



Date: April 20, 2020

To: Rocky Mountain Institute, World Resources Institute

From: Bo Mahr, Attorney, Husch Blackwell LLP & Lawyers For Good Government

Re: Municipal Authority to Enter Into Virtual Power Purchase Agreements in Missouri

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Though Missouri places many restrictions on a municipality's authority to contract, it is likely that Virtual Power Purchase Agreement ("VPPA") may be entered into by municipalities, such as the home rule City of St. Louis, under the authority of Mo. Ann. Stat. § 108.170(8)(1). This statute allows cities, meeting a requisite set of qualifications, the authority to enter into "agreements providing for fixing the cost of such commodity, including without limitation agreements commonly referred to as hedges, futures, and options." As detailed further in this memorandum, one such enumerated commodity, electricity, is the exact commodity VPPAs are designed to provide a hedge against. Neither Husch Blackwell LLP nor I are personally in an attorney-client relationship with Rocky Mountain Institute or World Resources Institute and this memorandum of legal research is not intended as legal advice.

## **1. Authority: Municipal VPPAs**

To understand a Missouri municipality's authority to enter into a VPPA, it's important to first understand the type and functions of a VPPA. VPPAs are similar to the more familiar power purchase agreement ("PPA"), in which an entity contracts with a generator of renewable energy to purchase and legally take title to electricity and the associated renewable energy credits ("REC"), at a fixed price over a certain period of time.<sup>1</sup> Unlike a PPA, a VPPA does not provide for the physical delivery of electricity.

Rather, a VPPA is a financial transaction in which an entity contracts with a renewable energy generator to pay a fixed price for electricity and RECs; the renewable energy generator receives the market price for electricity; and at a set date in the future, the two parties reconcile the differences in the fixed price and the market price.<sup>2</sup> This reconciliation is why a VPPA is sometimes referred to as a "swap" or "contract for differences".<sup>3</sup> If the market price of electricity

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<sup>1</sup> See Rachit Kansal, *Introduction to the Virtual Power Purchase Agreement*, Rocky Mountain Institute, Nov. 2018, <https://rmi.org/insight/virtual-power-purchase-agreement/>.

<sup>2</sup> *Id.*

<sup>3</sup> Alicia M. McKnight, *Virtual PPAs: Are They Right for Your Company?*, Pillsbury, Feb. 6, 2020, <https://www.pillsburylaw.com/en/news-and-insights/virtual-ppas-are-they-right-for-your-company.html>.

if more than the fixed-price, the contracting entity gets paid the difference; if the market price is less than the fixed-price, the generator of renewable energy gets paid the difference.<sup>4</sup> Because municipalities generally purchase electricity at market rates, this type of agreement functions as a hedging instrument against future electricity prices by providing the municipality funds when prices are high and costing the municipality funds when electricity prices are low.<sup>5</sup>

**a. Home Rule and Dillon Rule**

The authority afforded to a municipality in Missouri depends on whether the municipality operates under home rule or Dillon rule. Under home rule a municipality may act unless a statute prevents such action; however, under Dillon rule a municipality may act only where a statute permits such action. Missouri operates as a home rule state for qualifying municipalities that have adopted a “constitutional” or “special” charter<sup>6</sup> and a Dillon rule state for all other municipalities.<sup>7</sup> Therefore, the City of St. Louis, as a home rule municipality<sup>8</sup> may act where it is not prevented from doing so by statute or the Missouri Constitution.

**b. Constitutional Authority**

Missouri’s Constitution lays the framework for how local governments may expend public funds in Article 6, Section 23 and 25. However, Missouri courts have stated that “no violation of sec. 23 or 25, art. VI, Missouri Constitution, occurs where the expenditure of public funds is for a public purpose.”<sup>9</sup> Therefore, to maintain constitutionality under the public purpose doctrine, it is necessary to determine what qualifies an expenditure of public funds by a local government in Missouri as being put toward a public purpose.

The central test for what constitutes a public purpose lies with the Missouri legislature. The Supreme Court of Missouri has stated that, “determination of what constitutes a public purpose is primarily for the legislative department and it will not be overturned unless found to be arbitrary and unreasonable. The public purpose being apparent, it is unimportant that incidental benefits may accrue to private interests.”<sup>10</sup> Where the Missouri legislature has passed legislation authorizing local governments to expend money for specific reasons, those reasons, unless arbitrary and unreasonable, are deemed a public purpose and, as a result, constitutional.

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> Mo. Ann. Stat. tit. VII, Ch. 82.

<sup>7</sup> *See* Mo. Ann. Stat. tit. VII, et seq.

