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## WISCONSIN LEGISLATIVE COUNCIL INFORMATION MEMORANDUM

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### **Financing of Environmental Improvements to Energy Utility Facilities (2003 Wisconsin Act 152)**

#### **INTRODUCTION**

Act 152 of the 2003 Wisconsin Legislature creates a new financing mechanism, referred to as “environmental trust financing,” to finance the cost of certain investments intended to reduce environmental pollution from existing energy utility facilities. The Act creates a mechanism by which bonds would be issued under the authority of an order of the Public Service Commission (PSC), to be repaid from revenues collected from fees placed on the bills of the utility’s customers. The PSC order would create a property right to the collection of the fees from the utility’s customers and to the collected revenues. The utility would transfer this right to a third party, which would collect the fees for repayment of the debt. The debt associated with the bonds would not be shown on the books of the utility.

The Act establishes a process by which a utility may request the authority to utilize environmental trust financing and by which the PSC may review and approve such a request. Much of the Act, however, consists of provisions regarding the treatment of the bonds and the revenue stream to repay them. These provisions are designed to give investors sufficient confidence in the repayment of the bonds and associated financing costs to ensure that the bonds receive high ratings and, thus, are issued at low rates of interest.

#### **SCOPE OF FINANCING**

Environmental trust financing may be used for two types of projects:

1. The installation of environmental control equipment on existing energy utility facilities that were in service before the effective date of the act.
2. The retiring of existing plants, facilities, or other property of an energy utility to reduce, control, or eliminate environmental pollution in accordance with federal or state law.

#### **ENVIRONMENTAL TRUST BONDS**

##### **FINANCING ORDERS**

An energy utility (a natural gas or electric public utility) may petition the PSC for what is termed a “financing order.” The utility must include all of the following in its application:

1. A description of the project and the reasons for the project.
2. An estimate of the project cost (“environmental control costs”).
3. An indication of the portion of the environmental control costs that it intends to finance through environmental trust bonds.

4. An estimate of the cost of financing the bonds (“financing costs”).
5. An estimate of the “environmental control charges” (referred to hereafter as “charges”) that will be placed on the utility’s customers’ bills to recover the environmental control costs and financing costs. (Hereafter, environmental control costs and financing costs will be referred to collectively hereafter as “costs.”)
6. An estimate of the amount of money that consumers will save by the use of environmental trust financing relative to other financing methods.

The Act is very explicit that only an energy utility may initiate the process for using environmental trust financing and the PSC may not require a utility to do so. In addition, the PSC may not refuse to allow an energy utility to finance a project in an otherwise permissible fashion solely because of the potential availability of environmental trust financing.

If a utility submits an application for a financing order, the PSC must hold a hearing and act on the application within 120 days of receiving the application. The PSC must issue an order if it finds that: (1) the order will result in a lower cost to customers for the project than other financing options; (2) the proposed structure and expected pricing of the environmental trust bonds will result in the lowest charges to utility customers that are consistent with market conditions and the terms of the financing order; and (3) the order “is otherwise consistent with the public interest, and is prudent, reasonable, and appropriate.” The order must describe the project, specify the amount of costs, and the period over which the costs may be recovered. It must include a requirement that utility customers pay the specified charges and a formula-based mechanism for an annual adjustment of the amount of the charges to prevent overcollection or undercollection. In addition, an order must specify the

“environmental control property” created by the order. This concept is described below.

Financing orders are irrevocable. With two exceptions, the PSC may not modify an order once it is issued. As noted already, the PSC must annually adjust the amount of charges to utility customers, based on the formula-based mechanism in the financing order. In addition, the PSC may replace a financing order with a new order if the new order will have lower financing costs or otherwise be in the public interest. This is essentially the same as a homeowner refinancing a mortgage when interest rates fall. Also, if the PSC considers it to be appropriate, the financing order may include a provision allowing for the early retirement of the bonds.

The energy utility that requested the financing order and issued the environmental control bonds must place the proceeds of the bonds in a separate account and may use them only to pay costs. If the PSC determines that any of this revenue was used in a manner that was not prudent, reasonable, or appropriate, it may adjust the utility’s revenue requirement (the basis of its rates) so as to reduce rates in an amount that ensures that the utility’s customers do not pay for the imprudent, unreasonable, or inappropriate expenditures.

A financing order remains in effect until all bonds have been paid and all financing costs have been recovered.

### **REPAYMENT**

As noted earlier, the financing order requires that customers pay charges to the energy utility for the repayment of costs. This requirement applies to any customer of the utility as long as the customer resides in the utility’s service territory, regardless of whether the customer continues to receive service from the utility. This provision anticipates the possibility of retail competition at some time in the future, under which utility customers may drop their

utility service and instead buy energy from a competitive provider.

