

INDEXED REC PROCUREMENT

Comments on Draft Bidding Process and Key Contract Terms – December 17, 2021

Clearway Energy Group (“Clearway”) appreciates the opportunity to provide comments on the draft bidding process and key contract terms for the new Indexed Renewable Energy Credits (“indexed RECs”) product. These comments focus exclusively on the potential consequences of the annual payment cap term in the key contract terms.

Clearway understands that not only is this a new product—the IPA has not historically awarded REC contracts where REC prices are not fixed—but also is being developed against the background of a major change in legislation. While the budget for procuring RECs has increased, so have the procurement goals for new RECs to be delivered annually. In previous requests for comments, the questions have indicated that the IPA is wrestling with how to meet aggressive procurement targets and a mandate to spend the entire available budget while sensibly avoiding the scenario where resources are overprocured relative to available budget.

Against that background, the policy behind the annual payment cap appears to be adding a tool for the IPA to limit the impact on overall budget in the event of a low-price energy year (i.e. when the difference between the contract strike price and hub price is higher). Certainly if there was a future budget shortfall that called into question full, timely payment of REC revenue, it would have a negative impact on ongoing and future project financings, as was pointed out earlier this year.

Clearway respectfully notes that this particular budget management tool would put very significant pressure on project financing for every successful bidder. Indexed REC contracts provide insurance against low energy prices that would otherwise be reflected in higher per-REC bid prices. An annual payment cap is akin to a policy limit on that insurance—the indexed REC can only make up for so much energy revenue shortfall. This is particularly important because in the opposite scenario—high energy prices—the maximum revenue available to the generator owner from energy and RECs combined is the number of RECs delivered multiplied by the strike price.¹ In other words, particularly bad years for the generator cannot be offset by particularly good years because there is a strict revenue cap in good years.

Even if the annual payment cap was a known, fixed value it would be problematic. Based on Clearway’s experience, Clearway anticipates that most financing parties will use a low price energy year and the annual payment cap as the assumed revenue.² It is industry standard for investors that tend to engage in tax equity financing of utility-scale wind and solar projects to insist on conservative estimates to “de-risk” their transaction.

¹ Of course, if RECs in excess of the annual maximum delivered quantity are produced, there will be additional energy revenue associated with those RECs and some minimal value for selling spot RECs.

² To greatly simplify, Investment Tax Credit (*i.e.*, solar) tax equity transactions involve tax equity financing parties taking overwhelming ownership of the generating asset and receive five years of tax credits and the revenue streams until the tax equity financing parties exit (usually about seven years later). In exchange, the “sponsor” (long-term owner/operator) receives upfront and accelerated payments for a percentage of tax credit value and the revenues anticipated through when tax equity financing parties exit. Thus—again, greatly simplifying—the higher the anticipated revenue, the greater the tax equity financing revenue stream for the long-term owner/operator.

The IPA's use of a forward price curve that is modified annually to set the maximum payment is likely to cause a steep drop in tax equity financing revenue. That is because while many commercial transactions assume payment against reasonably expected revenues, the "de-risked" transactions contemplated in the key contract terms rely on bad (or worst) case scenarios. Here, because the annual forward curve is not known—even if there is an indicative 20+ year forward curve available at the time of procurement—the tax equity investor is likely to require and utilize revenue assumptions that set the annual payment cap at a "low energy price" scenario.

In order to make projects financeable, Clearway anticipates that there will be upward pressure on REC prices. This pressure is not beneficial to ratepayers or the IPA for two reasons. First it increases prices due to the cost of essentially insuring the risk that indexed RECs are meant to insure against (low energy prices). Second, it greatly increases the likelihood that many (or perhaps even most) bidders will submit prices above the confidential benchmark if the benchmark does not adequately take into account the financing penalties described above.

Clearway fears that under these circumstances the group of winning bidders will not be able to obtain financing. Not only will that be problematic for meeting the aggressive goals of the Renewable Portfolio Standard and the Illinois Power Agency Act, it wastes the Agency's, the Illinois Commerce Commission's and the utilities' resources.

As noted above, Clearway suspects that the function of the annual payment cap is to provide a tool to the IPA to promote budgetary stability. Clearway respectfully notes that this is one tool available to the IPA but not the only tool—and certainly not a useful one due to its side-effects on utility-scale solar procurements. We ask the IPA to fully consider the approach Agency has already proposed for public comment as part of its LTRRPP development process: to carry forward a budget buffer of at least 5% specifically to be used to mitigate the impacts of "low energy" years.

Clearway appreciates the opportunity to comment on the draft proposals the IPA is developing to implement the Climate and Equity Jobs Act. The scope of work the Agency is undertaking is very significant and highly complex. We think the Agency for it's work and look forward to future opportunities to comment to ensure the success of CEJA.