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REPORT

The Journal on the Law of Investment & Risk Management Products

Futures & Derivatives Law

April 2016 ▪ Volume 36 ▪ Issue 4

DODD-FRANK COMPLIANCE FOR CORPORATE VPPA BUYERS

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Corporate renewable energy purchases are on the rise in the United States. Using publicly available information, the Rocky Mountain Institute estimated that corporate buyers purchased 3.21 gigawatts of renewable electricity in off-site renewable power purchase agreements in 2015.[1] Corporate purchasers have included Google, Dow Chemical, Kaiser Permanente, IKEA and others.

Corporate renewable energy transactions are frequently driven by corporations' twin desires to meet environmental goals and provide long term electricity cost certainty. The desires of corporate buyers to hedge their electricity price risk and make environmental benefit claims, combined with the falling price for long term renewable electricity contracts has made corporate renewable electricity transactions very attractive.

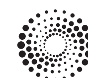
Off-site physical power purchase agreement transactions ("Physical PPAs") and virtual power purchase agreements ("VPPAs") enable buyers to realize electricity cost hedging and environmental goals in a very visible and compelling manner. This article offers analysis and contracting advice to assist corporate buyers to understand and meet Dodd-Frank compliance obligations associated with VPPA transactions.

Off-Site Physical Power Purchase Agreements

Through Physical PPAs, the seller delivers the electricity generated by the project to the grid, and the buyer receives it at a negotiated delivery point. The buyer takes title to the electricity, and consumes or resells the electricity to a third party. The selling of electricity requires that the seller be licensed by the Federal Energy Regulatory Commission or arrange for such services to be provided by a third party that is. Compliance, time, expertise, and the transactional complexity and risks of Physical PPA transactions exceed the expertise and desires of most corporate buyers.

Virtual Power Purchase Agreements

An alternative to a Physical PPA is a VPPA. A VPPA is a hybrid agreement which includes a contract for differences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to achieve electricity hedging benefits, and a renewable energy certificate agreement to achieve environmental goals. Under a VPPA the buyer never receives delivery of the electricity. The electricity generated by the project is delivered and sold to a third party.

Under the VPPA, the corporate buyer pays the renewable electricity generator the difference between a price fixed in the VPPA (the "VPPA price") for each megawatt-hour of electricity and a floating market price of electricity, such as a published index or the locational marginal price (the "market price"). If the market price is greater than the VPPA price, then the generator pays the buyer; if the market price is less than the VPPA price, the buyer pays the generator. One party pays the other the difference between the VPPA price and the market price, hence it is called a *contract for differences*.

Dodd-Frank Background

Many members of Congress attributed the severity of the economic recession in 2008 to the misuse of financial derivatives. As a response, Congress sought to require derivatives to be traded on public exchanges and parties transacting in derivatives to provide collateral to guarantee their obligations. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), enacted in 2010, regulates parties transacting in derivatives and the various parties providing services related to derivatives.

Dodd-Frank amended the Commodity Exchange Act, Securities Exchange Act, and Mortgage Reform and Anti-Predatory Lending Act to provide for comprehensive regulation of derivatives, including "swaps," in Dodd-Frank.[2]

The key factor in determining whether a given contract is a swap is whether the primary means of settlement of the parties' obligations is through the physical delivery of the underlying commodity, or whether no such physical delivery exists and there is a cash settlement based upon the movement of a floating price. If there is no physical delivery and the parties intend for there to be a cash settlement based upon a value of a floating price, the contract is a swap and subject to the Commodity Futures Trading Commission's ("CFTC") Dodd-Frank rules.

PPAs, VPPAs and Dodd-Frank

As described above, Physical PPAs require the buyer to physically receive the electricity; therefore Physical PPAs are not swaps.

The CFTC has not directly addressed whether VPPAs are swaps. However, it is likely the CFTC considers VPPAs to be swaps because VPPAs require the cash settlement of electricity price obligations based on a floating price without the physical delivery of the electricity to the VPPA buyer.

