

Green Building Newsletter

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To our clients and friends:

We are pleased to present you with our October Issue of Mintz Levin's Green Building Newsletter.

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Law and Policy Updates

Overview of Energy Savings Performance Contracts

BY DAREN GRAHAM

Energy savings performance contracts (ESPCs) are partnerships between energy services companies (ESCOs) and their customers for the purpose of financing and implementing cost-saving energy efficiency improvements. An ESCO's principal service under an ESPC is the development, design, engineering, and installation of projects that reduce the energy and operations and maintenance (O&M) costs of customers' facilities. These projects typically include a variety of measures customized for the facility and designed to improve the efficiency of major building systems, such as heating, ventilation, air conditioning, and lighting systems. When they enter into ESPCs, ESCOs typically commit to their customers that the energy efficiency projects will satisfy agreed-upon performance standards upon installation or achieve

specified increases in energy efficiency. In most cases, the forecasted lifetime energy and operating cost savings of the energy efficiency measures will defray all or almost all of the cost of such measures. In many cases, ESCOs can assist customers in obtaining third-party financing for the cost of constructing the facility improvements, resulting in little or no upfront capital expenditure by the customer. After a project is complete, most ESCOs have the capacity to operate, maintain, and repair the customer's energy systems under a multi-year O&M contract if the customer desires such services. The market for ESPCs has seen significant growth in recent years, driven largely by rising energy prices, advances in energy efficiency and renewable energy technologies, governmental support for energy efficiency programs, and growing customer awareness of energy and environmental issues. End-users, utilities, and governmental agencies are increasingly viewing energy efficiency measures as a cost-effective solution for saving energy, renewing aging facility infrastructure, and reducing harmful emissions.

The first step for a potential customer in determining whether an ESPC is a viable solution is to conduct an internal audit of its facilities, staff, and financial position. Conditions that make entering into an ESPC favorable include:

- aging buildings and equipment,
- recurring maintenance problems or high maintenance costs,
- limited budgetary resources,
- lack of energy management expertise among staff,
- no recent upgrades to lighting or controls systems, and
- energy-using equipment that is ready for replacement.

If it is determined that an ESPC is a viable solution, the customer will generally prepare a request for proposal (RFP) that will help identify interested ESCOs and their project proposals. In addition to setting ground rules for the project, an RFP should also include information regarding the facility, such as energy use, existing equipment, operating schedule, maintenance problems, and planned equipment replacement or renovation plans. Interested ESCOs will typically want to visit the facilities and interview facility staff before submitting a response. The winning ESCO will conduct a much more detailed energy audit and use that audit for the basis of the project costs included in the revised and final proposal. The cost of the detailed audit should be rolled into the cost of the ESPC; however, it is common for ESCOs to require that customers pay for the audit out-of-pocket if an ESPC is not ultimately entered into. ESPC payback terms can range from a few years up to 20 years in some instances. Therefore, choosing the right ESCO is a very important step, as the customer and the ESCO may be partners in the energy savings project for a relatively long period of time.

Once an ESCO has been selected and a detailed energy audit conducted, an ESPC will be negotiated by the customer and the ESCO. The terms of the ESPC will govern the development, design, engineering, and construction of a project and also guaranty that the project will satisfy agreed-upon performance standards. Commitments generally fall into three categories: pre-agreed, equipment-level, and whole building-level. Under a pre-agreed energy reduction commitment, the customer reviews the project design in advance and agrees that upon or shortly after completion of installation of the specified equipment comprising the project, the commitment will have been met. Under

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an equipment-level commitment, the ESCO commits to a level of energy use reduction based on the difference in use measured first with the existing equipment and then with the replacement equipment. A whole building-level commitment requires demonstration of energy usage reduction for a whole building, often based on readings of the utility meter where usage is measured. Depending on the terms of the ESPC, the measurement and demonstration may be required only once, upon installation, based on an analysis of one or more sample installations, or may be required to be repeated at agreed upon intervals, generally over the term of the ESPC.

ESCOs typically do not take responsibility for a wide variety of factors outside their control, and attempt to exclude or adjust for such factors in ESPCs. These factors include variations in energy prices and utility rates, weather, facility occupancy schedules, the amount of energy-using equipment in a facility, and failure of the customer to operate or maintain the project properly. In addition, performance commitments typically apply to the aggregate overall performance of a project and not to individual energy efficiency measures. Therefore, to the extent an individual measure underperforms, it may be offset by other measures that overperform during the same period. If an energy efficiency project does not perform according to the agreed-upon specifications, ESPC terms typically allow ESCOs to satisfy their obligation by adjusting or modifying the installed equipment, installing additional measures to provide substitute energy savings, or paying the customer for lost energy savings based on the assumed conditions specified in the agreement. Upon completion of the project, customers must ensure that facilities are operated and maintained as called for in the ESPC, as failure to do so will most likely relieve the ESCO of some or all of its responsibilities under the energy savings guaranties.

