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Renewable Energy Projects: Structuring REC Purchase and Sale Agreement, Interconnection Agreement

Negotiating Key Provisions, Navigating Regulatory Timelines and Requirements

TUESDAY, NOVEMBER 9, 2021

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Graham T. Coates, Attorney, **Holland & Knight**, New York

Kristen Thall Peters, Partner, **Cooper White & Cooper LLP**, San Francisco

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STRUCTURING REC PURCHASE AGREEMENTS

November 9, 2021

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Cooper, White & Cooper LLP

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Kristen Thall Peters

- **Kristen Thall Peters** is Chair of the Green Practice Group at Cooper, White & Cooper LLP. She is also a member of CWC's Energy, Real Estate and Environmental practice groups.

- This past year, Kristen aided her clients in acquiring, developing and expanding 50+ renewable energy facilities, including securing real property interests for the land on which the facilities operate, drafting host and royalty agreements, ensuring environmental compliance and compliance with renewable portfolio standards, resolving land use and permitting issues, and negotiating power purchase and interconnection agreements, construction contracts, and agreements for the purchase and sale of environmental attributes, including RECs, carbon credits, RINs, LCFS credits. She has also been successful in closing several financing transactions for these projects located throughout the United States.

- Kristen holds a B.A. in Environmental Sciences from the University of California, Berkeley and a J.D. from Santa Clara University.

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Graham Coates

- **Graham Coates** practices environmental, energy, public utility and infrastructure law at Holland & Knight.

- Graham advises clients on renewable energy regulatory, project finance and development issues, including environmental issues and project contracts. He represents project developers and sponsors of solar PV, biomass, geothermal and energy storage, among other technologies. He also assists clients with state and federal environmental and energy regulatory compliance and enforcement proceedings. He counsels clients on energy and environmental issues in corporate M&A transactions, including acquisitions, development and divestitures of fossil and renewable power plants.

- Graham is based in Holland & Knight's New York City office.

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Program Agenda

- Introduction to REC Purchase and Sale Agreements
- Regulatory Considerations (state created, net metering, size limits, mandatory vs. voluntary, compliance issues)
- Interconnection agreements and related PURPA QF considerations
- Best practices for negotiating and structuring REC agreements

Introduction to REC Purchase and Sale Agreements

- A Renewable Energy Credit (REC) is an "environmental attribute"
  - A single REC provides evidence that one megawatt-hour (MWh) of electricity was generated from a renewable energy resource
- RECs are state created, may be part of Renewable Portfolio Standard (RPS)
- Sample Master REC Purchase Agreement available from EEI at:

https://www.ipa-energyrfp.com/wordpress/wp-content/uploads/2021/03/1_EEI-Master-and-Coversheet_3-MAR-2021.pdf

Not to be confused with…

- Carbon Credits
- RINs
- LCFS Credits
- Emission Reduction Credits
- Other Environmental Attributes

Possible sources of RECs

- Wind
- Solar
- Biomass
- Geothermal
- Hydro
- Waste to Energy
- Energy Storage
- Energy Efficiency
- Nuclear

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Regulatory Considerations: Renewable Energy Incentives

- Renewable Portfolio Standards (RPS)
  - 30 states + DC have RPS; 5 states have clean energy standards.
- REC market value based on state mandates, such as RPS, and alternative compliance penalties
- RECs may qualify for another state's compliance program; can't be double counted

