Part II: Comments of the American Council On Renewable Energy to the Army EITF Model Renewable Energy Service Agreement

(NAICS: 221118 Other Electric Power Generation)

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The American Council On Renewable Energy ("ACORE") appreciates the U.S. Army's ongoing efforts to establish open communication with relevant renewable energy industry participants and the collaborative process it has demonstrated in developing the Model Renewable Energy Service Agreement (the "PPA"). ACORE also appreciates the time and attention given by the Army in consideration of ACORE's prior comments, submitted on May 29, 2013.

While significant progress has been made between the first draft and the current version of the PPA (and we appreciate the Government's flexibility in considering and reaching resolution on a number of points that were previously raised), several issues remain to be addressed which are crucial in order to enhance the financeability of installation renewable energy projects going forward. ACORE has therefore again gathered feedback from its diverse membership to provide the following additional comments to the PPA.

ACORE believes that the presented comments are integral to financing renewable energy projects. As previously discussed, financing parties evaluating renewable energy projects need certainty with regard to project economics in order to evaluate an investment and make informed decisions. The comments below primarily address issues that impact the potential pool of capital available for financing these projects or have the potential, if not resolved, to substantially increase transaction costs and project timing. Some of these comments, especially those related to government procurement regulations, are technical in nature, but nonetheless, if not resolved, could similarly limit third-party financing. To the extent it would be helpful to EITF, we would be happy to discuss these comments with the relevant procurement legal team, as well as answer any questions that they might have regarding our thoughts on government contracting and facilitating third-party finance.

As always, we appreciate your consideration of our comments and welcome ongoing conversations with our membership.

1. Minimum Annual Production and Government Payment Obligations

The most carefully scrutinized aspect of any PPA by financing parties is the certainty of the revenue stream. Successful project financing requires clear terms as to the parties' delivery and payment obligations. Financing parties also seek enhanced certainty for any potential PPA contract damages, so that they can forecast various downside scenarios when evaluating whether or not, or how much, to invest in a particular project. Uncertainty as to any of these items unnecessarily limits the pool of capital available for financing these projects. With these thoughts in mind, some provisions of the model PPA warrant reconsideration.

a. Minimum Annual Production

The Contractor required Minimum Annual Production of energy and corresponding Government minimum payment (set forth in Sections C.3 and C.5 of the PPA) will be the key components used by financing parties in evaluating the size of their financial commitment, and therefore the ultimate size of the renewable energy facility.

If the Government only commits to pay for the Minimum Annual Production (instead of all energy *delivered*) then the Contractor will generally only be able to obtain financing to build a project capable of producing the minimum, thus limiting the project's ultimate capacity. The Government's stated intention to pay for all energy "consumed" above the minimum amount does not provide comfort to financing parties as to the certainty of those payments. Obligations to pay merely for consumption are not generally found among project-financed utility PPAs. We previously proposed that the Government purchase all energy produced and delivered by the Project, or that could have been produced but for the action of the Government or the utility (*i.e.*, credit for "deemed production" during curtailment events). This proposal is consistent with the general commercial approach for financing projects of this type.

b. Replacement Energy: Deemed Production & Cover Damages

Section C.5 of the PPA requires the Contractor to pay the Government "cover damages" if the Contractor fails to produce energy equal to at least 75% of the Minimum Annual Production, in an amount equal to the "cost of energy actually purchased by the Government less the energy that would have been supplied had the contractor met the requirement." This provision can be improved in several ways.

First, linking liquidated damages to the cost of replacement energy could subject the Contractor to potentially uncertain cost swings, especially over the 20-year term of the contract, an outcome incompatible with the certainty of an anticipated cash flow needed for project financing. The easiest way to remedy this situation would be to include a Schedule within the PPA that provides values for calculating cover damages for both energy and renewable energy credits (RECs) over the term of the PPA, based on an agreed per kWh charge, escalated at an agreed rate. The schedule approach is consistent with commercial practice and would be beneficial both to financing parties, by enabling them to estimate project costs (and downside production modeling) with certainty, and to the Government, as it would provide assurance as to the basis of recovery if the project is seriously underperforming.

Second, as a technical matter, any cover damages to be paid should become due following the annual true-up. The document has an appropriate mechanism for this concept in Section G.9, but has inconsistent references (*ex*: "the next monthly invoice") in Section C.5. Also, it should be made clear that the phrase "met this requirement" means met 75% of Minimum Annual Production, not 100%.

