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By Electronic Mail

To: Robert LeLacheur, Jr., Town Manager, Town of Reading

cc: Reading Municipal Light Department Board of Commissioners
Coleen O'Brien, General Manager, Reading Municipal Light Department

From: Christopher Pollart and Karla Doukas

Re: Obligation of RMLD to Make Payments to Town of Reading

Date: March 7, 2018

INTRODUCTION

On behalf of the Reading Municipal Light Department ("RMLD"), the RMLD has asked us to discuss certain issues relating to RMLD's obligation to make payments to the Town of Reading ("Town"), including the Town's ability to exercise control over the amount of payment made by RMLD and its entitlement to RMLD funds and assets. In particular, we have been asked to address the following specific issues:

(1) The requirements and terms of the Agreement between RMLD and the Towns of Wilmington, Lynnfield and North Reading, including how the Agreement governs RMLD's obligation to make in-lieu of tax payments to the Towns for a 20-year term ("20-Year Agreement");

(2) The meaning of above-the-line and below-the-line items;

(3) The unique structure of municipal lights plants and their relationship to their host municipalities; and

(4) The ability of the Town and the process by which the Town may abandon the provision of electric service and sell RMLD's system.

In summary, while municipal light plants generally have no obligation to make payments to their host towns, the 20-Year Agreement and special legislation enacted pursuant to the 20-Year Agreement obligate RMLD to make above-the-line, in-lieu of tax payments ("PILOT") equal to two percent of (2%) of RMLD's net plant allocated to each of the towns RMLD serves on the basis of load (kWh sales). The 20-Year Agreement and the special legislation allows, but does not require, RMLD to make additional in-lieu of tax payments to the Town of Reading from its unappropriated earned surplus, which is the net income generated from its return on plant. These below-the-line in-lieu of tax payments are strictly voluntary, which have been based on an arbitrary amount of $1.5 determined more than 20 years ago and are increased annually based on the previous year's CPI. For clarity, above-the-line items are operating expenses, whereas below-the-line items are deducted after RMLD's return and expenses are calculated.

The Town of Reading has no control over the amount of RMLD's in-lieu of tax payments or over RMLD's use of funds, rates or operations. As a municipal light plant with a franchise obligation to provide low cost, reliable electric service to its ratepayers, RMLD is a legally separate and distinct, self-sustaining financial entity from the Town. RMLD's rates and its use of funds are subject to statutory and regulatory requirements and under this statutory and regulatory scheme, RMLD's obligation is to its electric ratepayers, not to the Town or taxpayers. Indeed, it is well settled that municipal light plants are not tax-collecting devices. Rather, the Town cannot acquire RMLD's funds and assets unless and until RMLD sells its plant, which requires, at a minimum, Town Meeting approval by two-thirds vote at two separate Town Meetings and approval by the Department of Public Utilities ("Department" or "DPU") that such sale and abandonment of service is in the public interest. Additional approvals also may be required, including consent of the towns of Wilmington, North Reading, and Lynnfield, as RMLD has a franchise obligation to provide electric service and a contractual obligation through the term of the 20-Year Agreement. Any such sale is likely to result in protracted proceedings and costs and present significant risks.

We have discussed these issues in more detail below as well as explained the statutory and regulatory scheme governing RMLD in order to show why the Town does not have any entitlement to RMLD funds beyond its share of the 2% above-the-line PILOT.

EXECUTIVE SUMMARY

Background and Nature of Municipal Light Plants

- Municipal light plants are public utilities which have the same service obligations as privately-owned utilities such as NStar, National Grid and other utilities. They are authorized by law to provide electricity, gas, cable television and communications services to customers in their franchise areas. Cities and towns have no inherent powers to operate light plants. Specific legislation is required.

- Because municipal light plants provide essential services traditionally provided by private sector businesses, but also are municipally-owned, they are considered to be "quasi-commercial" entities, *i.e.*, independently governed business enterprises.

- Municipal light plants generally are not governed by the same laws that govern cities and towns. Rather, General Laws Chapter 164 governs the management and operation of municipal light plants.

- In several cases, the court has recognized Chapter 164 as the primary and, in most instances, exclusive statutory authority governing municipal light plant operations.

- Municipal light plants operate and are managed as commercial enterprises, separate and independent from general city or town governmental departments and subject to regulatory oversight by the DPU. RMLD may contract in its own capacity and notably, RMLD and the Town are sufficiently separate that they even may sue each other for damages.

- Early on, municipalities were divested of control over the management of the light plants and such authority was transferred to the municipal light board and manager appointed in accordance with Chapter 164.

- Chapter 164, Section 56 vests exclusive managerial power over the municipal light plant in the light plant Manager, subject to the direction and control of the municipal light board.

- This statutory scheme provides for the operation of a commercial business, insulated from the political concerns and activities of the municipality.

- In some municipalities, the Board of Selectmen or the mayor may serve as the light board. But even in those instances, they still must act in accordance with G.L. c. 164 and the interests of the light plant and its ratepayers, and not general town interests. For the Town to have its Board of Selectmen serve as the Light Board would require a charter amendment obtained through the Home Rule process pursuant to G.L. c. 43B or special legislation. The Town's charter could only change the form of government and not how RMLD operates.

- Accordingly, RMLD would operate subject to the same requirements and restrictions, including those regarding the use of its funds, regardless of the Town's form of government.

<u>Use of Light Plant Funds</u>

- Under the statutory and regulatory scheme governing municipal light plants, ratepayer funds must be used for light plant purposes to fulfill the light plant's public service obligations, even in instances when the Board of Selectmen serves as the light commission.

- RMLD's rates are governed by statute. Pursuant to G.L. c. 164, § 58, rates must be cost-based. Rates are required to be set to cover operating expenses (above-the-line items), plus RMLD may earn a maximum return of 8% on its net plant. RMLD has discretion to earn less than an 8% return but it cannot earn more.

- Case law and DPU precedent confirm that municipal light plants, in general, have no obligation to make PILOT payments to towns and that any such payments, if made, cannot be included as above-the-line expenses and must be treated as below-the-line items.

