Contracting for a unified RECs market

Jeremy Weinstein reviews progress made, and the challenges faced, in drafting a standard contract for trading renewable energy certificates

Significant progress has been made in the effort to draft a standard contract for trading renewable energy certificates (RECs), or ‘green tags’. As was reported in these pages (see Environmental Finance, May 2006, p.35), a joint committee of the Renewable Energy Resources Committee of the American Bar Association and the American Council on Renewable Energy has been working to produce a form that is technology neutral, usable in both the voluntary and compliance markets, and legally robust regardless of American jurisdiction.

The contract is intended as infrastructure, or a paved road, to help buyers and sellers transact, foster market mechanisms to promote renewable resource development and, perhaps most importantly, stave off the potential ‘balkanisation’ of US RECS markets. Previously, the committee broke into several different workstream subcommittees, which each developed separate areas of the contract based upon member expertise. Those separate results have been reconciled and edited into a single draft document, a Master Renewable Energy Certificate Purchase and Sale Agreement, which the full drafting committee is now reviewing.

The committee has been making good progress in finalising the document through a series of conference calls. Some of the issues with which the committee has grappled include:

- **Change-in-law risk** When a REC is sold in a compliance market, is the seller who represents that it complies with the requirements of a particular programme making that representation as of the date of the agreement to sell, or as of the date the REC is delivered, which could be much later? The committee decided to provide that the buyer takes the risk on the potential for change in the legal requirements after the date of sale, unless the product in a particular transaction is sold with a ‘regulatorily firm’ or ‘regulatorily continuing’ label, in which case the seller takes the change-in-law risk. This concept was shared with the International Swaps and Derivatives Association’s US Emissions Trading Annex drafting committee, whose membership overlaps with that of the RECs contract committee, and may appear in that document.

- **Government action** The committee struggled to determine the appropriate consequences of government implementation of a new, or repeal of an existing, programme substantially changing the value of RECs under contract. A seller may be counting on the sale of RECs to support the economics of a project, and a buyer will want to know that the RECs it has foresight to purchase in advance of being required will be forthcoming. The committee opted to provide that government action does not excuse performance, but rather relates solely to the change-in-law risk which the parties allocate as described above.

- **Voluntary and compliance programmes** There are 50 states in the union; some of them have reductions offset credits. The verification option requires disclosing the ‘who and the how’, without mandating the who or the how; the parties could agree that it is one of them carrying out verification. This promotes disclosure and sets the stage for using market mechanisms to establish optimum verification methodologies as they become part of the landscape of REC markets.

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Renewable Portfolio Standards requiring utilities to acquire a certain proportion of their energy from renewable resources. Despite the danger of trying to be all things to all people, the contract tries to do just that, with definitions and contract mechanics carefully crafted to ensure that it not only works both in mandatory compliance and voluntary markets, but also works across different compliance and voluntary markets, each with their different mechanisms for certifying and clearing RECs. To support this, the committee is working hard to develop transfer documentation possessing the flexibility to work in, and fully inform, both classes of markets, with the fundamental committee goal of promoting fungibility of RECs across programmes.

- **Unbundling RECs** A particular quantity of renewable energy generation includes a variety of avoided emissions and other environmental impacts that are unknown in magnitude until measured. The standard REC product includes all these attributes intact. However, one can measure and verify a component – for example, avoided carbon dioxide (CO₂) emissions.

If sticks are identified in the REC bundle and verified to unlock their potential value, different buyers will attribute different values to the various sticks, and the agreement is being designed to maximise the ability of these components to find their highest bidder through full and accurate disclosure. The draft contract sets forth optional mechanics permitting component verification and disaggregation, from which the parties are fully free to abstain but, should they choose to disaggregate, a fully disclosing transaction record is generated.

This view is in line with the Kyoto Protocol’s Clean Development Mechanism Executive Board’s recent decisions on renewable energy targets and Certified Emission Reductions offset credits. The verification option requires disclosing the ‘who and the how’, without mandating the who or the how; the parties could agree that it is one of them carrying out verification. This promotes disclosure and sets the stage for using market mechanisms to establish optimum verification methodologies as they become part of the landscape of REC markets.

No matter how the products are defined, and whatever the methods proposed for defining, verifying, certifying and transferring RECs, the contract will not be complete until the committee members are confident that it effectively enables trading in today’s markets of currently traded products in the manner in which they are now traded.

- **Short positions** The measure of the successful development of RECs markets will be the existence not only of secondary and tertiary trading of RECs, but the ability of speculators to take short positions in RECs not yet generated. The draft contract contains clauses particularly intended to facilitate such developments.

The committee has revisited what proved to be an overambitious timetable, and is hoping to formally publish the contract by the end of this year. For more information, e-mail: recs.chairs@emissions.org

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