Comments of the American Council On Renewable Energy (ACORE): EITF Performance Work Statement Template

(NAICS: 221118 Other Electric Power Generation)

May 29, 2013

The American Council On Renewable Energy ("ACORE") has gathered feedback from its diverse membership of manufacturers, developers, financiers, end-users, and professional service firms, including energy and government contracts attorneys, to provide the following comments to the Army's Model Performance Work Statement (the "PPA"). We support the Army's continued leadership in diversifying its energy supply and interest in procuring clean and reliable renewable power to enhance the success of the warfighter and mission effectiveness. ACORE commends the Army for the opportunity of the private sector to comment on the model PPA.

ACORE believes that these comments address issues that are critical to financing renewable projects. Our comments primarily address the issues that impact the potential pool of capital available for financing projects. ACORE also believes that many of the identified issues will, if not resolved, increase transaction or financing costs at best and limit the success of this program at worst. Furthermore, we believe that the suggested changes provide a more appropriate level of risk sharing between the Government and contractor, and eliminate situations where less savvy market participants agree to unfinanceable contractual terms that lead to contract failure. We appreciate your consideration of our comments and welcome ongoing conversations with our membership.

1. Minimum Annual Production

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.

In this regard, some provisions of the model PPA warrant clarification. Under the terms in the model PPA, the Government would obligate itself to pay for 1/12 of a Minimum Annual Production amount on a monthly basis. As drafted in Sections C.5.a and C.5.b, the Minimum Annual Production also functions as an energy production guarantee to the Government. If the contractor fails to meet the production guarantee, the Government is entitled to true-up its bill for production shortfalls in the February following the shortfall year.

While we understand the Government's desire to have certainty that a project will produce a specified amount of power, the production guarantee should not be so high that project economics are materially imperiled. Therefore, the Minimum Annual Production should be set at a level where it is highly probable that the contractor can meet and exceed the production threshold. One commercially acceptable approach to this would be to set the minimum production amount as a fixed percentage (between 60-80%) of a projected project output

profile, which itself has a high exceedance probability (P90-P99).[1] In addition, force majeure events or system outages caused by the Government or the applicable utility should count as "deemed production" for purposes of both determining contractor compliance with the Minimum Annual Production requirements and calculating amounts owed by either party pursuant to the annual true-ups.

2. Government Payment Obligations above Minimum Annual Production

Although past Defense Department power purchase agreements have used a variety of terms to address Government energy consumption and payment obligations, the overall trend is to tie Government obligations to market-standard practice. Financing parties are comfortable evaluating utility power purchase agreements, and the Government taking positive steps to make the PPA more closely align with the general commercial approach of those types of agreements will attract a larger pool of capital to the program.

In that regard, another potential source of confusion for financing parties is how the PPA treats energy generated in excess of the Minimum Annual Production amount. Section C.4 of the PPA provides that the Government should pay, on a monthly basis, for all the energy that it "consumes" above that certain Minimum Annual Production. This concept of paying for consumption is not common for project-financed utility PPAs, and invites uncertainty as to the Government's payment obligations and therefore the firmness of the project's economics. Sections C.3 through C.5 of the PPA should be revised to clarify that the Government is obligated, consistent with commercial practice, to pay for all energy *delivered* by the project to a defined delivery point. Here again, energy that should have been delivered—but for curtailments by the Government or the relevant utility— should count as "deemed production" for purposes of the Government's payment obligations. To address these points, language like the following should be inserted in Section C.4 in lieu of the current language:

> For the avoidance of doubt, whether by means of the monthly Minimum Guarantee payment or payment for energy above the Minimum Annual Production, the Government will accept, purchase and pay for, at the applicable Contract Unit Price set forth herein, all energy that the Project generates and delivers, or could have generated and delivered but for the action of the utility or the Government, to the Point of Connection without regard to the demand for energy at the base from time to time.

This approach will increase certainty for anticipated project economics and be more familiar to financing parties.