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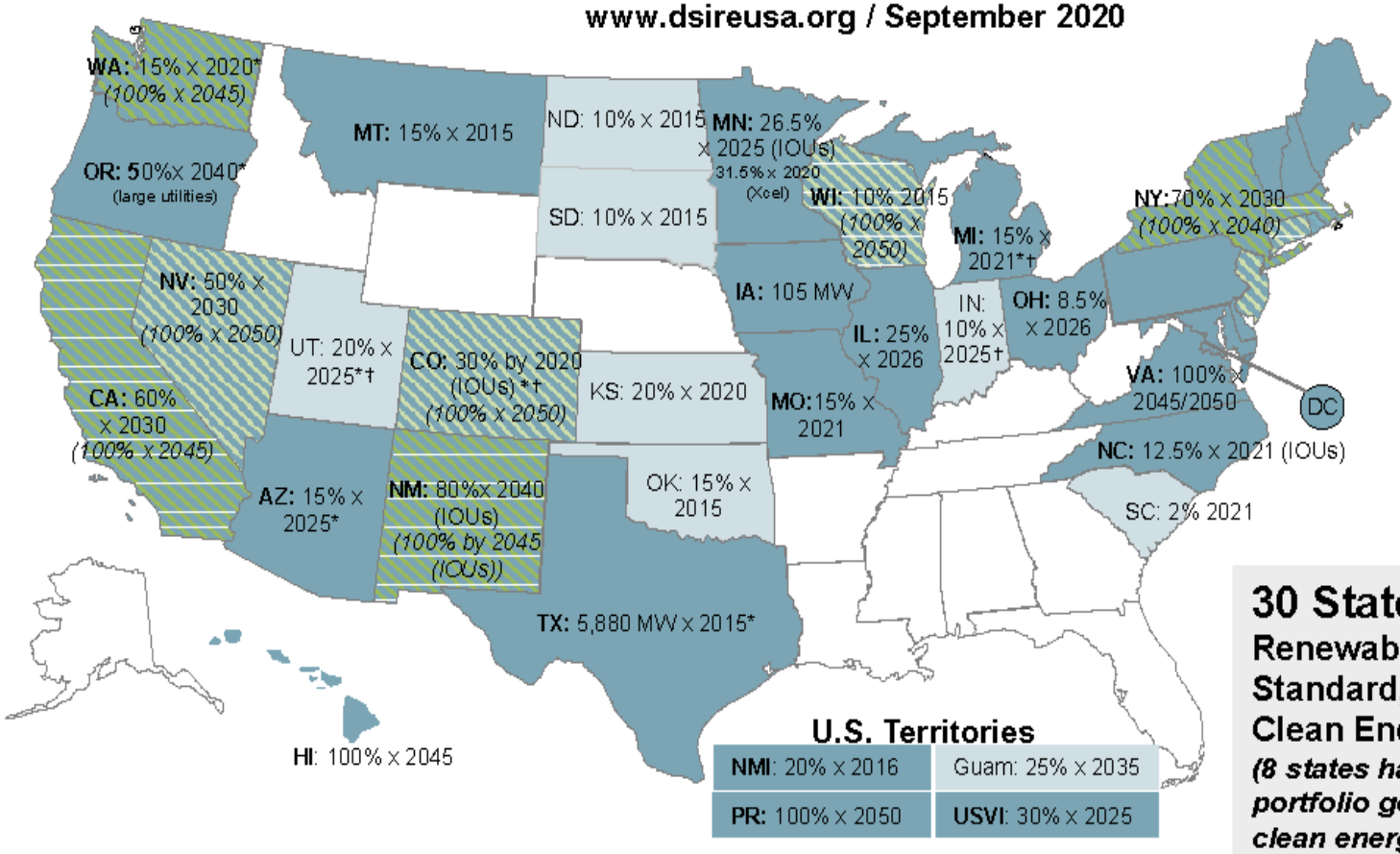
Renewable & Clean Energy Standards

www.dsireusa.org / September 2020



U.S. Territories

NMI: 20% x 2016	Guam: 25% x 2035
PR: 100% x 2050	USVI: 30% x 2025

30 States + DC have a Renewable Portfolio Standard, 5 states have a Clean Energy Standard

(8 states have renewable portfolio goals, 5 states have clean energy goals)

- Renewable portfolio standard
- Renewable portfolio goal
- *Clean energy standard*
- *Clean energy goal*

