BEFORE THE

PUBLIC UTILITIES COMMISSION

OF RHODE ISLAND

BLOCK ISLAND POWER COMPANY) DOCKET NO. 3655

DIRECT TESTIMONY

OF

THOMAS S. CATLIN

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

APRIL 2005

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 20904

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BLOCK ISLAND POWER COMPANY) DOCKET NO. 3655

Direct Testimony of Thomas S. Catlin

Introduction

Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Thomas S. Catlin. I am a principal and Vice President with Exeter Associates, Inc. Our offices are located at 5565 Sterrett Place, Suite 310, Columbia, Maryland 21044. Exeter is a firm of consulting economists specializing in issues pertaining to public utilities.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I hold a Master of Science Degree in Water Resources Engineering and Management from Arizona State University (1976). Major areas of study for this degree included pricing policy, economics, and management. I received my Bachelor of Science Degree in Physics and Math from the State University of New York at Stony Brook in 1974. I have also completed graduate courses in financial and management accounting.

Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE?

A. From August 1976 until June 1977, I was employed by Arthur Beard Engineers in Phoenix, Arizona, where, among other responsibilities, I conducted economic feasibility, financial and implementation analyses in conjunction with utility construction projects. I also served as project engineer for two utility valuation studies.

From June 1977 until September 1981, I was employed by Camp Dresser & McKee, Inc. (CDM). Prior to transferring to the Management Consulting Division of CDM in April 1978, I was involved in both project administration and design. My project administration responsibilities included budget preparation and labor and cost monitoring and forecasting. As a member of CDM's Management Consulting Division, I performed cost of service, rate, and financial studies on approximately 15 municipal and private water, wastewater and storm drainage utilities. These projects included: determining total costs of service; developing capital asset and depreciation bases; preparing cost allocation studies; evaluating alternative rate structures and designing rates; preparing bill analyses; developing cost and revenue projections; and preparing rate filings and expert testimony.

In September 1981, I accepted a position as a utility rates analyst with Exeter Associates, Inc. I became a principal and vice-president of the firm in 1984. Since joining Exeter, I have continued to be involved in the analysis of the operations of public utilities, with particular emphasis on utility rate regulation. I have been extensively involved in the review and analysis of utility rate filings, as well as other types of proceedings before state and federal regulatory authorities. My work in utility rate filings has focused on revenue requirements issues, but has also addressed service cost and rate design matters. I have also been involved in analyzing affiliate relations, alternative regulatory mechanisms, and regulatory restructuring issues. This experience has involved electric, natural gas transmission and distribution, and telephone utilities, as well as water and wastewater companies.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS ON UTILITY RATES?

A. Yes. I have previously presented testimony on more than 200 occasions before the Federal Energy Regulatory Commission and the public utility commissions of Arizona, California, Colorado, Delaware, the District of Columbia, Florida, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Maryland, Montana, Nevada, New Jersey, Ohio, Oklahoma, Pennsylvania, the City of Philadelphia, Utah, Virginia and West Virginia, as well as before this Commission. I have also filed rate case evidence by affidavit with the Connecticut Department of Public Utility Control and have appeared as an expert witness on behalf of the Louisiana Public Service Commission before the Nineteenth Judicial District Court of Louisiana.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL SOCIETIES?

A. Yes. I am a member of the American Water Works Association (AWWA) and the Chesapeake Section of the AWWA. I currently serve on the AWWA's Rates and Charges Committee and on the AWWA Water Utility Council's Technical Advisory Group on Economics.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. I am presenting testimony on behalf of the Division of Public Utilities and Carriers (the Division).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Exeter Associates was retained by the Division to assist it in the evaluation of the rate filing submitted by the Block Island Power Company (BIPCo or the Company) on December 17, 2005. This testimony presents my findings and recommendations with regard to the overall revenue increase to which BIPCo is entitled. In developing my recommendations, I have incorporated the recommendation of my associate, Mr. Lafayette K. Morgan, with regard to the appropriate allowance for cash working capital.

Q. HAVE YOU PREPARED SCHEDULES TO ACCOMPANY YOUR TESTIMONY?

A. Yes. I have prepared Schedules TSC-1 through TSC-14. Schedule TSC-1 provides a summary of revenues and expenses under present and proposed rates. Schedule TSC-2 summarizes my adjustments to BIPCo's proposed rate year rate base. Schedule TSC-3 provides a summary of my adjustments to rate year operating expenses and the resulting net income at present rates. Schedule TSC-4 provides a proof of income taxes at present and proposed rates. Schedules TSC-5 through TSC-14 present each of my adjustments to BIPCo's claimed rate base and operating income.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.

A. As shown on Schedule TSC-1, I have determined BIPCo's overall non-fuel revenue requirement to be $2,303,404. This represents an increase over revenues at present rates of $194,147. This is the amount by which revenues fall short of generating the overall return on rate base of 6.36 percent which I have identified on behalf of the Division.

Q. WHAT TIME PERIODS HAVE YOU UTILIZED IN MAKING YOUR DETERMINATION OF BIPCO'S REVENUE REQUIREMENTS?

A. Consistent with BIPCo's filing, I have utilized a test year ended May 31, 2004 and a rate year ending May 31, 2006 as the basis for determining the Company's revenue requirements and the rate increase necessary to recover those requirements.

Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A. The remainder of my testimony is organized into sections corresponding to the issue or topic being addressed. These sections are set forth in the table of contents for this testimony.

Rate of Return

Q. PLEASE EXPLAIN THE BASIS FOR THE OVERALL RETURN OF 6.36 PERCENT WHICH YOU HAVE UTILIZED IN DETERMINING YOUR RECOMMENDATION REGARDING THE APPROPRIATE RATE ADJUSTMENT FOR BIPCO.

