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September 26, 2011

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Registration of Municipal Advisors, File No. S7-45-10.

Dear Chairman Schapiro:

We are writing to provide further comments on the Securities and Exchange Commission's (SEC or Commission) proposed rule requiring registration of municipal advisors under section 975 of the Dodd-Frank Act.[1]

As the only national trade association representing the energy service company (ESCO) industry, the National Association of Energy Service Companies (NAESCO) continues to believe that the Commission has arbitrarily and inappropriately proposed to extend municipal registration requirements to members of our industry that are explicitly exempt from this requirement under the Dodd-Frank Act.[2] The Commission's proposed registration requirement, as applied to ESCOs, is contrary to the statute and provides no benefit for investors or the public. Indeed, the proposed requirement is likely to harm the public interest by restricting the access of municipalities to energy-saving, job-creating ESCO services. These harmful economic impacts were completely overlooked in the Commission's proposal, which fails to mention the most costly compliance burdens associated with the proposed rule and assumes away any impacts of the proposed rule on the availability and price of energy saving services required by municipal entities.

We explain these concerns in greater detail in this letter. We also offer a proposed regulatory solution that would establish a narrow safe harbor from regulation for legitimate, engineering-related ESCO activities, without affecting SEC's oversight over other industry sectors or over ESCOs that perform services beyond those defined in the proposed safe harbor. This safe harbor language is consistent with the request in the June 22, 2011 letter to the Chairman of the SEC from Senator Jeff Bingaman (D-NM), Chairman of the Senate Committee on Energy and Natural Resources; Senator Mary Landrieu (D-LA), Chairman of the Senate Committee on Small Business and

[1] Registration of Municipal Advisors, 76 Fed. Reg. 824 (Jan. 6, 2011).
[2] NAESCO outlined these concerns in considerable detail in its comments to the SEC on the proposed municipal advisor registration requirements. *See generally* Comments of the National Association of Energy Service Companies on Securities Exchange Act Release Number 34-63576; Registration of Municipal Advisors (filed Feb. 22, 2011).

Entrepreneurship; and Senator Chris Coons (D-DE), who serves on the Senate Committee on Energy and Natural Resources Committee and negotiated an energy services contract as a County Executive prior to his election to the Senate. This letter has been filed in the docket for this rulemaking proceeding.

I. ABOUT ESCOs AND THEIR SERVICES

ESCOs serve a vital role in the U.S. economy by conducting energy audits of large buildings—including public facilities such as municipal buildings, universities, schools, and hospitals—and implementing cost-effective retrofits that save building owners energy and money, while providing much needed jobs for our economy. These projects are designed to yield savings in utility and maintenance costs that far exceed the upfront cost of the building retrofits and improvements. ESCOs contract for an average of $3 billion in retrofits to public buildings each year - investments which pay for the purchase and installation of costly capital equipment, and also create an estimated 28,500 direct and 34,500 indirect jobs for construction workers, manufacturers, small businesses and other enterprises. These projects also help taxpayers save money, reduce our nation's use of energy and reduce harmful air emissions through the reduction of energy use. Public entities rely on ESCOs to provide a unique combination of engineering expertise and guaranteed performance that public entities are often not in a position to achieve on their own. For this reason, the Federal government has long used ESCO services to retrofit its buildings while achieving significant net savings for the taxpayer.[3]

ESCOs provide services that are fundamentally engineering-related, such as energy analysis, engineering design, construction, and performance monitoring. However, the essential purpose of ESCO services is to deliver packages of building retrofits that pay for themselves over time. In fact, ESCOs typically guarantee the savings that will be achieved under their contracts. Therefore, a cash flow analysis of the proposed package of retrofits to be delivered by the ESCO is indispensable to both the client and the ESCO to determine whether a proposed project makes economic sense. This cash flow analysis is an essential component of the engineering service, insofar as it depends on engineering-based calculations regarding building energy usage and maintenance before and after the project. Such analyses are in no sense investment or financial advice.

