



MEMORANDUM

TO: RMI
FROM: Clean Energy Counsel and Lawyers for Good Government
DATE: February 26 2021
RE: Virtual Power Purchase Agreements – Virginia

I. Executive Summary

This Memorandum: (a) addresses the legality of municipal jurisdictions in Virginia to enter into a specific type of virtual power purchase agreement (“VPPA”) – the Variable-Priced REC Agreement, (b) identifies critical issues for such municipal staff to review with their internal counsel prior to entering into such a VPPA and (c) suggests some language to incorporate into a request to the Attorney General for guidance on Variable-Priced REC Agreement procurement.

Due to the lack of direct precedent for municipal VPPA transactions in Virginia, this memo requires an examination of various ways in which a VPPA may be characterized under current state and local law. Because Virginia follows the Dillion Rule, local governments are limited to the power expressly granted to them by the state legislature or the Virginia State Constitution. There is no Virginia statute that expressly grants local governments the power to enter into VPPAs. Certain procurement and property management statutes could be construed as granting authority to enter into a VPPA (specifically, a Variable-Priced REC Agreement, further discussed herein). Also, guidance may be found in Virginia’s statutes authorizing the use and control of a locality’s real property, VA Code §15.2-1800(E), which are often relied on by local governments for the authority to procure electricity from local utilities. Implementing specific authorizing legislation or directives from public officials at the municipal or state level also would greatly enhance and clarify the legal authority for a municipality to enter into a VPPA, and as such, this framework is directed towards such requests.

II. Introduction – Background on VPPAs.

The term ‘VPPAs’ refers to a category of contracts related to a variety of legal structures utilized by customers to procure renewable energy, “green up” their existing electricity procurement, or structure financial arrangements to provide certainty to power pricing. As a starting point, VPPAs differ in a number of significant ways from traditional power purchase agreements (“PPA”), in which an entity contracts with a generator of renewable energy to purchase power and legally takes title to the electricity and the associated renewable energy credits (“RECs”), at a pre-negotiated price for a specific term. By contrast, in a VPPA, the renewable energy power provider (“**Provider**”) does not physically deliver the electricity to the purchaser. Rather, depending upon the form of VPPA, the Provider can deliver a variety of products or services:

1. Variable-Price REC Agreement – under this type of VPPA, the customer purchases RECs from a Provider at a price equal to the difference between a fixed price and the market prices 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 Agreements can be referred to as a VPPA, it is a contract for the purchase and sale of a specific commodity, namely, RECs.
2. Managed Power Purchase Agreement – under this type of VPPA, 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 RECs 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 power purchase agreement.
3. Utility-Sleeved Power Purchase Agreement – under this type of VPPA, the customer contracts with the Provider and the utility agrees to take the electricity and deliver it to the customer. In Virginia, this arrangement is available through contracts with Dominion and Dominion’s existing tariffs.

This Memorandum focuses specifically on the Variable-Price REC Agreement, the procurement of RECs, and the authority under Virginia state law and the Virginia Constitution for localities to enter into such an arrangement, as well as a consideration of the federal recordkeeping and reporting requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”).

In contrast to the Variable-Price REC Agreement, the Managed Power Purchase Agreement and the Utility-Sleeved Power Purchase Agreement are used less often and are more complex to negotiate and implement. Because the Variable-Price REC Agreement is more common and more closely aligns with the options available to the Virginia-based municipalities, this memo focuses on this type of VPPA.

III. Local Authority Under the Virginia Constitution and Dillon’s Rule.

A. *Dillon’s Rule*

Virginia is a “Dillon’s Rule” state, meaning that local governments are limited to the powers expressly granted to them by the state legislature or state constitution. In evaluating what legal considerations may apply were a municipality to enter into a VPPA, it is therefore first necessary to determine whether such an action would be within powers granted to the municipality either under the Virginia Constitution or by state statute.