A. In its filing, BIPCo has proposed that it be allowed to earn a return on equity of 11.70 percent, which was the return on equity which it was allowed in its last rate case in 1991. I am proposing to adjust the allowed return of equity to 10.50 percent. As shown on page 3 of Schedule TSC-1, incorporating this 10.50 percent return on equity in the Company's proposed capital structure results in an overall rate of return of 6.36 percent. I would note that in utilizing the Company's proposed capital structure and debt costs, I have incorporated the additional debt issuances of approximately $925,000 which the Company included in FY 2005 and FY 2006 at an interest rate of 6 percent. Once additional information is available regarding the amount of debt and the associated interest rate, I will revise the Division's position accordingly.

Q. HAVE YOU CONDUCTED A DISCOUNTED CASH FLOW (DCF) OR OTHER ANALYSIS OF BIPCO'S COST OF EQUITY?

A. No. I have utilized a return of equity based on information provided by the Division regarding the most recent return on equity allowed by the Commission. It is my understanding that the Commission approved a settlement which incorporated a 10.5 percent return on equity for Narragansett Electric Company. Similar to the Company, the Division concluded that the cost of fully litigating the rate of return issues for BIPCo was not justified because of the small number of dollars involved. For example, my adjustment to reduce the allowed ROE from 11.7 percent to 10.5 percent only reduces the overall revenue requirement by approximately $14,000 based on the Division's recommended rate base.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS WITH REGARD TO RATE OF RETURN?

A. Yes. The Company's claimed equity ratio is only 17.26 percent, which is extremely low. This appears to be due, at least in part, to the practice of financing most major capital improvement exclusively with long-term debt.

Q. HAS BIPCO HAD ANY OPPORTUNITIES TO INCREASE THE AMOUNT OF EQUITY CAPITAL WITHOUT REQUIRING THE SALE OF STOCK OR ADDITIONAL CAPITAL INFUSIONS FROM THE EXISTING STOCKHOLDERS?

A. Yes. In FY 2000, BIPCo distributed $45,031 for the proceeds from the sale of an Engine to its stockholders. In FY 2002, $90,000 of proceeds from the sale of another engine was paid out. Had this $135,000 been reinvested in new engines, it would have not only increased equity, it would have also reduced debt.

In this proceeding, it is my belief that the Commission should encourage BIPCo to take steps to increase its equity ratio. For example, the Company should avoid paying dividends or making other capital pay-outs until its equity ratio reaches a reasonable level. It may also need to consider seeking additional equity contributions.

Accumulated Deferred Income Taxes

Q. PLEASE EXPLAIN THE ADJUSTMENT THAT YOU HAVE MADE TO THE BALANCE OF ACCUMULATED DEFERRED INCOME TAXES.

A. The balance of accumulated deferred income taxes which the Company has recognized as a deduction from rate base was calculated by multiplying the cumulative balance of taxbook timing differences by a federal income tax rate of 15 percent. This tax rate only applies to the first $50,000 of income. The effective federal tax rate for corporations with less than $10,000,000 of income is 34 percent.[1] Accordingly, I have adjusted the balance of accumulated deferred income taxes to reflect a federal income tax rate of 34 percent. This adjustment increases deferred income taxes and reduces rate base by $201,947. The derivation of this amount is presented on Schedule TSC-5.

Materials & Supplies

Q. WHAT ADJUSTMENT HAVE YOU MADE TO THE BALANCE OF MATERIALS & SUPPLIES?

A. The allowance for materials and supplies which BIPCo included in rate base was the per books balance as of the end of the test year. In order to recognize the fluctuation in the balance of materials and supplies over the course of the year, I have made an adjustment to reflect an allowance equal to the 12-month average. This adjustment increases the balance of materials and supplies included in rate base by $21,325, as shown on Schedule TSC-6.

Prepayments

Q. PLEASE SUMMARIZE WHAT IS INCLUDED IN BIPCO'S CLAIMED ALLOWANCE FOR PREPAYMENTS.

A. BIPCo's claimed rate base allowance for prepayments consists of three components: $7,424 for prepaid insurance, $2,220 for other prepayments and $20,000 for prepaid

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[1] Because of the income brackets in the federal tax tables the effective tax rate for income between $100,000 and $335,000 is slightly below 34 percent. However, because BIPCo's deferred tax timing differences exceed $335,000, this difference is not applicable.

management fees. Like materials and supplies, these balances were based on the balances as of the end of the test year.

Q. WHAT ADJUSTMENTS HAVE YOU MADE TO THE BALANCE OF PREPAYMENTS CLAIMED BY BIPCO?

A. I have adjusted the balance of prepaid insurance and other prepayments to reflect a 12-month average. For prepaid insurance, this increases the balance by $13,512, as shown on Schedule TSC-6. For other prepayments, the balance was constant throughout the year at $2,220, so this change has no effect on rate base. With regard to the claim for prepaid management fees, I have eliminated the Company's claimed balance of $20,000. I do not believe that the management fee should be prepaid relative to other operating expenses such as wages or outside vendors. Moreover, to the extent that the management fee is prepaid, ratepayers should not be required to pay a return on that fee as a result of management's decision to pay that fee in advance of other operating expenses. The net effect of the adjustments which I have made to prepayments, as shown on Schedule TSC-6, is to reduce rate base by $6,488.

Engine No. 25 Investment

Q. PLEASE EXPLAIN WHAT ADJUSTMENT YOU HAVE MAE TO THE RATE YEAR INVESTMENT ASSOCIATED WITH THE NEW ENGINE NO. 25.

A. At the time of its filing, BIPCo estimated that it would invest $609,411 in a new Engine No. 25 during FY 2005, the interim year between the test year and the rate year. BIPCo has now entered into an arrangement with the engine supplier under which it will pay for the costs of the switchgear, SCR equipment and installation costs in FY 2005. It will then have the option to buy the engine at a discounted price in the FY 2006 rate year. The overall cost, if the option to purchase is exercised, will be $580,114.

As shown on Schedule TSC-7, I have adjusted rate year investment to reflect the revised cost agreement for Engine No. 25. Based on including the full amount of the costs incurred in FY 2005 and one-half of the additional costs to purchase the engine in the rate year, the average rate year investment will be $492,614. This represents a reduction of $116,797 in the average rate year plant balance included in BIPCo's filing. I would note that I have separately accounted for the effects of the reduced investment on depreciation expense and accumulated depreciation.

