

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

BLOCK ISLAND POWER) COMPANY-RATE CASE) COMPLIANCE FILING)	DOCKET NO. 3655
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**MOTION OF THE TOWN OF NEW SHOREHAM
FOR SUMMARY REJECTION OF BLOCK ISLAND POWER COMPANY’S
MANAGEMENT COMPENSATION COMPLIANCE FILING OR, IN THE
ALTERNATIVE, FOR AN INVESTIGATION OF BLOCK ISLAND POWER
COMPANY’S MANAGEMENT COMPENSATION PAYMENTS AND
PRACTICES**

I. INTRODUCTION

On December 12, 2005, Block Island Power Company submitted its Compliance Filing in response to Commission directives contained in the September 13, 2005, Rate Order in this matter. The Commission directed that:

Also, BIPCo must provide written job descriptions for its senior management. The funding level for the management fees that is agreed upon in the Settlement remains the settled amount subject to the Commission determining if the amount in the Settlement is appropriate.” (Rate Order at 16).

In the Stipulation and Settlement (“Settlement”) approved by the Commission in its Rate Order, with modification as to the timing of BIPCo’s management compensation compliance filing, BIPCo was required to do the following:

...justify how it pays its owners and/or management (management fees, management salaries, dividends, director’s fees, use of Company-owned or leased vehicles by owners and/or management, benefits provided to owners and/or management, etc., or some combination, and any other management-related transactions with affiliates) and show that its approach and the resulting payments are reasonable and in the best interest of ratepayers. (Section 9 of Stipulation).

BIPCo's Compliance Filing conforms to neither the directives of the Commission in its September 13, 2005 Rate Order nor the terms of the Settlement. The Commission should summarily reject BIPCo's Compliance Filing, issue further directives to BIPCo and take other actions that it deems appropriate.

BIPCo should be ordered to document and objectively demonstrate that: (1) the individuals being compensated are qualified to perform the services that comprise their respective job descriptions; (2) these individuals work a sufficient number of hours to justify the level of compensation that they are receiving; (3) the services performed provide sufficient benefit to ratepayers to support the level of payments being made; (4) compensation of a General Manager and several owners is reasonably necessary for BIPCo's operations, given its small size; and the (5) the level of payments is comparable to payments to management of other small, island-based utilities.

BIPCo also should be ordered to document the amount of personal use of company-leased vehicles by management. Finally, BIPCo should be ordered to demonstrate whether it has been in compliance with Rhode Island General Laws pertaining to transactions with affiliates, including its owners. R.I.G.L. §§39-3-15 through 39-3-33.¹

Pending BIPCo's submission and the outcome of any further investigation, and as a consequence of its submission of a patently defective Compliance Filing, the Commission should direct BIPCo to defer payment of any moneys to the owners. Deferral of these payments would allow the Company to book the costs as miscellaneous deferred debits, while preserving the interests of ratepayers in the event that the

¹ Management salaries were treated as affiliate transactions subject to these statutes in *Town of New Shoreham v. Public Utilities Commission*, 464 A.2d 730, 735-737 (R.I. 1983). These affiliate transactions also include, but may not be limited to, BIPCo's transactions with Ballard Oil.

Commission finds that the payments being made to management are unreasonable in whole or in part, or in violation of applicable affiliate transaction requirements.

In the alternative, the Commission should open an investigation to allow for the development of a complete record regarding issues related to BIPCo management compensation. The Commission should direct BIPCo owners/management to appear before the Commission forthwith and answer questions. The Town should be afforded an opportunity to issue discovery regarding BIPCo's Compliance Filing and the issues it raises concerning the reasonableness of compensation paid to BIPCo owners/management (including the use of company-leased vehicles) and affiliate transactions. The Commission should direct BIPCo to defer payment of any moneys to the owners pending such an investigation, for the same reasons stated above.²

The Town does not make these recommendations lightly. It raised its concerns about payments to owners from operating expenses during BIPCo's rate case and regards them to be dividends in disguise, not earned compensation. Since the Rate Order, it has repeated its concerns to BIPCo about the lack of a replacement for Mr. Wagner, who is in Costa Rica, and the general absence of ownership from Block Island. These concerns have been ignored. No replacement for Mr. Wagner has been hired or trained, and ownership-which purports to manage the Company-is largely absent. BIPCo has been on notice of the need to justify payments that its owners are making to themselves as well as other affiliate transactions. BIPCo has not taken adequate steps to address the Commission's or the Town's concerns in its Compliance Filing. Therefore, the Commission must take action.