- In general, only the income generated from the return on plant as authorized by G.L. c. 164, § 58 may be used to make payments to towns, as such payments are not legal obligations of the light plant and they do not relate to the provision of electric service.

- "Below-the-line" is an accounting term which means the item is deducted after the return and expenses are calculated. "Above-the-line" means the item is included as an expense for purposes of determining the light plant's total allowed revenues pursuant to G.L. c. 164, §. 58. In other words, above-the-line items are those expenses that a light plant incurs by statute or regulation, or are necessary to provide electric service.

- As the DPU has stated in the *Prybyla* order in 1979, the primary purpose of municipal light plants is "to provide reliable electric service at reasonable rates to its consumers," and not to subsidize the town budget or fund town expenses.

- The DPU further explained, the light department is not a tax collecting device. It has no legal obligation to make payments in lieu of taxes, and its primary purpose is to provide reliable electric service at reasonable rates to its consumers.

- In a later DPU case – 1987 - involving RMLD, the DPU confirmed that payments made by municipal light plants to the towns they serve are considered to be voluntary payments rather than in-lieu of-tax payments.

- In that case, the accounting treatment of payments made by RMLD to the towns were challenged. RMLD argued that the payments (particularly to the Town of Reading because it owns the system) should be treated as above-the-line costs, *i.e.*, operating expenses.

- The DPU distinguished tax payments made by investor owned utilities, which are treated as above-the-line costs, from payments made by municipal light plants. The DPU stated that, in contrast to investor-owned utilities, the payments made by municipal light plants to the towns they serve (including the host town) are costs which the light plant "has chosen to incur, and are not imposed by statute or regulation and are not otherwise necessary to provide electric service."

- According to the DPU, such payments, if made at all, may not be treated as an above-the-line expense (operating expense) and must be accounted for as below-the-line items (deducted after the rate of return and expenses are calculated).

- Any "PILOT" payments made by municipal light plants are voluntary and must be made from its unappropriated earned surplus, *i.e*., the income generated from its return on plant. By statute, return on plant may not exceed 8% of net plant. RMLD has no discretion to increase this amount.

- In RMLD's discretion, its earned surplus also may be left in the business for capital projects, ameliorate rate impacts, pay for unfunded liabilities, or any light plant purpose.

- In deciding whether to make a voluntary PILOT payment (or loan) to the town and the amount of such voluntary PILOT payment or loan, the DPU expects light boards to exercise discretion and consider the present and future needs of the light plant.

<u>20-Year Agreement – RMLD's PILOT Obligation</u>

- In response to the *Reading* decision and to resolve a dispute with the Town of Wilmington concerning the departure of Wilmington from the RMLD system, RMLD, the Town, and the Towns of Wilmington, North Reading and Lynnfield entered into the 20-Year Agreement to address RMLD's obligation to make PILOT payments to the towns, as well as RMLD's obligation to continue to provide electric service.

- Under the 20-Year Agreement, RMLD is obligated to make an above-the-line PILOT payment to each of the towns equal to 2% of RMLD's net plant. This above-the-line PILOT is paid to each of the towns based on their load in relation to system load.

- The 20-Year Agreement allows RMLD to make additional voluntary PILOT payments to the Town from its unappropriated earned surplus, *i.e.*, revenues generated from its return on plant authorized by statute. Any additional below-the-line PILOT payment to the Town is voluntary and within RMLD's discretion.

- In order to authorize the 2% above-the-line PILOT payment to the Towns, RMLD had to obtain special legislation because the statutory and regulatory scheme does not allow RMLD to treat such payments as operating expenses. As operating expenses, RMLD can include the expense of the 2% payments in the rates that it charges to its customers.

- The special legislation does not require RMLD to make payments *per se*; it only authorizes RMLD to make the above-the-line PILOT payment. The special legislation also makes clear that any payments in excess of the 2% on net plant must be made from RMLD's below-the-line earnings, *i.e.*, from its return on plant as authorized by G.L. c. 164, § 58 (*i.e.,* up to 8%). Below the line earnings are net profit and considered unappropriated earned surplus.

- Nothing in the 20-Year Agreement, special legislation, or general statutory and regulatory scheme requires RMLD to make any PILOT payment in excess of 2% of net plant. In fact, RMLD has no legal authority to make any additional above-the-line

PILOT payments and is prohibited from increasing these above-the line PILOT payments, whether by agreement or otherwise, without obtaining legislation. In addition, RMLD cannot be compelled to relinquish its unappropriated earned surplus to the Town based on long standing precedent.

- Accordingly, there is no legal basis for the Town to demand any PILOT payment in excess of its share of the 2% on net plant or for RMLD to raise its rates to make additional PILOT payments.

Sale of Plant – Town Acquisition of RMLD Assets

- In order for the Town to obtain RMLD funds in excess of the above-the-line PILOT and voluntary below-the-line PILOT and acquire control over RMLD's property and assets, the Town must obtain Town Meeting and DPU approval to abandon service and sell the plant.

- The sale of RMLD requires two separate Town of Reading Town Meeting votes, which both must pass by a two-thirds majority.

- The sale of the plant also is subject to the jurisdiction of the DPU. The DPU only will authorize RMLD to abandon service and sell the plant if, after notice and a public hearing, it finds that it is in the public interest to do so.

- The DPU proceeding could take several years.

- RMLD also would need to obtain consent from the towns it serves if it seeks to abandon service while the 20-Year Agreement is in effect. Under the 20-Year Agreement, RMLD has an obligation to serve Wilmington, North Reading, and Lynnfield and thus, RMLD may in breach if it attempts to abandon its obligation to provide electric service.

- Additional approvals also may be required depending on the interested buyer(s), if any. The Town cannot sell the plant to just anyone. Only municipal light plants and regulated electric companies may provide electric distribution services in Massachusetts. RMLD's likely successor(s) would be another municipal light plant established by Wilmington or one of the other towns, an investor-owned utility in the area, such as National Grid, or some combination. Any town seeking to establish a municipal light plant must follow a local approval process. Service territories of investor-owned utilities already have been defined.

