



To: Rocky Mountain Institute

From: Kirkland & Ellis and Lawyers for Good Government

Date: April 27, 2020

Re: Virtual Power Purchase Agreements - Indiana¹

1. **Executive Summary**

The provision of electricity (as well as other utility services) at retail in the State of Indiana is regulated by the Indiana Utility Regulatory Commission (the “IURC”), which divides Indiana into exclusive service areas for electricity providers, as addressed in our state-law analysis in Section 2, below. However, because a VPPA does not result in “electric service furnished to a customer for ultimate consumption”, we believe that a municipality in Indiana may enter into a VPPA without violating Indiana’s regulatory framework. Moreover, we have not found any State law that expressly prohibits a municipality’s entry into a VPPA. As such, in order to determine whether and how a municipality may enter into a VPPA, it is necessary for such municipality to carefully analyze local laws that may apply to such transaction, which may be different for each municipality.

As an example, this memorandum provides, in Section 3, a case study for the City of Indianapolis (the “City”). We have not found any provision in the City Code (as defined below) that expressly restricts the City’s ability to enter into a VPPA. Nevertheless, we have summarized below certain general contract guidelines that may apply to entry into a VPPA by the City—or an instrumentality thereof. We have also outlined below the steps that may be taken by the City to adopt a Code-based framework for entry into VPPAs.

Finally, Section 4 of this memorandum briefly addresses potential Federal law issues, including CFTC (as defined below) regulation of swaps, which may apply to any VPPA.

2. **State Law Issues**

- (a) *Does a municipal government or other agency have authority to enter into a VPPA and expend public funds in connection with such an agreement?*

¹ We have prepared this memorandum based on our current knowledge of virtual power purchase agreements (“VPPAs”) and this memorandum is intended to highlight critical issues to consider when entering into VPPAs. For purposes of this memorandum, a VPPA is purely a financial transaction, exchanging a fixed-price cash flow for a variable-priced cash flow and renewable energy certificates (“RECs”), with no physical sale or purchase of electricity.

This memorandum does not establish an attorney-client privilege with either you, the State of Indiana or the City of Indianapolis and nothing in this memorandum should be construed as legal advice. Additional consultation with a financial professional or attorney expert in municipal or public entity accounting considerations will be necessary to fully assess the potential for the City of Indianapolis or any other governmental entity in the State of Indiana to enter into a VPPA.

The Constitution of the State of Indiana provides that money may be drawn from the Indiana Treasury only in pursuance of appropriations made by law.² Beyond this general requirement, the Indiana Constitution does not provide rules for the expenditure of public funds.

We did not find any State law expressly prohibiting a municipal government or other agency from entering into a VPPA. However, as will be further detailed in Section 3 below regarding municipal law issues, municipal charters may include public-purpose requirements or other limitations on the expenditure of public funds. A case-by-case analysis will be required to identify the specific conditions, if any, imposed by a particular city or municipality's charter for entering into contracts and expending public funds. For purposes of this memorandum, we have analyzed whether the City could enter into a VPPA, based on the relevant City laws, rules and requirements.

(b) *Does entering into a VPPA violate utility franchise?*

Utility service in the State of Indiana is traditionally regulated, with oversight by the IURC. The IURC has authority over more than 600 utilities, including electric, natural gas, steam, water and wastewater utilities.³ Utilities may be privately⁴ or publicly owned, and significant portions of the state are served by rural electric membership cooperatives (“REMCs”). All of the privately-owned utilities and nine of the 72 municipally-owned utilities remain subject to the IURC's rate regulation framework,⁵ while the remaining municipal utilities and all of the REMCs have withdrawn from rate-related aspects of IURC regulation.

Indiana's electric framework is segmented into exclusive service areas; Sec. 8-1-2.3-4(a) of the Indiana Code provides that an electricity supplier⁶ has the “sole right” to furnish retail electric service to each consumer within the boundaries of its assigned service area and that no other electricity supplier may render electric service within its assigned service area. The IURC maintains jurisdiction over service areas for all utilities, including municipal utilities and REMCs. An exception to a service area can be made if: (i) the electricity supplier with the sole right to the assigned area consents to it in writing; and (ii) the IURC approves.⁷ Accordingly, without an exception from the IURC, a city or other entity in Indiana that is a customer of a particular electricity provider will be unable to enter into a traditional, physical power purchase agreement with a renewable energy producer. However, we believe that the framework may allow for a city or other entity in Indiana to enter into a VPPA.

² Ind. Const. art. 10, sec. 3.

³ See IURC's mission statement, history and responsibility, available at <https://www.in.gov/iurc/2451.htm>.

⁴ Examples of privately owned (investor-owned) utilities include Duke Energy Indiana Inc., Indiana Michigan Power Company, Indianapolis Power & Light Company, Northern Indiana Public Service Company, Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana, Inc.), and Greenfield Mills, Inc.

