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T: 617.556.0007 F: 617.654.1735

101 Arch Street, 12th Floor, Boston, MA 02110

By Electronic Mail

To:	Coleen O'Brien, General Manager, Reading Municipal Light Department
From:	Christopher Pollart and Karla Doukas
Re:	Debt and Financing Issues
Date:	April 30, 2020

INTRODUCTION

On behalf of the Reading Municipal Light Department ("RMLD"), you have asked us to discuss certain debt and financing issues involving catastrophic events requiring repairs to RMLD's system. In particular, you have asked us: (1) to identify various funding and financing options, including the issuance of general obligation ("GO") bonds; (2) whether the Town's issuance of GO bonds for light plant purposes counts towards the Town of Reading's ("Town") borrowing limit; and (3) under what circumstances the Town ultimately become liable for RMLD's costs and debt.

In short, RMLD would have several funding options to pay for repairing and rebuilding damaged plant, including the use of existing funds, bond proceeds and outside loans, as well as grant funds. If the Town approves the issuance of GO bonds for the purposes of making extraordinary repairs to RMLD's system, such amount would be outside of the Town's debt limit and would not count towards the Town's borrowing limit. RMLD would have legal obligation to repay the bonds and interest, as well as any other liabilities and costs. Indeed, the statutory and regulatory scheme governing RMLD is designed to insulate the Town from liability for light plant costs and debt obligations.

We have discussed these issues in more detail below.

DICUSSION

I. Funding and Financing Options

In the event of a small, medium, or large catastrophic event, RMLD would have access to a number of funding and financing options to repair or rebuild its electric facilities. The available funding options, however, may depend on the particular circumstances. Below is a list of potential funding and financing sources:

- Insurance. RMLD has five separate policies that work in unison to cover RMLD's total insured assets of $895,143,650 with a "loss limit" of $250,000,000 (the most the insurer is obligated to pay as a result of a single insured event). The $250,000,000 figure exceeds the total values at risk at any one of RMLD's insured locations. This insurance will pay for direct unforeseeable sudden and accidental physical loss or damage to Covered Property, which includes RMLD's substations, resulting from a Covered Cause of Loss, which includes fire, lighting, flood, earthquakes, windstorms, snowstorms, etc. RMLD also has a stand-alone terrorism policy.

- Depreciation Funds. By statute, depreciation funds may be used for renewals in excess of ordinary repairs, extensions, reconstruction, enlargements and additions of plant. Extensive damage to RMLD's system would qualify as extraordinary repairs rather than ordinary maintenance entitling RMLD to use its depreciation funds to pay for any system repairs or improvements.

- Rate Stabilization Funds. Rate stabilization funds are reserve funds typically funded through surplus or extra-period income (below-the-line earnings). Rate stabilization funds are intended to be used for any costs to avoid increases in rates or to ameliorate rate shock. RMLD has considerable flexibility over the use of rate stabilization funds. RMLD may use such funds for any light plant purpose, such as the payment of operating expenses, capital costs, or stranded costs, other such costs for the purposes of avoiding or limiting rate increases. The Department of Public Utilities ("DPU") has stated that the timing and use of rate stabilization funds rests within the light plant's discretion. As such, it is within RMLD's discretion to use rate stabilization funds for system repairs caused by damage from catastrophic or other events.

- Earnings from Return on Plant. RMLD may earn up to an 8% return on the cost of plant. RMLD has significant discretion over the use of these below-the-line funds. The Supreme Judicial Court has stated that light plants may keep such funds in the business or relinquish below-the-line funds to the Town for general tax relief, if such funds are not otherwise needed for light plant purposes. The DPU has confirmed that payments to the Town are strictly voluntary. Given that the primary purpose of RMLD is to provide reliable, low-cost service to its customers, the use of below-the-line funds for system repairs not only would be permitted but would be prudent.

- GO Bond Issuance through the Town. RMLD also may raise funds through the Town's GO bond process. State law permits the issuance of GO bonds for remodeling, reconstructing, or making extraordinary repairs to light plant systems. The issuance of GO bonds for such purposes requires a two-thirds vote by Town Meeting and approval by a majority of the members of the municipal finance oversight board. RMLD also may obtain a temporary loan in anticipation of receiving bond or other funds.

- MMWEC Pooled Loan Program. The Massachusetts Municipal Wholesale Electric Company's ("MMWEC") enabling legislation allows MMWEC to create a "pooled loan program" for members to finance a wide array of very broadly defined "energy" facilities, from substations and distribution system improvements to metering and energy efficiency projects. RMLD could become a member of MMWEC to take advantage of financing opportunities to rebuild or repair damaged electric infrastructure caused by catastrophic or other events.

- Municipal Light Plant Cooperative Financing Arrangements. Municipal light plant cooperatives have broad powers to borrow and lend money and perform services on behalf of its members. RMLD could join an existing light plant cooperative or form a new cooperative with at least one other municipal light plant and could explore financing (issuance of revenue bonds) and other arrangements to raise funds and obtain services for the repair or rebuilding of RMLD's distribution system, as needed.

- Emergency and Disaster Relief Funding. Emergency and disaster relief funding may be available for rebuilding utility infrastructure damaged during major disasters. For instance, in 2018, the Federal Emergency Management Agency ("FEMA") provided a grant in the amount of $1,278,272 to the New Hampshire Electric Cooperative ("NHEC") for the repair of downed wires and to replace utility poles and transformers damaged in the March 2017 severe winter storm. The grant paid for ¾ of the total project costs. The grant was funded through FEMA's Public Assistance Grant program, which reimburses communities for actions taken in the immediate response and during recovery from a disaster. Accordingly, RMLD would explore the availability of federal (and state) grant funds if its distribution system were to be damaged due to a catastrophic event or severe storm.

