing in performance contracts. He has over 8 years of experience in the performance contract arena and has been involved in over 40 projects encompassing over \$50 million dollars worth of improvements. He is a Certified Energy Manager (CEM), a Certified Demand-Side Management Professional (CDSM), a Certified Lighting Efficiency Professional (CLEP), and an EPA Green Lights Surveyor Ally. Mahesh holds a BS and MS in industrial engineering and management from Oklahoma State University.

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