⁵ Such utilities include Richmond Municipal, Anderson Municipal, Crawfordsville Municipal, Auburn Municipal, Frankfort Municipal, Lebanon Municipal, Tipton Municipal, Knightstown Municipal, and Kingsford Heights Municipal.

⁶ Ind. Code § 8-1-2.3-2(b) defines “electricity provider” as a public utility, a local district rural electric membership corporation, or a municipally owned electric utility which furnishes retail electric service to the public.

⁷ Ind. Code § 8-1-2.3-4(a).

Because a VPPA does not involve the buyer in any “production, transmission, delivery, or furnishing” of electric power,⁸ a VPPA does not subject the buyer to IURC public-utility jurisdiction, nor does a VPPA violate service-area rules because it does not result in “electric service furnished to a customer for ultimate consumption.”⁹ Instead, a VPPA results in a sale of RECs to the counterparty, while electric energy is sold either to an eligible electricity supplier or to a regional electric market.

We have not identified any IURC action to regulate RECs as retail electric service or otherwise, except in those cases where IURC-regulated utilities have proposed to purchase RECs for, and resell RECs to, their retail electric customers or to purchase RECs to meet voluntary goals (neither of which is applicable for our discussion herein). Therefore, from a utility regulatory perspective, we see nothing to prevent a city or municipality entering into a VPPA with a renewable energy generator (thereby procuring RECs), while the generator sells its associated electric output to an eligible entity for resale.¹⁰ A VPPA, then, could enable a municipality to support local production and supply of renewable electricity, even if it cannot directly purchase electricity from the project.

For those municipalities that own and operate their own municipal electric utilities, electricity purchases directly from renewable sources may remain an option, but would be subject to the local laws and ordinances that govern their respective utilities. Related requirements may also bear on the ability of such a municipality to enter into a VPPA, so careful analysis of local laws is essential in such situations.

3. **Municipal Law Issues: Indianapolis Case Study**¹¹

The Indianapolis City Code does not have any express prohibitions that prevent the municipality from entering into VPPAs. The City Council has broad authority to delegate and approve of the City’s expenditures and the incurrence of debt.¹² As the entry into a VPPA is arguably similar to a derivative or hedging contract, a claimant wanting to void such an agreement could argue that entry into a VPPA is similar to the incurrence of debt.¹³ As such, it would be best practice to carefully follow the rules applicable to the incurrence of debt by the City before approving the entry into a VPPA. The City Council determines whenever the City may borrow money, including from the Indianapolis Local Public Improvement Bond

⁸ See Ind. Code § 8-1-2-1 (g), defining “utility.”

⁹ See Ind. Code § 8-1-2.3-2(c), defining “Retail electric service” as electric service furnished to a customer for ultimate consumption, but excluding wholesale electric service furnished by an electricity supplier to another electricity supplier for resale.

¹⁰ See *id.* Such sales for resale are not IURC-jurisdictional.

¹¹ Citations in this section refer to the Revised Code of the Consolidated City and County Indianapolis/Marion, Indiana Codified through Ordinance No. 78, 2019, passed December 9, 2019 (Supp. No. 40) (the “City Code”), except as otherwise noted.

¹² See, e.g., Sec. 135-101, which dictates that the city council determines the budget and county general fund.

¹³ We note that Ind. Code § 5-1-14-17.2 imposes certain restrictions and requirements on entry by political subdivisions or other local entities into “swap agreements.” Based on our initial review, this appears to relate only to interest rate swaps entered into in connection with financing activities, which would not implicate VPPAs. However, we recommend as part of its analysis regarding entry into a VPPA that the City confirms that reading with local law experts.

Bank. Such a determination must be done by ordinance, including the terms of the debt to be issued, proper noticing of the debt, the manner in which such debt will be incurred and the total amount of such debt.¹⁴

The City also has strict rules for the entry of “city contracts” that need to be followed, which includes each contract entered into by the City or a City agency, officer or employee.¹⁵ The requirements for executing a city contract include that such contract be reviewed by the office of corporation counsel and by the city controller, as well as that all city contracts comply with all applicable law, that such contracts are subject to review and approval by the mayor (or at the mayor’s sole discretion, any designee of the mayor) and that each contract bear appropriate notations and signature lines showing that it was reviewed and approved by the office of corporation counsel, the city controller and/or the mayor.¹⁶ If the requirements are not followed, then such city contract is voidable on that basis alone.¹⁷ When reviewing contracts and potential budget expenditures, all city council agencies must follow “zero-base budgeting”, which necessitates an economic impact statement, a statement of goals and objectives and a cost/benefit analysis.¹⁸

In addition, Sec. 511-101 provides that that “the pollution control board and the air pollution control division shall protect the air resource through the prevention, abatement and control of air pollution by all practical and economically feasible methods.” Although there is no explicit authority for the pollution control board or air pollution control division to enter into a VPPA, it is possible that this broad policy directive could be used to argue that such boards have the authority to enter into VPPAs for environmental protection.

