MEMORANDUM

TO: WRI

FROM: Climate Edge Law Group and Lawyers for Good Government

DATE: May 18, 2022

RE: **Variable Priced REC Contracts– Georgia**

I. Executive Summary.

This Memorandum: (a) addresses the legality of municipal and county jurisdictions in Georgia to enter into a Variable-Priced REC Agreements (RECs) and (b) identifies critical issues for such staff to review with their internal counsel prior to entering into such RECs.

This memo examines the underlying laws and industry practices that impact whether RECs would be permitted under current state and local law. Georgia is a Home Rule state, giving county and municipal governments authority to adopt reasonable ordinances, resolutions and regulations regarding their property and local affairs as well as amending their own charters to the extent that such changes do not conflict directly with state law. They also have broad authority to enter into contracts regarding municipal property. Variable-Priced REC Agreements or "RECs" are essentially contractual rights in which a municipality will be listed as owner of a commonly accepted certificate evidencing partial funding of a renewable energy project and associating that environmental benefit with facilities in a different location (like a city building). Because a local government has clear authority to enter into contracts regarding property it owns, it also has authority to improve those building using RECs.

While the powers granted to local governments includes the broad authority to self-govern, limits may be imposed on those powers by the Georgia Constitution, the state legislature, the Public Service Commission (PSC) (in a very limited manner), the courts and by agreements the locality may have granted to electric utilities. Absent a specific prohibition, though, local governments are permitted to enter into RECs, subject to certain restrictions, as identified below.

II. Introduction – Background on VPPAs or RECs

The term "virtual power purchase agreement" (VPPA) refers to a category of contracts related to several legal structures utilized by customers to procure renewable energy, to "green up" their existing electricity procurement, or to structure financial arrangements to provide certainty to power pricing.[1] In contrast to traditional power purchase agreements, in a VPPA or a REC, the renewable energy power provider (Provider) does not physically deliver the electricity to the purchaser. Rather, depending upon the form of the REC, the Provider can deliver a variety of other products or services:

1. Variable-Price REC Agreement – Under this type of agreement, the customer purchases RECs from a Provider at a price equal to the difference between a fixed price and the market price for system power. Using this form of agreement, the customer receives RECs from the Provider and continues to make payments for electricity to the utility. While a Variable-Priced REC can be referred to as a VPPA, it is more appropriately described as a contract for the purchase and sale of a specific commodity, namely, renewable energy credits.
2. Managed Purchase Agreement – Under this type of agreement, a customer guarantees a fixed energy payment to the Provider, the Provider arranges for an energy manager to market the energy to maximize their value, and the customer receives the renewable energy credits and other environmental attributes of the project. By using an energy manager, the customer is more likely to receive the financial benefits associated with the long-term fixed-price agreement.
3. Utility-Sleeved Power Purchase Agreement – Under this type of agreement, the customer contracts with the Provider and the utility agrees to take the electricity and deliver it to the customer.

Variable-Price REC Agreements are the most common form of VPPA and represent the most straightforward path for most localities to achieve their green energy goals. As a result, this memo focuses on Variable-Price REC Agreements (RECs), but much of the analysis is equally applicable to the other VPPA types as well.

[1] Renewable Energy Credits are certificates issued for renewable electricity that represent all of the environmental attributes associated with the electricity. As a general rule, Renewable Energy Credits can be separated from the underlying electricity, which results in the electricity itself no longer having the environmental attributes.

III. RECs and Utility Rights: Legal and Contractual.

The Georgia electricity market is regulated with some open access options. The Georgia PSC regulates retail electric sales in the state, subject to certain exceptions. Under the Georgia Territorial Electric Service Act, the state was essentially carved up, granting specific entities rights to service certain areas and also clarifying options concerning new areas and new customers. At the direction of the PSC, Georgia Power has made certain options available to customers (including local government customers) to purchase renewable energy. Some municipally-owned utilities have also made their own direct purchases of renewable electricity and separately renewable energy credits. All local governments in Georgia have express powers to develop their own electric and natural gas systems. See OCGA § 36-82-61(4)(iv). Because local governments with their own electric systems have authority to directly purchase renewable energy, RECs are not a necessary tool for them to reduce their carbon footprint. Similarly, customers of Georgia Power can elect to reduce their carbon footprint by taking electricity service under green tariffs with their existing utility, provided such options are not cost prohibitive. In both situations, though, the utility is providing the electricity to the customer and the customer's options are limited to those made available under the approved tariffs. RECs make different options available to customers because they do not entail delivery of the actual electricity. As such, they are not subject to PSC oversight and regulation.