<sup>8</sup> *See* John R. Ashcroft, *The Missouri Roster 2019-2020*, Office of the Secretary of State (2019), [https://www.sos.mo.gov/CMSImages/Publications/2019-2020\\_MO\\_Roster.pdf](https://www.sos.mo.gov/CMSImages/Publications/2019-2020_MO_Roster.pdf).

<sup>9</sup> *State ex rel. Mitchell v. City of Sikeston*, 555 S.W.2d 281, 291 (Mo. 1977) *citing* *State ex rel. Farm Elec. Coop., Inc. v. State Env. I. A.*, 518 S.W.2d 68 (Mo.banc 1975); *State ex rel. City of Boonville v. Hackman*, 293 Mo. 313, 240 S.W. 135 (1922)..

<sup>10</sup> *State ex inf. Danforth ex rel. Farmers' Elec. Co-op., Inc. v. State Envtl. Improvement Auth.*, 518 S.W.2d 68, 74 (Mo. 1975) *citing* *State ex rel. City of Boonville v. Hackman*, 293 Mo. 313, 240 S.W. 135 (1922).

Additionally, Missouri's Constitution places further limitations on contracts exceeding one year in length. In Article 6, Section 26(a) a restriction on year-to-year indebtedness of local governments states that,

No county, city, incorporated town or village, school district or other political corporation or subdivision of the state shall become indebted in an amount exceeding in any year the income and revenue provided for such year plus any unencumbered balances from previous years, except as otherwise provided in this constitution.

However, municipalities in Missouri have been entering into and budgeting for long term contracts for some time. As with most long-term contracts, an annual appropriation clause allows the parties to contract with municipalities for multiple years. Moreover, Missouri courts have held that in long-term contracts, municipalities do not need to measure the entire contract obligation in the current year.<sup>11</sup> For that reason, a multi-year contract is valid as long as there are adequate funds appropriated to such contract either through the current year's budget or through a prior year's budget surplus.

But while multi-year appropriations are possible, the variability of VPPAs may make them difficult to budget for over the long-term. That is to say, whether a VPPA's combination of market price and strike price lead to measurable underruns or overruns. However, both Missouri municipalities and Missouri courts have dealt with contracts with uncertain and variable payment structures. In *Samuel Kraus Co. v. Kansas City*, 315 S.W.2d 758, 761 (Mo. 1958), Kansas City entered into a public works contract for a lump sum; however, the amount of pavement to be removed and replaced was still to be determined. The court stated that this variability was permissible because it was specifically provided for in the contract.<sup>12</sup> Following this rationale, a VPPAs should specifically state the strike price all associated variables in the body of the contract. Being aware of this variability upfront, cities should set the strike price of a VPPA at a value that, when combined with forecasted market prices, places the predicted underruns and overruns well within the city's budget.

### **c. Statutory Authority**

The structure, purpose, and relative newness of VPPAs make them susceptible to different definitions and therefore difficult to define. As such, there is no Missouri statute that explicitly authorizes municipalities to enter into such an agreement. However, Missouri maintains two statutes that control local government's authority to enter into specific categories

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<sup>11</sup> *Burks v. City of Licking*, 980 S.W.2d 109, 110 (Mo. Ct. App. 1998).

<sup>12</sup> *Samuel Kraus Co.*, 315 S.W.2d 758.

of agreements of which a VPPA likely falls. While the first statute prohibits municipalities from investing in VPPA-type agreements, the second statute overrides the first and affords municipalities broad discretion in entering into VPPA-type agreements.

The first statute, Mo. Ann. Stat. § 30.950, outlines a general prohibition on political subdivisions of Missouri entering into derivative securities. This statute defines derivative securities as, “a financial instrument, contract or obligation which has a value or return based upon or linked to another asset or index, or both, separate from the financial instrument, contract or obligation itself.” While it can be argued that VPPAs are not always structured in a way that allows them to be defined as a derivative, it is likely that a VPPA of any structure would fall under this broad definition. This is because VPPAs, as outlined previously in this memorandum, are a financial contract and the obligations of which are based not upon physically purchased asset (electricity) but upon the value of that asset on a certain date.

However, Mo. Ann. Stat. § 108.170(8)(1) may serve to override the limitations of Section 30.950. This statute provides municipalities the authority to control costs of certain commodities by entering into a variety of financial agreements. This section states, in relevant part,

8. Notwithstanding any provision of law or charter to the contrary:

(1) Any entity referenced in subsection 1 or 2 of this section and any other political corporation of the state which entity or political corporation has an annual operating budget for the current year exceeding twenty-five million dollars may, in connection with managing the cost to such entity or political corporation of purchasing fuel, electricity, natural gas, and other commodities used in the ordinary course of its lawful operations, enter into agreements providing for fixing the cost of such commodity, including without limitation agreements commonly referred to as hedges, futures, and options; provided that as of the date of such agreement, such entity or political corporation shall have complied with subdivision (3) of this subsection; and further provided that no eligible school, as defined in section 393.310, shall be authorized by this subsection to enter into such agreements in connection with the purchase of natural gas while the tariffs required under section 393.310 are in effect.