Dodd-Frank requirements for swap transactions can include clearing, margin, reporting, recordkeeping, and registration.[3] Most corporate VPPA buyers will be able to take advantage of exemptions from clearing, margin, reporting, and registration requirements, while meeting recordkeeping requirements themselves, and contracting for the seller to meet reporting requirements.

Clearing and Margin:[4] CFTC rules require that the swaps which have been "made available to trade" be cleared by a "derivatives clearing organization," as defined by CFTC rules.[5] VPPA's are not included on the list of swaps which are required to be cleared, and due to the highly

customized nature of VPPAs, it is unlikely that they will be subject to clearing requirements in the future.[6]

For swaps that are not required to be cleared, the CFTC considered imposing counterparty margin requirements. To the benefit of corporate buyers, on January 6, 2016, the CFTC adopted a final rule which established that a party to a swap who is a non-financial entity who is using the swap to hedge commercial risk (such as most commercial buyers) are not required to post margin.[7] Even without a regulatory obligation to do so, due to the credit risk associated with long-term contracts, VPPA counterparties may elect to request collateral from their counterparties to guarantee their respective performance obligations.

Reporting: The parties to a swap transaction are required to report the economic terms of the swap to a swap data repository ("SDR"). The parties are permitted to contractually determine which party must perform Dodd-Frank reporting obligations related to the swap. Reporting must be done "as soon as technologically practicable after execution," so parties should prepare Dodd-Frank reporting forms to be submitted concurrently with contract execution.[8] The reporting party needs to report post-execution changes to the primary economic terms of the swap,[9] and to file quarterly swap valuation reports.[10]

The swaps information reported to the SDR and the CFTC is aggregated by the CFTC and published on a weekly basis.[11] Generators are often more familiar with Dodd-Frank filings, so corporate VPPA buyers should contract so that the seller is obligated to make the required Dodd-Frank reporting filings.

Recordkeeping: The CFTC requires that swaps counterparties maintain swaps transaction records indefinitely in a retrievable format.[12] As such, VPPA buyers should maintain VPPA records in both virtual and physical formats indefinitely.

Registration: The CFTC requires Major Swap Participants ("MSP") to register with the CFTC and National Futures Association. An MSP is defined as a person (or entity) holding a "substantial position" in any of the major swap categories.[13] For a position to be "substantial," the entity must have a "daily average current uncollateralized exposure in excess of those specified in 17 CFR § 1.3(hhh)(6). Currently "substantial positions" are measured in the billions of dollars of swap exposure, which will serve to exempt almost all corporate buyers from registration requirements.

Conclusion

Corporate Physical PPA and VPPA transactions are increasing in number and size because they enable the buyer the opportunity to hedge future electricity prices and make environmental benefit claims consistent with their sustainability goals. When engaging in VPPA transactions corporate buyers should be aware of Dodd-Frank regulatory requirements and the exemptions from those requirements. With careful foresight and contracting, these requirements can be met efficiently by the corporate buyer. Corporate buyers should work with parties that are able to guide them through the process to ensure that they are able to capture the benefits of a VPPA while meeting regulatory obligations.

ENDNOTES:

[1] http://www.businessrenewables.org/corporate-transactions/.

[2] 7 USC § 1a(47).

[3] 17 CFR § 45.

[4] For less technical definitions of "clearing," "margin" and other terms, consult the CFTC Glossary available at http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm.

[5] See 17 CFR § 50.2 for the general requirement that swaps be cleared, and 17 CFR § 50.4 to see the list of swaps which have been made available to trade, and therefore must be cleared in practice.

[6] Even if VPPAs are made available to trade, most corporate buyers would be able to take advantage of the "end user exemption" from the clearing requirement embodied at 17 CFR § 50.50(a).

[7] See 17 CFR § 23.150(b) incorporating the exemption in 7 USC § 2(h)(7)(A).

[8] 17 CFR § 45.10.

[9] 17 CFR § 45.4.

[10] 17 CFR § 45.4(c).

[11] The Weekly Swaps report is available at http://www.cftc.gov/MarketReports/SwapsReports/index.htm.

[12] 17 CFR § 45.2.

[13] 7 USC 1a(33)(A)(i).

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