

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: Block Island Power Company : Docket No. 3655
General Rate Filing

BLOCK ISLAND POWER COMPANY'S
MOTION FOR INTERIM RELIEF

Pursuant to Rule 1.17 of the Rules of Practice and Procedure of the Public Utilities Commission, Block Island Power Company (BIPCo) hereby moves for interim relief.

BIPCo has filed a general rate case seeking a rate increase of \$463,171, which translates to a 21.96% across-the-board increase. However, BIPCo has also asked for approval of a rate design change that would extend BIPCo's June 1 through September 30 seasonal rates by two additional months so that the seasonal rates would be in effect from May 1 until October 31. If this rate design change is approved, the result would reduce the needed across-the-board rate increase to 11.49% instead of 21.96%.

As shown by the direct testimony filed on behalf of BIPCo in this matter, together with the additional interim relief testimony of Walter E. Edge, Jr., CPA, attached hereto, BIPCo is facing extraordinary, immediate and irreparable injury that can be avoided by the granting of the interim relief requested herein. BIPCo is operating at a significant loss. This has created two immediate problems which will not be solved, even if rate relief is granted on July 1, 2005, which is the current schedule for processing this case.

First, because BIPCo is operating at a loss (and is a summer seasonal utility), BIPCo is now losing significant money each month. BIPCo is therefore unable to pay all

Prefiled Interim Relief Testimony

Of

Walter E. Edge Jr. MBA, CPA

For

Block Island Power Company

Docket # 3655

January 2005

1 **Q. Please state your name and business address for the record.**

2 A. My name is Walter E. Edge Jr. MBA CPA and my business address is B&E Consulting,
3 21 Dryden Lane, Providence, Rhode Island 02904.

4

5 **Q. Are you the same Walter E. Edge Jr. that has previously filed prefiled testimony in**
6 **this Docket #3655?**

7 A. Yes.

8

9 **Q. What is the purpose of your interim rate relief testimony?**

10 A. This testimony will address the extraordinary, immediate and irreparable injury BIPCo
11 faces if interim relief is not granted. I will explain the extreme cash flow problem BIPCo
12 has and the difficulty that BIPCo faces with the loan coverage ratios of its Rural Utilities
13 Services (RUS) loan. I will provide more detail than I provided in my initial direct
14 testimony regarding the coverage ratios, how they are calculated, what is expected for
15 BIPCo at year end December 31st 2004 and 2005 and the default provisions of the loan. I
16 will provide additional information that relates to the need for interim relief.

17

18

I. The Impending RUS Default

19

20 **Q. Did you address this issue in your original prefiled testimony?**

21 A. Yes. In my original prefiled testimony I pointed out that there was going to be a
22 problem for BIPCo in reaching the coverage ratios for its RUS borrowing at year end
23 December 31, 2005 if the Commission agrees that an expansion of the shoulder months is
24 appropriate and in the best interest of the ratepayers, but does not agree to implement this
25 rate design May 1, 2005. The expansion of the shoulder months (to May and October)
26 reduces the across the board increase from 21.96% to 11.49%. It is also possible that the
27 Commission will find that the rate relief needed by BIPCo is less than 21.96%. Therefore,
28 the across the board increase implementing the expansion of the shoulder months could be
29 less than 11.49%. In my initial prefiled direct testimony I stated the following:

30

1
2
3 “Since this filing will not be filed until mid December, the seven month
4 suspension period will bring the rate relief beyond May 1st 2005.
5 BIPCo may not receive full rate relief until July 2005 and in that case
6 would lose a large portion of the rate increase (over \$110,000 for May
7 2005) in the calendar year 2005. Of course, BIPCo will get the May
8 shoulder month increase in 2006 (within the rate year) but it will be too
9 late to address a problem that will arise with the Rural Utilities Services
10 (RUS).” WEE direct testimony in Docket #3655, page 34.
11