- Litigation would be very expensive, and would present financial risks to the Town and potential losses, assuming it receives the requisite approvals to sell the plant. Any proceedings and terms of the sale also may be particularly complex if multiple entities are involved.

- In particular, the sale price, *e.g.*, valuation of RMLD's plant, as well as the assets to be included in the sale, most likely would be contentious and subject to litigation. The valuation of the plant could be low (or lower than expected), particularly where upgrades are needed, and the Town very well may be left with significant liabilities, such as those under power agreements that are not acquired as part of any sale.

- Assuming that the sale of RMLD is approved, potential risks and adverse consequences include: (1) low valuation of plant resulting in a relatively low purchase price; (2) retention of the Town of RMLD liabilities, such as power supply contracts; (3) loss of income earned on RMLD's deposits into the Town Treasury, which, as we understand, amounts to approximately $150,000 per year, (4) loss of PILOT payments, especially if RMLD is acquired by another municipal light plant; (5) payment of significant legal costs to obtain approvals and effectuate the sale; and (6) an increase of electric rates paid by Town residents and the Town itself.

- Accordingly, the Town potentially could realize a loss by selling RMLD or at the very least, it very well may receive more income over the long-run by retaining RMLD.

DISCUSSION

I. Background and Discussion of the 20-Year Agreement

The 20-Year Agreement is the result of a settlement between RMLD and the Town of Wilmington resolving certain disputes involving the operation of RMLD and the payment of PILOTs to the towns RMLD serves. The dispute dates back to the mid-1980s when the Wilmington Chamber of Commerce and approximately 70 other customers filed a petition at the DPU requesting an investigation into RMLD's rates and practices. In that DPU proceeding, *Reading Municipal Light Department* D.P.U. 85-121/85-138/86-28-F (1987) ("*Reading*"), the DPU examined RMLD's obligation to make PILOTs to the towns and the calculation of RMLD's rate of return, among other issues. Wilmington argued that the PILOT payments are discriminatory because RMLD makes a higher payment to the Town of Reading. The DPU determined that RMLD had no obligation to make any payments to the towns, including the Town of Reading. Rather, the DPU concluded that any such PILOT payments are voluntary to be made within RMLD's discretion. Such payments, if made, cannot be expensed (treated as above-the-line items) and must be treated as below-the-line items paid from RMLD's unappropriated earned surplus generated from its return on plant.[1] In addition, the DPU concluded that RMLD may not earn more than an 8% return on plant, which shall be calculated on the basis of net plant, not gross plant.

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[1] Earned surplus is net income represented by its earned return on investment as permitted by G.L. c. 164, §. 58. *See Littleton Elec. Light Dept*., D.P.U. 96-11, at 1, n.2 (1996).

In the meantime, the Town of Wilmington voted to depart from RMLD's system and acquire its own light plant. On the same day the DPU issued its decision, Wilmington filed a petition with the DPU seeking to resolve a dispute concerning the valuation of RMLD's plant located within the limits of Wilmington. As reflected by the recitals in the 20-Year Agreement, the parties decided to settle the matter given the costs and risks associated with the protracted DPU proceedings.

The 20-Year Agreement establishes RMLD's right and obligation to serve the Towns of Wilmington, North Reading, and Lynnfield Center during the term. The 20-Year Agreement also definitively establishes RMLD's obligation to make payments to the towns. The 20-Year Agreement required the parties to pursue special legislation authorizing RMLD to expense PILOT payments to the towns.[2] The parties obtained such special legislation in 1990, St. 1990, c. 405.

The special legislation, together with the 20-Year Agreement, squarely establishes RMLD's obligations to make PILOT payments to the towns, to treat such payments as expense of plant, and its right to earn and use its return on plant. Chapter 450 of the Acts of 1990 states in pertinent part:

> SECTION 1. Notwithstanding the provisions of any general or special law to the contrary, the municipal light department of the town of Reading hereby is authorized to include in <u>annual operating expenses and recover through its electric rates voluntary, in-lieu-of-tax payments made to the towns of Reading, Wilmington, North Reading and Lynnfield</u>. Such payments may be made during each calendar year commencing July tenth, nineteen hundred and ninety, in accordance with the following formula:
>
> (a) the municipal light department of the town of Reading <u>shall calculate an amount equal to two percent of its net plant</u>, determined in accordance with the policies and decisions of the department of public utilities, as/of the end of the calendar year prior to the year in which the in lieu of tax payments are to be made; and
>
> (b) <u>the amount calculated</u> in clause (a) shall be appropriated by the municipal light department of the town of Reading and distributed during such year to the towns of Reading, Wilmington, North Reading and Lynnfield <u>as in lieu of tax payments based on a pro rata allocation in accordance with the respective retail kilowatt-hour sales within each town</u> from such prior calendar year as a percentage of said municipal light department's total retail sales within all four of the town during such prior calendar year.

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[2] The 20-year Agreement also addressed RMLD's obligation to make payments from unappropriated earned surplus while special legislation was being pursued. If special legislation failed, the agreement would terminate.

Nothing in this section shall preclude said municipal light department from earning a return of eight percent per annum on the cost of the plant in accordance with section fifty-eight of chapter one hundred and sixty-four of the General Law making additional voluntary in lieu of tax payments to the town of Reading from its unappropriated earned surplus, and otherwise using its earned return of up to eight percent per annum for purposes authorized by law.

[Emphasis added].