* Extra credit for solar or customer-sited renewables

† Includes non-renewable alternative resources

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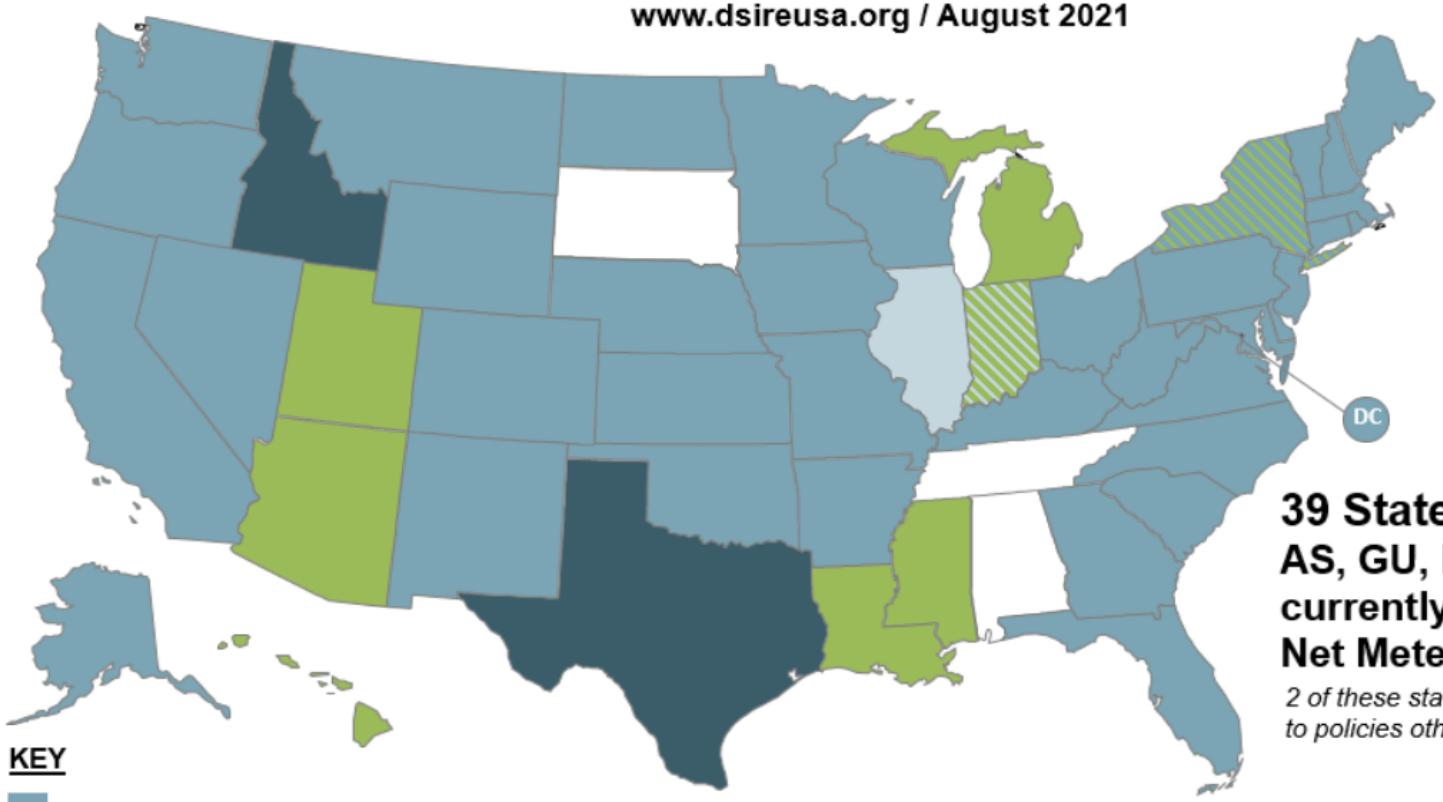
Net Metering

www.dsireusa.org / August 2021



NY: *Other DG compensation rules are for large customer-generators*

39 States + DC, AS, GU, PR, & USVI currently have mandatory Net Metering rules

2 of these states are in transition to policies other than net metering

KEY

- State-developed mandatory rules for certain utilities (37 states + DC+ 4 territories)
- In transition to statewide distributed generation compensation rules other than net metering (2 states)
- Statewide distributed generation compensation rules other than net metering (8 states)
- No statewide mandatory rules, but some utilities allow net metering (2 states)

U.S. Territories:

AS PR
VI GU

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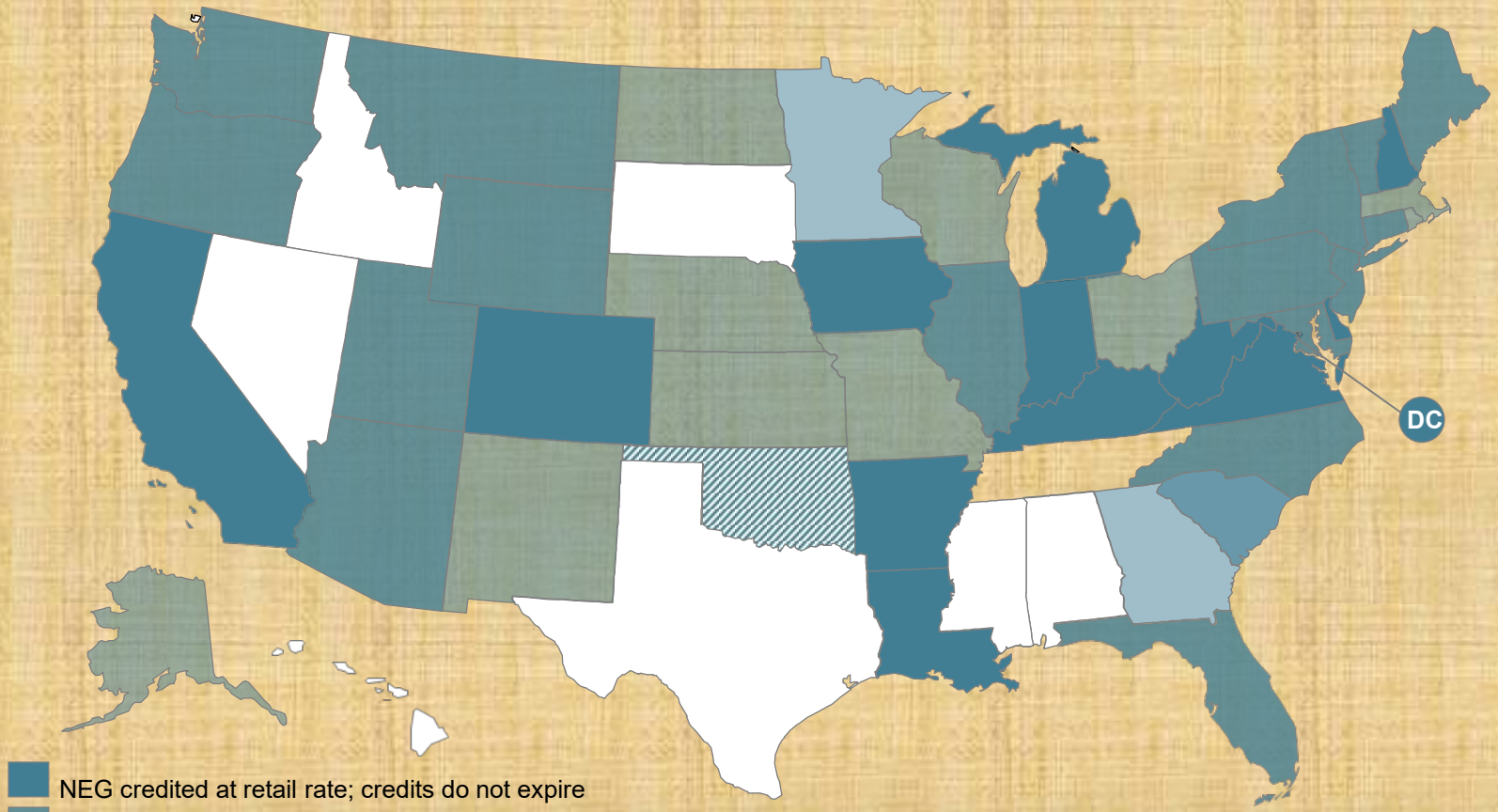
Customer Credits for Monthly Net Excess Generation (NEG) Under Net Metering

www.dsireusa.org / July 2016



- NEG credited at retail rate; credits do not expire
- NEG credited at retail rate at first, then credits expire or are reduced (e.g., to the avoided cost rate at the end of year)
- NEG credited at less than retail rate (e.g., avoided cost rate)
- NEG is not compensated
- No statewide mandatory net metering rules

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Regulatory Considerations: Net Metering and RPS Programs

State Requirements for RECs Vary Significantly

- Distributed Generation: Project is "inside the fence" and interconnected to host behind utility meter.
- Net Metering: Revenue meter tracks electric usage both ways. When host uses less electricity than intermittent source system generates, surplus flows to local electric utility – the issue is who gets the credit for surplus power generated and for how much (at wholesale or retail rate)? Some states use net metering as quid pro quo for transferring REC ownership to utility.
- DG Size Limits: Could be 2 MW or less, 6 MW or less, or less than the host's annual consumption needs. States allow utility's interconnection tariff to limit project size.