In light of the general prohibition on municipalities entering into derivatives found in Mo. Ann. Stat. § 30.950, it should be noted that this section explicitly authorizes municipalities to enter into the type of commodity cost management agreements it describes “[n]otwithstanding

any provision of law or charter to the contrary."<sup>13</sup> Next, it should be noted that cities are one of the several entities referenced in subsection 1 and 2 that are authorized to enter into the agreements outlined in this section.<sup>14</sup> Further, the City of St. Louis' annual operating budget greatly exceeds the \$25 million threshold required for cities to obtain the authority under this section.<sup>15</sup> Smaller cities in Missouri without an annual operating budgets above \$25 million may not be able to take advantage of the authority provided in Mo. Ann. Stat. § 108.170(8)(1).

Mo. Ann. Stat. § 108.170(8)(1) describes the type of agreements it authorizes municipalities to enter using broad terms. It does so by first outlining the issue these agreements are meant to mitigate, which is the effective management of the cost entities incur when purchasing commodities, such as electricity, during its ordinary course of operation. Second, it outlines the solution these agreements are meant to provide, which is providing for fixing the cost of such commodity. Additionally, it provides examples of the type of agreement the entity is authorized to enter into including "without limitation" agreements referred to as hedges, futures, and options.<sup>16</sup>

Under this statute it is likely that VPPAs—as agreements in which an entity pays a fixed cost for electricity and reconciles that difference against a future market price in order to hedge costs and receive RECs—are covered under the broad array of agreements municipalities are granted the authority to enter into. However, no decisions or direct authority currently exist interpreting this provision of Mo. Ann. Stat. § 108.170 to ensure VPPAs are authorized. To aid in this statutes understanding, a Missouri Attorney General opinion on this issue may be sought by Mo. Ann. Stat. § 27.040 by a variety of Missouri public bodies and offices, including the City of St. Louis' Circuit Attorney. If this statute, as an authorization of the legislature, does in fact grant this authority, then public funds appropriated for VPPAs would be de facto appropriated for public purposes.

Lastly, Mo. Ann. Stat. § 108.170(8)(1) requires with compliance with section 3, which requires the municipality to engage a municipal advisor, or an advisor that provides financial security advice to state and local governments, as defined by the Securities and Exchange Commission when entering into an agreement under Section § 108.170(8)(1).<sup>17</sup>

#### **d. Municipal Authority of the City of St. Louis**

Provided that VPPAs are authorized by Mo. Ann. Stat. § 108.170(8)(1), a home rule city would be able to expend public funds on and enter into VPPAs provided it does not have any

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<sup>13</sup> *Id.*

<sup>14</sup> Mo. Ann. Stat. § 108.170(1)-(2).

<sup>15</sup> *Annual Budget and Operating Plan*, St. Louis MO Gov (Last Accessed April 10, 2020), <https://www.stlouis-mo.gov/services/topic.cfm?id=215&name=account-and-annual-budget-and-operating-plan>.

<sup>16</sup> Mo. Ann. Stat. § 108.170(8)(1).

<sup>17</sup> *GFAO Issue Brief: SEC Municipal Advisor Rule*, Government Finance Officers Association (Last Accessed April 10, 2020), <https://www.gfoa.org/gfoa-issue-brief-sec-municipal-advisor-rule>.

municipal level restrictions to the contrary. The City of St. Louis, as a home rule city, maintains a Charter and set of Code of Ordinances that govern its ability to contract as a municipality. Neither the Charter nor Code of Ordinances contains language explicitly preventing the city from entering into a VPPA.

Article XXV, Section 9 of the Charter contains requirements for the general execution of City contracts. These straightforward requirements are: (1) that contracts relating to city affairs shall be in writing, signed, and executed in the name of the city, (2) in cases not otherwise provided by law or ordinance, they shall be made by the comptroller, (3) contracts not made by the comptroller shall be countersigned by him, and (4) all contracts shall be filed and registered by number, date, and contents with the register.

Further, the Code of Ordinances in Chapter IV, Section 25 states that no money shall be expended except in consequence of appropriations made by ordinance, and that no ordinance making an apportionment shall be adopted unless the board of estimate and apportionment shall have recommended or joined in recommending the same.