IV. Local Authority Under the Georgia Constitution.

A. Home Rule

Georgia is essentially a "Home Rule" state, meaning that local governments are generally permitted to self-govern. Counties are granted this authority under the Georgia Constitution and this power was extended to municipalities through the Municipal Home Rule Act.[2] Cities and counties have the express authority to adopt "clearly reasonable ordinances, resolutions, or regulations relating to their property, affairs, and local government" as long as they are not inconsistent with laws established by the state legislature or the Constitution. While there is no express authority in the Georgia Code authorizing localities to enter into RECs, these contracts almost certainly relate to their property or affairs. As such, unless there is another law that would preclude an ordinance authorizing the RECs or that ordinance is "unreasonable", cities and counties should have authority to enter into RECs.

[2] Ga. Const. Art. IX, Sec II, Par. I., O.C.G.A. §§ 36-35-1 to -8.

Under *Borders v. City of Atlanta,* 298 Ga. 188, 779 S.E.2d 279 (Ga. 2015), the courts use a two-part test to evaluate whether a local ordinance is valid. The court first assesses whether the locality has authority to enact the ordinance, and then assesses whether the ordinance is reasonable. At a high level, as noted above, an ordinance to enter into a REC almost certainly relates to a locality's property or affairs. As such, absent another conflicting law, there should be authority to enact the ordinance. A review of Georgia law did not uncover any specific prohibitions on adopting this type of ordinance. While there are a number of restrictions on a city or county purchasing electricity, including the Georgia Territorial Electric Service Act and agreements between cities and local utility suppliers, these restrictions only apply to the actual purchase of electricity. Under a REC, the purchaser is not purchasing electricity. Instead, the purchaser is only acquiring the environmental attributes (or renewable energy credits) along with the financial hedge against changes in electricity prices. As a result, these restrictions on the purchase of electricity are not applicable to ordinances authorizing execution of a REC.

The question of whether an ordinance is "reasonable" cannot be evaluated in the abstract. This is a facts and circumstances test. However, it is worth noting that in *Borders*, the court placed the burden on the plaintiff to demonstrate that the ordinance was unreasonable.[3] We would expect that localities should be able to enter into a REC that would survive a reasonableness challenge assuming the REC was consistent with the market.

B. Restrictions on Multi-Year Contracts

Georgia Code Sections 36-60-13 (Multiyear lease, purchase or lease purchase contracts) and 36-30-3 (Ordinances of a Council Not to Bind Succeeding Councils; Exceptions) may present restrictions on entering into RECs, and REC agreements should be drafted in such a way to avoid such issues. Under Section 36-60-13, any multiyear contract for the purchase of goods may be treated as debt and voided unless it receives voter approval or there is another exemption. Section 36-60-13 contains specific language that should be included into a REC contract to prevent it from being void. The provisions generally include subjecting the contract to annual termination rights and clarifying that amounts payable must be paid from funds in the current year. These types of provision are typical for local governments. Potential suppliers should be aware of any applicable restrictions to ensure that the REC is priced accordingly.

Section 36-30-3 prohibits one council from binding a later council in any way that would

[3] *Borders*, 298 Ga. 200.

"prevent free legislation in matters of municipal government." Contracts that violate this law would be considered void. As with Section 36-60-13, there are both express statutory exceptions and court decisions limiting the scope of Section 36-30-3. At a minimum, courts have found that contracts extending beyond the term of the current council are not facially void. The applicable test will focus on whether the contract has restricted the legislative or government powers. Shorter-term contracts and contracts that have annual termination rights and are paid out of the current-year's budget (consistent with Section 36-60-13) do not appear to violate Section 36-30-3.