Depreciation Accruals

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO RATE YEAR DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION.

A. In its filing, BIPCo inadvertently included a rate year allowance for depreciation expense of $226,761 rather than the rate year depreciation accrual of $304,040 which is calculated based on rate year plant. I have adjusted rate year depreciation expense to reflect the accruals associated with rate year plant. However, I have made two changes to the $304,040 accrual calculated by BIPCo. First, I have adjusted the plant subject to depreciation to reflect the revised cost estimate for Engine No. 25. Second, I have utilized 20-year life for that engine rather than the 10-year life utilized in BIPCo's calculation of rate year depreciation expense. As shown on Schedule TSC-8, I have calculated rate year depreciation expense to be $272,118. This reflects an increase of $45,357 compared to the depreciation allowance included in BIPCo's rate year income statement.

Q. WHY DID YOU REFLECT A 20-YEAR LIFE FOR THE NEW ENGINE RATHER THAN THE TEN-YEAR LIFE REFLECTED BY BIPCO IN ITS CALCULATION?

A. I utilized a 20-year life for the new Engine No. 25 because that is the service life which has been utilized for all of BIPCo's other engines. The Company has not provided any basis for using a life of only 10 years for the new engine.

Q. WHAT IS THE EFFECT OF YOUR ADJUSTMENT TO DEPRECIATION EXPENSE ON THE BALANCE OF ACCUMULATED DEPRECIATION DEDUCTED FROM RATE BASE?

A. Unlike depreciation expense, the Company did recognize its rate year depreciation accrual of $304,040 in developing the balance of accumulated depreciation recognized as a rate base deduction. As a result, the rate year depreciation accrual of $272,118 which I have recommended will reduce the end of rate year balance of accumulated depreciation by $31,922. As shown on Schedule TSC-8, this reduces the average balance of accumulated depreciation and increases rate base by $15,961.

Additional Substation Depreciation

Q. PLEASE SUMMARIZE THE COMPANY'S CLAIM FOR ADDITIONAL SUBSTATION DEPRECIATION?

A. BIPCo has proposed to include an additional annual allowance for substation depreciation of $30,000. According to company witness Walter Edge, the purpose of this additional allowance is to more closely match depreciation expense for the substation, currently about $30,000 per year, with the principal payments for the debt used to finance the substation of approximately $60,000 per year. This difference in depreciation expense and principal payments is due to the substation having a 40-year life while the debt must be repaid over 20 years.

Q. WHAT IS YOUR RESPONSE TO THIS PROPOSAL?

A. It is my recommendation that the Company's proposal to increase the depreciation expense associated with the substation to match the principal payments on the debt be rejected. Matching depreciation expense with principal payments is not an appropriate justification for shortening the time period and increasing the rate at which the costs are recovered from ratepayers. Providing the capital necessary to finance the assets needed to provide safe and reliable service is one of the obligations of investors for which they are provided a return on their investment. It is not the obligation of ratepayers. Accordingly, I have eliminated the $30,000 of additional substation depreciation claimed by BIPCo, as shown on Schedule TSC-9.

Payroll and Related Costs

Q. WHAT ADJUSTMENTS ARE YOU PROPOSING TO MAKE TO THE COMPANY'S CLAIM FOR PAYROLL AND RELATED EXPENSES?

A. In developing its rate year payroll expense claim and the associated costs for profit sharing, FICA/Medicare taxes and unemployment taxes, BIPCo included wage rate increases of 5 percent for both FY 2005 and FY 2006. Because actual wage increases of approximately 5 percent for FY 2005 were granted effective June 1, 2004, I have accepted the FY 2005 claim. However, I am proposing to limit the wage increases recognized for FY 2006 to 3 percent. This will result in average increases of approximately 4 percent for FY 2005 and FY 2006. This is consistent with BIPCo's recent experience of granting 4 percent annual wage increases (based on the increases granted from FY 2002 to FY 2004).

The second adjustment I have made to payroll and the related costs relates to the treatment of capitalized wages and benefits. During the test year, $14,913 of salaries and wages were capitalized. However, in developing the claimed level of payroll for the rate year, the Company assumed that all salaries and wages would be charged to O&M and none capitalized. I have adjusted rate year salaries and wages to recognize that a portion of those costs will continue to be capitalized.

Q. HAVE YOU PREPARED A SCHEDULE WHICH SHOWS THE DERIVATION OF YOUR ADJUSTMENT?

A. Yes. The derivation of my adjustment to payroll and labor related costs is presented on Schedule TSC-10. As shown there, I started with the total FY 2005 payroll of $401,504 claimed by the Company. I reduced this amount by $15,659 of capitalized labor to derive the amount charged to O&M. I calculated the capitalized labor for FY 2005 amount by increasing the capitalized labor for the test year by the 5 percent wage increase granted for FY 2005. To arrive at the rate year salaries and wages, I simply escalated the FY 2005 amounts by the 3 percent wage increase which I have proposed to recognize. This results in rate year salaries and wages charged to O&M of $399,468. This represents a reduction of $23,475 to BIPCo's claim.

Schedule TSC-10 also shows the associated adjustments to profit sharing expense, FICA/Medicare taxes and unemployment taxes which result from the adjustments I have made to payroll. In calculating the overall amounts of these expenses, I have accepted the Company's percentage allowance for profit sharing expense. As shown on Schedule TSC-10, the adjustments to these payroll related costs total a reduction of $2,583 ($704 plus $1,796 plus $83) and are primarily caused by recognizing the portion capitalized.

Management Fee

Q. WHAT CLAIM HAS THE COMPANY MADE FOR A MANAGEMENT FEE?

A. The Company is seeking approval to include $212,000 in the rate year cost of service for a management fee. The management fee is paid to the four owners of the Company for their roles in serving as the President, Chief Operating Officer, Secretary/Treasurer and advisor to the President.

Q. ARE THERE OTHER INDIVIDUALS INVOLVED IN THE MANAGEMENT OF BIPCO?

A. Yes. BIPCo employs a full-time Vice President/General Manager and retains an outside accounting firm to assist with financial and accounting management.