The City Code does not specifically contemplate the entry into VPPAs, but we also did not find any provision in the City Code prohibiting entry into these types of agreements. Given the lack of legislative certainty, prior to entry into a VPPA, it would be prudent for the City follow all of the approval, review and economic balancing requirements described above. In addition, the City could consider amending the City Code to explicitly permit the City’s entry into VPPAs. Any such amendment would require an official public hearing (with at least ten days’ prior notice), a regulatory impact statement and posting on the City website. At the conclusion of the public hearing, such a rule or amendment could be adopted and such rule or amendment would become effective 45 days after the date of the publication of such rule or amendment.¹⁹ During the 45-day period, the City Council could stay (up to a maximum of 90 days) or reject such rule or amendment.²⁰

4. Federal Law Issues

- (a) *Do VPPAs require FERC power marketing authority?*

¹⁴ See Ind. Code § 36-3-4-21.

¹⁵ Sec. 141-101.

¹⁶ Sec. 141-102.

¹⁷ *Id.*

¹⁸ Sec. 181-402.

¹⁹ Sec. 141-202; 141-204; 141-205.

²⁰ Sec. 141-307.

A buyer under a VPPA is not required to obtain authorization from the Federal Energy Regulatory Commission (“FERC”). Under the Federal Power Act, the FERC regulates sales of electric energy at wholesale in interstate commerce.²¹ More specifically, FERC has exclusive jurisdiction over the “transmission of electric energy in interstate commerce,” and over the “sale of electric energy at wholesale in interstate commerce,” and “all facilities for such transmission or sale of electric energy.”²² The “facilities” subject to FERC’s jurisdiction include contracts for sale at resale (wholesale) of electric energy, capacity and ancillary services. Thus, a VPPA itself, which does not provide for a sale of electric energy, capacity, or ancillary services, is not subject to FERC jurisdiction.

In contrast, some buyers under a traditional power purchase agreement (which involves physical delivery of energy, capacity, or ancillary services) may choose to obtain authorization from FERC to engage in sales of wholesale power. This is typically only undertaken, however, if the buyer procures more power than it anticipates needing and would like to be able to sell that power back to the grid. In that circumstance, the “buyer” becomes a seller of wholesale power, and must obtain authorization from FERC, typically in the form of an approved tariff to sell electric energy and related products at market-based rates.

(b) *What requirements may be applicable to the city as a swap counterparty under Dodd-Frank?*

The prevalent pricing structure for a VPPA (also sometimes called a financial or synthetic power purchase agreement) is a fixed-for-floating transaction, where (1) the buyer agrees to purchase RECs from an electric generator at a set, negotiated price—the strike price; (2) the seller generates electricity which is sold into the grid at a market price; and (3) the buyer and seller settle the difference between the negotiated strike price and the market price under a contract-for-differences arrangement. A transaction with this pricing structure typically will be deemed to be a “swap,” meaning that it is a financial transaction—an exchange of cash flows—which does not require or result in physical delivery of a product among the parties. As such, the transaction will be subject to regulation by the CFTC under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“**Dodd-Frank**”).²³

Under current CFTC rules, all swaps must be reported to a Swap Data Repository. The report must include primary economic terms (*e.g.*, parties, swap type, price, term) and all changes to those terms must be updated on an ongoing basis. A VPPA should specify which party (the buyer or the seller) will perform the required reporting.

The CFTC’s rules also impose certain recordkeeping requirements for all parties to a CFTC-regulated swap. Specifically, parties must maintain full, complete, and systematic records, together with all pertinent data and memorandum, with respect to each swap transaction, and must maintain those records for five years after the final termination of the swap in a manner that is retrievable within five business days. Thus, before executing a VPPA, an entity should have the necessary procedures in place to ensure that it is prepared to satisfy applicable recordkeeping requirements.

Certain swaps are also subject to margining and mandatory clearing, but under current rules, a swap of the type contained in a VPPA is highly unlikely to be subject to margin or clearing requirements. The clearing rules are still evolving, however, as are the CFTC’s reporting and recordkeeping requirements discussed

²¹ See, *e.g.*, 16 U.S.C. §§ 824, 824d, 824e.

²² 16 U.S.C. § 824(b).

²³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376.

above. In addition, the applicability of any of these requirements requires a fact-specific analysis. Thus, before executing a new VPPA, it is prudent to review current Dodd-Frank rules and the specific facts of the subject contract.