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# Local Finance Notice

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## Contracting for Renewable Energy Services: Update on Power Purchase Agreements

Since [Local Finance Notice 2008-20](#) was issued in December of 2008, there have been several changes regarding the contracting for renewable energy through power purchase agreements (PPA). One of the important actions is the release of the Board of Public Utilities (BPU) Guidelines for Public Entity Energy Efficiency & Renewable Energy Cost Savings Guidelines.

This Notice covers the newly released BPU Power Purchase Guidelines, PPA procurement procedures, a review of issues that must be addressed in preparing renewable energy RFPs, and issues specifically related to boards of education and PPAs.

### Power Purchase Agreements Generally

P.L. 2008, c.83 made amendments to the length of contracts sections of the Local Public Contracts Law (LPCL), the Public School Contracts Law (PSCL), and the County College Contracts Law by providing the following length of contracts provisions:

The provision or performance of goods or services for the purpose of producing class I renewable energy, as that term is defined in section 3 of P.L.1999, c.23 (C.48:3-51), at, or adjacent to, buildings owned by any *<type of contracting unit>*, the entire price of which is to be established as a percentage of the resultant savings in energy costs, for a term not to exceed 15 years; provided, however, that these contracts shall be entered into only subject to and in accordance with guidelines promulgated by the Board of Public Utilities establishing a methodology for computing energy cost savings and energy generation costs.

This section authorizes contracts of up to 15 years with private vendors for "power purchase agreements." These are programs where the contracting unit procures a contract for, in most cases, a private vendor to install, maintain, and own solar panels, in exchange for the contracting unit purchasing the power generated by the solar panels at agreed upon formula driven rates. The same principle can be applied to other Class I renewable energy sources, such as windmills, geothermal systems, and similar renewable power sources.

This provision does not apply when a contracting unit authorizes debt or uses other capital resources to directly procure the renewable system that it will own outright. In those cases, the contracting unit's procurement law will dictate procurement and financing policies.

Government agencies fall under the incentive programs of the BPU's [Clean Energy Commercial/Industrial Program](#), that may also provide other incentives that can result in lower costs or improved energy efficiency. All local initiatives to use renewable energy or improve energy efficiency should carefully review and evaluate options available under the program.

### **BPU Power Purchase Guidelines**

The law also requires that PPA contracts are subject to "guidelines promulgated by the Board of Public Utilities establishing a methodology for computing energy cost savings and energy generation costs." Adopted on February 27, 2009 (and subject to periodic modification), the Board Order and Guidelines for [Public Entity Energy Efficiency & Renewable Energy Cost Savings Guidelines](#) are posted online and included with the distribution of this Notice. The Guidelines include a document and an Excel worksheet to assist in the calculations. The technical nature of the material warrants review and implementation by individuals familiar with energy savings calculations.

To further assist local units, the Board and Division of Local Government Services are developing model documents that can be used as a Request for Proposals and a summary of elements to be considered in a RFP. Copies of presentations from recent seminars are also online on the [Office of Clean Energy website](#).

### **Power Purchase Agreement Contracting Procedures**

For many years, the LPCL and PSCL provided that power purchase type agreements were entered into through competitive contracting, although authorized under what became obsolete language authorizing energy savings contracts.

The recent adoption of P.L. 2009, c.4, Energy Savings Improvement Programs (ESIP), in addition to reforming the way energy contracts that "pay for themselves" (See Local Finance Notice 2009-11), repealed the obsolete LPCL and PSCL language noted above. In doing so, the ESIP law unintentionally eliminated the basis for competitive contracting for power purchase agreements.

Pursuant to the competitive contracting laws under the LPCL [N.J.S.A. 40A:11-4.1(k)] and PSCL [N.J.S.A. 18A:18A-4.1(k)], the Director of the Division of Local Government Services is authorized to allow competitive contracting for "the operation, management or administration of other services." The contracting laws also allow concessions to be awarded through the competitive contracting process (subsection j of those sections). Power Purchase Agreements can be considered as service contracts or as a concession: a private contractor using the contracting unit's facilities – the roof – to place its panels, provides a benefit to the local unit (reduced electricity rates), and provides private gain to the contractor.