² See the discussion, *infra*, on applicable affiliate transaction requirements.

II. BIPCO'S COMPLIANCE FILING IS PATENTLY DEFICIENT AND SHOULD BE SUMMARILY REJECTED

A. BIPCO'S FILING

BIPCo's filing was made in two parts: pre-filed testimony from Walter Edge and "An "Analysis of Executive Compensation at the Block Island Power Company"-plus BIPCo management job descriptions- submitted by Dr. Matthew M. Bodah, an Associate Professor of Industrial Relations/Research Coordinator at the Schmidt Labor Research Center of the University of Rhode Island.

1. Mr. Edge's Testimony

Mr. Edge's testified that:

- The allowed level of management compensation in the Settlement was \$247,000, which includes Mr. Wagner's \$84,844 salary, a retirement contribution of \$2,545 for Mr. Wagner and \$24,000 for bookkeeping and financial advice provided by Mr. Edge's firm. The balance of the management compensation allowance, \$135,611, is less than the \$168,000 BIPCo is now paying its President, COO, and CFO, and Mr. Edge states that the difference is being paid out of earnings.
- Management fees are no longer being paid by BIPCo.
- Personal use of Company-leased vehicles is admitted, but the amount of use was downplayed and no mileage or other records to substantiate the amount of personal use have been provided.
- Free electricity is being provided to BIPCo management and employees, as allowed by State law, according to Mr. Edge.
- Related party transactions are being reviewed by BIPCo's auditor and the Company hopes to have completed next year and filed with the Commission its auditor's review of the reasonableness of those transactions.
- BIPCo treats its owners and/or management (President, COO, CFO) as independent consultants (although they own the Company and effectively pay themselves).
- BIPCo gives its owners Form 1099s.
- Based on Dr. Bodah's analysis, Mr. Edge concluded that BIPCo's President, COO and CFO are underpaid in terms of salary and benefits.

2. Dr. Bodah's Report

In order to determine a reasonable salary for BIPCo's General Manager and a reasonable level of payments to BIPCo's owners, Dr. Bodah examined the compensation of municipal utility General Managers, as reported by 40 entities in Massachusetts, Connecticut and Rhode Island.³

Dr. Bodah then developed compensation for BIPCo's President, COO and CFO by applying a ratio of compensation for these types of positions relative to compensation of industry general managers, based on various United States and Rhode Island all industries data. He found that on average a CEO earns 163% of what a General Manager earns. He made no effort to determine whether a small company of BIPCo's size needs to pay (or pay an amount of the magnitude being paid) these three officers in addition to paying a General Manager. Nor did he report on whether the municipal utilities from which he developed General Manager compensation also made payments to Presidents, CFOs and COOs.

Dr. Bodah did not perform any specific evaluation of the qualifications of BIPCo's owners. He assumed that since each BIPCo executive "has been active with the company for at least 15 years" that "we can safely assume that they all possess the necessary attributes to perform competently. Individual salaries should, therefore fall within ranges determined by the market data." Dr. Bodah also did not evaluate whether or to what extent BIPCo's owners are actually providing services to BIPCo or whether ratepayers derive any benefit from such services, to the extent that they are performed.

³ Many of these municipal utilities are substantially larger than BIPCo. Dr. Bodah did not review compensation paid by other small, island-based utilities. Nor did he review compensation paid by other small entities that receive Rural Utilities Service loans. He made no attempt to find a group of "comparable" entities in terms of size (number of customers, sales volume, non-fuel revenues).

Nor did Dr. Bodah examine whether the types of services provided, if any, are consistent with the functions of a Board of Directors.