As discussed in this overview, ESPCs can be an excellent alternative for financing capital improvements to the energy infrastructure of large-scale facilities in certain circumstances, so long as care is taken in determining whether an ESPC is the appropriate solution for a facility's needs, requesting proposals from interested ESCOs, selecting the ESCO that will perform the project, and operating and maintaining facilities following completion of the project. If you are interested in learning more about ESCOs and ESPCs, or have specific questions about whether an ESCO may be the right solution for your facility, please contact Daren Graham at DGraham@mintz.com or (617) 348-1754.

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Texas Oil Companies Seek Repeal of California Global Warming Law

BY GABRIEL SCHNITZLER

Texas oil companies Valero Energy Corporation and Tesoro Corporation are largely [bankrolling](#) Proposition 23, which would effectively repeal AB 32, California's global warming law. Marketed as the "[California Jobs Initiative](#)," Prop. 23 would suspend AB 32 until California unemployment falls below 5.5% for four consecutive quarters, something that has happened only rarely. If Prop. 23 fails, AB 32's cap and trade system could come into effect in 2012.

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Texas oil and their allies are likely not concerned that the world will end if AB 32 is implemented. Rather, they are worried that it won't, and that a cap and trade system could come online in the nation's most populous state, achieving significant reductions in carbon emissions and creating alternatives to fossil fuels without material economic costs.

Opposition to Prop. 23 is being led by [Californians for Clean Energy and Jobs](#), a coalition of business, health care, and environmental groups. Former Reagan administration Secretary of State [George Schultz](#) is an honorary co-chair of Californians for Clean Energy and Jobs.

Parochially, what will Prop. 23 mean for green building in California if passed? In the short run, effects would likely be minimal. California's new [Green Building Code](#) and its [Title 24 energy efficiency standards](#) do not derive their statutory authority from AB 32, though these regulations support AB 32 implementation.

[SB 375](#) is a closer call. This legislation requires the California Air Resources Board (CARB) to set regional greenhouse gas reduction targets for 2020 and 2035, requires regional planning agencies to formulate plans for meeting these targets (known as "sustainable communities strategies"), allocates transportation dollars in accordance with these plans, and provides limited California Environmental Quality Act (CEQA) relief for certain projects supporting the greenhouse gas reduction targets. The overall goal of this legislation is to reduce greenhouse gas emissions by encouraging denser, more transit-oriented development. SB 375's scope is modest and imperfect—the CEQA relief it provides for transit oriented/infill projects is very limited and narrowly targeted. Further, while SB 375 allocates transportation dollars in accordance with sustainable communities' strategies for meeting greenhouse gas targets, it does not require cities and counties to adopt zoning consistent with these strategies. However, SB 375 is a critical first step towards reducing sprawl. If passed, Prop. 23 may create opportunities for challenging SB 375 implementation. SB 375 is separate legislation from AB 32, the state global warming law, but it was adopted in part to achieve the greenhouse gas emissions goals of AB 32. It is unclear how CARB will adopt the regional greenhouse gas reduction targets contemplated by SB 375 if the legislation setting those targets (AB 32) is suspended.

In the longer run, Prop. 23's passage could slow green building efforts in California. AB 32 would entirely change the paradigm in the state by putting a cap on carbon emissions and reorienting the state economy towards reduced emissions. Without AB 32, this overarching framework, predictability, momentum, and scale will be lost.

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More Obstacles to AB 32 Implementation

BY GABRIEL SCHNITZLER

Even if AB 32 survives the Proposition 23 challenge, there will be at least two further roadblocks to AB 32 implementation. First, Alabama and Texas (formerly champions of states' rights), along with Nebraska and possibly North Dakota, may be planning to sue if Prop. 23 fails, on the theory that AB 32 violates the commerce clause of the U.S. constitution. Details [here](#). Second,

Meg Whitman has said that if elected, [she would suspend implementation of AB 32 for one year](#), which is permitted by the statute. If elected, it is also likely that her administration would be less enthusiastic about implementing AB 32 than Governor Schwarzenegger or Democratic gubernatorial candidate Jerry Brown.

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Fannie Mae Regulators Shut Down Clean Energy Funding Program

BY GABRIEL SCHNITZLER

Pioneered in Berkeley, local Property Assessed Clean Energy (PACE) programs sought to reduce the financial obstacles to energy efficiency and clean energy retrofits of residential and commercial buildings by allowing the cost of such improvements to be financed via a municipal bond issue, and repaid by a property tax assessment on the home or property on which the efficiency or clean energy retrofits were constructed. The advantage of this financing method is that the interest rate would likely be lower than with conventional financing, and the loan would not need to be repaid upon a sale of the property, as the assessment would simply remain in place following the sale until the loan was fully repaid.

The Federal Housing Finance Agency (FHFA), regulator for Fannie Mae, has taken the position that PACE assessment liens are not permitted for mortgages bought by Fannie or Freddie, since (like any other property tax) they would be superior in priority to the lien of a mortgage. So far, advocates for PACE have been unable to get FHFA to back off from this position, and legislative action appears unlikely in the near term. Details [here](#), [here](#), and [here](#).