Financing for ESCO projects is often provided by third parties, such as banks, many of which are likely to be registered with the Commission as municipal advisors or investment advisors. ESCOs themselves are not involved in designing or recommending financing structures for ESCO projects. Instead, ESCO customers deal directly with banks or other third parties to arrange financing. ESCOs are often required by state law or procurement regulations to provide general background information on the types of

[3] *See, e.g.*, Federal Energy Management Program, *Energy Savings Performance Contracts* 1 (July 2011) (noting that Federal government has awarded 570 energy savings performance contracts as of May 2011, serving 25 Federal agencies in 49 states and Washington, D.C. FEMP expects these projects to save $13.1 billion in energy costs using $10.1 billion in project investments, leaving a net savings of $3 billion).

financing options that are sometimes used to fund the cost of an ESCO project. In addition, ESCOs, when requested, occasionally introduce customers to third parties who are in a position to finance an ESCO project. ESCOs are not compensated by clients or by third parties for these introductions. These ESCO activities are not directed at assisting clients to select a particular financing structure or financing institution, and should not be considered investment or financial advice. As you will see, the safe harbor we are proposing addresses this situation.

II. REGISTRATION OF ESCOS AS MUNICIPAL ADVISORS IS INAPPROPRIATE

Congress implicitly recognized in the Dodd-Frank Act that services offered by ESCOs inherently involve the provision of some economic and financial data. For that reason, Congress specifically exempted "engineers providing engineering advice" from the municipal advisor registration requirement. NAESCO was therefore surprised to see that the Commission's proposed rule implementing Section 975 defined the engineering exemption so narrowly that even a standard cash flow analysis or feasibility study — which is an integral part of, and indispensable to, the engineering service that ESCOs provide — would not be considered "engineering advice."[4] The Commission's proposed reading of the term is so narrow as to render this clear legislative exemption virtually meaningless. Congress would not have deemed it necessary to provide the engineering exemption if Congress believed that "engineering advice" extended only to design and cost information, as the Commission suggests in the proposed rule. Cash flow analyses and feasibility studies have always been considered part of a project's engineering, for the simple reason that financial considerations normally influence how the project is designed and determine whether or not the project is economically feasible and can move forward.

By extending Section 975 to normal engineering services provided by ESCOs, the Commission's interpretation would cause municipal advisor registration requirements to extend to an industry that does not provide financial or investment advice and with respect to which the Commission has no relevant regulatory expertise. We have met with a number of staff in the relevant congressional committees of both the House and Senate, and have been told uniformly that Congress never intended for Section 975 to extend to companies such as ESCOs when they are providing engineering services. The Commission's interpretation of Section 975 adopts an unreasonably narrow view of the scope of "engineering advice" that was never contemplated by Congress.[5]

The Commission's proposal also has no discernible reasonable policy justification. In the approximately three decades that the ESCO industry has existed, NAESCO is not aware of any instances in which an ESCO contract has been a vehicle for financial fraud or wrongdoing of the kind that Congress sought to avoid through Section

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[4] 76 Fed. Reg. at 834.

[5] Although NAESCO does not have any position on whether Section 975 requirements should apply to other engineering-related industries, we note that SEC's interpretation of "engineering advice" is so broad as to embrace almost *any* engineering company that provides any economic or financial data of any kind to a municipal entity.

975. To the contrary, careful studies have repeatedly demonstrated that ESCO projects perform successfully. For example, ESCO project data maintained in a joint Lawrence Berkeley National Laboratory/NAESCO database shows that ESCO projects implemented between 1996 and 2008 by state and local governments yield *median* energy savings of 28%, with the top 20% of projects saving 40% or more relative to project baselines. The same database shows that these projects paid for themselves in a median time period of just over 8 years.[6] At the Federal level, a 2007 Oak Ridge National Laboratory study determined that actual cost savings achieved through ESCO-implemented performance contracts exceeded the guaranteed cost savings by approximately 19%.[7] Lawrence Berkeley has also reported that across its entire database of ESCO projects, 72% achieved actual, verified cost savings that *exceeded* the guaranteed level, and an additional 9% met the guaranteed level of cost savings.[8] These studies offer vivid evidence that the system of monitoring, verification, and contractual guarantees provided in ESCO contracts more than adequately protect the interests of municipal governments and the public. There is simply no policy problem with the energy retrofits delivered by ESCOs that requires a federal regulatory response by the Commission.

Even if the case were otherwise, neither the Commission nor the Municipal Securities Rulemaking Board (MSRB) has any institutional experience or expertise in regulating engineering-based studies such as cash-flow analyses. Had Congress intended federal oversight of ESCOs for preparing cash flow analyses of proposed energy retrofitting projects, the logical regulators would have been either the Federal Energy Regulatory Commission or the Department of Energy since these cash flow analyses involve both building performance modeling and forecasting the cost of electricity, natural gas and, sometimes, fuel oil and liquid propane. Neither the Commission nor the MSRB has any expertise in these areas.