12 I stated further that:

13
14 “RUS requires BIPCo to file an annual report for the calendar year
15 ending each December. BIPCo had a fairly large loss in FYE 2004
16 and I expect that BIPCo will not make the covenants of the RUS loan
17 this year (CYE December 31, 2004). Failure to make the required
18 ratios results in RUS demanding an action plan to address the problem.
19 The action plan for this year will be to notify RUS that we have filed
20 for a rate increase that when fully implemented will eliminate the
21 issue. However, without the \$110,000 increase in May 2005 it is
22 obvious to me that BIPCo will once again fall short when the
23 December 2005 annual report is filed.” WEE direct testimony in
24 Docket #3655, page 34.
25

26 **Q. When you reviewed the RUS loan agreement for this testimony did you find any**
27 **language that would change your previous testimony?**

28 A. Yes I did. With the exception of the year end December 31st 2001, BIPCo has always
29 made the coverage ratios in the past three years. Each year BIPCo files the RUS Form 7
30 and subsequently receives either follow-up questions that are addressed by BIPCo or notice
31 from RUS that the Form 7 had been accepted. RUS never indicated that BIPCo should
32 calculate the coverage ratios in a manner other than the method filed on the Form 7 (i.e. an
33 individual calculation for each year).
34

35 In researching the RUS loan documentation for this testimony, I determined that the
36 coverage ratios are actually average ratios, using the best two of the last three years for the

1 calculation. In other words, the fact that BIPCo will not make the coverage ratios for the
2 one year CYE December 31st 2004 should not be a major problem.

3
4 BIPCo apparently will be able to calculate the average coverage ratios using the coverage
5 ratios for CYE December 31st 2002 and 2003 to meet the loan coverage ratio covenants.
6 However, this averaging method will not address the problem with meeting the coverage
7 ratios issue for the CYE December 31st 2005, because the two best years in the last three
8 will have to include either CYE December 31st 2004 or CYE December 31st 2005, both of
9 which will not make the coverage ratios and CYE December 31st 2003 which barely made
10 the coverage ratios. BIPCo will therefore find itself in default on the RUS loan.

11
12 **Q. What are the coverage ratios that BIPCo must make to satisfy RUS?**

13 A. They are as follows;

- 14 1. Times Interest Earned Ratio (TIER)
- 15 2. Operating TIER (OTIER)
- 16 3. Debt Service Coverage Ratio (DSC)
- 17 4. Operating DSC (ODSC)

18
19 The difference between the TIER and OTIER and the DSC and ODSC is the margin or
20 profit number used in the calculation. The operating coverage ratios (OTIER and ODSC)
21 allow only the use of the operating margin (profit) while the broader coverage ratios (TIER
22 and DSC) allow for the inclusion of all non operating revenues and expenses.

23
24 The calculation of TIER is stated simply as bottom line profit plus interest divided by
25 interest. BIPCo is required to have a TIER of 1.5. In other words, the bottom line profit
26 must be at least ½ of the interest expense. The OTIER must be 1.1.

27
28 The calculation of DSC is stated simply as bottom line profit plus interest, plus depreciation
29 and amortization divided by debt service payments. BIPCo is required to have a DSC of

1 1.25. In other words, the bottom line profit must be at least ¼ of the debt service payments
2 if depreciation and principal payments are synchronized. The ODSC must be 1.1.

3
4 It is very clear to see that any year with a loss, either operating, bottom line or both will
5 result in BIPCo not making the RUS coverage ratios.

6
7 **Q. How has BIPCo done in complying with these coverage ratios?**

8 A. The following table shows that BIPCo has almost made all of its coverage ratios since
9 January 1st 2001.

10

	Required	2001	2002	2003
TIER	1.5	1.23	1.55	1.62
DSC	1.25	1.36	1.31	1.33
OTIER	1.1	.54	1.14	1.39
ODSC	1.1	.99	1.11	1.22

11
12 **Q. What will happen if the Commission does not approve the interim rate relief that**
13 **BIPCo is requesting?**

