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Dealmaking

Dodd Frank 'Biggest Threat' To Renewables Industry

By **Felicity Carus**

Photo by Justin Sullivan, Getty

The Dodd-Frank Act, introduced to clamp down on the high-risk transactions that brought the financial system to its knees in 2008, could reduce capital funding for renewable energy projects and hit environmental commodity trading, leading industry experts said last week.

"There was a perception that bankers were ripping off Main Street folks and that needed to be changed. If you look at these causes and say what does this have to do with renewable energy ... this has very little to do with renewable energy," said Steve Michelson, counsel at environmental commodities specialist 3Degrees. "Our [environmental] markets and the energy industry did not cause the financial crisis. But if you look at Congress's solutions to these problems we are implicated in some ways."

Wall Street legislation was passed in July 2010 in response to the financial crisis. But the renewable industry is concerned that Renewable Energy Credits (RECs) could be defined as "swaps" and be subject to the same regulations aimed at curbing excessive risk-taking in derivatives trading.

Problems For The Little Guys

Under the Dodd Frank Act, entities participating in REC transactions will be required to post collateral deposits to a highly regulated exchange with a clearinghouse. But the Commodity Futures Trading Commission (CFTC) has not yet said what level of deposit would be required, although industry participants have suggested that the requirement could be between 5% and 25%.

The amount of capital available in renewable energy markets and for project development would be hit badly, attorney Jeremy Weinstein told last week's Renewable Energy Markets Conference in San Francisco.

"If you are a wind farm developer and you are [defined as a] swap dealer and you are required to post collateral ... In addition to the money needed to build your wind farm and the cash flow that you're getting from the utility, you've got to figure out a way to come up with tens of millions of dollars to collateralize a 20-year Power Purchase Agreement. What does that mean to who can participate in the renewable energy industry? It's going to be people who have access to that kind of capital on a non-project basis," he said.

> *If you're a utility and the price of power has gone down and you're required to post to an exchange to protect against the value of the contract, you're passing on that cost of capital and you've got to figure out a way to get [it from] your ratepayers.*

He added: "This is the potential impact on the renewable energy industry. If [a] contract is a swap, that means you've got to come up with tens of millions of dollars of additional cash just to clear this money which just sits in an exchange. If you are a utility seeking to use renewable energy the cost of renewable energy has just gone up."

Swap And Trade

Andrew Kolchins, managing director at Evolution Markets said it was the biggest issue currently facing the industry and that the current over-the-counter system was best for over the counter market transactions.

"Dodd Frank and the financial reform and whether they are going to try to qualify REC as a swap, if it becomes defined as a swap, then you're going to ultimately exchange trade and clear every product except end users who are exempt in certain scenario," he said.

For more on the impact of the financial crisis and resulting legislation on the energy markets, read AOL Energy's Financial Crisis Continues To Impact Energy Markets.

"My personal opinion is that a REC is not a swap. If for some crazy reason they do something against what I think is logical it will be a very bad sign for the market. Think about all the entities that will have to trade through an exchange."

The Renewable Energy Markets Association wrote to the Commodity Futures Trading Commission this summer to advocate for the exclusion of environmental commodities from the swap definition because they are "physically settled" rather than purely financial transactions.

Kolchins said that the extension of the definition could affect even small-scale residential installations.

"Think about the solar home owner. How is that person going to transact and clear? If you put a solar panel on your roof and you want to sell your credits you've got to be a member of this exchange. It doesn't seem logical that this could happen," he said.

"I'm cautiously optimistic but it's the biggest issue for our industry right now and hopefully they don't screw it up."

A Voluntary Market

Last month, the National Renewable Energy Laboratory published data that that the compliance market for RECs outpaced that on the voluntary market for the first time in 2010.

Compliance demand in 2010 was estimated at 55 million MWh while voluntary demand was 35.6 million MWh. Compliance demand is expected to increase to more than 150 million MWh by 2015, according to the report: *Status and Trends in US Compliance and Voluntary Renewable Energy Certificate Markets.*

Jennifer Martin, executive director of the Center for Resource Solutions told the conference: "In 2010, we saw a 20% increase in megawatt hours traded. But it was also the first year when the RPS markets grew faster than the voluntary markets. Up until this time those two markets were about the same size. But RPS has leaped ahead and the expectation is that it will continue to grow at a faster pace."

The CFTC is expected to publish final regulations before January 1, 2012, as many other Dodd-Frank rules that incorporate swap definitions are scheduled to take effect then. Proponents say that the regulations on swaps would reduce risk and speculation. The CFTC has not yet indicated whether RECs or other environmental commodities will be exempted from the Dodd Frank Act.