Finally, both curtailment events and force majeure events need to be considered in the 75% Minimum Annual Production damage calculation. See items d. and e. below for a detailed discussion.

c. Replacement RECs and Cover Damages

Section C.5 provides that if Contractor delivers an amount less than the Minimum Annual Production (and related RECs) to the Government, the Contractor must provide replacement RECs to compensate the Government for the difference between the actual amount delivered and 100% of the Minimum Annual Production. Requiring a Contractor to provide 100% of the Minimum Annual Production in RECs when it has not also produced an equivalent amount of energy materially increases uncertainty regarding project economics. As the price of RECs fluctuates substantially, the costs to the Contractor to fulfill this provision cannot be estimated with any degree of certainty over the term of the PPA. Further, asking the Contractor to procure whole replacement RECs (rather than pay cover damages) for failing to meet the minimum constitutes a penalty rather an appropriate mechanism to make the Government whole.

In order to resolve these issues and increase certainty for financing parties, REC delivery should always follow energy production, and the 75% of the Minimum Annual Production threshold applicable to energy should also apply to RECs. Consistent with our suggestion related to cover damages for energy above, the contract should specifically include a Schedule within the PPA that provides values for calculating cover damages for both energy and RECs over the term of the PPA, based on an agreed per kWh charge, escalated at an agreed rate. Sample language that could be used instead of the current language in Section C.5 could read as follows:

> If the Contractor fails to produce 75% of the Minimum Annual Production, the Government shall only pay for the quantities produced and delivered, and the Contractor shall provide a financial credit to the Government (following the annual true-up procedures set forth in Section G.9) that shall be equal to a per kWh charge for the production year indicated in Schedule [__] multiplied by the total of (a) the number of kWhs that would have been produced and delivered by the Contractor at 75% of the Minimum Annual Production minus (b) the amount of energy in kWhs actually produced and delivered by the Contractor during the annual measurement period.

Using this language (and including a to-be negotiated Schedule in the PPA) reduces uncertainty as to the extent and amount of future costs that the Contractor will incur when potentially purchasing RECs at a spot-price in an open market. This, in turn, reduces uncertainty for financing parties and increases the pool of potential capital available for a project.

d. Curtailment Events and Minimum Annual Production

Commercial practice typically allows the power producer to count as "deemed production" all amounts of energy which would have been delivered to a delivery point by a project – but for curtailments by the Government or the relevant utility. Consistent with these commercial contracts, outage hours caused by curtailment events that are attributable to either the Government or the relevant utility should count as "deemed production" for purposes of both (a) the Government's payment obligations to the Contractor and (b) whether the Contractor meets the Minimum Annual Production.

e. Effects of Force Majeure on Damage Calculations

Although force majeure events are taken into consideration for purposes of termination for default in Section C.5.a, force majeure hours are not considered in the Minimum Annual Production damage calculation. Consistent with commercial practice, force majeure events should be treated differently than curtailment events: outage hours caused by force majeure events should count as "deemed production" when determining the Minimum Annual Production for purposes of determining whether the Contractor should pay damages, but the Government should not have to pay for force majeure deemed production. This approach is consistent with standard commercial practice which traditionally supports project financings.

2. Defaults and Cure Periods

Sections C.5.a provides that the PPA may be terminated for default following a failure by the Contractor to produce 75% of the Minimum Annual Production in a given year, and expiration of the relevant cure and notice periods. We think that the cure periods and processes proposed by the Government in this Section are reasonable. However, consistent with the proposed contracts in Fort Detrick and Fort Irwin, the trigger point for beginning these notice and cure periods should only occur following three (3) years of Contractor failure to meet 75% of Minimum Annual Production.

3. Force Majeure Events and Suspension of Payments

We appreciate the Government's flexibility in considering our comments to the "Force Majeure Event" definition and improving the scope of events covered. However, a few shortcomings remain. In the definition of "Force Majeure Event," all actions of the Government in its sovereign or contractual capacity, not just "emergency orders" should be Force Majeure Events if they unavoidably prevent or delay performance. For an example of this standard, *see* Federal Acquisition Regulation ("FAR") 52.212-4(f) *Excusable Delays.* Also, contrary to the current provisions in Section H.7.3, the Government should not be able to terminate the PPA for default during a prolonged Force Majeure Event if that event was caused by or within the Government's control. Finally, in Section H.7.2, while the Government's need to suspend payment to the Contractor during a Force Majeure Event is understood if the entire project is offline, the Government should still continue to pay for all energy delivered in the case of a partial project shutdown.

4. Termination for Convenience

It is understood that the Government needs to reserve the right to terminate the PPA for convenience. But, in order for financing parties to evaluate risks associated with the project, termination remedies should be as clearly identified as possible.