It is difficult to see how Commission regulation of ESCOs as municipal advisors would in any way improve the integrity of the services that ESCOs provide to municipal entities.[9] Clearly, Congress is of the same view; hence the exemption for "engineering

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[6] DOE/Lawrence Berkeley National Laboratory, *State/Local Government Project Performance Benchmarks (All ASHRAE Zones)* at 2 (July 2011), *available at* http://eetd.lbl.gov/ea/emp/reports/esco-state.pdf. Comparable performance results have been reported for K-12 schools and university/college facilities, which are also important components of the municipal ESCO market. *See* DOE/Lawrence Berkeley National Laboratory, *K-12 Schools Project Performance Benchmarks (All ASHRAE Zones)*at 2 (July 2011), *available at* http://eetd.lbl.gov/ea/emp/reports/esco-k12.pdf; DOE/Lawrence Berkeley National Laboratory, *Post Secondary Project Performance Benchmarks (All ASHRAE Zones)*at 2 (July 2011), http://eetd.lbl.gov/ea/emp/reports/esco-uni.pdf.

[7] John A. Shonder and Patrick J. Hughes, *Evaluation of the Super ESPC Program: Level 2 — Recalculated Cost Savings* at viii (ORNL/TM-2007/065, Aug. 2007).

[8] Nicole Hopper et al., *Public and Institutional Markets for ESCO Services: Comparing Programs, Practices and Performance* at 50 (LNBL-55002, Mar. 2005).

[9] NAESCO takes this opportunity to clarify a potential point of confusion regarding the ESCO industry. In a meeting this spring between two NAESCO members and several of the Commissioners, one Commissioner raised a well-publicized incident involving derivative contracts used to finance a sewer project in Jefferson County, Alabama, as a possible reason for a narrow interpretation of the engineering exemption. In that incident, which was described in the *New York Times* (see attached article), Jefferson

advice." We believe that Congress clearly intended the Commission's regulatory efforts to be focused on those firms and individuals that Congress clearly intended to target through Section 975 — that is, financial professionals and intermediaries who market financial products and investment strategies to municipalities.

III. THE COST-BENEFIT ANALYSIS SUPPORTING THE PROPOSED RULE IS DEEPLY FLAWED

The cost-benefit analysis supporting the proposed rule is deeply flawed, for two principal reasons. First, the quantitative portion of the Commission's analysis of the cost of regulation addresses only the labor costs directly associated with registration and recordkeeping.[10] The Commission totally omits all other costs that flow directly from the proposed rule and that are likely to be far more significant, including the costs of potential fiduciary liability for municipal advisors[11] and the costs of regulation by the MSRB. For ESCOs, fiduciary liability is likely to represent a particularly costly compliance burden because this type of liability historically has been foreign to engineering companies. Pricing the risk associated with exposure to fiduciary liability — and protecting against that risk — is therefore particularly difficult for ESCOs. In overlooking what are potentially very significant costs that derive directly from the proposed rule on "municipal advisors", the Commission has based its proposed rule on a woefully incomplete cost-benefit analysis.

Second, the Commission's cost-benefit analysis makes sweeping assertions that municipal advisor registration will not cause an excessive number of exits of companies that provide energy services to municipal entities or cause significant new costs to be passed on to municipalities.[12] The Commission's conclusions may or may not be true for traditional investment or financial advisors, but these rosy conclusions do not apply to the ESCO industry. Many small and medium-sized ESCOs are in no position to shoulder the combined burdens of registration, recordkeeping, fiduciary liability, and MSRB regulation. These firms likely will either withdraw from the municipal energy services market altogether if the proposed registration requirement is finalized, or pass on their higher costs by either raising the price of ESCO services or significantly lowering guaranteed energy savings to municipalities, thus reducing the economic benefits of ESCO services to municipalities.

County purchased interest-rate swaps that ultimately caused severe financial losses. However unfortunate, the events in Alabama had no connection whatsoever to the ESCO industry or the kinds of services that ESCOs provide. ESCOs do not market, design, or recommend financing products (least of all derivatives or swaps) to municipalities. If an ESCO were to engage in the kind of marketing activities that occurred in Jefferson County, NAESCO agrees that such activity would most likely be outside the scope of the engineering exemption.

[10] *See* 76 Fed. Reg. at 875-76.