14 A. First, as addressed below in more detail, cash flow, which is already very difficult, will
15 continue to deteriorate until this summer when the rate relief is finally approved and the
16 normal (much larger) summer sales are realized. Vendors will be forced to wait for
17 payments, resulting in late payment fees and/or discouraging them from dealing with BIPCo
18 in the future, and/or possible litigation against BIPCo. The unpaid vendors could even try
19 to force BIPCo into an involuntary bankruptcy or receivership. As it did last year, BIPCo
20 will draw down its line of credit, which will result in additional interest cost for the company
21 and in turn the ratepayers. BIPCo may have to discontinue its automatic deduction from its
22 bank account for fuel purchases and lose the discount offered for prompt payment. In short,
23 BIPCo and its vendors will suffer through a very difficult winter and spring. Second,
24 BIPCo will probably be in default on its loan with RUS on December 31st 2005.

25
26 The RUS default remedies are as follows:

1 Generally:

2 “Upon the occurrence of an Event of Default, then RUS may pursue all rights and
3 remedies available to RUS that are contemplated by this Agreement or the Mortgage
4 in the manner, upon the conditions, and with the effect provided in this Agreement or
5 the Mortgage, including, but not limited to, a suit for specific performance,
6 injunctive relief or damages.

7 Nothing herein shall limit the right of RUS to pursue all the rights and remedies
8 available to a creditor following the occurrence of an Event of Default listed in
9 Article VII hereof. Each right, power and remedy of RUS shall be cumulative and
10 concurrent, and recourse to one or more rights or remedies shall not construe a
11 waiver of any other right, power or remedy.” Article VIII of the RUS loan agreement
12

13 Suspension of Advances:

14 “In addition to the rights, powers and remedies referred to in the immediately
15 preceding section, RUS may, in its absolute discretion, suspend making
16 or.....approving Advances.....” Article VIII of the RUS loan agreement
17

18 **Q. Are there other problems associated with a RUS default?**

19 A. Yes. I believe that RUS will not approve any additional financing until the coverage
20 ratios can once again be met. This would eliminate RUS as a borrowing source in the near
21 future, resulting in much more expensive borrowing for both the new engine and for the
22 distribution work that is badly needed. Moreover, because BIPCo is in default with its
23 primary lender, it will be very difficult, if not impossible, for BIPCo to obtain a loan of any
24 kind for the engine or the distribution work.
25

26 **Q. What do you think RUS will do?**

27 A. In addition to the borrowing problem, I would expect that RUS will do the same thing
28 that they did after the 2001 report was filed and BIPCo was found noncompliant with the
29 coverage ratios. BIPCo was required by RUS to file three quarterly reports. Although
30 these quarterly Form 7 reports are less effort than the annual Form 7 report, I anticipate that

1 the cost of these quarterly reports will be on average about \$4,000 per quarter (about
2 \$12,000 total). This cost, which can be averted, represents over 10% of the interim relief
3 that BIPCo is requesting. I strongly believe the \$12,000 would be better spent improving
4 the distribution system. Only after filing three quarterly reports and the 2002 annual Form
5 7 report (all of which were compliant) did RUS relax the filing requirements and return
6 BIPCo to a schedule of annual filings.

7 8 9 II The Cash Flow Crisis

10
11 **Q. Would the additional monies generated from the May 2005 additional seasonal**
12 **billing at current rates address the cash flow crisis that BIPCo is facing?**

13 A. Yes. As I stated in my initial prefiled testimony the additional May billing would off
14 set some of the expected loss for FYE 2005. Cash generated by this additional billing could
15 be used to off-set the current existing serious cash flow problem. BIPCo and its vendors
16 suffered through a very bad cash flow problem in the late winter and spring in 2004 when
17 accounts payable exceeded \$400,000 and certain vendors did not get paid for six months. I
18 expect that this year to be even worse than last year because we are already substantially
19 behind last years cash balance at this time. Last year, BIPCo drew down \$50,000 of its
20 \$75,000 line of credit (\$25,000 was left in reserve for emergency purchases) for the first
21 time in a dozen years.