Section H.12 identifies two possible periods when the PPA may be terminated for convenience by the Government (before the Commercial Operation Date and after Commercial Operation Date) and two FAR clauses for use in determining Termination Values (FAR 52.241-10 and 52.249-2). This bifurcation is understandable. However H.12 also provides that termination values and other allowable costs "shall be negotiated and reconciled in accordance with" the two FAR clauses. Unfortunately, these two FAR clauses are inconsistent in scope and methods of recovery, and using two inconsistent FAR clauses creates uncertainty for financing parties evaluating project economics. FAR 52.249-2 is also incompatible with general "commercial items" accounting methods (namely FAR 52.212-4(l)), which rely on the Contractor's standard record keeping when determining the basis for recovery—a more commercially acceptable approach than the inventory-based system set forth in FAR 52.249-2. This comment is consistent with the preferred approach of using FAR Part 12 and general commercial item FAR clauses mandated by that Part.

Some simple modifications can be made to Section H.12 which will allow the Government to distinguish between the two periods for termination (before and after the Commercial Operation Date) and provide the needed clarity as to termination costs for financing parties to use in their evaluation. One change includes replacing FAR 52.249-2 with FAR 52.212-4(l) to account for termination before the Commercial Operation Date. Then, after the Commercial Operation Date, the Government should, when determining termination recovery (a) first look to the Termination Value Schedule and (b) then to FAR 52.212-4 for other allowable costs not contemplated by that schedule (*i.e.* attorney fees and other costs resulting from the termination).

Incorporating these changes eliminates the inconsistencies of the currently proposed FAR clauses, and provides clarity for financing parties.

5. REC Sales

The Government should consider the needs of each Installation when deciding whether to contract for the purchase and sale of RECs within the PPA. If the Government determines that an individual installation needs to purchase RECs as part of the PPA, the agreement should set a fixed price for RECs so that the Contractor can properly evaluate its options for sourcing RECs required under the PPA.

6. Most Favored Nation Provision and Restrictions on Third-Party Sales

Sections H.6.a of the PPA sets forth a particularly punitive approach to potential third party sales. The current draft provides that sales of energy to a third party at a price less than the price of energy under the PPA will have the effect of reducing the price of energy under the PPA to that third-party price. As contractors will seek to maintain their PPA price, including this provision effectively prohibits (or, at a minimum, greatly reduces the possibility for) third-party sales, which could result in less overall revenue for the project. This provision is also inappropriate given that the project would only be selling to third-parties in cases where there is energy in excess of Government's needs (such as a holiday or a weekend). We would welcome additional conversations with the Army to consider alternatives to this approach.

7. Commercial Item Acquisitions and Applicable FAR Clauses

Other solicitation PPA terms, such as those of the Fort Detrick and Fort Irwin RFPs, have been structured as "commercial item" contracts under FAR Part 12. FAR Part 12 was established to make federal acquisitions more closely resemble those in the commercial marketplace, thereby streamlining the FAR provisions applicable to the project and providing for a more commercially acceptable approach. This approach implements the Government's policy and preference for the acquisition of commercial items contained in Title VIII of the Federal Acquisition Streamlining Act of 1994 (Public Law 103-355). We believe that contracts based on FAR Part 12 should become preferred templates for acquisitions of this type.

Inclusion of extensive FAR and Defense Federal Acquisition Regulation Supplement ("DFARS") provisions beyond what is contemplated by FAR Part 12 and necessary FAR Part 41 clauses related to utility service unnecessarily burdens the Contractor and the Government. In addition, inserting these provisions creates burdensome transaction costs for project financing and overall project economics. Considering that the Government is generally unwilling to pay more for renewable energy than its current utility bill outlays, which means that margins on these projects are already incredibly tight, inserting additional and unnecessary FAR clauses could be the difference between an economical project and an uneconomical one.

As such, the approach to the procurement should be reconsidered to reflect a FAR Part 12 acquisition based principally on FAR 52.212-4, *Contract Terms & Conditions – Commercial Items*, and only those applicable selected clauses contained in FAR 52.212-5, *Contract Terms & Conditions Required to Implement Statutes or Executive Orders – Commercial Items*.

Some of the FAR and DFARS clauses that are particularly unnecessary, inapplicable or not appropriate are discussed in points 8-10 below.

8. Davis-Bacon and Service Contract Act

While we understand that applicable state-based prevailing wage requirements may be required for some procurements of this type, federal Davis-Bacon wage requirements and related requirements (FAR 52.222-5 through 52.222-16 of the incorporated FAR clauses) should not apply to contracts like the PPA. The Government is not intending to use or acquire any generation assets through the PPA, and PPAs are not contracts for the construction of public works. They are contracts for the purchase and sale of energy.

FAR 52.222-41, the Service Contract Act of 1965, is likewise inapplicable to this type of contract and should be deleted. This type of contract is not a "service" contract in any traditional sense, rather the "service" of operating the power project is incidental to the provision of power. While the Contractor is often not a public utility, the Government is essentially procuring "public utility services", an activity which is expressly exempt from the Service Contract Act. See 41 U.S.C. §356.