At least annually, the PSC must adjust the customer charges. In doing so, it must apply the formula-based mechanism specified in the financing order, “based on estimates of demand and other mathematical factors.” The PSC is prohibited from holding a hearing on adjustment of the charges, but must provide a 30-day period for interested parties to make comments. The comments must be limited to any error in the application of the formula-based mechanism relating to the appropriate amount of overcollection or undercollection, and the appropriate amount of an adjustment.

The utility must annually provide its customers a concise explanation of the customer charges.

#### **ENVIRONMENTAL CONTROL PROPERTY**

As noted earlier, a financing order must “[s]pecify the environmental control property that is created and that may be used to pay or secure the environmental trust bonds.” Such property is different from the common understanding of property as something tangible; in this case, it is also a right. Specifically, it is the right to collect the charges on consumers’ bills established in the financing order as well as the actual revenues generated by those charges.

The concept of environmental control property is closely related to environmental control bonds. The Act states that the financing order *may* provide that the energy utility’s acquisition of environmental control property is conditioned on, and simultaneous with, the sale of that property to a third party and the pledging of the property to secure the bonds. The use of the word “may” suggests that other arrangements are allowable, but the Act gives no indication of what these arrangements might be.

The Act contains extensive language relating to the creation and perfection of environmental control property, security interests in it, and the

sale, assignment, and transfer of it. Environmental control property continues to exist until the bonds are fully repaid and financing costs are fully recovered.

Environmental control property may be sold to any person. However, an affiliate of the utility that issued the bonds may not buy environmental control property unless the affiliate was created for the limited purpose of facilitating or administering environmental control property or trust bonds under the financing order.

Public entities (including public officers but not including members of the PSC), financial institutions, and other persons may invest in environmental trust bonds.

#### **TAX TREATMENT**

The Act adds the revenues from customer charges to the definition of “gross receipts” in s. 76.28, Stats., with the result that the utility will pay license fees (also referred to as gross receipts taxes) on those revenues.

#### **NO STATE FINANCIAL OBLIGATION**

The Act specifies that environmental trust bonds are not a debt of the state and do not impose any financial obligation on the state or its political subdivisions.

#### **PSC RATE-MAKING**

In exercising its powers and carrying out its duties regarding rate-making, the PSC may not do any of the following:

1. Consider environmental trust bonds to be debt of the energy utility.
2. Consider charges collected from the utility’s customers for repayment of costs to be revenues of the utility.
3. Consider environmental control costs or financing costs to be costs of the utility.

- Determine any action taken by the energy utility that is consistent with the financing order to be unjust or unreasonable.

**PROVISIONS AFFECTING THE TREATMENT OF ENVIRONMENTAL CONTROL PROPERTY AND THE RECOVERY OF COSTS**

**FINANCING ORDERS**

A number of the Act's provisions relating to financing orders affect environmental control property and the recovery of costs. The limitations on the PSC's authority to revoke or modify financing orders, described earlier, are an example.

**STATE PLEDGE**

The Act contains a pledge of the state to not take any action that impairs the value of environmental control property or the ability of the owner to collect the charges that are a part of such property.

**ENVIRONMENTAL CONTROL PROPERTY**

The provisions relating to the creation and perfection of security interests in, and the sale, assignment, and transfer of environmental control property are too extensive to detail in this memorandum. These provisions generally establish what laws will govern these topics. In particular, they establish that specific provisions of the Act supersede regulations otherwise applicable under ch. 201, Stats., *Securities of Public Service Corporations*, and ch. 409, Stats., *UCC--Secured Transactions*. It appears that these provisions are designed specifically to help ensure the security of this property for the benefit of bond holders.

**BANKRUPTCY**

If the utility that issued environmental trust bonds files for bankruptcy, the financing order that authorized the bonds remains in effect and unabated. Furthermore, the interest of the owner of environmental control property is not affected by such a bankruptcy.

**FAILURE OF UTILITY TO ACT**

The failure of a utility to comply with the requirements regarding the separate accounting of proceeds from the sale of environmental trust bonds or the annual explanation of charges billed to customers does not affect the validity of financing orders, environmental control property or bonds, or charges.

**CONFLICTS**

In the event of conflict between the Act and any other law regarding any security interest in environmental control property, the Act shall govern.

**EFFECT OF INVALIDITY OF ACTIONS**

Any action taken by an energy utility or other entities under a financing order will remain in full force and effect in the event that any provision of the Act is subsequently invalidated or repealed.

This memorandum was prepared on March 24, 2004, by *David L. Lovell, Senior Analyst*. The information memorandum is not a policy statement of the Joint Legislative Council or its staff.

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