Q. HAVE YOU PREPARED AN ANALYSIS OF THE OVERALL LEVEL OF COMPENSATION OF BIPCO'S MANAGEMENT?

A. To evaluate the overall reasonableness of the compensation paid to BIPCo's management personnel, I have made a comparison of that compensation to the compensation paid to the management personnel of Pascoag Utility District (Pascoag). Pascoag is relatively close in size to BIPCo (4,200 plus customers for Pascoag versus approximately 1,700 for BIPCo) compared to other Rhode Island electric utilities. And, while Pascoag does not have generation operations, it has both electric and water utility operations. Finally, Pascoag's management employees are all full-time, which is not the case for BIPCo.

As shown at the top of Schedule TSC-11, the total salaries which Pascoag pays to its management employees for calendar year 2005 is $224,500. This includes the total paid to its general manager, assistant general manager and customer service and accounting manager for both electric and water division operations. Pascoag employees receive a 10 percent retirement plan contribution compared to the 3 percent profit sharing contributions made on behalf of BIPCo employees. Therefore, to be conservative, I have included the 10 percent retirement contribution for Pascoag in deriving the total management compensation for Pascoag of $247,000.

To determine the comparable amount of management compensation for BIPCo, I have included the General Manager's salary for FY 2005 plus the 3 percent retirement contribution applicable to that salary. I have also included $24,000 out of the total fees paid to Bacon & Edge based on the amount identified in the minutes of BIPCo's May 15, 2004 Board of Director's meeting as the stipend for bookkeeping and financial advice. These amounts total $111,389 as shown on Schedule TSC-11. When the $212,000 management fee is added to this amount, the total management compensation for BIPCo is $323,389 compared to $247,000 for Pascoag.

Q. ARE YOU PROPOSING AN ADJUSTMENT TO BIPCO'S CLAIMED MANAGEMENT FEE?

A. Yes, I am proposing to reduce BIPCo's claimed management fee by $76,389. This represents the amount by which BIPCO's total claimed management compensation exceeds that of Pascoag.

Health Insurance Premiums

Q. WHAT ADJUSTMENT HAVE YOU MADE TO HEALTH INSURANCE PREMIUMS?

A. In BIPCo's filing, the medical and dental insurance premiums for the rate year were estimated. Actual premiums for the period beginning April 1, 2005 are now known. Accordingly, I have updated to reflect these actual premiums. In addition, based on the responses to Division 1-34, it appears that Mr. Edwards will no longer be eligible to participate in the medical plan now that he has retired as President of the Company. Therefore, I have not included a premium expense for him. As shown on Schedule TSC-12, this adjustment reduces rate year expense by $31,475.

Engine Maintenance

Q. WHAT CLAM HAS BIPCO MADE FOR ENGINE MAINTENANCE EXPENSE?

A. The Company has included a total of $190,000 in the rate year for engine maintenance expense. This claim is comprised of $40,000 for routine maintenance and $150,000 for major maintenance. Major maintenance includes $100,000 for the complete overhaul of Engine No. 22 and $50,000 for the top-end maintenance of Engine No. 23.

Q. HAS THE COMPANY MADE ANY REVISIONS TO ITS ESTIMATED RATE YEAR COSTS FOR ENGINE MAINTENANCE?

A. Yes. In an updated response to Division 1-41, BIPCo has now indicted that a top end rather than complete overhaul will be required on Engine 22. This reduces the projected rate year expense by approximately $50,000.

Q. HOW DOES THE COMPANY'S CLAIM COMPARE TO ACTUAL EXPERIENCE?

A. Schedule TSC-13 provides a summary of engine maintenance expenses for each year from FY 2000 through FY 2004 based on the account level detail presented on Schedule DGB-2 accompanying BIPCo witness David Bebyn's testimony. As indicated there, the expenditures in FY 2000 through 2002 ranged from $26,460 to $34,201. In FY 2003 the amount spent increased to $113,347 and in FY 2004, the total was $95,931. Overall, the average for the last five years was $60,009. For FY 2003 and FY 2004, the average was $104,639.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THE COMPANY'S CLAIM FOR ENGINE MAINTENANCE EXPENSE?

A. As noted previously, the response to Division 1-41 indicated that BIPCo has reduced its major maintenance expense estimate from $150,000 to approximately $100,000 for the rate year. This response also indicates that the projected major maintenance expenditures are $100,000 in FY 2007 and $50,000 in FY 2008 and FY 2009. Accordingly, BIPCo's filed claim should be reduced by at least $50,000.

Moreover, as shown on Schedule TSC-13, BIPCo's actual expenditures on engine maintenance have been well below the amount claimed for the rate year, even after reflecting the $50,000 reduction in major maintenance. Absent a more detailed explanation and documentation that an expense level of $140,000 is justified, I am proposing to limit the allowance for engine maintenance to the average expense for FY 2003 and FY 2004 of $104,639. This represents a reduction of $85,361 to BIPCo's filed claim and a reduction of $35,361 beyond the $50,000 reduction in major maintenance costs acknowledged in response to Division 1-41.

Insurance Premiums

Q. HOW WAS THE COMPANY'S CLAIM FOR ITS PROPERTY AND LIABILITY INSURANCE PREMIUMS DEVELOPED?

A. In the Company's filing, the expense for property and liability insurance premiums is based on the projected premiums applicable for the rate year. This projection was calculated based on 27 days of the actual premiums for the policy year ended June 27, 2005 and 338 days of the projected premiums for the policy year beginning June 28, 2005. The premiums for the policy year beginning June 28, 2005 were projected based on the assumption that those premiums would increase by 11 percent over the premiums for the prior policy year.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THE COMPANY'S CLAIM?

A. The projected premiums for the 2006 policy year are not known at this time and the projected increase of 11 percent is speculative. Accordingly, I have adjusted the expense for property and liability insurance to reflect the most recent actual premiums-- currently, those for the policy year ended June 27, 2005. If the premiums for the plan year ending June 27, 2006 become available before the close of the record, I will review those premiums and adjust my recommendation as appropriate. As shown on Schedule TSC-14, this adjustment reduces rate year expense by $8,606.