In short, the special legislation authorizes RMLD to make an above-the-line PILOT payment to the four towns in an amount equal to 2% of its net plant and include such PILOT payments as operating expenses in its rates. The above-the-line PILOT payments are to be allocated to each of the towns based on kwh sales, *i.e.*, the percentage of each town's load to system load. By law, RMLD cannot increase these above-the-line PILOT payments, whether by agreement or otherwise, without obtaining additional legislation as G.L. c. 164 does not authorize municipal light plants to expense any payments to towns or otherwise obligate light plants to make such PILOT payments. The special legislation also makes it clear that RMLD may make additional voluntary (below-the-line) PILOT payments to the Town from its unappropriated earned surplus, *i.e.*, income generated from its return on plant. The special legislation expressly clarifies that RMLD may earn another 8% return on net plant in accordance with G.L. c. 164, § 58, which RMLD may use, in its discretion, to make additional "voluntary" payments to the Town of Reading or for any other purposes authorized by the statutory and regulatory scheme. As discussed below, RMLD may retain such income for operations, *e.g.*, rate stabilization purposes, ratepayer refunds, deposit into depreciation account, or RMLD may loan such funds to the Town or may relinquish the funds to the Town for general tax relief. Nonetheless, the special legislation unequivocally establishes that: RMLD has no obligation to make any below-the-line PILOT payments to the Town or any payment beyond the above-the-line payments made from the 2% on net plant.

RMLD's obligation to make PILOT payments to the Towns under the 20-Year Agreement is equally clear and well-established. Section 5 of the 20-Year Agreement provides:

> Subject to and expressly conditioned upon (1) there being in effect on or before January 1, 1992, the special legislation described in paragraph 3 of this Agreement which authorizes RMLD to include in annual operating expenses for purposes of G.L. c.164, §§57 and 58 in lieu of tax payments to Reading, Wilmington, North Reading and Lynnfield, and (2) upon Wilmington's performance of its obligations under paragraph 6 of this Agreement, RMLD shall make in lieu of tax payments to such towns during each year commencing with the year in which the effective date of such special legislation occurs through the end of the term of this Agreement in accordance with the following formula:
>
> (i) RMLD shall calculate an amount equal to **two (2%) percent** of the cost of its **net plant** (determined in accordance with the policies and decisions of the DPU) as of the end of the calendar year prior to the year in which any such in lieu of tax payments are to be made; and

> (ii) the amount calculated in accordance with subparagraph (i) shall be **<u>appropriated and applied or distributed</u>** during such year to Reading, Wilmington, North Reading and Lynnfield as payments in lieu of taxes based on **<u>a pro rata allocation in accordance with the respective retail kilowatthour sales</u>** within each town from such prior calendar year as a percentage of RMLD's total retail sales within all four of the towns during the same year,

See 20-Year Agreement, Section 5(a) (emphasis added). As with the special legislation, the 20-Year Agreement also makes clear that RMLD may, but is not required, to make additional below-the-line PILOT payments to the Town of Reading from its unappropriated surplus earned from its return on plant as provided in G.L. c. 164, § 58. In this regard, Section 5 of the 20-Year Agreement states in relevant part:

> <u>Nothing</u> in this paragraph <u>shall preclude RMLD from</u> earning a return of eight percent per annum on the cost of plant in accordance with G.L. c.164, §58, <u>making additional **voluntary** in lieu of tax payments to the Town of Reading from its unappropriated earned surplus</u>, and otherwise using its earned return of up to eight percent per annum for purposes authorized by law.

See 20-Year Agreement, Section 5(c) (emphasis added). As such, the 20-Year Agreement squarely establishes that any PILOT payments to the Town of Reading in excess of its share of the 2% on net plant above-the-line payment are strictly voluntary and would be treated as below-the-line items. This provision also unequivocally establishes RMLD's right to use the 8% return on plant for any purposes authorized by law, including retaining such income for the operation of RMLD.

Accordingly, there is no legal basis for the Town to demand any PILOT payment in excess of its share of the above-the-line PILOT generated from the 2% on RMLD's net plant or for its assertion that RMLD can simply increase its rates to make additional payments.

II. <u>Above-the-Line and Below-the-Line Payments. (Rates and Use of Funds)</u>

In *Reading*, the DPU examined the accounting treatment of payments made by RMLD to the Towns of Wilmington and Reading and distinguished between above-the-line and below-the-line items or costs. As the DPU explained, "below-the-line" is an accounting term which means the item is deducted after the return and expenses are calculated. *Reading, supra, at 15, n.4*. "Above-the-line" means the item is included as an expense for purposes of determining its total allowed revenues pursuant to G.L. c. 164, § 58. *Id.*

Under the statutory scheme governing municipal lights, rates are cost based and cannot exceed more than 8% on the cost of the plant. G.L. c. 164, § 58 provides in pertinent part:

> There shall be fixed schedules of prices for gas and electricity.... No price in said schedules shall, without the written consent of the department, be fixed at less than production cost as it may be defined from time to time by order of the department. 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, interest on the outstanding debt, the requirements of the serial debt or sinking fund established to meet said debt, and also depreciation of the plant reckoned as provided in section fifty-seven, and losses; but any losses exceeding three per cent of the investment in the plant may be charged in succeeding years at not more than three per cent per annum....

G.L. c. 164, § 58. The DPU summarized the total revenues that municipal light plants may earn under G.L. 164, § 58 in the following formula:

MAXIMUM REVENUES = PLANT x RATE OF RETURN + ALLOWABLE EXPENSES

See Reading, *supra*, at 5, n.2. By statute, rates cannot yield more than 8% per year on cost of plant. *See* G.L. c. 164, § 58 ("Such schedules of prices shall be fixed to yield not more than eight per cent per annum on the cost of the plant"). Section 57 defines "cost of plant" as follows: "By cost of the plant is intended the total amount expended on the plant to the beginning of the fiscal year for the purpose of establishing, purchasing, extending or enlarging the same." In determining the allowable rate of return, Section 58 establishes a maximum return of 8% on cost of plant. While RMLD has discretion to earn less than an 8 percent return, it may not earn more as the allowable return is established by statute and only can be changed only by a statutory amendment. *Reading*, at 10. The return is calculated on the basis of net plant, not gross plant. *See id.*, at 9. As the DPU explained, the inclusion of previously depreciated plant in the calculation of the statutorily allowed return by RMLD would result in ratepayers repeatedly paying a return of and a return on utility plant. *See id.*

Pursuant to G.L. c. 164, § 58, income from retail electricity sales (above-the-line earnings) and the money appropriated must be used to pay the annual expense of the plant (*i.e.*, 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 plant), for the fiscal year. However, the DPU has determined that municipal light plants have discretion over the use of below-the-line or earned surplus funds. RMLD certainly may keep the funds in the business to pay light plant expenses or may relinquish or loan the below-the-line funds to the Town for general tax relief. Here, the Department stated:

> If there is any excess of income over current expenses (including, as required by the statute, depreciation, interest and maturing debt requirements), such excess or profit may be left in the business, or returned to the town treasury, to be used, like other municipal receipts for the relief of general taxes.

