

Renewable Energy Credits: Representations and Warranties Every Buyer Should Ask For

When buying **renewable energy credits** (RECs), purchasers should make sure to negotiate a short but critical set of REC-focused representations and warranties. These representations and warranties are promises regarding the REC itself or the seller's ownership of the REC. The purpose of these promises is to set out the parties' expectations as to the nature of what is being sold and properly allocate risks between the seller and the buyer if one of the parties' expectations is not met. These representations are equally important whether an entity is purchasing RECs for its own compliance purposes or for the purpose of reselling them to a third-party.

The representations must address the specific concerns raised by the unique nature of RECs. As opposed to a contract for widgets, where a buyer is purchasing a known physical item, RECs are created by regulation and do not exist other than in relation to some governing set of rules. At its most basic level, a REC represents the separation of certain environmental attributes from the actual power being generated by a renewable source that was not conveyed to the purchaser of the power. Those attributes may themselves be further disaggregated into components that are of value to particular buyers. Accordingly, the representations help establish the scope and nature of the attributes owned and being transferred by the seller to the buyer.

Representations and Warranties – Scope

- **Good and Marketable Title.** Seller should represent and warrant that it has good and marketable title to the REC. This means that the seller's ownership of the REC is free of defects and the seller has the ability to transfer ownership to the buyer without third parties claiming the seller was not the rightful owner of the REC. This is a basic representation for the sale of almost any asset. A seller that either cannot make or is not willing to make this representation should be viewed with considerable concern.
- **No Liens or Encumbrances.** Seller should represent and warrant that there are no liens, claims or encumbrances of any kind on the REC. If there were liens, claims or encumbrances, the Seller either would not have the right to sell the REC or the lien might travel with the REC, so the REC in the buyer's hand would be subject to the same lien. It is important to make sure that the representation is not limited to "liens, claims or encumbrances created by the Seller." Because RECs are assets capable of being sold more than one time, a buyer wants to know that no liens attached to the REC at any stage of its ownership. This distinction can create additional risk if the purchaser resells the REC and must represent to its buyer that there are no liens on the REC generally.

- ***Seller has not sold the product to any other person or entity.*** If a buyer receives proper “good title” and “no lien” representations, this third representation is not, strictly speaking, necessary. If an entity has already sold the REC to someone else, the seller either no longer has good and marketable title to the REC or there is a lien, claim or encumbrance on the REC. However, some purchasers like to include this very tailored representation, especially when dealing with smaller counterparties where they think the risk of a double-sale may be higher. It says in laymen’s terms what the first two representations say in legal terms and make the buyer’s expectations on this point beyond doubt.
- ***Product complies with the applicable renewable portfolio standard.*** This representation goes to the heart of what a buyer is purchasing. When a buyer negotiates the purchase of a REC, it negotiates a price and terms based on the REC it intends to purchase. If it receives a different REC, that REC may either not be of value to the buyer or it may be of a different value than the REC for which it negotiated. In any event, the buyer will not have the REC it intended to purchase. To ensure that the REC that is delivered is the REC that the buyer intended to buy, a buyer should always ask for a representation that the REC complies with the applicable renewable portfolio standard. Along the same lines, if there are other specific terms central to the buyer’s decision to buy a particular REC (e.g., generation at a particular facility), a buyer should also ask for representations attesting to those facts.
- ***Product has not been used to meet compliance requirements under the applicable renewable portfolio standard or any other regulatory or voluntary renewable program or standard.*** Like the prior point, this representation gives the buyer comfort that it is getting the benefit of its bargain. The buyer is being told that the REC has not been used to meet some other entity’s compliance requirements and is therefore available for the buyer to use it for its own compliance or resale needs.

Representations and Warranties – Timing

The timing of when representations and warranties are made is of equal importance as the scope of the representations and warranties being made. The question presented is if a seller should make its representations and warranties as of the date it agrees to sell the REC (whether that is the trade date or the date it signs a written contract) or the date it delivers the REC. This is especially important because REC purchases can be agreed to years in advance of the actual delivery dates. Ultimately, the critical date is the date on which the seller delivers the REC. A buyer’s initial position, however, should be that a seller gives its representations and warranties as of both the sale date and the delivery date. The buyer would have the comfort of knowing that all the key assurances it is looking for are true as of the date it agrees to buy the REC and will be true as of the time the REC is delivered, and the request for sale date representations and warranties may provide an opportunity for some additional diligence.

A seller may have a specific and legitimate reason why it cannot make a particular representation as of the date it agrees to the sale. For a long term contract, for example, a seller may say it does not have good and marketable title to a REC because the REC has not yet been created. Alternatively, it may say that it has a blanket financing lien on its assets which will be released upon the actual sale of the asset. In such situations, a seller can make the particular representation as of the delivery date but all other representations and warranties can still be made as of both dates.

A buyer should also consider other protections it may want in its agreements, particularly if it is signing a long term and/or multi-year arrangement, or if its counterparty is a relatively young or not well-financed entity and taking into account it is transacting in a potentially changing regulatory landscape. Although representations and warranties will almost never reduce a REC purchaser's risk level to zero, a buyer can more effectively manage and reduce its risk by negotiating appropriate representations and warranties and other contractual protections.

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