[11] Section 975 requires all municipal advisors to assume a fiduciary duty towards their municipal clients. 15 U.S.C. § 78o-4(c)(1).

[12] *See* 76 Fed. Reg. at 876 (asserting that the market for municipal advisors is "competitive" and will therefore not be harmed by the exit of some entities from the market, and assuming that "few" costs associated with the proposed rule would be passed on to municipal entities in the form of higher fees).

These actions would have important adverse consequences for the public. As discussed above, state and local governments around the nation depend on ESCOs to provide guaranteed savings in energy consumption and much-needed energy upgrades to public buildings. Were smaller ESCOs to withdraw from the market, the supply of ESCO services to municipalities would likely diminish and the prices charged to municipal entities for municipal services would almost certainly rise. Those ESCOs that do remain in the market likely will need to pass on the substantial costs of meeting Section 975 requirements to municipal entities through higher prices or reduced energy savings guarantees. The Commission's economic analysis of the proposed rule simply ignores all of these potential impacts, without even attempting to quantify them.

For these reasons, we believe that the "cost/benefit analysis" of the proposed rule by the Commission is fatally deficient and will not withstand third party scrutiny.

IV. PROPOSED SAFE HARBOR

Given the legal, policy and economic arguments against the regulation of ESCOs as municipal advisors, NAESCO supports the request contained in the June 22, 2011 letter from Senators Bingaman, Landrieu, and Coons. These Senators have asked the Commission to promulgate a safe harbor exempting ESCOs from Section 975 regulation so long as ESCOs confine their activities to the engineering-related services described in the safe harbor provision. NAESCO believes the Commission has clear authority to issue such an exemption under Section 15B(a)(4) of the Securities Exchange Act,[13] which empowers the Commission to exempt any person from the municipal advisor registration requirements, if consistent with the public interest, the protection of investors, and the purposes of the section. These criteria for exemption are clearly applicable to ESCOs. As explained herein, regulating ESCOs as municipal advisors would create no benefit for investors or the public and would, in fact, materially harm an industry that creates jobs and helps municipalities save energy and money. The exemption of ESCOs from this regulatory program, so long as their actions fall within the limits of the attached proposed safe harbor, would be consistent with the existing exemption from municipal advisor registration for "engineers providing engineering advice."

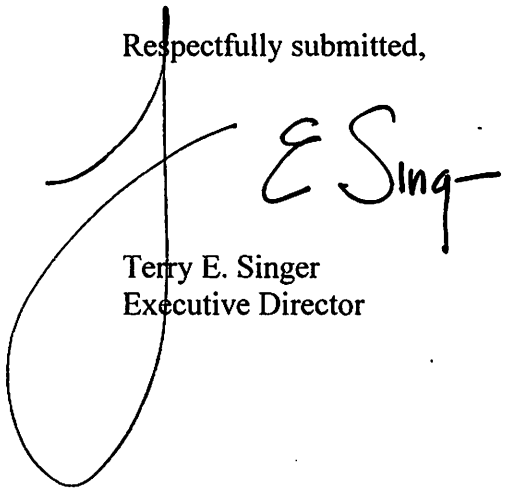
Therefore, NAESCO respectfully submits the attached proposed regulatory language, which would create a safe harbor from municipal advisor registration for ESCOs that engage only in the approved activities described in the safe harbor. The safe harbor language also explicitly identifies certain prohibited activities — such as recommending financing vehicles or accepting compensation for introductions of financial firms — which would cause an ESCO to lose eligibility to be considered under the protection of the safe harbor designation. We believe the proposed safe harbor is narrowly crafted to provide regulatory certainty to ESCOs providing engineering-related services, while preserving the Commission's authority to regulate other sectors and to regulate those ESCOs that engage in genuine financial advisory activities.

[13] 15 U.S.C. § 78o-4(a)(4)

V. CONCLUSION

Thank you for your thoughtful consideration of our concerns and the attached proposal. NAESCO would welcome the opportunity to meet with the Commission Members and your staff to discuss this letter and any outstanding policy concerns the Commission may have with respect to ESCOs. Please direct any inquiries to Lynn Sutcliffe, Chairman of NAESCO Government Affairs and CEO, Energysolve at lsutcliffe@energysolve.com or Robert Szabo, Member, Van Ness Feldman at RGS@vnf.com .