See In re Paras, D.P.U. 86-16, at 3. However, the DPU expects managers and light boards to exercise prudent management discretion in determining the amount, if any, to be transferred to the town, with consideration of the light plant's cash position and anticipated needs. *See id*. at 3-4. Thus, DPU precedent requires light plants to act reasonably in determining if, when and how to allocate surplus funds in order to meet the ratepayers' interests. *See id.; see also Littleton Elec. Light Dept.,* D.P.U. 96-11, at 5. In other words, when deciding whether to make a voluntary, below-the-line PILOT to the Town, RMLD should consider whether such revenues are needed for light plant purposes.

In *Reading, supra,* RMLD argued that the payments (particularly to the Town of Reading because it owns the system) should be treated as above-the-line costs, *i.e.,* operating expenses. The DPU, however, distinguished tax payments made by investor owned utilities, which are treated as above-the-line costs, from payments made by municipal light plants. *See id.* The DPU stated that, in contrast to investor-owned utilities, the payments made by municipal light plants to the towns they serve (including the host town) are costs which the light plant "has chosen to incur, and are not imposed by statute or regulation and are not otherwise necessary to provide electric service." *See id.* As the DPU recognized and affirmed by the Single Justice of the Supreme Judicial Court ("SJC"), municipal light plants are not tax collecting devices and they have no legal obligation to make payments in lieu of taxes. *See Prybyla v. Wellesley Municipal Light Plant,* D.P.U. 19535, at 3, affirmed *Prybyla v. Department of Pub. Utils*. S.J. No. 79-188 (1979). In other words, an "above-the-line" item is a cost that the light plant incurs by statute or regulation or necessary to provide electric service. Therefore, according to the DPU, such payments to the towns, if made at all, may not be treated as an above-the-line expense and must be accounted for as below-the-line items. *See id.* at 15-16. Rather, any payments made to the towns are considered voluntary and are solely within the light plant's discretion to the extent it has available any surplus funds.[3]

As discussed above, these regulatory requirements governing municipal light plant PILOT payments have been altered somewhat by special legislation obtained by RMLD. Unlike all other municipal light plants, the special legislation allows RMLD to treat PILOT payments in the amount equal to 2% of RMLD's net plant to the towns as operating expenses, *i.e.,* above-the-line items. *See* St. 1990, c. 405. However, any additional PILOT payments made to the Town are treated in the same way as payments made to the towns by other municipal light plants: the special legislation makes clear that any additional PILOT payments to the Town in excess of the 2% of net plant are wholly within RMLD's discretion and must be made from its unappropriated

[3]We note that G.L. c. 164A, § 8 imposes a statutory obligation on municipal light plants to make certain in-lieu-of-tax payments from above-the-line earnings for Pool Transmission Facilities (PTF). G.L. c. 164A, § 8 pertains to "electric power facilities," which are defined for purposes of that statute as:

> generating units rated twenty-five megawatts or above and transmission facilities rated sixty-nine kilovolts or above which (i) have been designated as pool or pool-planned facilities under the New England power pool agreement or (ii) are financed in whole or in part under the provisions of sections eleven to twenty-two, inclusive.

G.L. c. 164A, § 8. In other words, G.L. c. 164A, § 8 only authorizes in-lieu-of-tax payments on PTF facilities or certain generating and transmission facilities financed through revenue bonds. Even then, that statute does not apply to facilities constructed prior to September 30, 1973. To our knowledge, RMLD does not own any PTF facilities in the Towns, and thus, G.L. c. 164A, § 8 would not apply to any payments made to the Towns under the 20-Year Agreement or otherwise.

earned surplus in accordance with the policies of the DPU, *i.e.*, income generated from its 8% return on plant.[4]

III. Unique Structure of Municipal Light Plants and Relationship to the Town

RMLD, as a municipal utility with a franchise obligation to provide low-cost, reliable service to its ratepayers, is a legally and financially separate entity from the Town, operating as a business enterprise pursuant to G.L. c. 164, rather than another Town department. It is well settled that the Town has no authority over the management of RMLD, including its expenditures. The court has long recognized the autonomy of municipal light plants from traditional town government processes and operations. *See, e.g., Municipal Light Commission of Peabody v. Peabody*, 348 Mass. 266 (1964); *Municipal Light Commission of Taunton*, 323 Mass. 79 (1948). According to the court, municipal light plants are "quasi-commercial" entities created by special act; municipalities themselves have no inherent rights to own and operate such a business in the absence of special legislation and the enabling statutes, found at G.L. c. 164, §§ 34 *et. seq. See, e.g., MacRae v. Concord*, 296 Mass. 394, 396 (1934); *Spaulding v. Peabody*, 153 Mass. 129, 137 (1891). Municipal light plants, such as RMLD, operate and are managed separate and independent from general town governmental departments and subject to regulatory oversight by the DPU. The SJC has recognized G.L. c. 164 as the primary and, in most instances, exclusive statutory authority governing municipal light plant operations. *See, e.g., Municipal Light Commission of Taunton*, 323 Mass. at 84; *MacRae*, 296 Mass. at 397. As a consequence, municipal light plants generally are not subject to town by-laws and ordinances or control by Town officers. *See Municipal Light Commission of Taunton*, 323 Mass. at 84 (holding that city ordinances specifying procedures for the fixing of salaries do not apply to municipal light plants).

