New Jersey Seeks to Ramp Up ESCO Contracting to Achieve Renewable Energy and Conservation Goals

New Jersey legislative and regulatory initiatives are making greater use of multi-year contracts with environmental services companies for purchasing electrical power or installing energy upgrades.

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As renewable energy facility development and energy conservation services have become a much-touted centerpiece of the Obama Administration's economic recovery program, New Jersey is moving rapidly to do the same at the state level with the added impetus of meeting the state's goal of reducing greenhouse gas (GHG) emissions 20 percent by 2020 and 80 percent by 2050. As the dust begins to settle on the latest round of state legislative and regulatory initiatives aimed at achieving these goals, one area in particular that the state has begun to ramp up is the use of multi-year contracts with environmental services companies (ESCOs) for purchasing electrical power or installing energy upgrades.

On Jan. 21, 2009, the New Jersey Legislature enacted the Energy Savings Improvement Program (Public Law 2008, Ch. 83), which amended N.J.S.18A:18A-42, to authorize municipalities and counties to enter into power purchase agreements (PPAs) and performance contracts for terms of up to 15 years for construction of renewable energy generation facilities and equipment, as well as energy conservation measures in existing public buildings. The contracts are required to follow competitive bidding procedures and must be awarded in accordance with guidelines issued by the state's Board of Public Utilities (BPU) on Feb. 24, 2009, outlining a methodology for computing and tracking energy cost savings and energy generation costs.

While PPAs and performance contracts have been used by ESCOs in the past as a mechanism to fund energy-related upgrades or construction with the long-term cost savings generated by the upgrades, the state hopes to use them to spur renewable energy construction projects and energy conservation retrofits in public buildings. Could this mean a bonanza for ESCOs and their suppliers? In addition to specifically authorizing their use under the state's Local Public Contracts Law, Public School Contracts Law and County College Contracts Law, the state is also moving aggressively to provide funding to local government entities for renewable energy and energy conservation projects. Coupled with Governor Corzine's commitment to growing "green energy" jobs in New Jersey as part of the state's economic recovery program and to meet the state's GHG emission reductions goal, it is reasonable to expect that ESCO performance contracting will provide a fertile ground for business development in the next few years.

Notwithstanding this favorable picture, securing PPAs and performance contracts with local government entities will not be without its challenges. Already, the New Jersey Department of Community Affairs (DCA) has circulated an advisory to responsible local governmental contracting officials warning against hasty consideration of bid offers. State agencies also have begun to provide guidance to local contracting officials, including new contracting models and advice on how to ensure contract integrity and maximize cost savings. Intimate knowledge of these guidelines and performance contract drafting experience will no doubt provide a significant competitive edge for ESCOs in bid competitions.

A performance contract can be used, where necessary, as part of a mix of financing solutions that avoid or minimize the need for public financing of energy equipment upgrades, renewable energy construction projects or energy conservation measures. In essence, a performance contract is an agreement offered by an ESCO whereby the ESCO (or a commercial lender) will advance the required capital, subject to a right of repay-

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ment that is paid from funds derived from cost savings generated by the improvements. The contract describes the particular energy efficiency improvements to be made, associated costs, estimated energy to be generated and other savings, as well as the expected cost savings. In most cases, the cost savings are guaranteed, subject to the condition that the associated equipment is properly operated and maintained over the course of the contract. Typical performance contracts have a term of 10 to 20 years.

PPAs have been used in a similar way to finance (or partly finance) the construction of renewable energy production facilities, like solar panels, for public properties with long-term future cost-savings achieved by supplanting energy that otherwise would have to be purchased off the electrical grid. Since federal and state tax credits cannot be used by a public entity to help pay for renewable energy facility construction, such as solar panels, public agencies have sometimes granted concessions to ESCOs allowing them to install renewable energy production facilities on government property. This approach allows the ESCO to minimize the cost of facility construction in comparison with the cost that the governmental entity would incur to do the same.

New Jersey is moving aggressively to provide funding to local government entities for renewable energy and energy conservation projects.

Another important source of revenue that may be used to leverage renewable energy facility and conservation projects is grant funding that will soon be made available from the proceeds of auctioning off carbon emissions allowances generated through New Jersey's participation in the Northeastern Regional Greenhouse Gas Initiative (RGGI). The New Jersey Department of Environmental Protection (DEP), which has primary responsibility for implementing RGGI in New Jersey, is currently promulgating rules under the Local Government Greenhouse Gas Reduction Program that will govern how these funds will be allocated to projects designed to promote local government agencies' efforts to reduce greenhouse gas emissions through energy efficiency, renewable energy or distributed energy projects that will lead to measurable reductions in greenhouse gas emissions or energy demand.

According to the state's draft of the *Global Warming Response Act Recommendation Report,* which was released for stakeholder input on Dec. 15, 2008, the development of renewable energy will be one of the major cornerstones in New Jersey's efforts to achieve the state's GHG reduction goals. As contemplated by the state's Energy Master Plan (EMP), which was released in final form in October 2008, in order to meet the 2020 GHG emissions reduction goal, projected statewide energy use will have to be decreased by 20 percent by 2020, while 30 percent of the state's electricity needs will have to come from Class 1 renewable energy sources. There can be little doubt that the state's achievement of these goals will create unprecedented opportunities for ESCOs that are able to provide competitive bids with appropriate contractual mechanisms that conform to the state's guidance and requirements. ■

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