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December 15, 2010

Ms. Leslie Seidman  
Acting Chairman  
Financial Accounting Standards Board  
c/o Technical Director, File Reference No. 1850-100  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-05116

**Re: Comments of the National Association of Energy Service Companies (NAESCO) on the Financial Accounting Standards Board's Proposed Accounting Standards Update, *Leases (Topic 840)***

Dear Chairman Seidman and FASB Staff:

The National Association of Energy Service Companies ("NAESCO") respectfully submits the following comments on the Financial Accounting Standards Board's ("FASB") Proposed Accounting Standards Update, *Leases (Topic 840)* (hereinafter referred to as the "Exposure Draft" or "Standard No. 13"). For over 25 years, NAESCO has served as the national trade association for companies and institutions engaged in providing energy services and in the development, marketing, installation, and maintenance of energy efficient equipment. Our members play a key role in promoting energy efficiency in the U.S., helping customers save money and minimize the environmental impacts associated with energy consumption.

NAESCO member companies deliver between \$4 and 5 billion in energy efficiency projects annually to institutional, commercial, residential and industrial customers nationwide. NAESCO numbers among its members some of the most prominent companies in the world in the clean energy services industry, including Honeywell, Johnson Controls, Siemens, Trane, Comfort Systems USA Energy Services, and Schneider. Our members also include many of the nation's largest utilities: Duke Energy, Pacific Gas & Electric, Southern California Edison, and the New York Power Authority. In addition, ESCO members include affiliates of several utilities including ConEdison Solutions, FPL Energy Services, Pepco Energy Services, Constellation Energy Projects and Services and Energy Systems Group. Prominent national and regional independent members include AECOM Energy, NORESKO, Onsite Energy, EnergySolve Companies, Ameresco, UCONS, Chevron Energy Solutions, Synergy Companies, Wendel Energy Services, Control Technologies and Solutions, Clark Realty Capital, McClure, and Lockheed Martin. NAESCO regularly participates in regulatory proceedings regarding energy

efficiency programs, and is a member of regulator-appointed energy efficiency program review and evaluation groups in several states.

NAESCO and its membership are concerned that the Exposure Draft could disrupt innovative contractual arrangements—known as performance contracting or energy savings performance contracts (“ESPCs”)—that have long served as the cornerstone of our industry. An ESPC is a long-term agreement between a building owner and an energy service company (“ESCO”) in which the ESCO undertakes to provide a suite of energy-saving services including the performance of an energy audit and identification of cost-effective efficiency measures; installation of energy-saving equipment or building improvements; and, regular monitoring and verification services to ensure ongoing achievement of energy savings. Although the terms of ESPCs vary widely, many of these agreements provide for the building owner to compensate the ESCO for these services through contingent payments based on actual, verified energy savings, as well as fixed payments for certain services (such as maintenance and monitoring) that are carried out over the life of the contract. Often, the level of energy savings is contractually guaranteed, ensuring that the customer can make payments under the ESPC at a cost that is less than the customer previously paid for its energy bills. ESPCs allow building owners to tap the professional expertise of an ESCO while giving both parties a shared stake in maximizing energy savings resulting from the contract—an elegant, market-based solution.

Over the last quarter century, NAESCO member ESCOS have delivered more than \$40 billion of energy efficiency, renewable energy, demand response and distributed generation projects to institutional, commercial, residential and industrial customers nationwide. These projects have produced:

- \$50 billion of dollar savings to customers, **verified and guaranteed**
- 377,000 person-years of direct employment
- \$34 billion of public infrastructure improvements
- 480 million tons of Carbon Dioxide saved, **at no additional project cost**

We believe the Exposure Draft fails to consider how expanding the capitalization of leases would affect this vital class of contracts. At present, the third party financing agreement that funds the ESPC is, in many instances, accounted for as an operating lease and thus presented separately from the balance sheets of building owners. The Exposure Draft’s over-broad definition of a “lease” could, however, be interpreted to include ESPCs. If adopted, such an interpretation would cause many ESPCs to be inappropriately capitalized as liabilities for building owners, potentially causing many of our customers to exceed allowable debt levels under existing debt agreements and otherwise adversely impacting their balance sheets.

At a time when debt financing for energy efficiency is difficult to come by, the Exposure Draft would create accounting obstacles to using one of the most affordable and financially sound means of making energy-saving improvements. Indeed, by discouraging the use of ESPCs, the Exposure Draft would have the perverse outcome of preventing building owners from *improving* their long-term financial positions by reducing energy-related operating

expenses and enhancing the value of their building stock. In so doing, the Exposure Draft could also undermine key Federal policy goals; since the early 1990's, Congress has sought to promote the use of energy efficiency generally and specifically the employment of ESPCs in Federal, state, and local government facilities. More recently, Congress promoted the use of funds provided in the American Recovery and Reinvestment Act to support and, in some cases, leverage the investment provided by ESPC projects to be implemented in state and local governments.

To avoid this result and provide appropriate treatment of ESPCs, NAESCO urges the FASB to consider clarifying the final language of the Exposure Draft to ensure that ESPCs are wholly or (depending on the terms of the ESPC) partially excluded from the definition of a "lease." This clarification is appropriate from an accounting perspective because an ESPC is fundamentally distinct from ordinary leases of real property or equipment in the following ways:

- An ESPC serves as a vehicle for carrying out a suite of permanent improvements and providing long-term energy-related services at a customer's facility.
- Although an ESPC customer commits to make a series of payments over time under the third party financing agreement, payments are tied to the *performance* of the systems installed by the ESCO. Under most ESPCs, when contractually guaranteed energy savings are not sufficient to repay the financing, the amount of the payment shortfall is paid by the ESCO. This type of repayment mechanism demonstrates that the financing agreement is linked to the service rather than the equipment.
- ESPCs also may include separate payments from the ESPC customer for operating, maintenance, and energy monitoring services. These, too, are not payments for the use of property, but are instead payments for energy services.

In sum, an ESPC provides a no-risk method for the customer to essentially dedicate a portion of its operating expenses—its energy bills—to cover the cost of energy services and equipment provided by an ESCO partner, in exchange for *guaranteed* reductions in overall energy bills during and after the ESPC. As such, it is logical and consistent with good accounting practice to treat the ESPC as a service agreement or operating expense, rather than a lease.

NAESCO urges the FASB to so recognize in the final version of its update to Standard No. 13, either in the form of Application Guidance on the scope of the term "lease" (similar to the exclusions already included in the Exposure Draft for intangible property and biological property), or a separate opinion on the interpretation of the term "lease" in the context of ESPCs. NAESCO would welcome the opportunity to work with the FASB on appropriate language to ensure that this guidance is properly limited in scope to ESPCs with relevant characteristics. With this modification, we are confident that the FASB can produce an update to Standard No. 13 that is professionally sound and does not harm the essential work being carried out pursuant to performance contracting or ESPCs.

Thank you for the opportunity to comment on the Exposure Draft.

Respectfully submitted,

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