Guidance Regarding Refinancing, Restructuring, or Modifying Loan Agreements Entered into by an Energy Services Company Under a Federal Energy Savings Performance Contract

This FEMP guidance addresses potential refinancing, restructuring, or modifying of loan agreements (collectively called a "debt modification") entered into by an Energy Services Company (ESCO) under federal Energy Savings Performance Contracts (ESPCs). In considering the impact of debt modifications on ESPCs, it is important to recognize that ESPC financing arrangements are between the ESCO and a third-party financier – the Government is ***not*** a contractual party. Responsibility therefore rests with the ESCO to initiate communication with its financier regarding a debt modification. As emphasized throughout this guidance, to the extent there is any role for a Federal agency in debt modifications undertaken by the ESCO, decisions regarding an agency's implementation of an ESCO's debt modification is within the discretion of and rests with the particular agency's Contracting Officer (CO). FEMP provides this guidance to assist the agency decision makers when considering the potential options related to debt modification.

ESPCs are generally awarded by a federal agency either (1) as a stand-alone contract (where the agency itself competitively selects an ESCO through full and open competition) or (2) as a task order under one of DOE's or another agency's Indefinite Delivery, Indefinite Quantity (IDIQ) contracts. Funding options for an ESPC may include a combination of appropriated funds and private financing, as permitted under the ESPC authority. Because private financing is usually required, a typical ESPC involves an ESCO borrowing funds from a financier and financing the cost of the ESPC contract or task order capital improvements over the life of the contract or task order.

Since ESPCs may have a maximum contract period of 25 years, and frequently are structured with terms of 17-20 years, market interest rates may vary significantly over the performance period of any contract or task order. Consequently, the question sometimes arises whether it is possible for an agency to benefit from declining interest rates through reduced payments to the ESCO, an earlier payoff of the ESPC contract or task order, or further capital improvements through the implementation of additional Energy Conservation Measures (ECMs). The purpose of this guidance is to assist agency COs in answering those questions.

I. IS IT POSSIBLE TO REFINANCE ESPC CONTRACTS TO TAKE ADVANTAGE OF DECLINING INTEREST RATES TO THE BENEFIT OF AN AGENCY?

Yes. Consistent with the guidance described below, to the extent that the ESCO initiates and the agency contracting officer and legal staff concur with the approach, there may be opportunities for an ESCO to refinance an ESPC and for an agency to benefit from the declining interest rates.

Agencies are strongly encouraged to explore with an ESCO the potential for debt modification and the potential opportunities to apply refinancing savings to an ESPC.

II. MAY AN AGENCY DIRECT AN ESCO TO REFINANCE ITS ESPC DEBT AGREEMENT?

No. As previously noted, ESPC financing is accomplished through an agreement between the ESCO and its financier. As such, the Government is not a party to the financing agreement, has no privity of contract with the financier, and has no basis for requiring refinancing through that instrument. Similarly, DOE's existing ESPC IDIQ contracts contain no express authority for an agency to require refinancing. Agencies should review the terms in their stand-alone ESPCs and task orders to see if there is provision that addresses refinancing. Agencies should also check under their individual authorities to determine what options may be available with regard to ESCO refinancing an ESPC. Absent such specific authorities, an agency cannot direct an ESCO to refinance or otherwise modify its ESPC debt. Nonetheless, as already stated, agencies are strongly encouraged to explore with an ESCO the potential for debt modification and the potential opportunities to apply savings to an ESPC.

III. CAN ESPC DEBT MODIFICATIONS TAKE DIFFERENT FORMS?

Yes. Privately financed debt service agreements can take many forms, and the revised debt agreement may or may not stay with the original financier. For the Government to benefit from the refinancing, the agency and ESCO may jointly consider several possibilities, including the addition of ECMs or other modifications as discussed below.

IV. WHAT SHOULD BE CONSIDERED WHEN CONTEMPLATING ASSOCIATED CONTRACT MODIFICATIONS?

As noted above, any modifications and related determinations of an agency's stand-alone ESPC contract or an agency task order under a DOE or other agency's IDIQ contract rests with the **ordering agency Contracting Officer**. General procurement rules and requirements for contract modifications apply to ESPCs. Agency COs should be prepared to implement and justify any ESPC contract changes accordingly and to ensure changes are in-scope of the particular ESPC task or contract. With respect to modifications that would shorten the ESPC contract term and/or reduce the annual payments from the agency to the ESCO, the agency CO should assure that all contract requirements, including the exchange of legal consideration between parties, have been met. As a result of an interest rate reduction, it may also be beneficial to the Government and the ESCO to mutually agree to incorporation of new ECMs into the ESPC contract or task order, where the ESCO uses the interest savings to pay for additional ECMs and receives payment for the savings associated with the new ECMs. If additional ECMs are contemplated, the additional work must be in scope of the underlying contract or task.

In determining whether additional ECMs may be added to a task order (or to a stand-alone ESPC contract) without impermissibly expanding the scope of the contract, agencies are encouraged to consider a variety of factors – the most important of which may be whether the proposed scope change was suggested or envisioned in the contract or task order. There is no hard line rule in making this determination. In conducting the analysis, the agency CO must determine whether the change is within scope, consulting with his or her agency legal counsel, as needed. Some factors that the agency CO may wish to consider are:

- Are the proposed ECMs covered by DOE's ESPC IDIQs (if you are dealing with a task order under an IDIQ)?
- What are the terms and conditions of the existing contract or task order?
- What was the entire contract or task order originally intended to cover, including projected growth and/or phases? Is there any reference to project progression in the original solicitation, Task Order Request for Proposals, Preliminary Assessment (PA), Investment Grade Audit (IGA) or task order?
- Was the additional scope contemplated at the time the contract or task order was entered into?
- Were the proposed ECMs considered and/or rejected at the time of the PA? If so, for what reasons?
- Has something changed since the IGA that would make inclusion of the additional ECMs justifiable?
- What was the scope of the original Notice of Opportunity (NOO)? Were the proposed ECMs referenced?
- What is the total dollar difference added by the new ECMs versus the original contract or task order value?
- What is the percentage cost difference added by the new ECMs versus the original contract or task order value?
- To what extent will the additional ECMs increase the size of the project?
- How similar are the proposed ECMs to the existing ones?
- How significant is the change in the period of performance?

This list of issues is not all-inclusive and no one factor is determinative. In addition, each site CO may need to consider other agency-specific requirements. Ultimately, however, in order to incorporate new ECMs into an ESPC contract or task order using interest savings from a refinancing, the agency CO must examine the particular facts for the contract or task order involved and be able to determine that the addition of proposed ECMs properly falls within the scope of that contract or task order.

V. CONCLUSION

When the interest rate on an ESPC contract or task order is significantly higher than the current market rates and sufficient time remains on the contract, the Contracting Officer may explore with the ESCO whether debt modification is appropriate and whether the ESCO is willing to explore changes to the ESPC agreement to benefit both parties.