SCR Maintenance

Q. WHAT CLAIM HAS BIPCO MADE FOR SCR MAINTENANCE COSTS?

A. BIPCo has included $100,272 in rate year expense for SCR maintenance. Approximately $82,000 of this total is for the replacement of the catalysts installed with the SCR units. The replacement of the catalysts is the result of the problems which have required replacement on an almost annual basis, even though the catalysts were supposed to last for up to five years.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS CLAIM?

A. The response to TOWN-31 indicates that BIPCo is working with a new company in an attempt to resolve the problems with the catalysts and avoid the need for the expense of replacing them on such a frequent basis. Because of the uncertainty, I have not made an adjustment to reduce this expense. Instead, I am proposing that the Commission require the Company to set up a reserve account to track actual catalyst replacement costs. The $82,000 included in rate year costs would be accrued into the reserve each year costs would be credited to the account each year and actual costs incurred for the replacement of the catalysts would be charged against the reserve. At the time of the Company's next rate case, the costs charged to the reserve can be reviewed and any surplus or shortfall can be addressed.

Federal Income Taxes

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO RESTATE FEDERAL INCOME TAX EXPENSE.

A. In the Company's filing, federal income taxes were adjusted from the test year level to the rate year level in one step based on the proposed income at proposed rates. In order to show income taxes at present rates and to facilitate the calculation of the required rate increase, I have made an adjustment to show rate year income taxes at present rates. I have then separately calculated the income taxes associated with the rate increase. These tax calculations are shown on Schedule TSC-4.

As part of my income tax calculations, I have made two corrections to the Company's income tax claim. First, in the calculation of the Company's income tax claim, the excess tax depreciation and other timing differences which give rise to deferred income taxes were not recognized as deductions to current income taxable income. As a result, rate year income taxes were overstated by an amount equal to the rate year deferred income taxes. For simplicity, I have calculated total federal income taxes by applying the 34 percent marginal income tax rate to taxable income without separately netting out excess tax depreciation and then calculating deferred income taxes on that excess.

Second, in calculating rate year income taxes required at proposed rates, the Company multiplied the required return on equity by the 34 percent marginal income tax rate. (See Schedule WEE-18.) This fails to account for the fact that the revenues collected to pay the taxes on the equity return are themselves subject to income taxes.

(This is referred to as "the tax-on-tax effect.") As a result, the Company's filing understated income taxes at proposed rates. I have corrected this in my calculations of the required rate increase.

I would note that the effects of these two corrections to income taxes are largely offsetting. Without any of the Division's other adjustments to BIPCo's filing, the two income tax corrections reduce the Company's claimed revenue deficiency from $463,171 to $458,564, a change of only $4,607.

Q. HAVE YOU MADE ANY OTHER CHANGES TO THE INCOME TAX CALCULATIONS?

A. Yes. I have adjusted the interest expense used to calculate taxable income to reflect the Division's recommended rate base multiplied by the weighted cost of debt. This procedure synchronizes the interest deduction for income tax purposes with the interest component of the return on rate base to be recovered from ratepayers. As shown at the bottom of Schedule TSC-4, this adjustment reduces the interest deduction by $16,624 compared to that recognized by BIPCo. This increases federal income taxes by $5,652.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes, it does.

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SCHEDULES ACCOMPANYING THE

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OF

THOMAS S. CATLIN

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DIVISION OF PUBLIC UTILITIES AND CARRIERS

APRIL 2005

EXETER

ASSOCIATES, INC.

5565 Sterrett Place

Suite 310

Columbia, Maryland 20904

BLOCK ISLAND POWER COMPANY

Summary of Operating Income
Rate Year Ending May 31, 2006

	Amounts Per Company at Present Rates (1)	Division Adjustments	Amounts Per Division at Present Rates	Pro Forma Increase	Amounts at Proposed Rates
Operating Revenue					
Electricity Sales Revenue	$ 1,697,000		$ 1,697,000	$ 194,147	$ 1,891,147
Customer Charge Revenue	215,000	-	215,000	-	215,000
Late Payment Charges	15,499		15,499		15,499
Other Revenue	181,758	-	181,758	-	181,758
Total Revenue	$ 2,109,257	$ -	$ 2,109,257	$ 194,147	$ 2,303,404
Operating Revenue Deductions					
Operating Expenses	1,800,177	(226,010)	1,574,167		1,574,167
Depreciation Expense	256,761	15,357	272,118	-	272,118
Miscellaneous Expense	674	-	674	-	674
Taxes Other Than Income	150,717	(1,879)	148,838	7,766	156,604
Total Operating Deductions	$ 2,208,329	$ (212,532)	$ 1,995,797	$ 7,766	$ 2,003,563
Operating Income Before Taxes	$ (99,072)	$ 212,532	$ 113,460	$ 186,381	$ 299,841
Income Taxes					
Amortization of Prepaid Taxes	(6,073)		(6,073)		(6,073)
Federal Income Taxes	31,623	(58,601)	(26,978)	63,370	36,392
Deferred Income Taxes	18,382	(18,382)	-	-	-
Total Income Taxes	$ 43,932	$ (76,983)	$ (33,051)	63,370	$ 30,319
Utility Operating Income	$ (143,004)	$ 289,515	$ 146,511	123,011	$ 269,522
Rate Base	$ 4,604,693	(365,503)	$ 4,239,190		$ 4,239,190
Rate of Return	-3.11%		3.46%		6.36%

BLOCK ISLAND POWER COMPANY

Determination of Revenue Increase
Rate Year Ending May 31, 2006

		Amount	Source
Recommended Rate Base per Division		$ 4,239,190	Schedule TSC-2
Required Rate of Return		6.36%	Schedule TSC-1, page 3
Net Operating Income Required		$ 269,522	
Net Operating Income at Present Rates		146,511	Schedule TSC-3
Net Income Surplus/(Deficiency)		$ (123,011)	
Revenue Multiplier		1.57828	
Revenue Increase/(Decrease)		$ 194,147	
Revenue Increase/(Decrease)		$ 194,147	
Rhode Island Gross Earnings Tax	4.0%	$ 7,766	
Federal Income Tax	34%	63,370	
Net Income Surplus/(Deficiency)		$ 123,011	

