Standardising RECs contracting

Jeremy Weinstein and Daniel Chartier report on an interdisciplinary effort to improve the contracts used in renewable energy certificate markets

This spring, the Environmental Markets Association (EMA), the Renewable Energy Committee of the American Bar Association (ABA) and the American Council on Renewable Energy (ACORE) launched an ambitious stakeholder-driven process to draft an industry standard trading enabling agreement for renewable energy certificates (RECs, or ‘green tags’).

The main driver for the effort is that contracting in today’s market for the sale and purchase of RECs is not easy, and has generated uncertainties that put the RECs marketplace at unnecessary risk. Unlike the gas, electricity and emissions markets, there is no standard form of agreement widely recognised across the industry. This often requires each RECs trade to be handled as a unique bilateral transaction, with its own form of contract for the occasion. This process is slow, cumbersome, and costly.

This absence of a robust, recognised industry standard trading agreement for RECs, while a windfall for transactional attorneys, inhibits the development of the standardisation that is so important for successful markets. Counterparties to RECs trades desire a more efficient way to manage a growing volume of contracts and to capture for RECs markets the gains that contract standardisation has brought to the gas, electricity and emissions markets. Well-thought out standard forms of trading enabling agreements help ensure that legal outcomes match the expectations of the contracting parties, shorten the time necessary to trade, and lower the costs of individual transactions, all of which promote efficient markets.

RECs markets have progressed from an initial voluntary market, where parties traded RECs to improve the ‘greenness’ of their individual portfolios, to one where an increasing number of US states are adopting renewable portfolio standards (RPS), mandating a portion of electricity to come from approved renewable resources. These RPS requirements, many of which allow for the trading of RECs to demonstrate compliance with targets, are transforming today’s sleepy voluntary markets into powerful, fast-moving markets used by utilities to manage least-cost compliance. This makes the need for a trustworthy RECs trading enabling agreement all the more pressing.

The immediate objective of the EMA/ABA/ACORE RECs Committee is to draft and promulgate a standard form of agreement that is technology-neutral, usable in both the voluntary and compliance markets, and legally robust regardless of jurisdiction. The committee co-chairs are Jeremy Weinstein, representing EMA, Roger Feldman and David South, representing the ABA, and Michael Eckhart, representing ACORE.

To support this work, the RECs Committee has assembled a group of more than fifty experts on RECs trading, representing utilities, renewable project developers, marketers, regulators, and certification agencies, and including members from contract committees of other industry associations that have developed successful forms of trading enabling agreement, such as the standard energy trading contract of the Edison Electric Institute. This group has split into three workstreams, and has begun the drafting process. Two workstreams will focus on issues around RECs contracting itself, including transfer of RECs as an asset, trading terms, taxes, governmental action, and force majeure.

Of particular interest to the developing marketplace is a third workstream, Product Definitions, which will develop a set of product definitions for parties to use that are most applicable to the instrument they wish to trade. Example products include ‘whole RECs’ (that is, RECs which include all the green characteristics of the particular MWh of power), RECs documented as qualifying under a particular state’s RPS programme, and RECs which are a state cap-and-trade emissions credit or other component may have been added to or disaggregated from.

The need to improve efficiency as markets move from purely voluntary to partially or wholly compliance-driven is important. Nascent RECs markets face significant risks as they grow and make this transition. The most successful markets have commonly accepted definitions of the commodity. In the emission markets, for example, each sulphur dioxide allowance of a given vintage is interchangeable with every other one.

Yet today’s RECs markets are at risk of ‘balkanisation’ as different states and regions set specific and often potentially incompatible definitions of RECs. Also, different stakeholders see benefits from varying RECs products, leading to the questions of what is left behind as various attributes are stripped out, and how best to document trading to ensure functioning markets that can provide least-cost alternatives. Balkanisation leads to confusion, smaller and more splintered markets for RECs, fewer compliance options for utilities seeking to comply with an RPS and, in the end, higher costs for the implementation of renewable energy programmes for any given state or region.

Solving issues like these is critical to the continued development of the RECs market.

Work is under way and is expected to be completed by this autumn. After the RECs Committee has published its form of contract, the EMA, ABA and ACORE will reconvene on the many additional issues necessary in order to facilitate continued advancement of RECs markets. We’ll report further progress in this space.

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The Environmental Markets Association consists of more than 270 members from 190 companies worldwide. Its aim is to promote market-based trading solutions for environmental control.