Nothing in the Virginia Constitution expressly authorizes local governments to enter into VPPAs. The only powers explicitly granted to local government under the Virginia Constitution can be found in Article VII, Section 3, which states:

“The General Assembly may provide by general law or special act that any county, city, town, or other unit of government may exercise any of its powers or perform any of its functions and may participate in the financing thereof jointly or in cooperation with the Commonwealth or any other unit of government within or without the Commonwealth. The General Assembly may provide by general law or special act for transfer to or sharing with a regional government of any services, functions, and related facilities of any county, city, town, or other unit of government within the boundaries of such regional government.”

Article VII, Section 2 further provides that “The General Assembly may also provide by special act for the organization, government, and powers of any county, city, town, or regional

government, including such powers of legislation, taxation, and assessment as the General Assembly may determine, but no such special act shall be adopted which provides for the extension or contraction of boundaries of any county, city, or town.”

Therefore, in order to assess whether a local government in the State of Virginia has the power to enter into a VPPA, one must look to what statutory authority has been granted to such local governments by the General Assembly, which is addressed further below in Section III of this memo.

B. Debt

Assuming that local municipalities have statutory authority to enter into VPPAs, as further discussed in Section IV, further analysis is warranted as to whether the form of VPPA chosen constitutes financial instruments or other agreements subject to the Virginia Constitution. Specifically, some VPPAs are structured specifically as derivatives or financial hedges. Those VPPAs could arguably be construed as the incurrence of debt. However, the analysis of whether they would constitute debt under the Virginia Constitution is beyond the scope of this memo.

IV. Authority under State Law.

This memo examines Virginia State law to identify express authority for municipalities to enter into a Variable-Priced REC Agreement and identifies the following potential sources of statutory authority: The VA Public Procurement Act and VA Code §15.2-1800(E), which grants municipalities broad authority to manage real property that they own.

A. VPPA as Procurement Contract.

1. The Virginia Public Procurement Act

The Virginia Public Procurement Act of 1982 (the “**Procurement Act**”) is the primary source for statutory and regulatory provisions governing the “purchase and sale of goods and services, and not to real property....”¹ Largely comprising procedural requirements and express prohibitions on certain matters and contractual terms, the Procurement Act is intended to “enunciate the public policies pertaining to governmental procurement from nongovernmental

¹ R.I.S.E., INC. v. Kay, 1991, 768 F.Supp. 1141.

sources,”² and accordingly, would apply to a VPPA that established a local governmental entity as the purchasing party and a nongovernmental entity as the selling party, so long as the VPPA is also viewed as a contract for the purchase and sale of goods or services. Under a Variable-Priced REC Agreement, the customer would procure RECs, so the question thus turns on whether a REC is deemed a “good” under the Procurement Act.

The Procurement Act defines “goods” as “all material, equipment, supplies, printing, and automated data processing hardware and software.”³ This definition suggests that goods are tangible items, although no Virginia case law was found elaborating on what may qualify as goods. However, the Commodity Futures Trading Commission and the Securities and Exchange Commission published guidance⁴ in the Federal Register supporting the argument that a REC is a tangible commodity. The CFTC argues that environmental commodities, while intangible in nature, are nonetheless commodities, in that ownership of the commodity can be transferred and the commodity can be “consumed” (or, in the case of RECs, retired) as a means of complying with an environmental program. The CFTC states that “the ownership transfer and consumption features render such environmental commodity transactions similar to tangible commodity transactions that clearly can be delivered, such as wheat and gold.”⁵ Given that a Variable-Priced REC Agreement is an agreement for the procurement of RECs or other environmental attributes, a strong argument exists that the RECs supplied by the Provider likely qualify as a “good” under the Procurement Act.

Assuming that a REC is deemed a “good” under the Procurement Act, thus enabling a locality to enter into a contract for the procurement of RECs, the local municipality would be required to comply with certain procedural and contracting constraints in the procurement of a VPPA at the individual local level.

2. Deference to Local Laws.

The Procurement Act also provides a mechanism for a locality to effectively “opt out” of significant portions of the Procurement Act by promulgating their own policies and procedures, which, so long as they adhere to the spirit of the Procurement Act, could supersede it. The

² VA Code §2.2-4300.