BLOCK ISLAND POWER COMPANY

Rate of Return Summary
Rate Year Ending May 31, 2006

Capital Source	Balance (1)	Capitalization Ratio	Cost Rate (2)	Weighted Cost Rate
Total Debt	4,138,521	82.74%	5.50%	4.55%
Common Equity	863,535	17.26%	10.50%	1.81%
Total	$ 5,002,056	100.00%		6.36%

Notes:
(1) Per Schedule WEE-17

(2) Cost rate for debt calculated from Schedule WEE-17

BLOCK ISLAND POWER COMPANY

Summary of Rate Base
Rate Year Ending May 31, 2006

Description	Balance per Company Filing	Division Adjustments (1)	Balance Per Division
Plant in Service	$ 8,002,271	(116,797)	$ 7,885,474
Reserve for Depreciation	(3,296,979)	15,961	(3,281,017)
Net Utility Plant	$ 4,705,293	$ (100,836)	$ 4,604,457
Cash Working Capital	$ 190,197	$ (77,557)	112,640
Materials & Supplies	45,525	21,325	66,850
Prepayments	29,643	(6,488)	23,155
Total Working Capital	$ 265,365	$ (62,720)	$ 202,645
Deferred Credits	(206,533)	-	(206,533)
Accumulated Deferred Income Taxes	(159,432)	(201,947)	(361,379)
Other	-		-
Total Rate Base	$ 4,604,693	$ (365,503)	$ 4,239,190

Note:
(1) Refer to page 2 of this schedule.

BLOCK ISLAND POWER COMPANY

Summary of Adjustments to Rate Base
Rate Year Ending May 31, 2006

	Amount	Source
Rate Base per Company Filing	$ 4,604,693	Schedule WEE-16
Division Adjustments		
Cash Working Capital	(77,557)	Schedule LKM-1
Restate Accumulated Deferred Income Taxes	(201,947)	Schedule TSC-5
Materials & Supplies	21,325	Schedule TSC-6
Prepayments	(6,488)	Schedule TSC-6
Updated Engine No. 25 Cost	(116,797)	Schedule TSC-7
Revised Depreciation Expense	15,961	Schedule TSC-8
Total Division Adjustments	$ (365,503)	
Adjusted Rate Base per Division	$ 4,239,190	

BLOCK ISLAND POWER COMPANY

Summary of Adjustments to Net Income
Rate Year Ending May 31, 2006

	Amount	Source
Net Income per Company	$ (143,004)	Schedule WEE-2
Division Adjustments		
Rate Year Depreciation	(29,935)	Schedule TSC-8
Eliminate Additional Substation Depreciation	19,800	Schedule TSC-9
Labor and Labor Related Expenses	17,198	Schedule TSC-10
Management Fees	50,417	Schedule TSC-11
Actual Health Insurance Premiums	20,774	Schedule TSC-12
Major Engine Maintenance	56,338	Schedule TSC-13
General Insurance Premiums	5,680	Schedule TSC-14
Income Tax Corrections	154,896	Schedule TSC-4
Interest Synchronization	(5,652)	Schedule TSC-4
Total Division Adjustments	$ 289,515	
Adjusted Net Income per Division	$ 146,511	

BLOCK ISLAND POWER COMPANY

Summary of Adjustments to Net Income
Rate Year Ending May 31, 2006

	Revenue	O&M and Other	Depreciation	Taxes Other Than Income	Federal Income Tax	Deferred Federal Income Tax	Invest Tax Credit	Net Operating Income
Net Income per Company	$ 2,109,257	$ 1,800,851	$ 256,761	$ 150,717	$ 31,623	$ 18,382	$ (6,073)	$ (143,004)
Division Adjustments								
Rate Year Depreciation	-	-	45,357	-	(15,421)	-	-	(29,935)
Eliminate Additional Substation Depreciation	-	-	(30,000)	-	10,200	-	-	19,800
Labor and Labor Related Expenses	-	(24,179)	-	(1,879)	8,859	-	-	17,198
Management Fees	-	(76,389)	-	-	25,972	-	-	50,417
Actual Health Insurance Premiums	-	(31,475)	-	-	10,702	-	-	20,774
Engine Maintenance	-	(85,361)	-	-	29,023	-	-	56,338
General Insurance Premiums	-	(8,606)	-	-	2,926	-	-	5,680
Income Tax Corrections	-	-	-	-	(136,514)	(18,382)	-	154,896
Interest Synchronization	-	-	-	-	5,652	-	-	(5,652)
Total Division Adjustments	$ -	$ (226,010)	$ 15,357	$ (1,879)	$ (58,601)	$ (18,382)	$ -	$ 289,515
Division Adjusted Net Income	$ 2,109,257	$ 1,574,841	$ 272,118	$ 148,838	$ (26,978)	$ -	$ (6,073)	$ 146,511

BLOCK ISLAND POWER COMPANY

Income Tax Reconciliation
Rate Year Ending May 31, 2006
($000)

	Corrected Amount at Present Rates	Division Adjustments	Adjusted per Division at Present Rates	Proposed Revenue Increase	Amount at Proposed Rates
Operating Income before Taxes	$ (99,072)	$ 212,532	$ 113,460	$ 186,381	$ 299,841
Adjustments to Taxable Income					
Interest Expense	(209,431)	16,624	(192,807)	-	(192,807)
Other		-	-	-	-
Total Adjustments	$ (209,431)	$ 16,624	$ (192,807)	$ -	$ (192,807)
Income Subject to Federal Income Tax	$ (308,503)	$ 229,156	$ (79,347)	$ 186,381	$ 107,034
Total Federal Income Tax at 34%	$ (104,891)	$ 77,913	$ (26,978)	$ 63,370	$ 36,392
Less: Bracket Savings		-	-	-	-
Current Federal Income Tax	$ (104,891)	$ 77,913	$ (26,978)	$ 63,370	$ 36,392
Calculation of Interest Deduction					
Rate Base	$ 4,604,693		$ 4,239,190		$ 4,239,190
Weighted Cost of Debt	4.55%		4.55%		4.55%
Interest Deduction	$ 209,431	$ (16,624)	$ 192,807		$ 192,807
Federal Income Tax Effect at 34%		5,652			
Interest Synchronization Adjustment		$ 5,652			