Neither code section applies to a local government's "proprietary" (rather than "governmental") functions. As a result, it is possible to argue that RECS are entirely exempt from these restrictions as proprietary functions related to local government property. No Georgia case law or state attorney general opinions have been identified definitively addressing whether RECs (or comparable contracts) are considered "proprietary" (rather than "governmental"). In other jurisdictions with similar conditions, developers and lenders have tended to prefer that the contract be subject to an annual termination right rather than risk having it be completely voided. Sustainability managers and staffers looking to enter into RECs should work with their in-house counsel to structure the contract in a way that complies with Sections 36-60-13 and 36-30-3.

V. Local Procurement Rules.

There is no state-wide mandate addressing how RECs should be procured by local governments. In general, a city's authority to contract comes primarily from its charter proscribing who has authority to execute contracts and bind the city. Local ordinances may also require certain contracts be put out to bid. These are issues that need to be addressed on a case by case by the city or county government.

VI. Requirements of Dodd-Frank.

Most forms of VPPAs involve a fixed-for-floating price swap and as such need to find an exemption from the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[4] The most common exemption is for goods bought in the normal course of managing operations at an indexed price for physical delivery. The Utility-Sleeved Power Purchase Agreement is the only VPPA structure that squarely falls within this exemption. The

[4] Steven Mickelsen, Dodd-Frank Compliance for Corporate VPPA Buyers, Futures & Derivatives Law Report, Thomson Reuters (Apr 2016), *available at* https://3degreesinc.com/wp- content/uploads/2016/05/GLFDLR4_Article-1.pdf.

Managed Power Purchase Agreement falls more squarely within Dodd-Frank as it operates primarily as a financial hedge. The Variable-Priced REC Agreement is in a grey area in that while it contemplates the physical delivery of a good, and is entered into in the normal course of managing operations, the price for the good (i.e., the renewable energy credit) is not indexed to the REC market – rather it is indexed to the electricity market. There is no guidance as to whether a Variable-Priced REC Agreement is or is not subject to Dodd-Frank.

If the agreement is subject to Dodd-Frank (or the parties elect to treat it as such), the requirements are primarily grouped into five categories: clearing, margin, recordkeeping, registration, and reporting.[5] Clearing, margin and registration requirements would generally not apply in the context of a REC, as RECs are not included within the list of swaps subject to clearing requirements,[6] fall within the end-user exception to margin requirements,[7] and are unlikely to involve a "major swap participant."[8] Reporting requirements, which require quarterly reporting of valuation data among other information, apply to all swap counterparties.[9] However, these responsibilities are customarily assumed by the seller under a REC, so the locality would likely be able to avoid the administrative burdens associated with this requirement through appropriate allocation of responsibilities under the contract.

As the clearing, margin and registration requirements should not apply, and the reporting obligations can be allocated to the seller, the only Dodd-Frank requirement that the locality would likely be subject to is the recordkeeping requirement. These requirements obligate swap counterparties to keep "full, complete and systematic" records for the life of the swap and a period of at least five years after termination.[10] To the extent this conforms to existing practice, this should not represent a significant incremental burden to the city or county.

VII. Conclusion and Recommendations.

A strong argument exists that municipalities have legal authority to enter into the Variable-Price REC Agreement. Under Home Rule, local governments have broad authority to self-govern, and there does not appear to be any legislation that would prohibit a local government from

[5] *Id.*
[6] 17 C.F.R § 50.4
[7] 17 C.F.R § 23.150
[8] U.S.C. 1a(33)(A)(i); *See also* U.S. Securities and Exchange Commission Fact Sheet, Defining Swaps-RelatedTerms, *available at* https://www.sec.gov/opa7 USC 1a(33)(A)(i)/Article/press-release-2012-67---related- materials.html (indicating the threshold used for determining "substantial position" is $1 billion of uncollateralized
[9] 17 C.F.R § 45.3
[10] 17 C.F.R § 45.2

entering into these contracts. The primary barrier is ensuring the city or county complies with Georgia Code Section 36-60-13 (Multiyear lease, purchase or lease purchase contracts) and have the ability to terminate the REC and only pay out funds for the current year. In addition, in order to avoid prohibitive administrative burdens that may be associated with implementation of a REC, a locality should require that Dodd-Frank reporting responsibilities are allocated to seller.