Municipalities were divested, early on, of control over the management of their light plants and such authority was transferred to the municipal light board. *Capron v. Taunton*, 196 Mass. 41 (1907); *Whiting v. Mayor of Holyoke*, 272 Mass. 116 (1930). The municipal light board is vested with all the powers and duties formerly exercised by the mayor and the Selectmen with respect to light plants and with all of the powers and duties conferred upon municipal light boards under G.L. c. 164. *Adie v. Mayor of Holyoke*, 303 Mass. 295 (1939).

G.L. c. 164 sets out the entire process with regard to, *inter alia*, municipal light plant budgets, expenses, accounts, and rates for service, and this statutory scheme provides for the operation of a commercial business, insulated in terms of budgets, appropriations, and operation and maintenance from the political concerns and activities of the municipality. G.L. c. 164, § 56 vests exclusive managerial power over the municipal light plant in the light plant Manager,

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[4]See above for the text of the special legislation.

subject to the direction and control of the Light Board. *Commonwealth v. Oliver,* 342 Mass. 82, 85 (1961) (management and operation of the light plant is vested in the Light Board by virtue of G.L. c. 164, § 55, and in the Manager acting under them as their executive officer under G.L. c. 164, § 56). Specifically, the Manager of a municipal light plant, under the direction of the Light Board has:

> full charge of the operation and management of the plant, the manufacture and distribution of gas or electricity, the purchase of supplies, the employment of attorneys and of agents and servants, the method, time, price quantity and quality of the supply, the collection of bills, and the keeping of accounts.

G.L. c. 164, § 56. To carry out its business, RMLD also has authority under G.L. c. 164 to enter into contracts in its own name. *See* G.L. c. 164, §§ 56A - 56D. While G.L. c. 164 imposes some filing and disclosure requirements with the Town, the Town lacks authority over the approval of light plant contracts and terms. The court has interpreted G.L. c. 164 as giving municipal light plants considerable freedom to make management decisions. Indeed, by virtue of the express language of Section 56 and with the creation of a Light Board within the Town, virtually exclusive managerial control of RMLD has been placed in the hands of the Light Board and the Manager, appointed by the Light Board pursuant to G.L. c. 164, § 56. In particular, the Manager and the Light Board have full authority over RMLD's budget and expenditures, personnel policies and compensation of its employees, and the keeping of accounts, subject to any oversight authority of the DPU and any requirements imposed by G.L. c. 164. Here, the Town can exercise no control over the management of RMLD, including its finances.

The SJC's decision in *Taunton, supra*, illustrates the Town's lack of authority and control over the light plant. There, the court made clear that municipal light plants are not subject to Town personnel policies or bylaws or compensation levels for their employees. In that case, the City of Taunton had established an ordinance which set salary scales for janitors and custodians and sued to have the Taunton Municipal Light Plant ("TMLP") follow the City's salary scale. The court held that TMLP did not have to follow the City ordinance and that the TMLP Commission and Manager could set compensation levels pursuant to their exclusive managerial power. In so ruling the Court stated:

> It is well settled by the decisions of this court in which statutes similar to that in the present case creating municipal light commissions were considered, that <u>where cities and towns are authorized to enter the field of business enterprises like the manufacture of gas and electricity, they do it</u>, not under the laws relating to private corporations, but <u>under special statutory provisions; that, the officers of the [lighting plant] have been created and their duties defined by statute, they must be held to be public officers under legislative mandate, and not agents of the city</u>; that the design of the statute in the present case is to <u>vest exclusive managerial powers in the commission</u> <u>subject to the supervision</u> of other public officers and particularly <u>of the department of public utilities</u> of the Commonwealth as provided by G.L. (Ter. Ed.) c.164, Whiting v. Mayor of Holyoke, 272 Mass. 116; subject only to the provisions of c. 164. Adie v. Mayor

> of Holyoke, 303 Mass. 295. **It is also settled that a municipality can exercise no direction or control over one whose duties have been defined by the legislature.** Adie v. Mayor of Holyoke, 303 Mass. 295, 299. *Breault v. Auburn*, 303 Mass. 424, 428. *Gibney v. Mayor of Fall River*, 306 Mass. 561, 565. *Sweeney v. Boston*, 309 Mass. 106, 110.

Id. at 84 (emphasis added).

Unlike budgets for town departments, municipal light plant budgets are not subject to Town Meeting approval. In *Municipal Light Commission of Peabody v. Peabody*, 348 Mass. 266 (1964), the SJC specifically considered the scope of the light plant's authority over its budget and appropriations. In that case, the court ruled that the budget of municipal light plant should be determined in accordance with G.L. c. 164 and not by procedures of statute governing control of municipal departments, such as those procedures found in G.L. c. 44. *Peabody*, 348 Mass. at 273. Specifically, the SJC stated:

> The management and fiscal operation of the municipal light department... are vested in the commission and the manager of the plant... and the budget of the light department is to be determined in accordance with c. 164 and not by the procedures of c. 44; any appropriations under the procedures of c. 44 if less in amount than the budget the light department requires shall not limit the expenditures of the department; so far, if at all, as such appropriations are in excess of the amounts that the city is required to appropriate under c. 164, §57, they shall be deemed appropriations under c. 164, §57A.

See id. (emphasis added). G.L. c. 164 does not subject municipal light plant to the town appropriation process to use revenues generated by the light plant and therefore, the SJC determined that appropriations for the "expense of the plant" may be made by vote of the Light Board on a budget submitted by the light plant Manager. *See id.* at 268, 270. Moreover, the court found that because the town cannot control the size of the light plant's budget, it necessarily follows that it cannot control any of its expenditures. The SJC reasoned, "...§§57 and 58 confirm the implication of § 56 that the municipal light plant shall have in each fiscal year the funds to meet the 'expense of the plant' as estimated by the Manager at the beginning of the year, and that, within the limits of the business operation as defined by the statute, the mayor and city council have no restrictive powers." *Id.* at 270 (emphasis added). The SJC further noted that "[s]ection 57A of c. 164 ... throws light on the intent of § 57 and confirms that the operation of the municipal plant is not dependent upon ... appropriations [from the tax levy] by the municipality." Any appropriations made by the Town from the tax levy are considered advances on receipts of the light plant, which the light plant must repay when the receipts are collected. *Id*. at 271.

