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Development of energy efficiency credits could depress RECs markets

By Amanda Luhavalja

Although the majority of states have already adopted renewable energy requirements, market participants say a single, nationwide standard for renewable energy supply, implemented through the creation of a national market for federal compliance certificates that sits alongside the existing state systems and voluntary renewable energy credit markets, is needed.

And hopes for a federal renewable portfolio standard may not be dead. On Sept. 21 Senate Energy and Natural Resources Committee Chairman Jeff Bingaman, D-N.M., and Sens. Sam Brownback, R-Kan.; Susan Collins, R-Maine; Byron Dorgan, D-N.D.; and others introduced a bill in the Senate that would establish a nationwide 15% renewable electricity standard.

The senators said the stand-alone renewable standard bill is substantially the same as legislation Bingaman proposed in 2009, the American Clean Energy Leadership Act, S. 1462.

The most recent, bipartisan bill would require sellers of electricity to retail customers to obtain certain percentages of their electric supply from renewable energy resources or energy efficiency, beginning with 3% in 2012-2013 and increasing to 6% in 2014-2016, 9% in 2017-2018, 12% in 2019-2020, and 15% beginning in 2021 and running through 2039.

The bill specifies that any state may opt for its utilities to meet up to 26.67% of the requirement by improving energy efficiency in their systems. The items that qualify as energy efficiency savings include customer facility savings, electricity savings, recycled energy, and combined heat and power.

To meet the federal standard, each seller may produce or purchase the specified amount of renewable electricity or efficiency savings itself or RECs or energy efficiency credits (EECs) from entities that have excess. Also known as "white tags," EECs represent 1 MWh of electricity savings through energy efficiency measures.

The question of whether an EEC requirement will depress REC prices is a tricky one. "The obligation is for 15%, but over a quarter of that can be met with EECs. So to answer the question of how one market, that for EECs, will affect another market, that for RECs, will depend on how available EECs are and how costly they are compared to compliance with RECs," said Nicole Fabri, president of Clear Energy Brokerage & Consulting LLC. "If EECs are widely available and cost-effective, then you can expect buyers to use them for the full 26.67% of their compliance, dampening the demand for and price of RECs. If, however, EECs are hard to come

by (which is the case in some existing EEC markets), then buyers will have to purchase more RECs to comply, creating upward pricing pressure in the REC market."

"Overall, creating a law with REC and EEC obligations is a balancing act," Fabri said. "Lawmakers need to make sure that the supply and demand curves (which they influence directly in how they write the law) for REC and for EECs are such that prices are robust enough to actually get new projects built — but not too high as to scare folks away from signing the bill."

If EECs are used as an alternative to meeting obligations under an RPS, "then this could depress RECs prices." It ultimately depends on how the law is written, a Houston-based analyst from ICAP Energy said.

Other sources, such as Andrew Kolchins, managing director of renewable energy markets at Evolution Markets Inc., are not as certain the inclusion of EECs in a national RPS will necessarily have a dampening effect on REC prices.

Ultimately, "I think energy efficiency credits will be a large part of any federal bill," Kolchins said.

EECs, like the more established RECs, are traded in two types of markets: compliance and voluntary. In voluntary markets, companies purchase EECs as an environmental gesture or an act of corporate goodwill. In compliance markets, EECs are bought and traded among utilities and other electricity retailers in order to meet certain mandates required by law. In some states, energy efficiency methods are either required or permitted to make up a certain percentage of the portfolio.

In an executive brief dated Aug. 23 by Evolution Markets, analysts said "states are clearly leading the way" in the drive to create EEC markets. Several states have policies permitting energy efficiency initiatives to qualify for portfolio standard requirements.

According to the Database of State Incentives for Renewables and Efficiency, Evolution reported, 29 states and the District of Columbia have an RPS in place. Of those states, approximately half allow energy efficiency initiatives to contribute to the portfolio mandates.

Despite the growing number of states with an RPS and the relatively high percentage that permit the use of efficiency to comply with RPS goals, actual EEC compliance trading markets exist in just four states: Connecticut, Massachusetts, Nevada and Pennsylvania.

Adopting legislation in 2007, Connecticut was the first state to take the lead in the EEC market, beginning with a 1% mandate in 2007 and increasing by 1% for the three subsequent years. Connecticut's RPS requires that 4% of a utility's electricity supply be provided by energy efficiency technologies from 2010 through 2020.

Eligible EECs in Connecticut historically traded near the \$31-per-MWh alternative compliance payment set by state officials, but with the recent influx of qualified supply, the current vintage trades closer to the price floor of \$10 per MWh, Evolution said.

Eligible vintage 2010 EECs in Massachusetts have traded in a range of about \$15 to \$18 per MWh, with an alternative compliance payment of \$20 per MWh.

"There has been increasing voluntary interest in EECs, but credit trading in voluntary markets is still sparse. Demand in all four of the existing compliance markets will continue to grow in the future as requirements increase as designed in each program," Evolution said.

"Perhaps the greatest potential for the EEC market is the possible adoption of an EEC carve-out by more states with RPS requirements. There is the potential for several more states to establish EEC markets in the near future," Evolution said.

According to the National Renewable Energy Laboratory, Evolution reported, several other states, including New Jersey and Illinois, are investigating the possibility of incorporating EEC trading into their energy policies.

"The combination of a potential national market and several new state markets represent tremendous potential for the EEC market moving forward," Evolution said.

With only four states making up the EEC market in the U.S., the market is valued at about \$200 million. With indications of additional states considering adding portfolio standards and the possibility of a national market, "the EEC market could grow to over \$1 billion in the next five years," Evolution Markets wrote, citing estimates from Nexant Inc.

Apart from the state efforts, there is continued hope of a federal energy efficiency market program that will create nationwide liquidity for EECs.

"The inclusion of energy efficiency portfolio standards in select versions of federal energy legislation indicates the potential for an eventual national market," Evolution said.

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