II. Issuance of GO Bonds – Borrowing Limit

G.L. c. 44 authorizes the Town to issue bonds for municipal light plant system repairs outside of the debt limit. Those bonds would not be counted in determining the Town's debt limit. G.L. c. 44, § 10 governs the Town's debt limit and authorizes indebtedness of up to 10% with the municipal finance board's approval. Debt authorized under G.L. c. 44, § 8 is excluded. The statute provides in relevant part:

> Except as otherwise provided by law, a city or town shall not authorize indebtedness to an amount exceeding 5 per cent of the equalized valuation of the city or town. A city or town may authorize indebtedness in excess of 5 per cent but not in excess of 10 per cent, of the aforesaid equalized valuation; provided,

> however, that the amount of indebtedness so authorized shall be subject to the approval of the members of the municipal finance oversight board, which approval may be given either before or after such authorization.
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> All authorized debts, except those expressly authorized by law to be incurred outside the debt limit, shall be reckoned in determining the limit of indebtedness under this section.

Debt incurred for the purpose of remodeling, reconstructing, or making extraordinary repairs is authorized by G.L. c. 44, § 8(8A) and is outside of the Town's debt limit. This provision would encompass costs to rebuild or repair damaged facilities caused by catastrophic events or other disasters.

We note that approval of Town Meeting and the municipal finance board would be required to authorize debt for repairs and reconstruction of RMLD's system. G.L. c. 44, § 8(8A) limits the term of the debt to 10 years. In contrast, debt for extending or expanding RMLD's electric plant may be incurred for a term up to 20 years and does not require approval of the municipal finance. *See* G.L. c. 44, § 8(8).

III. Town's Liability for RMLD Costs and Debt

Under the statutory scheme governing RMLD, the Town is insulated from liability for the costs of operation of the light plant, including the repayment of notes and bonds, although legally, debt for RMLD plant incurred under G.L. c. 44 is a municipal debt, *i.e.*, debt of the Town (*see Municipal Light Comm'n. of Taunton, 344 Mass. 533 (1962)).* By law, RMLD has an obligation to repay all notes and interest on bonds as well as capital improvement and other costs and to ensure that its rates are set at such levels to meet its obligations.

Pursuant to G.L. c. 164, § 58, RMLD must set its rates to cover all expenses and debt. Specifically, the statute states in relevant part:

> There shall be fixed schedules of prices for gas and electricity, which shall not be changed oftener than once in three months. ... Such schedules of prices shall be fixed to yield not more than eight per cent per annum on the cost of the plant, as it may be determined from time to time by order of the department, after the payment of all operating expenses, <u>interest on the outstanding debt, the requirements of the serial debt or sinking fund established to meet said debt</u>, and also depreciation of the plant reckoned as provided in section fifty-seven, and losses….

G.L. c. 164, § 58. G.L. c. 164, § 57 also requires RMLD's budget to include debt obligations as well as all operating costs and losses from the previous year. That statute provides in relevant part:

> At the beginning of each fiscal year, the manager of municipal lighting shall furnish to the mayor, selectmen or municipal light board, if any, an estimate of the income from sales of gas and electricity to private consumers during the ensuing fiscal year, and of the expense of the plant during said year, meaning the gross expenses of operation, maintenance and repair, the interest on the bonds, notes or certificates of indebtedness issued to pay for the plant, an amount for depreciation equal to three per cent of the cost of the plant …. the requirements of the sinking fund or debt incurred for the plant, and the loss, if any, in the operation of the plant during the preceding year, and of the cost, as defined in section fifty-eight, of the gas and electricity to be used by the town…. The income from sales and the money appropriated as aforesaid shall be used to pay the annual expense of the plant….

(Emphasis added). Further, Section 57 authorizes RMLD to use its depreciation fund to make capital improvements to its system and to "pay notes, bonds or certificates of indebtedness issued to pay for the cost of reconstruction or renewals in excess of ordinary repairs, when such notes, bonds or certificates of indebtedness become due" with the approval of the DPU.

Accordingly, as long the Town/RMLD owns and operates the electric system, the Town would not be liable for any costs or debt associated with the plant. Because RMLD is the exclusive electric service provider in its territory and RMLD's rates must cover its costs and debt obligations, the Town can be assured that RMLD, not the Town, would repay debt for repairing or rebuilding its system from ratepayer revenues.[1] We note that if the Town seeks to abandon the provision of electric service and sell the RMLD system, the condition of the system and outstanding debt and liabilities, as well as other factors very well may affect the purchase price.

Moreover, municipal light plants are excellent credit risks because they not are rate regulated (they can raise rates as often as every three months); they must set rates that are high enough to cover production costs, which, among other things, includes the debt and other costs owed to its host municipality; they are fiscally independent from their host municipalities and their expenditures are not subject to second-guessing by other municipal officers; and they are not authorized to file for bankruptcy relief.

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[1] Although the Town may make a temporary loan and appropriate amounts to RMLD for operation and normal maintenance in advance of receipts, RMLD is legally obligated to repay the Town from its revenues. G.L. c. 164, § 57A states:

> Any city or town having a municipal light plant may appropriate money for the maintenance and operation of such plant, specifying that the same shall be taken from the receipts of the department; and where such appropriations are made, the city or town treasurer may, in advance of the collection of said receipts, pay bills on account of the said appropriations, and any sum so advanced **shall** be repaid to the city or town from such receipts, when collected, and **shall** be applied as reimbursement to the city or town, or to the payment of any temporary loan made by the city or town in anticipation of revenue of that year.

(Emphasis added).

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Please do not hesitate to contact us if you have any questions or comments.