Docket No. 3655
Schedule TSC-5

BLOCK ISLAND POWER COMPANY

Adjustment to Restate Accumulated Deferred Income Taxes
to Reflect 34 Percent Marginal Tax Rate
Rate Year Ending May 31, 2006

	Total Adjustment to Test Year Balance
Average Balance of Deferred Income Taxes per Company Filing Based on 15% Tax Rate (1)	$ 159,432
Divide by Tax Rate	15%
Average Balance of Underlying Timing Differences	$ 1,062,878
Marginal Federal Income Tax Rate	34%
Restated Balance of Deferred Federal Income Taxes	$ 361,379
Adjustment to Rate Base	$ (201,947)

Note:
(1) Per Schedule WEE-13 and responses to DIV 1-49 and 1-50.

Docket No. 3655
Schedule TSC-6

BLOCK ISLAND POWER COMPANY

Adjustment to Materials and Supplies
and Prepayments to Reflect Average Balances
Rate Year Ending May 31, 2006

	Materials and Supplies (1)	Prepaid Insurance (2)	Prepaid Other (1)	Prepaid Management Fee (1)
June	$ 54,358	$ 3,586	2,220	20,000
July	58,366	(376)	2,220	20,000
August	60,977	16,916	2,220	20,000
September	64,900	13,282	2,220	20,000
October	67,129	8,464	2,220	20,000
November	67,129	42,905	2,220	20,000
December	68,090	48,060	2,220	20,000
January	78,126	39,933	2,220	20,000
February	78,269	31,806	2,220	20,000
March	78,269	23,679	2,220	20,000
April	81,065	15,552	2,220	20,000
May	45,525	7,424	2,220	16,000
Total	$ 802,203	$ 251,231	$ 26,640	$ 236,000
Average Balance	$ 66,850	$ 20,936	$ 2,220	$ 19,667
Division Adjustment	-	-	-	(19,667)
Adjusted Balance	$ 66,850	$ 20,936	$ 2,220	$ -
Amount Per Company (3)	45,525	7,424	2,220	20,000
Adjustment to Rate Base	$ 21,325	$ 13,512	$ -	$ (20,000)

Notes:

(1) Monthly balances per response to DIV 1-62.

(2) Balances for January through April per response to DIV 1-62 were unchanged from December. These balances have been adjusted to reflect uniform drawdown of prepayment between December and May.

(3) Per Schedule WEE-16 and respnse to DIV 1-62.

Docket No. 3655
Schedule TSC-7

BLOCK ISLAND POWER COMPANY

Adjustment to Reflect Updated
Replacement Plan for Engine No. 25
Rate Year Ending May 31, 2006

	Amount
Updated Cost Estimate (1)	
Initial Costs (FY 2005)	$ 405,114
Engine Purchase (Rate Year)	175,000
Total Cost	$ 580,114
Average Rate Year Balance (2)	$ 492,614
Original Estimated Cost (Interim Year) (3)	609,411
Adjustment to Average Rate Year Plant in Service	$ (116,797)

Notes:

(1) Per response to DIV 1-61 and informal follow-up.

(2) Based on initial costs in interim year plus one-half of rate year engine purchase cost.

(3) Per testimony of Walter Edge at page 28.

Docket No. 3655
Schedule TSC-8

BLOCK ISLAND POWER COMPANY

Adjustment to Reflect Rate Year Depreciation Expense
Rate Year Ending May 31, 2006

	Service Life (1)	End of Test Year Balance (2)	Additions	End of Rate Year Balance (1)	Rate Year Depreciation Expense (3)
Access Electric	20	$ 87,252	$ -	$ 87,252	$ 3,308
Aid in Construction	20	181,697	-	181,697	6,613
Communication Equipment	15	262,680	-	262,680	16,609
Fuel System	16	374,609	-	374,609	21,981
Furniture & Fixtures	Fully Depr.	1,327	-	1,327	-
Land and Land Rights	Fully Depr.	79,610	-	79,610	-
Lines	20	190,978	-	190,978	7,295
Meters	20	159,663	-	159,663	3,512
Office Furniture and Equipment	5	87,684	15,000	102,684	808
Oil Polution Equipment	Fully Depr.	63,005	-	63,005	-
Overhead Devices	20	588,906	315,000	903,906	22,464
Poles	20	199,892	-	199,892	4,713
Generation Equipment (4)	20	2,547,578	580,114	3,127,692	143,685
Street Lighting	20	16,292	-	16,292	324
Structures and Improvements	40	263,189	-	263,189	1,610
Structures and Improvements-Substations	40	1,661,363	55,000	1,716,363	43,948
Tools, Shop and Garage Equipment	7	25,431	-	25,431	322
Transportation Equipment	16	460,056	-	460,056	8,886
Underground	20	744,886	-	744,886	28,230
Vaults	20	28,971	-	28,971	870
Negative Fixed Assets (Contributions In Aid)	20	(861,209)	-	(861,209)	(43,060)
Total Amount		$ 7,163,860	$ 965,114	$ 8,128,974	$ 272,118
Depreciation Expense per Company Filing					226,761
Adjustment to Depreciation Expense					$ 45,357

Depreciation Reserve Effect	Amount
Rate Year Depreciation Accrual per Company (1)	$ 304,040
Rate Year Depreciation Accrual per Division	272,118
Adjustment to End of Rate Year Reserve Balance	$ (31,922)
Adjustment to Average Rate Base	$ 15,961

Notes:

(1) Per Responses to DIV 1-43, 1-44 and 4-8, except as noted.