22
23 Although customers were patient in the beginning they were much less patient when the
24 summer came and everyone expected to be paid first. BIPCo would like to avoid having
25 this problem occur again, and \$111,000 would go a long way toward alleviating the cash
26 crisis.

27
28 **Q. Why does BIPCo have such a bad cash flow problem?**

29 A. As I stated in my original prefiled testimony, BIPCo is not only a seasonal company, but
30 in order to produce electricity BIPCo must buy fuel. Having to (1) buy fuel in advance of

1 using it, and (2) then waiting to bill the customer at the end of the month, and (3) then
2 waiting a couple of weeks before seeing any measurable amount of collection on the billing,
3 exacerbates the cash flow problem.

4
5 Added to this is the fact that BIPCo has to carry fuel inventories to protect the ratepayers,
6 because BIPCo operates on an Island where daily deliveries can be interrupted by weather or
7 other extraordinary events. Moreover, the State of Rhode Island collects 100% of the
8 estimated gross receipts tax for the entire calendar year by June of each year (long before
9 BIPCo recovers the revenue from the ratepayers).

10 Finally, by law BIPCo has to pay fuel excise taxes to the State (even though it is exempted)
11 only to have them refunded months later. Putting all of these factors together creates a
12 significant cash flow problem. The extra \$111,000 in May 2005 from the rate design
13 change is critical to continued efficient operations.

14
15 **Q. In your original prefiled testimony you requested a working capital allowance.
16 Wouldn't this allowance cover these cash shortfalls?**

17 A. No. We have requested a working capital allowance in rate base. However, this does
18 not provide cash for these cash flow shortages. It simply provides a return on the monies
19 that are required to meet these cash shortfalls. BIPCo would be happy to forgo the working
20 capital allowance in this filing in exchange for the accelerated interim relief as requested.

21 22 **III Requested Relief**

23
24 **Q. What could the Commission do to help BIPCo address these serious problems?**

25 A. In my original prefiled direct testimony I provided three options as follows:

- 26 1. One option would be for the Commission to approve interim rate relief for part of the
27 rate increase (\$111,000) if the parties agree that at least the amount needed to meet
28 RUS loan covenants (about \$111,000 of the \$463,171 requested rate relief) will
29 eventually be approved. BIPCo would agree that should there be a shortfall and at
30 least \$111,000 is not approved, then BIPCo would refund the difference to the

1 ratepayers. This option assumed that interim rate relief in whatever form be granted
2 as soon as possible.

- 3
- 4 2. A second option would be to compress the docket schedule and work toward
5 approving rate relief for May 1st 2005. This would reduce the time for the rate relief
6 review and BIPCo would do everything in its power to facilitate the process.
7 Unfortunately, BIPCo did not have the information, resources or manpower to get
8 this docket filed by October 1st 2004 which would have been required to assure rate
9 relief by May 1st 2005. At the pre-hearing scheduling conference it was concluded
10 that this option was not viable.
- 11 3. As a third option, BIPCo is prepared to suffer the consequences of not getting the
12 full interim rate relief by May 1st if BIPCo is allowed interim relief in the form of
13 implementing only the shoulder month rate design change on May 1st, 2005 (using
14 current seasonal rates for May 2005) and then the full rate increase for consumption
15 on and after July 1st, 2005.

16

17 **Q. Have you done a ratepayer impact analysis showing the impact of implementing**
18 **the seasonal rate design (at current rates) on May 1, 2005?**

19 A. Yes I have. Because the implementation of seasonal rates for May is new and the
20 breakdown of customer class usage and individual usage within classes is such that an
21 accurate projection is not very meaningful for individuals or even customer classes, I did a
22 reasonableness calculation. BIPCo is requesting a rate design change that will result in a
23 one time payment by the ratepayers. Given that the revenue generated is \$111,000 and
24 BIPCo has approximately 1,700 customers the average increase would be a one time
25 payment of \$65.29. BIPCo expects that the year round residential customers will pay less
26 than \$65.29 and the commercial and seasonal residential will pay more than \$65.29.