When these clauses are included in defense renewable energy solicitations, prospective contractors often conclude, based on time-consuming, costly analysis that the clauses will not affect performance. But the cost and confusion introduced by the clauses' inclusion does significant harm. Much good would come from omitting them.

9. Domestic Preference Rules and Transportation of Items by Sea

Special domestic preference rules clearly apply to contractors' acquisition of photovoltaic panels used for defense solar projects pursuant to 2011 federal legislation, as implemented by DFARS 252.225-7017. However, generally applicable domestic preference rules, including the Buy American Act, should not be found to apply to acquisition of other equipment for defense renewable energy projects even if general domestic preference FAR clauses are included in the contract. This is because the government is buying electrical power – not the equipment that contractors use to produce the power. The delivery of electric power is not subject to the Buy American Act. Inclusion of these FAR clauses contributes significant costs and confusion even if parties conclude that they would not ultimately affect performance. Therefore, references to FAR sections 52.225-3, 52.225-4, 52.225-13 and 52.225-23 should be omitted from the PPA.

DFARS section 252.247-7023, *Transport of Items by Sea*, is a requirement that is not applicable to subcontracts related to contracts for commercial items, but will, as currently drafted, be applicable to subcontracts under this PPA. Implementation of this requirement would increase transportation risk concerning critical components of renewable facilities and therefore likely will negatively affect overall project economics.

Again, including unnecessary FAR clauses has the potential to increase the transaction costs, often confuses potential investors and generally has the effect of negatively impacting the overall project economics.

10. Construction and Utility Service FAR Clauses, Work and Access Restrictions, Etc.

The PPA incorporates several FAR clauses which traditionally apply to construction contracts. Here, the Government is contracting to purchase power – it is not funding construction of a facility. Funding for the project will be provided by private investors. Therefore, these FAR clauses are unnecessary and including them in the PPA creates an undue burden on the parties and negatively impacts the overall project economics.

For example, FAR 52.236-28, *Preparation of Proposals-Construction*, prescribes guidelines for price proposals that appear to be inapplicable to the structure and scope of this contract. Other construction-related clauses such as FAR 52.236-5, *Material and Workmanship* (which requires the Contracting Officer's approval of all machinery and equipment used in connection with building the project) are burdensome to the Contractor and inconsistent with other contracts of this type. FAR 52.236-9, *Protection of Existing Vegetation* and 52.237-2, *Protection of Government Buildings, Equipment and Vegetation* both provide that the Contractor should not disturb existing vegetation and Government equipment during the course of construction. The PPA should make explicit that the Contractor will be deemed in compliance with these provisions if it builds the project in accordance with design and construction plans approved by the Government. If the Government later claims that the Contractor is disturbing vegetation, or unilaterally alters the construction or design plans in a way that materially affects the construction schedule, the Contractor should be entitled to an equitable adjustment under the Changes clause of the FAR. This result should also be made explicit in the PPA.

The Government generally has the ability to restrict access to the project for national security or other considerations, as well as to change the layout and design of the project. While the Government needs these protections, problems arise when the Government restricts access unnecessarily or makes such changes without covering the Contractor's excess costs that result. The PPA should make clear that restrictions on access impacting the construction, operation or maintenance of the project or changing the scope of the contract entitle the Contractor to equitable adjustments under the Changes clause of the FAR.

As discussed above, the preferred approach would be to use clauses mandated by FAR Part 12, the FAR 52.212-4, *Contract Terms & Conditions – Commercial Items*. The "Changes" clause of FAR Part 12 should be utilized here. Under this clause, Changes are subject to written agreement by the parties so that they cannot be unilaterally ordered by the Government or the Contractor. Utilizing the FAR Part 12 Changes clause reduces Contractor risk regarding the ultimate construction and layout of the project and ensures that both parties mutually agree on any Changes to the project which are necessary in order to meet the needs of the Government.

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ACORE supports EITF's efforts to create a model PPA designed to enhance the economics of military renewable energy projects through the use of acquisition and commercial tools which provide greater certainty for contractors and financing parties. Our comments are intended to clarify and streamline the PPA and create a workable, financeable document to further ensure the Army's success in achieving its renewable energy goals. We are available to discuss the concepts in this letter at your convenience.

Sincerely,

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About ACORE:

ACORE, a 501(c)(3) non-profit membership organization, is dedicated to building a secure and prosperous America with clean, renewable energy. ACORE seeks to advance renewable energy through finance, policy, technology, and market development and is concentrating its member focus in 2014 on National Defense & Security, Power Generation & Infrastructure, and Transportation. Additional information is available at www.acore.org.