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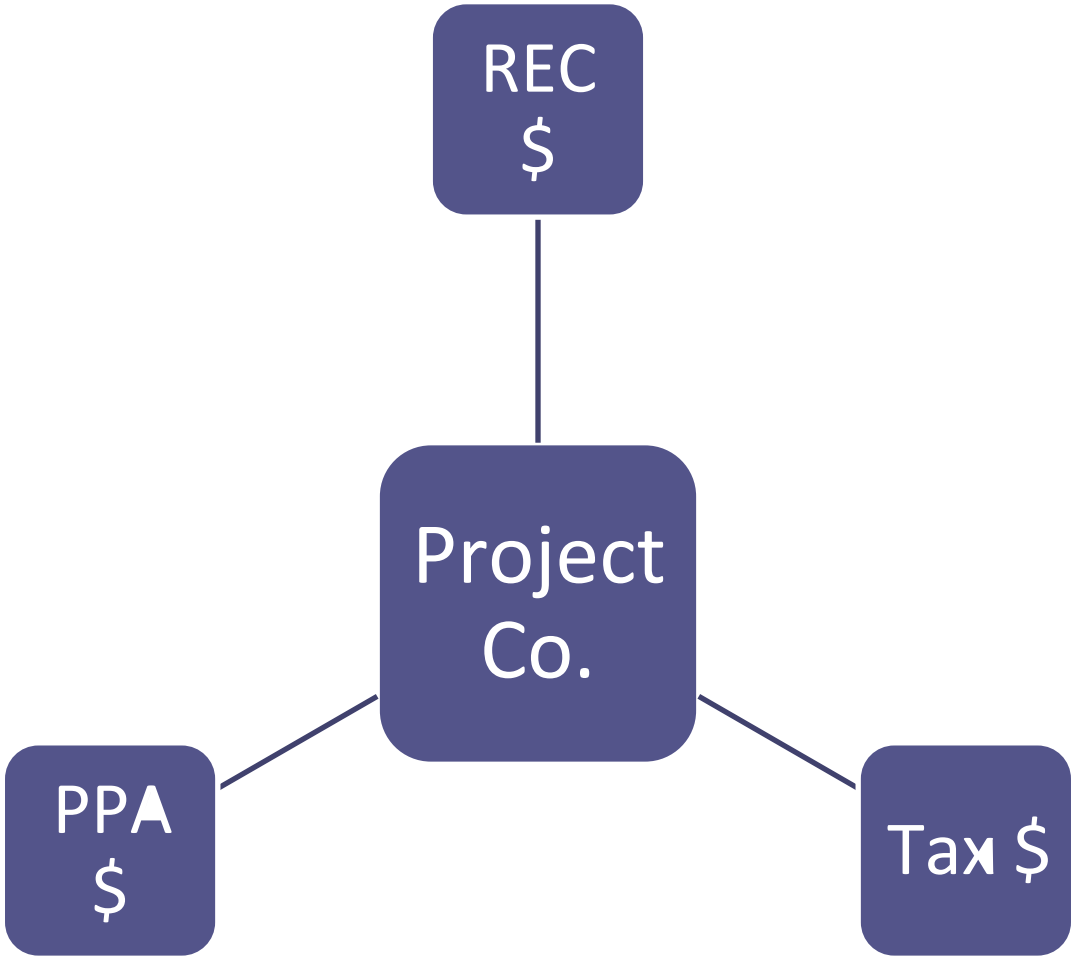
Overview of Typical Revenue Model Supporting Renewable Energy Project



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REC Purchase Agreement

- An offtake contract between Seller that generates electricity and Buyer, typically a load-serving entity with a compliance obligation or desire to show green power in portfolio.
- RECs usually are state-created and state-issued instruments certifying that energy was generated pursuant to certain requirements, such as a renewable portfolio standard. RECs can be bundled with related electricity or unbundled (disaggregated) and sold independently of electricity.
- If RECs are sold separately, electricity is no longer called "renewable energy" because renewable property disaggregated.