Respectfully submitted,



Terry E. Singer
Executive Director

cc:

Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner

SUGGESTED TEXT OF PROPOSED RULE TO EXEMPT ESCOs FROM REGISTRATION AS MUNICIPAL ADVISORS

Overview

This document proposes regulatory text designed to exempt energy service companies (ESCOs) from being subject to regulation as "municipal advisors" under Section 975 of the Dodd-Frank Act, provided that they confine their activities to offering engineering analysis and general financial information customarily provided by ESCOs.

The proposed text below contemplates that the SEC would exempt ESCOs specifically from the municipal advisor registration requirement, using its authority under 15 U.S.C. § 78o-4(a)(4) to exempt any municipal advisor or class of municipal advisors when consistent with the "public interest," the "protection of investors," and the purposes of the relevant section of the Securities Exchange Act.[1] ESCOs would not be subject to registration for providing energy audits, cash flow analyses and feasibility studies, the provision of general educational information on financing options or methods, and uncompensated introductions to financing entities. ESCOs would not qualify for the exemption if they provide financing, either directly or through a subsidiary or related party, make recommendations to clients as to particular methods of financing; offer compensated introductions or referrals regarding financing; or apply for financing on behalf of a client, where that financing involves instruments or products covered by Section 975.

Proposed Regulatory Text

§ 240.15Ba1-XX. Exemption for Energy Service Companies.

(a) Exemption from registration and regulation as municipal advisors.

Subject to the conditions described below, this section exempts energy service companies (as defined in Section 240.15Ba1-1 of these regulations) from all registration and regulation requirements that apply to "municipal advisors" under Section 15B of the Securities Exchange Act, as amended by Section 975 of the Dodd-Frank Act. As

[1] Alternatively, the SEC could protect ESCOs from registration as municipal advisors by broadening its interpretation of the term "engineering advice" in Section 975 of the Dodd-Frank Act to *include all or most* ESCO business activities. This alternative route would have the same legal effect as the exemption described in this document.

required by Section 15B of the Securities Exchange Act, the Commission has determined that this exemption is consistent with the public interest, the protection of investors, and the purposes of the section.

(b) Conditions. An energy service company shall qualify for the exemption described in subsection (a) above insofar as its municipal advisory activities consist of offering and, or, providing, in the course of developing and implementing projects, one or more of the following energy services:

(i) Preparation of energy audits, engineering diagrams, equipment or building specifications, and related technical reports;

(ii) Preparation of estimates of costs and benefits resulting from an energy service company project, including cash flow analyses and studies evaluating the economic feasibility or viability of an energy service company project;

(iii) Provision of general educational information to energy service company clients on common methods for financing energy service company projects; and

(iv) Offering introductions to individuals or institutions that are in a position to finance energy service company projects, where that financing involves instruments or products covered by Section 975, provided that:

(I) the energy service company receives no direct or indirect compensation from the individual or institution for the introduction;

(II) the individuals or institutions named are either registered as municipal securities dealers or municipal advisors under section 15B of

the Securities Exchange Act (15 U.S.C. § 78o-4), or are exempt from or not subject to registration under section 15B of the Securities Exchange Act; and

(III) the energy service company makes no recommendation as to which introduced individuals or institutions should be used for financing the project in question.

(c) Prohibited activities. An energy service company shall not qualify for the exemption in subsection (a) above if its activities include any of the following:

(i) Recommending any particular proposal for debt financing of an energy service company project;

(ii) Accepting direct or indirect compensation of any kind from an individual or institution in exchange for referring a particular individual or institution to be considered for debt financing of an energy service company project; and

(iii) Applying for debt financing for an energy service company project on behalf of an energy service company client, where such debt financing involves the issuance of municipal securities or a municipal financial product.

(d) Meaning of "direct or indirect compensation." For purposes of this section, the phrase "direct or indirect compensation" shall not include compensation provided by the energy service company client to the energy service company as payment for design and implementation of the energy service company project.

§ 240.15Ba1-1 is amended to read as follows:

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(k) An energy service company ("ESCO") is defined as a company that develops and implements comprehensive building energy efficiency projects, offering, as a significant part of their business, performance-based contracts pursuant to which the compensation of the ESCO is dependent in some manner on the energy savings generated by the project, including but not limited to guarantees of energy savings. ESCOs typically have the ability to offer the following services: energy audits; design engineering; construction management; commissioning and retro-commissioning of buildings; operations and maintenance of energy efficiency technologies; and verifying energy savings.