(2) Per Schedule WEE-9.

(3) Per response to DIV 4-8, except where noted.

(4) Additions have been adjusted to reflect updated costs per Schedule TSC-7. Depreciation has been calculated based on 20 year life and one half year's depreciation has been included on the rate year portion of additions.

Docket No. 3655
Schedule TSC-9

BLOCK ISLAND POWER COMPANY

Adjustment to Eliminate
Additional Substation Depreciation
Rate Year Ending May 31, 2006

		Amount
Proposed Additional Depreciation per Company (1)	$	30,000
Amount per Division		-
Adjustment to Depreciation Expense	$	(30,000)

Note:
(1) Per Schedule WEE-11.

Docket No. 3655
Schedule TSC-10

BLOCK ISLAND POWER COMPANY

Adjustment to Labor and Related Costs
Rate Year Ending May 31, 2006

	FY 2005 Wages (1)	FY 2006 Wages (2)	Profit Sharing	FICA & Medicare	Unemployment Tax
		3.0%	3.0%	7.65%	
Alpers	$ 40,817	$ 42,042	$ 1,261	3,216	$ 266
Foote	36,203	37,289	1,119	2,853	266
Fowler	41,601	42,849	1,285	3,278	266
Hiccox	34,127	37,198	1,116	2,846	266
Martin	61,345	63,185	1,896	4,834	266
Milner	65,438	67,401	2,022	5,156	266
Sovoie	37,129	38,243	1,147	2,926	266
Wagner	84,844	87,389	2,622	6,685	266
Total	$ 401,504	$ 415,597	$ 12,468	$ 31,793	$ 2,128
Capitalized Labor (3)	$ (15,659)	(16,128)	(484)	(1,234)	$ (83)
Net Labor Expense	$ 385,845	$ 399,468	$ 11,984	$ 30,559	$ 2,045
Amount Per Company (4)		422,943	12,688	32,355	2,128
Adjustment to Expense		$ (23,475)	$ (704)	$ (1,796)	$ (83)

Notes:
(1) Per Schedule WEE-4a and response to DIV 4-3.

(2) Reflects 3% increase for all employees except Hiccox, for which a 9% increase is included.

(3) FY 2005 and FY 2006 capitalized labor calculated by applying 5% and 3% wage increases to prior year amounts.

(4) Per Schedules WEE-4, WEE-6 and WEE-10.

Docket No. 3655
Schedule TSC-11

BLOCK ISLAND POWER COMPANY

Adjustment to Proposed Management Fee
Rate Year Ending May 31, 2006

Pascoag		Amount
Comparable Management Compensation (1)		
Management Salaries		224,500
Retirement Contribution at 10%		22,500
Total Pascoag Management Compensation	$	247,000
BIPCO		
General Manager Salary (Wagner) (2)	$	84,844
Retirement Contribution at 3%		2,545
Bookkeeping & Financial (3)		24,000
Management Compensation before Management Fee	$	111,389
Management Fee		212,000
Total BIPCO Management Compenation	$	323,389
Adjustment to Claimed Management Fee	$	(76,389)

Notes:

(1) Based on compensation of General Manager, Assistant General Manager and Customer Service and Accounting Manager at Pascoag Utilities for 2005.

(2) FY 2004-05 salary per Schedule WEE-4a.

(3) Based on stipend to Walter Edge for bookkeeping and financial advice for FY 2004-05 per minutes of May 15, 2004 Board of Directors Meeting.

Docket No. 3655
Schedule TSC-12

BLOCK ISLAND POWER COMPANY

Adjustment to Medical and Dental Insurance Expense
Rate Year Ending May 31, 2006

	Monthly Medical Premium (1)	Monthly Dental Premium (2)	Total Annual Premiums
Alpers	$ 457.30	$ 34.98	$ 5,907
Foote	731.68	103.83	10,026
Fowler	1,211.85	103.83	15,788
Hiccox	457.30	34.98	5,907
Martin	1,074.66	103.83	14,142
Milner	1,211.85	103.83	15,788
Sovoie	1,211.85	103.83	15,788
Wagner	1,211.85	103.83	15,788
Edwards	-	-	-
McGinnes	457.30	34.98	5,907
Total	$ 8,025.64	$ 727.92	$ 105,043
Months	12	12	
Annual Expense	$ 96,308	$ 8,735	$ 105,043
Amount Per Company (3)	127,689	8,829	136,518
Adjustment to Expense	$ (31,381)	$ (94)	$ (31,475)

Notes:

(1) Reflects Blue Cross/Blue Shield Premiums for April 2005 through March 2006 per response to DIV 4-6.

(2) Reflects Delta Dental Premiums for April 2005 through March 2007 per response to DIV 4-6.

(3) Per Schedule WEE-5b. Does not include Medical Reimbursement for Slate.

Docket No. 3655
Schedule TSC-13

BLOCK ISLAND POWER COMPANY

Adjustment to Major Engine Maintenance Expense
Rate Year Ending May 31, 2996

Engine Maintenance Expenes (1)		Amount
Fiscal Year 2000	$	26,460
Fiscal Year 2001		30,106
Fiscal Year 2002		34,201
Fiscal Year 2003		113,347
Fiscal Year 2004		95,931
Total	$	300,045
Five Year Average	$	60,009
Two Year Average (FY2003 - FY2004)	$	104,639
Division Recommended Allowance	$	104,639
Amount Per Company Filing (2)		190,000
Adjustment to Rate Year Expense	$	(85,361)

Notes:
(1) Per Schedule DGB-2

(2) Per Schedule WEE-3.

Docket No. 3655
Schedule TSC-14

BLOCK ISLAND POWER COMPANY

Adjustment to Reflect Actual
General Insurance Premiums
Rate Year Ending May 31, 2006

		Amount
Insurance Premiums for Policy Year Ended June 27, 2005 (1)	$	111,313
Rate Year Insurance Expense per Company (1)		119,919
Adjustment to Insurance Expense	$	(8,606)

Note:
(1) Per Schedule WEE-11.