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Partisan Gridlock Complicates Already Difficult Energy Debate

BY SARAH LITKE, KEVIN KAPPEL, AND STEPHEN P. TOCCO

After a year of significant work and progress on climate and energy legislation, Congress entered recess late September with little finalized and much left to be accomplished. Though the House passed comprehensive climate and energy legislation last summer and the Senate Energy and Environment Committees held numerous hearings, and even approved pieces of climate and energy packages, no legislation in the energy agenda has yet become law.

When the Senate returned this September, they had roughly a month to prepare some combination of clean energy and oil spill language enough so that it could be addressed during the lame duck session and possibly conferenced with the House in late November and early December. Though many believed that little would move this Congressional session and participants in the energy debate had seemingly grown tired after numerous

attempts to move climate or clean energy legislation this year, Senators Jeff Bingaman (D-NM), Sam Brownback (R-KS), Susan Collins (R-ME), and Byron Dorgan (D-ND) introduced the Renewable Electricity Promotion Act of 2010 (S. 3813) on Tuesday, September 21st. The bill has the same targets and timeframes for renewable energy deployment as the renewable electricity standard (RES) in the American Clean Energy Leadership Act (S. 1462), which was reported out of the Senate Energy Committee last summer, but with 2012 as the first target year rather than 2011 due to the fact that a year has elapsed since the previous legislation was the focus of Senate energy debates. By the time the Senate recessed upon passing a Continuing Resolution late September, 44 Senators had come out in public support for the RES, and others are expected to do so in the coming weeks and months.

The renewable electricity standard has been gaining momentum for the past couple of months. Just before the August recess, a group of 32 senators sent a letter to Senate Majority Leader Harry Reid (D-NV) calling on him to include a strong renewable electricity standard in any energy legislation that moves forward this Congress. Following recent reports demonstrating that the U.S. has lost more than \$11 billion in clean energy investments to China and other leading nations since the Senate dropped efforts to approve comprehensive clean energy legislation, a diverse group of industry, clean energy, labor, agricultural and environment organizations have worked with additional Senate offices to garner additional support for passing an RES this Congress.

In addition to an RES, five other pieces remain options for inclusion in a small energy package or other legislative vehicle this year, including an expansion of the 48C Advanced Energy Manufacturing Tax Credit, a one-year extension and possible expansion of the 1603 grants in lieu of tax credits program, the creation of a HomeStar energy efficiency program as well as a green bank such as the Clean Energy Deployment Administration, and funding for a natural gas vehicle program.

Efforts are also underfoot to delay the EPA from regulating greenhouse gas emissions under the Clean Air Act. In fact, Senator Jay Rockefeller (D-WV) said in September that he is confident that he has 53 votes for his amendment to delay the EPA from regulating greenhouse gas emissions under the Clean Air Act for two years, and that he believes that he can secure at least seven more votes to support his measure.

President Obama continues to reiterate his call to put a price on carbon and to note that while the Administration is willing to compromise on a number of energy issues, it is important to move forward with a clean energy agenda as soon as possible, and he has recently acknowledged that this may have to occur in piecemeal packages rather than via comprehensive legislation. Though the prospects for climate legislation this Congress are grim, there are a few groups who still suggest that Congress could use the lame duck session to cap carbon emissions this year. Some clean energy and environment groups are still pushing on Congress to pass energy legislation soon. Most supporters of climate policy, however, are refocusing their energies on the EPA, and, in the meantime, are hoping that the Senate will move forward on a number of other energy issues during the lame duck session.

With this fall's midterm elections looming, many worry that Congress' already hyper-partisan climate debate could grow even worse in the coming months and perhaps even more difficult after November. As with all legislation this fall,

Congress and the Administration will need to demonstrate significant leadership if they hope to move any energy pieces forward.

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In the Spotlight—U.S. Regenerative Network

The U.S. Regenerative Network is an exclusive business consortium of green building product manufacturers and service providers. Member firms are committed to improving the environmental, social, and economic sustainability of their companies using the Network's consulting and sales services. The 23 members include established companies such as Carrier, Interface, Armstrong, Colliers, Sloan, and Wells Fargo, as well as clean tech companies such as Calera, Serious Materials, Cypress Envirosystems, Project Frog, and Redwood Systems.

The Network's signature biannual event, Regenerative Marketplace Day, is being held this month on October 14th in Berkeley, California. Network Affiliates (generally, purchasers of green building products and services) including Google, Hines, Walmart, and McDonald's, as well as architects, engineers, contractors and real estate developers, will personally connect with cutting-edge Network Members through individually scheduled green speed dates (appointments)—tailored events to match Members and Affiliates based on their green product needs. There will be interactive panel discussions with our Network Member companies and experts discussing the latest issues in green building, such as the "World Beyond LEED," "Innovations in Clean Tech," and "Green ROI".

If your firm is interested in attending this free event, please e-mail Suzi Fenn at sfenn@regenv.com.



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