The light plant Manager's obligation to report income and expenses of the light plant pursuant to G.L. c. 164, § 57 has raised an issue of the role of municipalities over budgetary matters. That statute provides, in relevant part, that the Manager is to submit, each year, to the Light Board:

> an estimate of the income from sales of ... electricity to private customers... and of the expense of plant... meaning the gross expenses of operation, maintenance and repair, the interest on the bonds, notes of certificates of indebtedness issued to pay for the plant, an amount of depreciation equal to three per cent of the cost of the plant exclusive of land and any water power appurtenant thereto, or such smaller or larger amount as the department [of public utilities] may approve, 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... electricity to be used by the town.

G.L. c. 164, § 57. The court, however, interpreted this provision as not conferring any oversight authority to the town and held that, where a Light Board exists, the statute requires the Manager to provide this information to the Light Board, rather than to other officers in the town. *See Peabody* at 268, 270.

Several years after the *Peabody* decision, the SJC reaffirmed the autonomy of municipal light plants from other town departments, even to the extent that the courts view light plants as separate and distinct financial entities. *See Middleborough v. Middleborough Gas & Elec. Dept*., 422 Mass. 583, 588 (1996). Consequently, the SJC determined that municipal light plants and towns are capable of suing each other for money damages.[5] *See id.* The SJC reasoned that the different sources of revenues largely account for this separate financial treatment. *See id.* Ratepayers support the operations of municipal light plants, whereas towns and cities generate their revenues from the taxpayers. This decision clearly illustrates that RMLD and the Town are not the same.

We note that G.L. c. 164 allows the Board of Selectmen to serve as the light board and the Town may change its form of government under Home Rule procedures. However, RMLD still must act in accordance with G.L. c. 164 and the interests of the light plant and its ratepayers, and not general town interests. *See Middleborough, supra,, citing Hull Mun. Lighting Plant v. Massachusetts Mun. Wholesale Electric Co*., 399 Mass. 640 , 647 (1987) (municipal lighting boards act on behalf of ratepayers). First and foremost, RMLD is an electric utility providing essential services. Under the statutory and regulatory scheme, RMLD is recognized as a public service corporation and has a legal obligation to provide low cost, reliable electric service to its ratepayers. It is well settled that municipal and private utilities are subject to identical public service obligations. *Planning Bd. of Braintree v. Department of Pub. Utils*., 420 Mass. 22, 27 (1995). Each has the same "duty to exercise [their] franchise for the benefit of the public, with a

[5] By filing the lawsuit, the Town of Middleborough sought to shift the burden of the cost of MGED's alleged negligence resulting from a fire from its taxpayers to MGED's ratepayers either directly or, if MGED's insurers pay for the damage, through increased premiums. The SJC agreed that MGED should be responsible for the loss. The court stated that had the loss been a loss incurred by MGED due to its mismanagement, its ratepayers would have absorbed the loss. Accordingly, for this and other reasons, the court concluded that MGED and the town are sufficiently distinct as financial and political entities to support a suit by the town against MGED for the town's loss as a result of the fire. This case illustrates that RMLD is a self-sustaining enterprise, financially and legally separate from the Town and the Town has no liability for RMLD operations, whether in contract or in tort.

reasonable regard for the rights of individuals who desire to be served, and without discrimination between them." *See id*. at 27-28; *Bertone v. Department of Pub. Util*s., Mass. 411 Mass. 536, 544 (1992). Specifically, the DPU has recognized that utilities, including municipal utilities, have an "obligation to furnish adequate, reliable service to all of [their] customers." *See North Attleborough Elec. Dept. ("NAED"),* D.P.U. 86-261, at 17 (1987). In fact, the DPU stated that the primary purpose of municipal light plants is "to provide reliable electric service at reasonable rates to its consumers." *Prybyla v. Wellesley Municipal Light Plant*, D.P.U. 19535, at 3, *affirmed Prybyla v. Department of Pub. Utils*., S.J. No. 79-188 (1979). Notably, the Appeals Court, in *Golubek v. Westfield Gas & Elec. Light Bd*., 32 Mass. App. Ct. 954 (1992), confirmed that local legislation cannot alter the comprehensive statutory scheme pertaining to municipal light plants. Thus, even if the Town were to change its form of government, RMLD would be subject to the same statutory and regulatory requirements and restrictions regarding the operation of RMLD, including the establishment of rates and the use of its funds. In other words, the Town could not simply transfer RMLD funds for Town purposes.

IV. Sale of RMLD

The Town, through its Board of Selectmen, lacks authority to sell RMLD. In general, the sale of RMLD requires **two, two-thirds vote of Town Meeting and approval of the DPU**. G.L. c. 164, § 68 governs the sale of municipal light plants, stating:

> A town which has acquired a municipal lighting plant shall not sell it for the purpose of abandoning the distribution of gas or electricity to its inhabitants until such sale has been authorized in the manner and by the votes prescribed for the acquisition of such plants by sections thirty-five and thirty-six. No sale of such a plant shall be made for any purpose until the department, after notice and a public hearing, has determined that the facilities for furnishing and distributing gas and electricity in the territory served by such plant will not thereby be diminished, and that such sale and the terms thereof are consistent with the public interest.

Pursuant to this statute, the Town must obtain the same authorization to sell RMLD as it did to acquire RMLD. G.L. c. 164, § 36 sets forth that procedure and requires two separate Town Meeting votes, which must pass by a two-thirds majority. If any of the votes fail, the Town will have to wait at least two years before attempting to sell RMLD again. Specifically, the statute states:

> A town shall not acquire such a plant until authorized by a two thirds vote, taken by ballot with the use of the voting list, at each of two town meetings called therefor and held at intervals of not less than two nor more than thirteen months. If the first of such votes is favorable and the second unfavorable, or if both such votes are unfavorable, no similar vote shall be passed within two years thereafter.
>
> *See* G.L. c. 164, § 36.