3. Minimum Annual Production and Termination Liability

Linking the Minimum Guarantee payment obligation in Section C.3 to the Termination for Convenience formula in Federal Acquisition Regulation ("FAR") 52.241-10, *Termination Liability*, is inappropriate. As suggested above, the Minimum Guarantee should be based on a percentage of estimated annual production and should not be confused with the measure of

[1] P99 denotes the level of annual renewable-driven electricity generation that is forecasted to be exceeded 99% of the year. In contrast, P50 is average level of generation: half of the year's output is expected to surpass this level, and the other half is predicted to fall below it.

damages upon a Government termination for convenience. Introducing this linkage will cause confusion for financing parties and raise transaction costs or limit the pool of capital available for a project.

4. Replacement Energy

In Section C.5.a and 5.b, the Government's linkage of a liquidated damages cap to "replacement energy" is inappropriate and should be deleted. No payment should be made by the Government unless power is delivered. If the Government makes excess payments during any year, that amount will be refunded in the annual true-up as liquidated damages. Further, the replacement energy liquidated damages concept should be rejected in the abstract. Linking liquidated damages to the cost of replacement energy could subject a contractor to potentially uncertain cost swings, an incompatible outcome with firm cash flow needed for project financing.

5. Termination for Convenience

While the Government's need for a termination for convenience clause in the PPA is understood, financing parties need recovery upon a termination for convenience to be as predictable as possible. A termination value schedule is preferred because it enables investors and financing parties to model the financial impact of termination for convenience with reasonable confidence. The PPA contemplates the schedule approach by referencing Attachment 8, but would incorporate two different termination for convenience FAR clauses, which are inconsistent in scope and recovery mechanics. Use of only one clause, FAR 52.241-10, *Termination Liability*, when coupled with a reference to a negotiated Termination Value Schedule would provide the requisite predictability for financing. FAR 52.249-2, *Termination for Convenience of the Government (Fixed Price)*, should be discarded because its limitation of recovery to the "contract price" is incompatible with this approach and will, if included, increase transaction costs and dampen capital appetite. Even if FAR 52.249-2 is ultimately included in the PPA, it needs (a) to be significantly tailored to account for a more commercially acceptable approach to termination for convenience (such as the approach generally contemplated by FAR 52.212-4(l)) and (b) to indicate that the clause should only apply to terminations for convenience that occur prior to project commercial operation.

Third-party financing costs should be allowable and reimbursable upon termination for convenience. To that end, Section C.33.k is a good start. This section indicates that financing costs are recoverable and that termination value schedule amounts should be adjusted for financing costs at the financial closing. This Section is critical – it must be clear that the amount needed to make financing parties whole will be treated as a recoverable contractor cost in order to attract broad lender participation to a project. In addition to traditional debt-financing costs, tax equity's financing costs should also be included in the concept of financing costs.

6. Buy-Out Right

The buy-out right in Section C.33m of the PPA should be deleted or, at minimum, extensively limited**.** The right creates three types of uncertainty that could prevent or significantly impair the likelihood of financing: enforceability risk, ownership risk and tax risk. Under 10 U.S.C. § 2922a, the Department of Defense is not authorized to buy energy facilities; it is authorized to

purchase power. Given this statutory mandate, the existence of this buy-out right may create uncertainty regarding the enforceability of the PPA. The buy-out right also creates future ownership risk; it grants the Government a purchase right upon 90-days' notice at the greater of (a) the fair market value of the project or (b) the amount needed to cover of the project owner's outstanding financing costs. This unconstrained right is not consistent with market practice and disrupts the possibility of accurate financial forecasts and will therefore impair project financeability.

As formulated, the buy-out right in its current form creates significant tax risk for equity investors. Most renewable projects are partially financed with tax credits which are subject to "recapture" if project ownership changes occur within a specified period of time following project commercial operation. Thus, due to this tax credit recapture risk, even if the buy-out right is ultimately included, the Government should not be able to exercise a buy-out right within the first 7 years of project operation.