Dr. Bodah concluded that the salaries proposed by BIPCo during the rate case (which would have raised management fees from \$192,000 to \$212,000, well above the amount allowed in the rate case settlement (\$135,611 per Mr. Edge) and the amount currently being paid (\$168,000 per Mr. Edge), were below what he considered reasonable. Dr. Bodah next found that BIPCO management receives benefits well below those that could be expected based on a review of national data and responses to questions to a handful of Massachusetts municipal utilities.

Dr. Bodah's Report utilized salaries for full-time employees and did not take into account Mr. Edge's treatment of the owners as independent consultants who, by definition, do not work full-time as employees.

B. BIPCO'S FILING IS PATENTLY DEFICIENT AND NON-COMPLIANT WITH THE COMMISSION'S DIRECTIVES AND BIPCO'S SETTLEMENT OBLIGATIONS

Unfortunately, BIPCo has not complied with its filing obligations. BIPCo has failed to demonstrate that the owners receiving payments (now paying themselves as outside consultants rather than receiving the same payments as management fees) are (1) actually performing services for BIPCo; (2) qualified to perform the services that they claim to be performing; and (3) putting in a sufficient amount of time on BIPCo matters to justify the payments being made to themselves.

Furthermore, BIPCo has not demonstrated the need for three officers in addition to a General Manager and that paying for all of these positions is in the interests of BIPCo and its ratepayers. BIPCo did not justify the continued payment of Mr. Wagner's

salary, given, on information and belief, his presence in Costa Rica and the absence of any hired and trained replacement for Mr. Wagner.

BIPCo also has failed to provide for any allocation of company-leased vehicle expenses based on personal use by the ownership. BIPCo did not submit any justification for affiliate transactions and did not demonstrate its compliance with applicable affiliate transactions statutes.

To summarize, BIPCo's Compliance Filing is patently deficient in multiple respects:

1. the amount of compensation to owners has not been supported by any documentary evidence of work actually being performed or the time spent performing such work by qualified persons
2. no documentation was provided as to the amount of personal use of Company-leased vehicles
3. no evaluation of transactions with "affiliates" was included, only a promise that one will be provided "next year"
4. BIPCO presented no evidence of compliance with applicable affiliate transactions statutes
5. Dr. Bodah's Report fails to analyze whether all or a portion of the payments being made to owners/management are more properly classified as dividends, which are not chargeable to ratepayers as operating expenses and must be paid out of earnings
6. there has been no showing that the payments being made (or the method of making payments to consultants as opposed to treating all or any portion of these payments as dividends) are reasonable and in the best interests of ratepayers
7. Dr. Bodah's methodology ignores the role and duties of a Massachusetts municipal electric department general manager by equating these general managers with the general manager terminology applied in the industry-wide sector from which his relative salary comparison between CEOs and General Managers was made. Municipal electric department general managers function just like CEOs and have broad powers. They operate in systems where they carry out CEO, COO and often CFO roles under their jobs as general manager and are not surrounded by multiple officers.⁴ As a

⁴ See, Massachusetts General Laws, Chapter 164, Section 56 (general manager has "full charge of the operation and maintenance 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."). See also, *Golubek v. Westfield Gas & Elec. Light Bd.*, 591 N.E.2d 682 (Mass. App. Ct. 1992). *Commonwealth v. Oliver*, 172 N.E.2d 241

result, a better comparison between BIPCo management salaries would be total compensation for all owners plus the General Manager versus the salary of a municipal electric department general manager. On top of a general manager's compensation, some minimal compensation to the owners through board of directors fees would be warranted. The mean General Manager salary per Dr. Bodah was \$105,261. Municipal utility systems of the same relative size as BIPCo, as reported by Dr. Bodah, had general manager salaries well below the mean. Dr. Bodah's sample does not include small, island-based utilities or small RUS-funded utilities that might be comparable to BIPCo.