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Renewable Attribute defined:

- Renewable Attribute – all environmental characteristics, claims, credits, benefits, emissions reductions, offsets, allowances and allocations attributable to Delivered Energy and/or Capacity at any time during the Term, including any such attributes initially created, denominated or defined after the Execution Date. Renewable Attributes include but are not limited to: (i) any avoided emissions of pollutants to the air, soil or water including but not limited to sulfur oxides (SOx), nitrogen oxides (NO), carbon monoxide (CO), particulate matter and other pollutants; (ii) any avoided emissions of carbon dioxide (CO2), methane (CH4) and other greenhouse gases that have been or may be determined by the United Nations Intergovernmental Panel on Climate Change to contribute to the actual or potential threat of altering the Earth's climate by trapping heat in the atmosphere; (iii) all set-aside allowances and/or allocations from emissions trading programs; and (iv) all credits, certificates, registrations, recordations or other memorializations of whatever type or sort, representing any of the above, including but not limited to all RECs.

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Renewable Attributes Typically Exclude:

- any energy, capacity, reliability or ancillary services;
- production or investment tax credits or grants associated with the construction or operation of the project or other financial incentives in the form of credits, reductions, exemptions, deductions, adjustments or allowances related to local, state or federal taxes
- fuel-related subsidies or “tipping fees” that may be paid to the Seller to accept certain fuels, or local subsidies received by generator for the destruction of particular pre-existing pollutants or promotion of local environmental benefits
- emission reduction credits encumbered or used by the Project for compliance with local, state, or federal operating and/or air quality permits

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REC Benefits for Buyer

- No direct commitment of capital to invest in renewable energy project
- Pay only for RECs needed
- No renewable facility ownership risks (e.g., equipment failure, damage and obsolescence) shift to third party
- Avoids alternative compliance payment
- "Green" image from supporting renewable energy
- Can re-sell energy to end users as 100% renewable

Other REC Issues

- RECs can be traded like a commodity and brokers may play a role in buying in bulk and reselling to load-serving entities at a profit
- Depending on state RPS requirements, RECs must be dated or “minted” to match the compliance period
- RECs used for compliance must be retired to ensure they are not reused

REC Registries

Major REC Tracking Systems in United States:

- ERCOT (Texas)
- NEPOOL GIS (New England)
- PJM GATS (Mid-Atlantic)
- WREGIS (Western States)
- M-RETS (Midwest)
- NYGATS (New York)

Issue: Who owns the RECs if PPA silent?

- In *American Ref-Fuel Company* in 2003, FERC held that avoided cost PPAs between a qualifying facility ("QF") and a utility buyer under the Public Utility Regulatory Policies Act of 1978 ("PURPA"), do not also convey RECs to utility unless the contract expressly states otherwise. 105 FERC ¶ 61,004
- But, see *Wheelabrator Lisbon v. CT DPUC*, 531 F.3d 183 (2nd Cir. 2008) (state law governs conveyance of RECs; "state may decide that a sale of power at wholesale automatically transfers ownership of the state-created RECs [but] that requirement must find its authority in state law, not PURPA.").
- Practical Advice: Make sure Power Purchase Agreement clearly identifies owner of any RECs created by project.

Alternative Approach: Bill Credits

- State programs can allow for “virtual” net metering of renewable projects and provides for retail bill credits. Allows for off-site use of renewable energy.
- Net Metering Credit Purchase Agreements (NMAs): Allow for buyer to receive 100% of the value of net-metering credits on their utility bill and pay project owner a fixed percentage of that value, such as 95%, for a guaranteed savings of 5%.
- NMAs may include a floor price for utility rates, below which the project company will not guarantee savings to the buyer. Under this scenario, the payments made to the project owner will be directly related to the utility net metering rate.
- With NMAs, no PPA is necessary. Energy goes to utility which generates bill credits; project sponsor gets negotiated discount off the bill credit transferred to buyer that host would otherwise get.

