

Thursday, March 26, 2010, 10:30AM
Testimony of Michael Beauregard
RI Public Utility Commission Hearing
Town of New Shoreham, RI (Block Island)
Subject: Docket Matter 4111

Good Morning. My name is Mike Beauregard. Thank you for this opportunity to be heard. First, I would like to thank Mr. Wolberg for pointing out the painting on the wall behind you of the Southeast Lighthouse, the iconic symbol of this island. I believe that it is cruel and punishing to some long-time residents in this audience who must look at that picture, put here as the centerpiece in the official meeting room at Block Island Town Hall, and the prospect that it may need to be altered to include utility scale wind turbines. My house is located on Mohegan Trail on the Southeast side of the island and I also live in Detroit, Michigan. I am a year-round ratepayer.

Because I have some technical points to make, I believe it is useful to summarize my professional background. I hold a Bachelors Degree in Economics from the University of Michigan, an MBA from the Katz Graduate School of Business, and a law degree from the University of Pittsburgh School of Law. I am admitted to the Pennsylvania bar. I once was a corporate lawyer and a municipal bond lawyer for various State agencies raising capital for municipal projects. Now, I am Partner at Huron Capital Partners, a large private equity firm investing equity and mezzanine capital in firms like Deepwater and other private companies. I am also a member of the Economic Leadership Council for the Department of Economics at the University of Michigan, where I serve as a faculty advisor and teach private equity seminars to students. I am an expert in highly-structured financial transactions. Although I am not a power purchase expert, I am familiar with every filing in this docket item. I am also familiar with Deepwater and its equity capital sources and how their markets measure successful investments and Internal Rates of Return.

I stand before you today as a member of the public.

I have two points to make, and will expand on them.

Point 1 - The terms of the PPA are not “commercially reasonable”, not even close.

You must reject the PPA because it will generate outsized investment returns to DEEPWATER’s investors at the expense of RI ratepayers.

I am not here to repeat at length existing testimony from some quite smart people. This voluminous testimony speaks for itself. However, based on your formal requests for information, it appears that you may still be grappling with whether the PPA is commercially reasonable. I, for one, agree with Mr. Hahn, the State’s expert witness, in his findings that the calculated IRR anticipated for the BI Wind Farm will, in fact, generate significantly outsized investment returns for DEEPWATER and its investors.

Acceptable IRRs for regulated power companies operating conventional and renewable on-shore energy generators are well established. In my experience, these rates of return generally fall in the range of 17%. According to disclosures made by CalPERS (the California Public Employees

Retirement System, which is the most prolific investor in private equity funds like mine and DEEPWATER's investors), this range of return is consistent with the return posted by the most successful private equity funds in the US that have concentrated in making energy investments in the past decade. However, using the PPA's energy purchase costs, DEEPWATER's anticipated 4:1 debt to equity capital structure, federal investment & production tax credits and other subsidies, Mr. Hahn and others place DEEPWATER's expected IRR at close to 100%. This return is well beyond average rates of return for energy projects and pretty much all other asset classes. An IRR of that size means DEEPWATER's investors will, on average, double their equity investment each and every year of the BI Wind Farm's 20-year project life. Even if DEEPWATER uses a more conservative capital structure of 1 part debt to 1 part equity, the IRR approximates 50%. At this level of return, DEEPWATER's investors would double their equity investment every other year of the 20-year project life. Any way you cut it, it's a really superior return....and, is at its source, on the backs of RI ratepayers paying excessively for power.

In Mr. Moore's rebuttal testimony, he suggests that the PUC should accept a forecasted calculation of its IRR using the PPA contracted power rates WITHOUT regard to how it will capitalize the project and WITHOUT the investment & production tax credits and other subsidies it will no doubt be using. This artificially depresses the IRR because it requires an all-equity capitalization and makes the return "appear" lower and more "reasonable" for the sole purpose of showing a depressed IRR and getting this PPA approved. If Mr. Moore were to present that kind of logic to the Investment Committee at my firm, he would not have gotten past the first slide. No one expects DEEPWATER to miss the opportunities for debt leverage and tax credits in this project. The timing of their application is the only variable. At the end of the day, what's good for DEEPWATER comes at the expense of ratepayers. Either way, providing DEEPWATER a path to such elevated returns is an inappropriate use of Rhode Island's common wealth.

