KP | LAW
The Leader in Public Sector Law
T: 617.556.0007 F: 617.654.1735
101 Arch Street, 12th Floor, Boston, MA 02110

By Electronic Mail

To: Christopher Roy, General Manager, Belmont Municipal Light Department

From: Christopher Pollart and Karla Doukas

Re: Payments to the Town

Date: March 2, 2020

INTRODUCTION

Pursuant to your request, we have reviewed the "PILOT Payment Schedule" set forth in your November 21, 2019 memorandum to the Town Administrator. According to the memorandum, Belmont Municipal Light Department ("BMLD") offered to provide a one-time PILOT funding increase equivalent to two years at the current PILOT rate of $650,000. This amount would be provided in FY21 but spread across two BMLD calendar year budgets. In conjunction with this increased payment, BMLD requested the Town to agree to an annual fixed PILOT payment of $500,000 for the calendar year 2020 through 2029, at which point the $650,000 payment would resume in 2030 and be subject to further review and adjustment. The memorandum states that any PILOT payments are subject to the availability of funds in accordance with Massachusetts General Laws. You have asked us whether this payment plan complies with all applicable laws. Based on our research, the payment plan is fine as long as BMLD has sufficient below-the-line funds to make the payments. We have explained the parameters for making payments to the Town and generating below-the-line funds below.

DISCUSSION

With the exception of payments made in connection with pool transmission facilities ("PTF"),[1] BMLD's payments to the Town are considered voluntary payments and must be made from below-the-line surplus funds. Case law and precedent of the Department of Public Utilities ("DPU") confirm that municipal light plants, in general, have no obligation to make "PILOT"

[11] G.L. c. 164A, § 8 governs in-lieu of tax payments made by municipal light plants in connection with their ownership of PTF facilities. Those payments are considered to be PILOT payments and may be expensed and treated as above-the-line items.

payments to towns and that any such payments, if made, cannot be included as above-the-line expenses. Rather, they 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 because such payments are not legal obligations of the light plant and they do not relate to the provision of 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 *Reading Municipal Light Department ("Reading"),* D.P.U. 85-121/85-138/86-28-F (1987), the DPU confirmed that payments made by municipal light plants to the towns they serve are considered voluntary payments rather than in-lieu of-tax payments.[2] There, the DPU distinguished tax payments made by investor-owned utilities ("IOUs"), which are treated as above-the-line costs, from payments made by municipal light plants. The DPU stated that, in contrast to IOUs, 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).

In generating below-the-line funds that may be used to make payments to the Town, BMLD is limited to an 8% return on plant. In *Reading, supra,* the DPU considered the calculation method for the return on plant and determined that the return should be based on net plant. The DPU noted that it is an accepted regulatory accounting practice for IOUs to use net plant "because to do otherwise would mean that the ratepayers provide the IOUs with a return on funds provided by the ratepayers through the depreciation expense included in rates." (Citations omitted). The DPU explained that when an IOU's investment in plant is placed in rate base and depreciated (added into the depreciation expense), the stockholder is reimbursed by the ratepayers for that capital investment, and the company is permitted to earn a return on its unreimbursed investment that is used and useful in providing service to its ratepayers. The DPU reasoned that to allow a return on gross plant in addition to allowing the company to expense depreciation of the investment would result in the ratepayers' repeated reimbursement of the capital costs for an investment of which they had already paid. The DPU determined that there should be no difference in the treatment of municipal light plants and IOUs on this issue, because the inclusion of previously depreciated plant in the calculation of statutorily allowed return would result in ratepayers repeatedly paying a return of and a return on utility plant. Accordingly, the DPU found that calculating the rate of return on gross plant is inappropriate.

[2] Since then, RMLD obtained special legislation authorizing the use of above-the-line funds to make payments (within certain limits) to the towns within its service territory.

The DPU also determined that light plants have no flexibility to increase the amount of the return. The DPU reasoned that the 8 % return has been established by statute and can be changed only by a statutory amendment (or special legislation applicable to a particular light plant). Similarly, the DPU found unpersuasive the argument that items such as working capital, prepayments, and other items may be included in rate base in order to provide a higher return. The DPU noted that the inclusion of cash working capital in rate base for IOUs is designed to reimburse electric companies for the short-term interest costs needed to pay for its day-to-day operations. Accordingly, the DPU concluded that the inclusion of a cash working capital adjustment to rate base would be unnecessary and inappropriate for municipal light plants. We note, however, that according to the email from Paul Osborne, the DPU seems less concerned with an occasional yield in excess of the statutory limit. However, exceeding the 8% limit for several years may warrant and investigation and remedial action to bring rates in compliance with statutory requirements.

To the extent that BMLD has surplus funds generating from its return on net plant, BMLD would have discretion to provide the Town with the payments in accordance with the payment schedule. As the DPU 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. The DPU expects General 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. If BMLD does not have sufficient below-the-line funds in a given year, it would need to adjust the payment to the Town.

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If you have any questions, please contact us.