8. Dr. Bodah had no evidence of the actual experience or qualifications of BIPCo owners/management to carry out the job descriptions he prepared based upon testimony from BIPCo's last rate case. He simply assumed that they are qualified to carry out these jobs.
Dr. Bodah had no evidence on the amount of time that owners/management actually work for BIPCo or whether they actually carry out the job descriptions that he prepared; according to Mr. Edge, they do not work on a full-time basis, follow instructions or receive training.⁵
9. BIPCo presented no evidence whether such a small company needs a relatively large group of "independent consultants" in addition to a General Manager. The municipal utilities from which the General Manager's salary was compared do not have such additional positions.
10. Neither Mr. Edge nor Dr. Bodah have disclosed whether Mr. Wagner is now currently working full-time for BIPCo or has been so working.⁶

In sum, there are so many cumulative, obvious flaws in BIPCo's filing that it is not in compliance with the terms of the Settlement or the Commission's Rate Order directives.

Under these circumstances, the Commission should summarily reject BIPCo's filing as non-compliant with its Rate Order directives and the Settlement. BIPCo should be required to comply. The Commission, in its discretion, should consider whether any

(MA 1961). Had Dr. Bodah examined the management structures of Massachusetts municipal electric departments, he would have found that they do not include both general managers and CEOs, CFOs and COOs.

⁵ The Town disputes Mr. Edge's contention that the owners should be classified as independent consultants. Absent any objective proof of the performance of services commensurate with the level of payments charged to ratepayers, the Commission should direct BIPCo to treat these payments as dividends. To the extent that earnings are insufficient to make these payments to the owners as dividends, or to the extent the Commission finds that non-payment of dividends is needed to improve BIPCo's common equity ratio, the payments should not be made at all.

⁶ In the case of Mr. Wagner, the Company stated that he had agreed to stay on through November 2005 in order to train his successor (BIPCo Response to TOWN-42). But no successor has been named or trained and the Town believes that Mr. Wagner is spending his time in Costa Rica.

finances are appropriate. Given BIPCo's non-compliance, the Commission also should direct that BIPCo defer any future payments to its owners pending the outcome of Commission review of BIPCo's compensation and affiliate transaction practices.

III. IN THE ALTERNATIVE, THE COMMISSION SHOULD OPEN AN INVESTIGATION OF BLOCK ISLAND POWER COMPANY'S MANAGEMENT COMPENSATION PAYMENTS AND PRACTICES AND AFFILIATE TRANSACTIONS

In the alternative, the Commission should open an investigation of BIPCo's filing, including its management payment practices and affiliate transactions. The Commission should require BIPCo's owners to appear and testify and undergo cross-examination and Commission questioning. The Town should be afforded an opportunity to conduct discovery and present evidence.

Given the lack of any evidence in BIPCo's filing that payments being made to its owners are being earned or provide benefit to ratepayers, the payments to BIPCo's owners are no more than dividends in disguise that are being improperly charged to ratepayers as operating expenses.⁷ An investigation also is needed to determine whether and to what extent the owners and other management have been physically present within the Town of New Shoreham, whether they are qualified to perform the duties contained in job descriptions prepared for them by Dr. Bodah and what, if any, work for BIPCo they have been performing. The status of Mr. Wagner also must be investigated to assure that ratepayers are not paying for a "phantom" position.⁸

⁷ In the recent rate case, BIPCo admitted that its owners do not maintain any time records (BIPCo Response to TOWN-15). The Company also was unable to produce resumes for all of its owners (BIPCo Response to TOWN-13), and the owners who produced resumes are doctors.

⁸ In the case of Mr. Wagner, the Company stated that he had agreed to stay on through November 2005 in order to train his successor. (BIPCo Response to TOWN-42). But no successor is on board and the Town believes that Mr. Wagner spends a significant amount of time in Costa Rica.

An investigation is further warranted by the lack of any documentation regarding the amount of personal use of company-leased vehicles.⁹ BIPCo also has promised, but did not provide, evaluations of its affiliate transactions. These transactions require an investigation. The Commission also should investigate whether BIPCo has been or currently is in compliance with Rhode Island General Laws pertaining to affiliate transactions.