If the sale passes at Town Meeting, the town also will need to obtain DPU approval to effectuate the sale. This DPU process requires notice and a public hearing. We would expect that any such sale not only would be controversial but involve some complex issues particularly in light of the fact that RMLD serves multiple communities, Wilmington, North Reading and Lynnfield Center Wilmington, North Reading and Lynnfield Center. Pursuant to special act, St. 1908, c. 369, RMLD obtained authority to extend its service territory to these areas and as a result, RMLD has a franchise obligation to provide such service. Specifically, Section 3 of the special act states:

> The town of Reading shall furnish to the towns North Reading and Wilmington for municipal use and to the town of Lynnfield for municipal use in that part thereof known as Lynnfield Centre, and to the respective inhabitants of said towns of North Reading and Wilmington and of that part of the town of Lynnfield known as Lynnfield Centre.

Further, the 20-Year Agreement requires RMLD to provide such service. Paragraph 1 of the 20-Year Agreement states:

> Subject to the provisions of this Agreement, RMLD will continue to furnish electric service to Lynnfield, North Reading and Wilmington, and their inhabitants, on a reliable basis and at a reasonable cost.

The 20-Year Agreement also precludes Wilmington, North Reading and Lynnfield from acquiring RMLD plant. Accordingly, as long as the 20-year agreement is in effect, RMLD would have an obligation to continue to provide service. Notably, the 20-Year Agreement recognizes that RMLD's obligation to provide service extends beyond the term. Specifically, Section 12 states:

> Upon the expiration of the term of this Agreement in accordance with the provisions of paragraph 11 or termination of this Agreement in accordance with the provisions of paragraphs 3 or 6, RMLD shall continue to serve Wilmington, North Reading and Lynnfield pursuant to St. 1908, c.369 and G.L. c. 164.

In the event that RMLD were to move forward with the sale, RMLD very well could face litigation and contentious regulatory proceedings. While we are not aware of any proceedings in which a municipal light plant sought to sell its system pursuant to Section 68, the sale and acquisition of light plant facilities could take years, is very costly and presents some significant risks. Indeed, the Town of Wilmington sought to establish its own municipal light and acquire a portion of RMLD's system. The 20-Year Agreement acknowledges that placing a valuation on RMLD's plant would be contentious, take a very long time, and present some unacceptable risks not only to ratepayers in the Town of Wilmington, but to the ratepayers in Reading. Here, the recitals states:

> WHEREAS, RMLD and Wilmington are in substantial disagreement as to the **valuation to be placed upon RMLD's plant** within the limits of Wilmington and the amount of severance damages, if any, arising out of the transfer of such plant by RMLD to Wilmington;
>
> WHEREAS, discovery and the presentation of evidence to the Department would in all probability take months, if not years to complete, all at **great expense** to Wilmington and RMLD's ratepayers;
>
> WHEREAS, an adverse **outcome of a Department valuation proceeding involves substantial and unacceptable risks** for both RMLD, Wilmington and RMLD's ratepayers;

In addition, a DPU decision involving Stow's acquisition of plant in Hudson (*Petition of Stow Municipal Electric Department for a determination by the Department of Public Utilities of damages pursuant to St. 1898, c. 143, and G.L. c. 164, s.s. 42 and 43,* D.P.U. 94-176 (1996), illustrates some of the complexities, costs, and risks associated with selling plant. That case involved the sale of a portion of Hudson's system to Stow. Hudson did not seek to abandon service to Stow; rather Stow sought to depart from Hudson's system and establish its own municipal light plant. Stow petitioned the DPU for a determination of purchase price and damages, if any, resulting from its separation from Hudson. The process involved lengthy DPU and court proceedings, taking approximately seven years. (Stow filed its petition in 1994; the DPU issued an order on reconsideration in 2001.) The DPU awarded Hudson only $2,554,472 as compensation for the purchase of its physical property located within Bolton, Boxboro, Maynard, and Harvard and physical termination and reconnection costs. The DPU denied Hudson compensation for power supplies.[6]

Any sale by RMLD could be even more complex, depending on whether the sale involves one or multiple parties, such as one or more of the towns or an investor-owned utility such as National Grid.[7] If a municipality seeks to acquire all or a portion of RMLD's plant, that municipality (or municipalities) would have to obtain the necessary Town Meeting approvals as well. We would expect any such proceedings to take years and there is no guarantee that the DPU would find such sale to be in the public interest, particularly if there is no willing buyer. Nor is there any guarantee that the Town of Reading would receive the compensation from the sale that it expects, particularly where plant is in need of updating and the Town could be left with significant contractual liabilities. Rather, the Town might be better off financially by retaining RMLD and continuing to receive low-cost, reliable electric service from RMLD and receiving income from the above-the-line and below-the line PILOT payments from RMLD and earning interest on its deposit of funds in the Town Treasury. Rates of investor-owned utilities are generally higher and service is not as reliable. The Town most likely would not receive higher PILOT payments if an investor-owned utility acquired the system within Reading and may receive no PILOT payments at all if the Town is served by another light plant. RMLD also provides other benefits to the Town, such as the use of its facilities, and community relations, through the Citizens Advisory Board ("CAB"), the Town participates in the operation of RMLD. Accordingly, selling RMLD would not necessarily place the Town in any better financial position.

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

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[6] G.L. c. 164, § 43 governs the purchase price when a town seeks to establish a municipal light plant. Thus, this statute would apply if Wilmington or one of the other towns seeks to acquire RMLD's system or a portion of RMLD's system. The purchase price by an investor-owned utility likely would be negotiated and subject to review under Section 68 and may be subject to additional regulatory approvals, as a regulated distribution company. We also note that it is possible that the towns or an investor-owned utility would not have a strong interest in taking over RMLD's system particularly if the valuation is high, or that its system may be sold to multiple utilities. We also note that the *Stowe* case is distinguishable as the light plant continued to provide service in the Town of Hudson.

[7] Investor-owned utilities are subject to different regulatory requirements. They are subject to retail competition and their power purchases are subject to DPU approval. Accordingly, an investor-owned utility would not necessarily seek to acquire all of RMLD's assets.