**Given the nature of power purchase agreements, the Director is authorizing contracts that meet the following definition to be procured and entered into pursuant to competitive contracting (subsections j or k as appropriate) pursuant to the LPCL and PSCL:**

The provision or performance of goods or services for the purpose of producing class I renewable energy, as that term is defined in section 3 of P.L.1999, c.23 (C.48:3-51), at, or adjacent to, buildings owned by any < type of contracting unit>, **the entire price of which is to be established as a percentage of the resultant savings in energy costs;** provided, however,

that these contracts shall be entered into only subject to and in accordance with guidelines promulgated by the Board of Public Utilities establishing a methodology for computing energy cost savings and energy generation costs. [emphasis added]

This language replicates the statutory authorization for 15 year renewable energy contracts.

Contracting units shall comply with the competitive contracting process. That process requires that contracts be based on firm proposals submitted by vendors, with an evaluation process guiding the contracting unit's determination of the proposal that is "most advantageous, price and other factors considered." The competitive contracting process does not permit contracts to be negotiated.

Contracting officials and industry vendors may not be familiar with competitive contracting and therefore contracting officials should carefully review the relevant statutes (N.J.S.A. 40A:11-4.1 through 4.5 and N.J.S.A. 18A:18A-4.1 through 4.5) and regulations (N.J.A.C. 5:34-4.1 et seq.) as appropriate to their organization. The nature of PPAs also warrants including an engineer or architect familiar with renewable energy systems in the planning process.

In considering the criteria to evaluate PPA vendor proposals, the following examples may be useful, given individual circumstances and RFP requirements:

- The structure and financial terms of the Power Purchase Agreement and responsiveness to RFP financial requirements or considerations
- History and financial strength of the design/installation firm
- History and financial strength of the financial/Power Purchase Agreement provider firm
- Experience of the design/installation firm in completing similar projects
- Experience of the financial/Power Purchase Agreement provider firm in completing similar projects
- Knowledge of New Jersey regulations for permitting and construction of renewable energy projects
- Knowledge of New Jersey renewable energy programs, requirements, regulations, and financial incentives
- Clarity and conciseness of the submittal
- Responsiveness and understanding of the scope of work, management of site conditions

Renewable energy industry vendors must recognize that renewable energy projects fall under State public works contracting laws, i.e., prevailing wages and Public Works Contractor Registration laws, among others. In addition, as these systems connect to building power systems or the electric grid, laws and regulations concerning electrical contractors also apply. Subcontractors may also fall under these requirements. RFP documents should make it clear that public works contracting laws and rules apply to the work and that contractors are responsible for complying with the appropriate construction trade practices and laws.

### **Renewable Energy Contract Variables**

Officials should also be aware that when it comes to contracting for renewable energy systems (i.e., solar panels, windmills) through power purchase agreements, there are different circumstances, building and environmental conditions, and pricing options that must be considered.

Depending on the specific project, pricing options may be affected by federal tax credits and five-year accelerated depreciation provisions that are available to private businesses. A private company granted a concession to install solar on a government facility can use them to lower the cost of the installation

below the cost that could be obtained if the government paid for the improvement itself. In some cases, a PPA vendor may be a company that specializes in financing renewable installations who subcontracts the physical installation work to another company.

Further, BPU authorized Renewable Energy Credits (REC) and Solar Renewable Energy Credits (S-REC) are financial instruments that may be available and can be sold to offset energy or construction costs.