The PPA may, itself, become a benchmark in this nascent industry. What kind of benchmark it becomes is very important. Already, the current PPA has been singled out by Massachusetts's Secretary of Energy & Environmental Affairs as the benchmark for "unreasonableness" when assessing power purchase costs for Cape Wind's project in that State. It is why all offshore wind developers & investors are keeping their fingers crossed that you approve this PPA untouched...so that they can justify above market energy costs to other utility commissions and enhance their investment returns far far beyond acceptable IRRs. To me, a PPA of this type, one that significantly enriches investors, and others that would follow it, would be a terrible application of TARP funds and other funds appropriated by the Federal government under The American Reinvestment and Recovery Act to pull this country out of its terrible recession.

I have a solution for you in this debate -- If you choose to reject the PPA and send its parties back to the negotiating table, you should incorporate a feature that is very common and well-established in structured finance transactions. This feature is often referred to as a "Clawback Provision" or "Yield-Limiting Collar". The current struggle facing the PUC is trying to predict DEEPWATER's IRR at a static moment in time, doing so now, only once, before the project is built. A "Clawback Provision" would involve measuring the actual audited free cashflows of the project, its annual ROE, and IRR through the date of measurement as each year goes by. If the ROE for any one year exceeds more commonly acceptable and negotiated rates somewhere in the range of 17%, the PPA should require a

rate “decelerator” to rebate DEEPWATER’s excess return in the prior year to the ratepayers in the subsequent year. Similarly, if the ROE of the measured year falls below the common acceptable range, a rate escalator could be applied. Each adjustment measure would, therefore, normalize returns to those deemed “commercially reasonable” today.

Point 2 – The record of this docket matter includes strong letters of support from government officials to approve a “quasi tax” on RI’s ratepayers & citizens via the PPA to fund a specific State economic development initiative when it appears to me that the PUC is not authorized to do so under RI Law.

I may be wrong but I still don’t envy your position. Your mandate under House Bill 5002 is to simply determine whether the PPA pending before you is “commercially reasonable”. Based on my research, the PUC does not appear to be empowered to set public policy, impose taxes, or to advance specific economic development projects.

The PUC’s stated Agency Objectives include ensuring just and reasonable power rates and ensuring sufficient utility infrastructure to promote general economic development. There is a point at which the proposed PPA’s power costs begin to depart from the realm of commercial reasonableness and take on their characteristic as a “quasi-tax” for the purpose of financing a specific economic development project itself: the BI Wind Farm. There is a real difference -- You did not ask to be put in this position but you are being asked to step across that line that separates the PUC and other State agencies with taxing authority. You appear to be asked to approve a PPA with excessively high utility purchase costs, leaving ratepayers to foot the bill as a quasi-tax for economic development purposes. Some parties, testifying in this docket matter, try to tie job creation to this issue as a justification for your approving the PPA, with its high rates. The Governor’s office, the President of the RI Senate and the Speaker of the RI House have chosen to provide you with strong letters of encouragement to approve the rates under the PPA because of economic development policies they want implemented. They should instead be turning to the RI Economic Development Corporation (RIEDC) for such purposes. The RIEDC assists companies with business financings and other relevant issues. However, unlike the PUC, the RIEDC’s financing arm is funded primarily with annual State budget appropriations to provide financing assistance. If the EDC were to be petitioned to finance the BI Wind Farm, instead of the PUC, the RIEDC would likely need tax base allocations to help finance the project. And nobody, especially the RI Assembly, wants to increase taxes to fund a demonstration project. Instead, the PUC is being asked to invoke a taxing power to “find” the tax base through above market power purchase costs. To me, and many others on and off this island, this is not right and may be redressable since there is no electoral representation on the PUC. The issue of taxation without representation in this country was addressed long ago.

Finally, some of us don’t like our island being referred to as a “stepping stone”. Throw them a cable and the islanders will sacrifice some part of their preservation fiber. This sentiment is a means to an end. Most islanders do want the cable, not necessarily the wind farm. Alternatives to financing a one-way cable are available and should be explored. I will offer my time to help source the financing and grants for it.

I leave you with this final thought -- please do not mistake the relative silence from Block Island residents (compared to your other proceedings) as a tacit approval that islanders do not care if a wind farm is erected so close to shore. The survey conducted by Dr. Pavlides at Roger Williams University only posed questions tying the cable with wind mills. It did not query whether islanders would prefer a scenario that decoupled the cable from the wind farm. The PUC should help focus island resources on that alternative. Importantly, the due process hearings for this docket matter have been held during the island's off-season, when the island's summer population drops from 20,000 to under 1,000, and where much of that latter figure depart for warmer climates from October through April. This room would not hold 10% of the interested parties if this hearing were held in August.

Thank you for your time.