A. BIPCO HAS PROVIDED NO EVIDENCE THAT ITS OWNERS AND MANAGEMENT HAVE EARNED THE PAYMENTS BEING MADE TO THEM AT RATEPAYER EXPENSE

In the discussion in Part II above, the Town explained why BIPCo's Compliance Filing is patently deficient and should be rejected. It is rare indeed to find a company whose owners and officers classify and pay themselves as independent consultants, as they clearly are not independent in any way from the ownership and control of this company. There are no management checks on the reasonableness of these payments, which would exist if payments were being made to outside consultants on an arms-length basis.

Fundamentally, BIPCo has failed to demonstrate in its filing that its owners and other management are putting in the time that would justify the level of payments being made to them out of operating expenses. As noted during the Company's last rate case, BIPCo failed to maintain any business records that would substantiate the degree of

⁹ BIPCo has not maintained any records of personal use of company-leased vehicles (BIPCo Responses to TOWN-95 and to 3-3). It has admitted that one of five leased vehicles is for the use of its Treasurer (now President), who was and still may be based off-island. In its response to 3-2, BIPCO listed a lease expense of \$467/month (which would not include any gasoline, insurance and maintenance expenses).

involvement of owners to justify the payments being made to them at ratepayer expense.¹⁰ The same problems exist with respect to BIPCo's Compliance Filing.

The Town also is concerned that the owners are primarily absentees, with little, if any, expertise in running a public utility. Owners are living off-island and have "day jobs" unrelated to BIPCo. The owners' degree of involvement in BIPCo management has not been quantified in any objective way that is reviewable by the Commission and supports the level of payments being made to them at ratepayer expense.¹¹

BIPCo's owners also have not demonstrated that their qualifications to provide any benefit whatsoever to the Company or at a level of benefit commensurate with the payments being made to them.¹² If, as the Town expects, these individuals are doing little more than what one might expect from a board of directors, they are not entitled to the payments that they have made to themselves. Any excess above reasonable directors' fees should be treated as dividends and should not be charged to ratepayers through operating expenses.¹³

The Town remains very concerned that Mr. Wagner is spending time off-island in Costa Rica and BIPCo's owners have made no effort known to the Town to replace Mr. Wagner with a qualified, full-time manager.

¹⁰ See, BIPCo Responses to TOWN-15 (no time records for owners receiving management fees), TOWN-16 (no detailed description of what services are being performed by the owners due to the absence of time records). These practices are especially unreasonable in light of BIPCo's current claim that its owners are independent consultants.

¹¹ During the rate case, BIPCo did not respond to the town's request for information as to which positions in its organizational chart (including the owners who are paying themselves as officers) were full-time or part-time (BIPCo Response to TOWN-8).

¹² In the rate case, only two owners supplied resumes (BIPCo Response to TOWN-13) and these two owners are physicians. Neither included any experience or qualifications relevant to an electric utility other than the possession of a MBA degree by one owner without any corresponding general management experience.

¹³ The Town does not support the payment of these sums as dividends, given BIPCo's thin common equity ratio and the Commission's telling BIPCo to improve its equity ratio in the Rate Order.

C. BIPCO HAS NOT PROPERLY ALLOCATED TO THE OWNERS COMPANY-LEASED VEHICLE EXPENSES BASED ON REVIEWABLE DOCUMENTATION

BIPCo also failed to maintain automobile records to determine the amount of personal use of company-leased vehicles, at least one of which had an EZ-Pass (used to pass through tolls in the metropolitan New York area) on its windshield (as noted by Mr. Nault’s questioning). The Commission may take notice that there are no EZ-Pass toll booths on Block Island. Such use of company-leased vehicles is hardly consistent with BIPCo’s current claim that its owners are independent consultants (who normally supply their own vehicles are not afforded personal use of company-leased vehicles).¹⁴ BIPCo should be reimbursed for any costs associated with the personal use of company-leased vehicles.

D. BIPCO’S COMPLIANCE WITH AFFILIATE TRANSACTION LAWS MUST BE INVESTIGATED

The Commission also must investigate BIPCo compliance with affiliate transaction statutes in Rhode Island. BIPCo has presented no evidence of its compliance with these requirements.