³ VA Code § 2.2-4301.

⁴ Federal Register, Vol.77 No. 156, August 13, 2012.

⁵ Id. at 48234.

Procurement Act provides local government entities with significant latitude in formulating their own policies and procedures with respect to procurement:

The provisions of this chapter shall not apply to: ... (a) any county, city or town whose governing body has adopted, by ordinance or resolution, alternative policies and procedures which are (i) based on competitive principles and (ii) generally applicable to procurement of goods and services by such governing body and its agencies...⁶

These locally-promulgated alternatives must still conform to the spirit of the Procurement Act: the above exemption is expressly subject to the requirements of Section 2.2-4300 – Purpose and Declaration of Intent - of the Procurement Act, which includes, among other things, obtaining high quality goods and services at reasonable cost and fairness, impartiality, efficiency and competition in the procurement process.⁷

Whether the municipality has enacted its own procurement policies and procedures or must comply with the Procurement Act, the effect is the same, and the process and mechanism for procuring a VPPA would be subject to specific requirements. Additionally, the municipality could choose to impose additional requirements on the procurement of RECs under a Variable-Priced REC Agreement that promote local and state goals, including that RECs are sourced from new renewable generation, that the generating plant be located within a certain proximity to the municipality, and that it employs local or Virginia labors and/or materials during construction and/or operation. Such best management practices are likely to support the justification for the procurement of RECs under these agreements. Municipalities should consult with their local officials and legal counsel to evaluation which best management practices to incorporate.

3. Public Contract; Pricing Arrangements.

⁶ VA Code §2.2-4343(A)10 *effective until March 1, 2021*; VA Code §2.2-4343(A)10 *effective March 1, 2021*.

⁷ VA Code §2.2-4300. Full text: To the end that public bodies in the Commonwealth obtain high quality goods and services at reasonable cost, that all procurement procedures be conducted in a fair and impartial manner with avoidance of any impropriety or appearance of impropriety, that all qualified vendors have access to public business and that no offeror be arbitrarily or capriciously excluded, it is the intent of the General Assembly that competition be sought to the maximum feasible degree, that procurement procedures involve openness and administrative efficiency, that individual public bodies enjoy broad flexibility in fashioning details of such competition, that the rules governing contract awards be made clear in advance of the competition, that specifications reflect the procurement needs of the purchasing body rather than being drawn to favor a particular vendor, and that the purchaser and vendor freely exchange information concerning what is sought to be procured and what is offered. Public bodies may consider best value concepts when procuring goods and nonprofessional services, but not construction or professional services. The criteria, factors, and basis for consideration of best value and the process for the consideration of best value shall be as stated in the procurement solicitation.

Additional provisions of the Procurement Act worth noting include the definition of a “public contract” and the pricing arrangements to which a local government entity may agree in such a contract: a public contract is “an agreement between a public body and a nongovernmental source that is enforceable in a court of law”⁸ and “except as prohibited [herein], public contracts may be awarded on a fixed price or cost reimbursement basis, or on any other basis that is not prohibited.”⁹ It seems non-controversial that a VPPA would qualify as a public contract; the only pricing arrangement expressly prohibited is cost plus a percentage of cost.¹⁰

B. VPPAs Authorized by Control of Municipal Property.

Shifting from the Procurement Act framework, towards the use and management of real property owned by a municipality, authority for a Variable-Priced REC Agreement form of VPPA may also be found in VA Code §15.2-1800(E), which states that: “[a] locality may operate, maintain, and regulate the use of its real property or may contract with other persons to do so.” Generally, this is the statute that local governments rely on to procure electricity from the local utilities.¹¹ As such, cities and municipalities could argue that the statute enables them to purchasing RECs to offset the carbon footprint of its properties. This argument is squarely within the definition of contracting for the management and operation of the real property of such locality. Furthermore, there is a compelling argument that obtaining RECs to offset a locality’s carbon impact is a favorable business decision when framed in the context of being done for the good of the citizens of not only the locality, but the world as a whole.