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Alternative Approach: Clean Energy Standard

- New York defines at risk nuclear energy as eligible for zero emission credit (ZEC) payments and offshore wind farms as eligible for offshore wind emission credits (OREC) payments.
- State agency (NYSERDA) will buy all ZECs and ORECs produced by at risk nuclear plants and offshore wind farms.
- All load-serving entities in NY, including municipal, self-generating and public power customers of LIPA and NYPA, must buy ZECs and ORECs from NYSERDA at state-approved price.
- LSEs to pass costs of ZECs and ORECs through to all end use customers.
- Program is mandatory; ZECs and ORECs cannot be traded.
- ZEC/OREC program is in addition to RECs required to satisfy NY RPS.

Design, Permitting and Construction Risk

- Will equipment and/or technology fail?
- Is the site suitable for construction and operation of the facility?
- Will EPC contractor fail to complete construction?

REC Risk Identification

In any REC purchase agreement:

- Completion Risk (is project delivered on time such that buyer can receive RECs when needed)
- Force Majeure
- Conveyance of Title (seller must convey good title)
- Credit (Seller will insist that buyer satisfy credit requirements to assure its financiers that offtaker is not a credit risk)

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REC Agreement: Key Contract Terms

- Quantity (can be all output)
- Payment terms
- Term (may very from 1 to many years)
- Warranties (Seller warrants title to RECs)
- Indemnification (Should back up Seller warranty)
- Force Majeure (If plant fails, RECs unavailable)
- Termination
- Assignment
- Guarantees (Minimum quantity can be guaranteed)
- Dispute resolution

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REC sales: What exactly is being bought and sold

- Bundled versus unbundled
  - Agreement to buy and sell included in PPA or stand alone agreement?
- All environmental attributes sold or just RECS?
  - Definition of commodity needs to be clear
  - Risks associated with insufficient definition

Transferability/ Assignability of RECS

- Does agreement allow for transfer of RECs or assignment of agreement to a third party?
- Consent requirements
- Back-to-back sale agreements
- Collateral assignment

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REC Contract Key Term: Standard of Care

"Prudent Electric Industry Practice"

- Practices that, at a particular time, in the exercise of reasonable judgment in light of the facts known or reasonably should have been known at the time a decision was made, could have been expected to accomplish the desired result consistent with good business practices, reliability, economy, safety and expedition
- Generally conform to operation and maintenance standards recommended by the Facility's equipment suppliers and manufacturers, applicable Facility design limits and applicable Governmental Approvals and Applicable Law
- Not intended to be limited to the optimum practice, method or act to the exclusion of all others, but rather to include acceptable practices, methods or acts generally accepted
- Includes, but not limited to, practices engaged in or approved by a significant portion of the U.S. electric power generation industry

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Security

- Ensures payment of REC purchase obligations
- Ensures Seller REC deliver performance
  - Indemnification obligations
  - Insurance obligations
  - Completion

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Interconnection Agreement

- Construction
- Distribution
  - sending energy directly to utility
  - sending energy via utility's system to 3P off taker
- Term and renewals
- Point of interconnection/access
- Allocation of responsibility
  - PUC guidelines/tariff
  - Disconnection of unit
  - Ownership rights over wholesale power capacity
- Invoicing and payment
- Security
- Governing Law

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Security Agreements

- **Security Agreement** is a contract that governs the relationship between parties to a secured transaction
- Personal property in which a secured interest in owned is the "collateral"
- Collateral can only be personal property, not real property
  - Stock, membership or partnership interest
  - Licenses, contracts
  - Equipment

Security Agreements Cont.

- Governed by contract wording and UCC
- What further permitted sales or assignments are allowed?
  - What notices must be given by the parties if certain actions are taken?
- Must be perfected by filing UCC lien

Guaranty

- **Guaranty** can be granted by any third party to encourage the entering into of a contract
  - Parent of single purpose entity
  - Shareholder of corporate entity
- What are limits of guaranty?
  - What if project is sold or expanded?
  - What if underlying agreements are changed?

Letter of Credit

- Issued by a financial institution
- Typically irrevocable for a period of time, but may be automatically renewed
- Form of demand typically attached

Developer Covenants

- No sale or transfer of property
- Affiliate transactions/restrictions on change of control
- At end of term, property must be returned in specified condition
- Grantee bears risk of any loss or damages; must replace or pay termination value
- Failure to pay rent, breach of covenants, inaccuracy of representations and bankruptcy will trigger default allowing grantor to exercise various remedies from repossession to payment of damages

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Questions and Answers

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