



CLIMATE CHANGE BUSINESS JOURNAL®

REPRINT

Volume IV, No. 6/7

3 Degrees Sees Steady Growth In RECs to Stimulate Renewable Energy Generation

As a wholesaler/retailer of renewable energy certificates, 3 Degrees takes title and can offer long-term price guarantees.

3 Degrees is ranked at the top of the Renewable Energy Credit (REC) and carbon offset markets in North America by energy and environment trade publications, and the U.S. Department of Energy has designated the San Francisco firm one of a handful of non-utility green power suppliers of the year—every year since 2007.

3Degrees was founded in 2007, but CEO Dan Kalafatas founded the REC marketing division of 3 Phases Energy in 2002 before spinning off 3Degrees in 2007—with four of the firm's current five-member management team. "We're sort of the old men and women of this relatively young industry," said Vice President for Marketing and Business Development Steve McDougal.

"Since 2002, we've seen steady and at times explosive growth in the popularity of the REC as a mechanism to help stimulate more renewable generation." 3Degrees has more than 50 employees today, adding seasonal workers as needed for green power outreach campaigns.

According to McDougal, the REC space includes three distinct markets.

Leading Player Reflects on REC Market

3Degrees has more than 50 employees and is a leading player in the REC and carbon markets. On the supply side, it signs long-term REC purchase contracts with renewable generators. On the sell side, customers range from utilities and large corporate buyers to small businesses that purchase 10 RECs at a time. Recession and stimulus spending have softened REC pricing, but growth in REC trading remains steady.

"One is the compliance market for 30 states that have set renewable portfolio standards that are tightening and evolving over time," said McDougal. "Another is utility green power pricing programs. Roughly half of all Americans have some access to a green power option through their utilities."

In the utility green power market, 3Degrees' role can range from simply supplying RECs to meet a load-serving entity's green power demand from customers to partnering with the utility to develop and market a green power program. In June 2011, the firm was advertising for part-time outreach workers (\$10/hr plus commission or bonuses) to staff tables at storefronts and events and go door-to-door seeking green power customers in Oregon and Utah for Pacific Power and in Washington for Puget Sound Energy.

"The third major pillar is the voluntary REC market, the Starbucks and Whole Foods of the world who are buying RECs to help achieve sustainability goals," said McDougal.

In the industry taxonomy of the REC and carbon offset market, 3Degrees is a wholesaler and retailer, not a broker, project developer or investor. The firm takes title to RECs and carbon offsets and markets them using a wide variety of sales contracts.

3Degrees deploys proprietary algorithmic trading and portfolio management software to manage its portfolio in the complex and ever-changing markets. "Ultimately we manage a very large book of different environmental commodities from projects that we've made commitments to," said McDougal.

While 3Degrees doesn't disclose sales volume or revenue, it is clearly a top player in the REC and carbon markets. In 2010, the firm launched an internal *Research, Strategy, and Analysis* division to track and analyze U.S. renewable energy and carbon markets, calculate the firm's own risk profile, decipher and forecast market trends,

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CLIMATE CHANGE BUSINESS JOURNAL®

Vol. 4, No. 6/7 ISSN 1940-8781
June/July 2011

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Climate Change Business Journal® newsletter is published 8 times a year (includes 4 double issues) by Environmental Business International Inc., 4452 Park Blvd., Suite 306, San Diego, CA 92116. Phone: 619-295-7685 or email info@climatechangebusiness.com

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state and national regulatory policy and to perform "selective regulatory advocacy," according to its website.

On the supply side, 3Degrees signs long-term REC purchase contracts with renewable generators, and McDougal says the firm makes hundreds of such commitments annually. "We guarantee these projects a price they can bank on," he said. "That's an important distinction from what a broker can offer."

On the sell side, 3Degrees' customers range from investor-owned and publicly owned utilities and large CSR buyers such as Starbucks and Safeway to small businesses that purchase as few as 10 RECs at a time. (One REC is one MWh.) The market is highly competitive, with sellers like **Element Markets**, **Community Energy** and **Sterling Planet** competing for REC buyers. Energy companies, independent power producers, financial firms and even public power entities also play in the market. (See chart of top green power purchasers and their providers on page 8.)

McDougal says 3Degrees' longevity and track record give it an edge. "Our customers know they're dealing with a team that's been in this market for nearly 10 years and that knows this market very well."

Compliance-oriented buyers look primarily for reliability in supply and pricing, said McDougal. "We have partners who want to know we can provide them the RECs they need to help them meet their RPS obligations and that we know the markets well enough to advise them on what's coming in and around their region," he said. "This is expertise we've developed by participating in this market, making transactions on a daily basis both in the voluntary and RPS markets."

Supply & Demand Balance Softens REC Pricing

Each state's annual requirements for renewable generation are public, and this

sets a baseline for future demand projections. However, changes in state policies can and do impact the market. A major question hanging over the market now is what rules California will adopt for its stated intention to let utilities to use out-of-state RECs for their RPS compliance.

In the last 18 months, the REC market has seen declining prices due to increased supply (courtesy of Recovery Act funding and the grant-in-lieu of investment tax credit for renewable energy projects) and decreased demand as the Great Recession curtailed industrial electricity usage. "With the economy softening, electric generation was down, which has enabled load-serving entities to hit their renewable targets with fewer RECs," said McDougal.

Green building is the "most exciting and dynamic segment of the voluntary market now," said McDougal.

"In the very near term, we're seeing that continue," said McDougal, noting that stimulus funding is still priming the renewable development pump and that the ITC grant is valid through December 31, 2011. Renewed load growth should accompany an economic recovery, but it's too early to say when that will occur, according to McDougal.

"Among voluntary buyers, we've seen just a little bit of a slowdown in terms of brand new commitments, but we've seen companies who have made commitments in the past continue purchasing RECs to realize some of their sustainability goals," said McDougal.

While compliance RECs are commodities with their worth attached to the buyer's mandatory renewable targets, voluntary buyers will often put value on a certain flavor of REC that resonates with their brand or is located in their market

territory. McDougal reports that Host-Gator, a web hosting customer in Texas wanted to make sure they were supporting projects in Texas, while prAna, a yoga, climbing and sports apparel company, wanted to buy windpower RECs to resonate with their brand name, which means “breath” in ancient Sanskrit. “These are the kinds of things that people can create with RECs. In addition to the positive impact of the commodity itself, there are ways to tighten the bond between what they’re doing to procure clean energy and what their company stands for.”

A relatively new segment of demand for voluntary RECs is coming from building owners seeking to achieve LEED certification for existing buildings—operations and maintenance (EBOM). “That is the most exciting and dynamic segment of the voluntary market now,” said McDougal. The U.S. Green Building Council gives from one to six points to applicants for demonstrating that they are buying RECs to match from 25% to 100% of their electricity demand.

While the commercial development market has been slow for several years, demand for LEED EBOM is strong according to McDougal. “We’ve seen a surge in class A office buildings seeking to achieve LEED certification,” he said.

“More tenants want green buildings. I hear this from property managers all the time. Especially in this difficult market, they want whatever kind of differentiation they can get.” McDougal advocates that USGBC require a longer performance period than the current two year minimum. “Commitments of five years would send a strong demand signal to the renewable energy market. It’s our understanding that such a requirement is under consideration by the USGBC.” ⚙