C. VPPA as Investment.

Under the Investment of Public Funds Act (the “**Act**”), municipal corporations and other political subdivisions, among others, may invest in a variety of traditional instruments, including stocks, bonds, notes and other evidences of indebtedness, “prime quality” commercial paper, and, in the case of public sinking funds, savings accounts or time deposits, so long as certain criteria are met.¹² Investment in overnight, term, and open repurchase agreements may also be allowed,

⁸ VA Code §2.2-4301

⁹ VA Code §2.2-4331.

¹⁰ *Id.*

¹¹ Individual municipalities should confirm this with their counsel.

¹² VA Code Ann. §2.2-4500-4502.

subject to collateralization with securities.¹³ However, “investment” is not defined in the Act, so whether the Managed Power Purchase Agreement and the Utility-Sleeved Power Purchase Agreement would fall under the purview of the Investment Public Funds Act is unclear. Further research is warranted into the types of investments that historically have qualified as “investments” under the Act that could potentially serve as a basis for comparison to one of three two types of VPPAs. Such research is beyond the scope of this Memo. Alternatively, as discussed in Section A above, a colorable argument exists that Variable-Priced REC agreement falls within the scope of the Procurement Act, and as such, is the recommended form of VPPA.

D. VPPAs and Utility Rights: Legal and Contractual.

Virginia has a regulated retail electricity market, whereby Virginia electric utilities have the exclusivity right to provide electric service within their defined service areas. This retail market is governed by the Virginia Electric Utility Regulation Act (the “VEURA”) and administered by Virginia’s State Corporation Commission (the “SCC”). The entry into a VPPA by a local government municipality should not subject the municipality to SCC oversight and regulation. First, the restrictions related to the purchase and sale of electricity, which have effectively created a monopoly for Virginia’s largest electric utilities, relate to the retail¹⁴ electricity market, and a VPPA would involve the wholesale market. Additionally, certain VPPA’s can operate as a financial instrument and may not provide for physical delivery of electricity for consumption within the exclusive territory of a utility. Accordingly, utility exclusivity should not operate as a bar preventing the city from entering into a VPPA.

One additional consideration in Virginia involves the Virginia Energy Purchasing Governmental Association (VEPGA), a governmental body that includes over 170 of Virginia’s local governments and negotiates contracts for the purchase of electricity on behalf of its members.¹⁵ In 2014, VEPGA negotiated a 5-year contract with Dominion Energy Virginia (“**Dominion**”), naming Dominion as the sole provider of retail electric service to VEPGA’s members; this contract has subsequently been extended through June 30, 2022.¹⁶ Cities and municipalities should consult with their legal counsel to evaluate whether a specific municipality

¹³ VA Code Ann. §2.2-4507.

¹⁴ “Retail electric energy” means electric energy sold for ultimate consumption to a retail customer. VA Code Ann. § 56-576.

¹⁵ <https://vepga.org>

¹⁶ <https://vepga.org/wp-content/uploads/2020/09/VEPGA-Amendment-No.-1-062620.pdf>

is a member of VEPGA, and how such membership would impact its ability to procure electricity via a Variable-Priced REC Agreement. Arguably, because a Variable-Priced REC Agreement does not provide for the delivery of electricity, but rather the delivery of a REC Certificate, such agreements would not run afoul of any agreement with Dominion. Interested entities should confirm with their local counsel.

V. Requirements of Dodd-Frank.

A. *Dodd-Frank Requirements*

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”).¹⁷ 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 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 REC) 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 VPPA 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.¹⁸ Clearing, margin and registration requirements would generally not apply in the context of a VPPA, as VPPAs are not included within the list of swaps subject to clearing requirements,¹⁹ fall within the end-user exception to margin requirements,²⁰ and are unlikely to involve a “major swap participant.”²¹ Reporting requirements, which require quarterly

¹⁷ 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.