**Other considerations that may be part of a renewable energy power purchase agreement include:**

- Sale of the renewable energy generator (i.e., solar panels) at fair market value or removal of the equipment
- Calculation of the price for energy and its basis for escalation
- Maintenance of and any repair of the facility
- Termination and removal provisions (including potential abandonment or sale of property)
- Assignment of or change in vendor, including but not limited to considerations for system resale prior to start-up
- Security and personnel (especially for school projects)
- Insurance (who covers fires, or other unanticipated circumstances)

There are also a variety of technical issues to be considered on a site-by-site basis that can affect the cost (and ultimately the rates) of the work.

- Utility interface, metering, and power quality reliability
- Existing capability of the facility's power system and any upgrades that may be necessary, including meeting current electrical code compliance
- Roof conditions, warranties, and repairs and renovations

Of critical importance is the condition of a roof when a PPA involves the placement of solar panels on a contracting unit's roofs. Current and future roofing conditions must be taken into account when planning a solar project. Analysis of structural integrity, condition of roofing material, and impact of any existing roofing warranties must be investigated prior to issuing a PPA RFP and impact results reflected in, or provided as part of the RFP process. For example, a RFP may require the PPA contractor be held responsible for ensuring that any existing roof warranty is not violated by the construction. Some roofs may need to be replaced prior to installation of solar panels. Projects may also require an engineering certification on roof loadings and roof warranty.

In many cases, roof repairs or renovations are needed prior to the installation of solar panels. In some cases, a PPA **may** include roof improvements. For example, an RFP response may require the contractor perform roof repairs or maintenance to support the addition of solar panels. This requires that those costs must be built in to the cost of electricity paid to the contractor.

In this case, the PPA works only when the roofing related costs result in pricing to the local unit that does not exceed what the projected cost of energy otherwise available from the grid. If the cost of PPA power, including any roof work exceeds the projected grid rate (i.e., no savings in electricity cost), the roof work must be performed separately from the PPA under normal public works contracting procedures. The competitive contracting process for PPAs **does not** provide a mechanism to avoid public works contracting requirements or to build long term roof renovation or replacement costs into

the cost of electricity so that the cost of energy exceeds what would otherwise be available from the local utility company.

To summarize, a PPA may include roof improvements only when the projected cost of the energy otherwise available from the grid is not exceeded by the cost of the PPA power and any roof work. The BPU Guidelines for Public Entity Energy Efficiency & Renewable Energy Cost Savings Guidelines must be used to calculate energy savings.

To address these and other variables that can be part of a power purchase agreement, RFPs should be carefully researched by the local unit, and the RFP should encourage vendors to submit alternative proposals that can address the contracting unit's needs. Careful evaluation, including application of the BPU Guidelines, is critical to the success of the project.

### **Boards of Education and Power Purchase Agreements**

In addition to the foregoing issues, because of the oversight of school construction activities by the State Department of Education, the following additional conditions apply to schools entering into PPAs:

1. All plans for PPAs that affect a school building must be incorporated into the school's Long Range Facility Plan and the appropriate filing made with the Department of Education for approval.
2. PPA applications require an engineering certification on roof loadings and roof warranty filed with the application.
3. School debt service aid is not provided for a PPA. Solar panel projects are eligible for debt service aid if the school district purchases and installs the panel through an approved bond referendum.

Entering into a PPA for installation of solar panels on a roof does not trigger the requirement that a Board of Education obtain the approval of the Department of Education to "lease" or "rent" a school facility.

### **Conclusion and Additional Information**

Issues concerning contracting for energy related services are continuing to evolve and will pose challenges to contracting unit officials as the details of the new laws are finalized. The Division continues to partner with the Board of Public Utilities' Office of Clean Energy to work through the issues and provide guidance.

Questions concerning contracting issues can be e-mailed to [lpcl@dca.state.nj.us](mailto:lpcl@dca.state.nj.us). Information and answers to questions concerning BPU Commercial/Industrial programs are best answered through the [Office of Clean Energy's contact website](#). In addition, the Board's [Office of the Business Ombudsman](#) may be of assistance.

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Approved: Susan Jacobucci, Director

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