Therefore, for the City of St. Louis to appropriate public funds toward and enter into a VPPA, the city would follow much the same process as it does when entering into other contracts and authorizing corresponding appropriations for such contracts. This includes passing an ordinance, which details and approves the parameters of a VPPA, and having said ordinance recommended or joined in recommending by the board of estimate and apportionment as is required by the City's Code of Ordinances. Lastly, to remain a valid contract authorized under Mo. Ann. Stat. § 108.170(8)(1), and therefore authorized for a public purpose, the City must also adequately budget sufficient funds toward the VPPA year-over-year.

## **2. Reporting and Recordkeeping: Municipal Reporting and Recordkeeping under Dodd-Frank**

As a “contract for differences,” or “swap,” a VPPA is regulated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) as a financial derivative.<sup>18</sup> Dodd-Frank’s requirements for the buyer of a swap, in this case the municipality, can include clearing, margin, reporting, recordkeeping, and registration.<sup>19</sup> Fortunately for municipalities the reporting and recordkeeping burdens of VPPAs are minimal to begin with, and, with informed contract drafting, can become even less burdensome.

In regard to clearing, according to the Commodity Futures Trading Commission (“CTFC”), VPPAs are not the type of swaps required to be cleared.<sup>20</sup> Additionally, the CTFC

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<sup>18</sup> 7 USC § 1a(47).

<sup>19</sup> Steven Mickelsen, *Dodd-Frank Compliance for Corporate VPPA Buyers*, Futures and Derivatives Law Report, Apr. 2016, at 1, [https://3degreesinc.com/wp-content/uploads/2016/05/GLFDLR4\\_Article-1.pdf](https://3degreesinc.com/wp-content/uploads/2016/05/GLFDLR4_Article-1.pdf).

<sup>20</sup> See 17 CFR § 50.4.

adopted a rule which allows municipalities to avoid posting margin.<sup>21</sup> While the economic terms of a swap must be reported expediently and frequently, the parties to the swap may contractually decide which party will perform such obligation.<sup>22</sup> Given that sellers of VPPAs are sophisticated parties to these transactions, municipalities should contract to obligate the seller to perform reporting requirements.<sup>23</sup> In regard to recordkeeping, records of the swap should be maintained throughout the agreement's term,<sup>24</sup> as is standard practice for most municipalities. Lastly, the CFTC registration requirements will likely exempt a municipality under a VPPA. This is because such requirements only apply to major swap participants with substantial positions or positions in the billions of dollars of swap exposure.<sup>25</sup>

A municipality may also be required to alter their accounting methodology to appropriately account for VPPAs. However, this depends on the structure of the specific VPPA entered into by the municipality.<sup>26</sup> Though information exists regarding private, corporate accounting practices related to VPPAs, for municipal accounting practices related to derivative accounting requirements and VPPAs a Governmental Accounting Standards Board expert should be consulted. Generally, if a city employs an accounting firm, said firm should be familiar with such requirements and should be able to advise the city and provide such derivative accordingly.

### **3. Conclusion**

Under Missouri's current Constitution and statutes, a home rule city with no municipal level regulations to the contrary should be able to enter into and expend public funds toward a VPPA under the authority of Mo. Ann. Stat. § 108.170(8)(1), provided that city meets said statute's requirements, including having an annual operating budget of over \$25 million. When entering into a VPPA, the municipality must be advised by a municipal advisor and use best practices by contracting to have Dodd-Frank reporting requirements transferred to the seller.

Though caution should be exercised as there currently exists no decision on or interpretation of Mo. Ann. Stat. § 108.170(8)(1). While a VPPA and a city ordinance entering into that VPPA can be specifically crafted to fit the anticipated requirements of authorizing law, without such decisions and interpretations it cannot be made certain that a VPPA falls squarely under said statute's authorizations. The clearest, and most reasonable, course of action to remedy this is for an interested party, authorized under Mo. Ann. Stat. § 27.040, to seek an Attorney General's opinion on the applicability of this statute as it relates to VPPAs.

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<sup>21</sup> See 17 CFR § 23.150(b).

<sup>22</sup> 17 CFR § 45.10.

<sup>23</sup> Mickelsen, *supra* at 3.

<sup>24</sup> 17 CFR § 45.2.

<sup>25</sup> 17 CFR § 1.3(hhh)(6).

<sup>26</sup> Shane Randolph and Matt Smith, *Derivative and Dodd-Frank Considerations for Wind Farm Owners*, Opportune LLP, JDSUPRA, Jan. 29, 2019, <https://www.jdsupra.com/legalnews/derivative-dodd-frankconsiderations-18900/>.