¹⁸ *Id.*

¹⁹ 17 C.F.R § 50.4

²⁰ 17 C.F.R § 23.150

²¹ U.S.C. 1a(33)(A)(i); *See also* U.S. Securities and Exchange Commission Fact Sheet, *Defining Swaps-Related Terms*, *available at* [https://www.sec.gov/opa7 USC 1a\(33\)\(A\)\(i\)/Article/press-release-2012-67---related-](https://www.sec.gov/opa7 USC 1a(33)(A)(i)/Article/press-release-2012-67---related-)

reporting of valuation data among other information, apply to all swap counterparties.²² However, these responsibilities are customarily assumed by the seller under a VPPA, 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 city would likely be subject to is therefore 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.²³ To the extent this conforms to existing practice, this should not represent a significant incremental burden to the city.

VI. Additional Analysis for Local Counsel Discussions and Requests to the Attorney General

One avenue for confirming the authority of cities and municipalities to enter into Variable-Price REC Agreements would be to request an opinion on the legality of such procurement from the Virginia State Attorney General (VA AG). This Memorandum does not opine on the probability of success or advise as to the prudence of such an action. Individual cities and municipalities should confer with their own local legal teams and obtain advice and guidance on the matter. To the extent that the municipalities agree to file a joint request for clarification from the VA AG, we have provided below a framework that could support an inquiry to the VA AG seeking guidance as to whether Virginia law permits localities to enter into Variable-Price REC Agreements.

- Variable-Price REC Agreements are contracts for the purchase and sale of RECs. Title to the REC transfers upon delivery of a REC Certificate, evidencing the existence of the REC, and/or payment therefor. The REC is then “retired,” i.e. consumed by the Purchaser to “green up” its power supply. These characteristics lead the CFTC to recognize RECs as a commodity (or physical good) rather than a financial instrument.
- Given the above construct, some potential questions to pose to the VA AG might include:

materials.html (indicating the threshold used for determining “substantial position” is \$1 billion of uncollateralized

²² 17 C.F.R § 45.3

²³ 17 C.F.R § 45.2

- Under the Procurement Act, cities and municipalities are granted the authority to procure goods and services. Given that a REC can be purchased, sold, and consumed, as with other commodities, do RECs qualify as a “good” under the Procurement Act?
- And by extension, if RECs do qualify as a “good” under the Procurement Act, then can the VA AG confirm that localities have authority under the Procurement Act to enter into Variable-Price REC Agreements?

In addition to using the framework above, municipalities may want to consider first having informal discussions with staff at the VA AG’s office to learn the likely outcome of requesting a formal decision on the matter. Any decision rendered by the AG’s office would become final and likely would set precedent for all other municipalities within the State of Virginia.

We recommend first broaching the VPPA legality issue with in house attorneys using the outline above to correctly frame the instrument as a contract for goods and services, not a financial arrangement. Staff may want to work to reach internal consensus with in-house counsel first before determining whether a letter to the VA AG would be helpful. If the municipalities decide to move forward with a letter to the VA AG, Lawyers for Good Government may be available to help prepare such a letter and also may be able to assist with lobbying efforts, if deemed helpful.

VII. Conclusion and Recommendations.

A strong argument exists that municipalities have legal authority to enter into a certain type of VPPA – the Variable-Price REC Agreement. Because Virginia follows the Dillion Rule, local governments are limited to the power expressly granted to them by the state legislature or Virginia State Constitution. There is no statute expressly granting local governments the power to enter into VPPAs. However, municipalities are authorized to procure goods and services under the Procurement Act. Starting from the premise that a REC is a “good” under the Procurement Act, which is supported by findings by the CFTC, the procurement of RECs pursuant to a Variable-Price REC Agreement would be permissible. Alternative guidance may also be found in Virginia’s statutes authorizing the use and control of a locality’s real property, which are often relied on by local governments for the authority to procure electricity from local utilities. Receiving confirmation of this legal analysis from the VA AG would clarify the legal authority for a

municipality to enter into a VPPA, and as such, this framework is directed towards such requests. Cities should work with their own counsel to frame any question posed to the VA AG prior to engaging in such meeting. Finally, in order to avoid prohibitive administrative burdens that may be associated with implementation of a VPPA, a municipality should require that Dodd-Frank reporting responsibilities are allocated to seller.