27

28 **Q. Does that conclude your testimony?**

29 A. Yes.

of its vendors and suppliers as and when due. Although it is possible that the vendors may be patient with BIPCo, this is the second year in a row that this has occurred. The situation is even worse this year than it was last year. Some of BIPCo's vendors and suppliers may choose to stop providing needed goods and services to BIPCo, which could put BIPCo in a crisis situation. Other vendors and suppliers could choose to exercise their legal rights and remedies and sue BIPCo. They could even attempt to place BIPCo into bankruptcy or involuntary receivership due to BIPCo's inability to pay its bills as and when due. This inability to pay its bills as and when due renders BIPCo technically insolvent.

The second extraordinary and immediate irreparable injury that BIPCo and its ratepayers would suffer is that, even if general rate relief is granted on July 1, 2005, if interim relief as requested below is not granted, BIPCo will nevertheless soon be in default under its Rural Utilities Service (RUS) first mortgage financing. RUS will then have all of the legal rights and remedies available to it as of December 31, 2005, when BIPCo will have to report to the RUS that it did not make the financial covenants of its loan. This could result in RUS exercising its legal and equitable remedies. But even if RUS does not choose to exercise its legal and equitable remedies, it is extremely unlikely that the RUS would be willing to provide additional loan funds to BIPCo that BIPCo needs to purchase the new engine to meet additional demands, and to provide funds for distribution system improvements that are overdue and badly needed.

As set forth in the testimony of Walter Edge, there are two alternatives for granting interim relief that will alleviate both the cash flow crisis as well as the RUS loan covenant default. The first option would be to grant across-the-board interim rate relief

for \$111,000 of the requested \$463,171 rate increase being sought. This would be granted across-the-board on an interim basis and would be subject to refund if the Commission eventually approves a rate increase of less than \$111,000. This would be similar to what the Commission did in 1991. In BIPCo's last full rate case in Docket 1998 (Order No. 13769, effective November 1, 1991), BIPCo filed for a rate increase of \$488,410. A motion for emergency relief was filed and the Commission granted an across-the-board \$190,000 emergency rate increase, subject to refund.¹ Eventually, at the completion of the case, the Commission granted a rate increase of \$172,702 (plus an environmental surcharge of \$40,000 per year for three years) and accordingly no refund was necessary.

The second option (which is identified as the third option in Walter Edge's testimony because the second option of compressing the schedule was ruled out by the parties at the prehearing conference) would be the simplest option. It is also the option that BIPCo prefers. If the Commission elects to utilize this option, the Commission would simply order interim relief in the form of accelerating the proposed rate design change so that seasonal rates for 2005 would commence on May 1, 2005 instead of June 1, 2005 (at current rates, not at increased rates). Mr. Edge has calculated that this one-month rate design change at current rates would generate about \$111,000 and would alleviate BIPCo's crisis. Under this option, BIPCo's rates would remain at current rates until the Commission concluded its review and implemented the general rate increase in July of 2005.

¹ Of the \$190,000 awarded for emergency rate relief, \$40,000 was restricted for environmental remediation costs.

Either of these options should alleviate the extraordinary problem BIPCo is currently facing. July 1, 2005 rate relief will not solve either the cash flow problem or the RUS loan covenant problem. Because the option of moving the effective date for the seasonal rate solves both problems without any change in rates, and because it is only an interim change in rate design, it is the simplest and easiest solution to implement, and it is the solution that BIPCo recommends and requests, although either option would be satisfactory.

Accordingly, for the reasons set forth herein, in the prefiled direct testimony of BIPCo's witnesses, and in the prefiled direct and interim relief testimony of Walter Edge, Jr., CPA., BIPCo respectfully requests that the Commission grant interim relief utilizing either of the two alternatives set forth above.

Respectfully submitted,
Block Island Power Company
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CERTIFICATE OF SERVICE

I hereby certify that on the ____ day of January, 2005, I mailed a true copy of the foregoing by first class mail to the following:

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