7. REC Sales

Renewable energy credits ("RECs") are often of significant value to the project developer, and how RECs are accounted for affects project economics and the financeability of renewable projects. Meeting the Army's various renewable energy goals and mandates does not require that RECs be purchased in all cases. For example, under 10 U.S.C §2911(e), which is the provision requiring military branches to purchase 25% of their energy needs from renewable energy sources by 2025, retaining RECs in connection with energy purchases is not required. This is in contrast to the renewable energy mandates under section 203 of the EPAct 2005, which require the Army to purchase RECs, but have a lower applicable threshold of 7.5% of total energy purchases. Thus, the Government will need to consider on a case-by-case basis whether to acquire RECs for each particular project. Contractors would prefer more flexibility on this point (including selling RECs to third-parties). If a contracting entity wishes to purchase RECs in a particular solicitation, those purchases should be separately accounted for as a line-item in the PPA Schedule. We recommend eliminating or bracketing references to RECs in the PPA so as not to imply that these purchases are mandated in all cases. We also recommend deleting the concept in Section C.5.b of providing replacement RECs as liquidated damages, as REC purchases are not currently properly accounted for in this model PPA. By providing contractors with greater flexibility on the retention of RECs, a wider range of private sector financing of projects may be feasible.

8. Force Majeure Event

The "Force Majeure Event" provision set forth in Section C.33.g.1 and g.2 has a few shortcomings. First, all actions of the Government, not just "emergency orders," should be Force Majeure Events if they unavoidably prevent or delay performance. In addition, strikes or other events outside the reasonable control of the contractor also should be included in the concept of a Force Majeure Event. For a standard that includes these provisions, see FAR 52.212-4(f), *Excusable Delays*, which provides that the contractor shall not be liable for nonperformance or delay if such are "caused by an occurrence beyond the reasonable control of the Contractor and without its fault or negligence such as, acts of God or the public enemy, acts of the Government in either its sovereign or contractual capacity, fires, floods, epidemics, quarantine restrictions, strikes, unusually severe weather, and delays of common carriers."

Similarly, outage hours that are caused by Force Majeure Events should be credited towards the Minimum Annual Production guarantee. This approach is consistent with standard commercial practice that traditionally supports project financings.

9. Preference for Commercial Item Acquisitions

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. It 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.

Application 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. 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 10-12 below.

10. 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 and related requirements (FAR 52.222-5 through 52.222-16 of the incorporated FAR clauses) should not apply to contracts like the PPA because they are not contracts for the construction of public works but 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. The Service Contract Act only applies to covered employees for "service contracts." 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. In addition "public utility service" (*i.e.* what this PPA is providing) is specifically exempt from the requirements of 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.

11. 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.

Defense Federal Acquisition Regulation Supplement ("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.

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

The PPA incorporates several other FAR clauses which traditionally are applicable to construction contracts. These provisions should not apply to a power purchase agreement. 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 contractors' 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. Further, consistent with the preferred approach to use clauses mandated by FAR Part 12 (as discussed above), the FAR 52.212-4, *Contract Terms & Conditions – Commercial Items,* "Changes" clause should be utilized. Under that clause, Changes are subject to written agreement by the parties, so that they cannot be unilaterally ordered by the Government. Utilizing this Changes clause reduces contractor risk regarding the ultimate construction and layout of the project.

13. Construction of the Project

Section E.1 inserts language allowing the Government discretion to reject a project which it deems not "aesthetically acceptable." This and similar concepts introduce ambiguity and should be discarded in favor of reliance on clear standards and specifications.

14. Test Energy

Test energy is not accounted for in the PPA. Consistent with commercial practice, the PPA should include a mechanism establishing that Government is to pay for energy delivered during the test period prior to commercial operation (at an appropriately discounted rate). Consistent with the concept of test energy, there would be no minimum delivery obligation during the test period.

15. Integration with the Lease

Department of Defense power purchase agreements should be thoughtfully integrated with the accompanying lease at the start to promote certainty and streamline negotiations. In the past differences have arisen with respect to environmental standards, construction guidelines, and default and remedy standards and rights. When the EITF issues a model lease to accompany the draft PPA, careful attention should be made integrate the documents.

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ACORE supports the 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 2013 on National Defense & Security, Power Generation & Infrastructure, and Transportation. Additional information is available at www.acore.org.