As a “public utility” under R.I.G.L. Section 39-1-2(20), BIPCo is subject to restrictions imposed under other sections [Sections 39-3-15 through 39-3-33] of the Rhode Island General Laws. R.I.G.L. Section 39-3-34. Included among these restrictions are affiliate transaction requirements.

Under R.I.G.L. Section 39-3-27, an “affiliate” is defined as including “(1) [e]very person owning or holding, directly or indirectly, ten percent (10%) or more of the voting capital stock of a public utility.” An “affiliate” also includes “(3) [a]ny person with whom

¹⁴ See, BIPCo Responses to TOWN-95, 3-2 and 3-3.

a public utility has a management or service contract or arrangement of the character set forth in §39-3-28, including contracts for personal services with persons not otherwise affiliated.” “Persons” include individuals, corporations, trustees, lessees, holders of beneficial equitable title, voluntary associations, receivers and partnerships.

Under R.I.G.L. Section 39-3-28:

The original or a verified copy of any contract or arrangement and of any modification thereof or a verified summary of any unwritten contract or arrangement, the consideration of which exceeds five hundred dollars (\$500), hereafter entered into between a public utility and an affiliate for the furnishing of managerial...or any other services, either to or by a public utility or an affiliate, shall be filed by the public utility with the division within ten (10) days after the date on which the contract is executed or the arrangement entered into.

R.I.G.L. Section 39-3-29 provides that any contract or arrangement not filed with the Division pursuant to Section 39-3-28 “shall be unenforceable in any court in this state, and payments thereunder may be disallowed by the division, unless the later filing thereof is approved in writing by the division.” Under R.I.G.L. Section 39-3-30, the Division is authorized to investigate any utility arrangements with an affiliate. If it finds the arrangement unreasonable, it may “make such reasonable order relating thereto as the public good requires.” The Division can disapprove the arrangement, disallow payments, or both.

Under R.I.G.L. Section 39-3-31, if the Division, as a result of a Section 39-3-30 investigation, finds that “any public utility is making payment or about to make any payment...which substantially threatens or impairs the ability of the public utility to render adequate service, at reasonable rates, or otherwise to discharge its duty to the public, the division may apply to the superior court for an order directing the public utility to cease any payment..., and thereupon the court shall make such order as the

public good may require.” Last, under R.I.G.L. Section 39-3-32, in any rate proceeding, the Division may “disallow the inclusion in the accounts of a public utility of any payments or compensation to an affiliate for any services rendered...under existing contracts or arrangements with an affiliate unless the public utility shall establish the reasonableness of the payment or compensation.”

The owner/management compensation arrangements between BIPCo and its owners constitute affiliate transactions. The owners fall under the definition of “affiliate” based upon their holding of ten percent (10%) or more of BIPCo voting stock and the existence of their “consulting” or “independent contractor” service arrangements with BIPCo. If these arrangements were not properly filed with the Division as required under Section 39-3-28, they should be considered unenforceable and the payments disallowed under Section 39-3-29 “unless the later filing thereof is approved in writing by the division.” Moreover, the amounts of payments being made have not been shown to be reasonable.

Given the lack of any presentation by BIPCo regarding its compliance with affiliate transactions requirements, despite the Commission’s Rate Order directives, the Commission must investigate. After investigation, the Commission should determine what remedial actions are needed (including, but not limited to, the disallowance of payments to owners and a requirement that owners reimburse BIPCo for the fair value of any personal use of company-leased vehicles) and whether any fines are justified.

IV. CONCLUSION

For the reasons stated above, the Commission should summarily reject BIPCo’s filing as not in compliance with its Rate Order directives and the terms of the Settlement.

In the alternative, the Commission should immediately open an investigation of BIPCo's Compliance Filing and afford the Town an opportunity to conduct discovery and cross-examination and to present evidence. In either case, remedial action is needed to protect the interests of ratepayers.

Respectfully submitted,

TOWN OF NEW SHOREHAM

By its attorneys,

Alan D. Mandl, Bar No. 6590
Mandl & Mandl LLP
10 Post Office Square-Suite 630
Boston, MA 02109
(617) 556-1998

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