STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DIVISION OF PUBLIC UTILITIES AND CARRIERS
89 JEFFERSON BOULEVARD
WARWICK, RHODE ISLAND 02888

IN RE:	Interstate Navigation Company	:	
	Application to Refinance Debt with	:	Docket No. D-02-1
	Washington Trust Company	:	

REPORT AND ORDER

On January 25, 2002, the Interstate Navigation Company ("Interstate") filed an application with the Rhode Island Division of Public Utilities and Carriers ("Division") seeking authority to refinance debt with the Washington Trust Company ("WTC"). The application was filed in accordance with the requirements contained in Section 39-3-15 of the Rhode Island General Laws and Rule 14 of the Division's Rules of Practice and Procedure.

In response to the application filing, the Division conducted a duly noticed public hearing on March 12, 2002. The hearing was conducted in the Division's hearing room, located at 89 Jefferson Boulevard in Warwick. The following counsel entered appearances:

For Interstate: Michael R. McElroy, Esq.

For the Division's Advocacy Section: Leo J. Wold, Esq.
Special Assistant Attorney General

Interstate proffered one witness in support of its application. The witness was identified as Mr. Walter E. Edge, Jr., a partner in the consulting firm of Bacon & Edge, 1 Worthington Road, Cranston, Rhode Island.

Mr. Edge testified that Interstate's application seeks authority from the Division to refinance its approximately $6.9 million outstanding loan with the WTC, to take advantage of the recent drop in short-term interest rates (Interstate Exh. 2, p. 2). Mr. Edge related that the funds will be used exclusively to pay off the current loan and certain refinancing costs (Id.).

Mr. Edge testified that Interstate contacted and received proposals from six banks regarding its decision to refinance its debt. He related that all six banks offered variable and fixed rate options (Id., Schedule WEE-1). Mr. Edge stated that because only short-term interest rates had dropped significantly in 2001, Interstate discovered that its refinancing options were limited to only short-term loans.

Mr. Edge additionally related that not only did Interstate determine that its refinancing options were limited to short-term loans, it also had to consider the $2,900,000 "prepayment premium" it was obligated to pay the WTC in order to refinance the original $6.9 million WTC loan. Mr. Edge testified that "*this meant...to refinance the current $6,900,000 loan, [Interstate] would have to refinance a total of about $9,800,000*" (Id., p.3).

Mr. Edge explained that because none of the banks were offering a "fixed rate" low enough to justify the refinancing decision (the interest rate on Interstate's current WTC loan is approximately 10%), Interstate decided to explore the possibility of a "variable rate" option. According to the witness, Interstate thereupon learned that a variable rate option was available and that "substantial savings" were possible (Id., p.4).

With the variable rate option numbers from five banks in hand, Mr. Edge testified that Interstate decided to discuss its refinancing plans with the WTC again. From this meeting, Interstate was able to persuade the WTC to reduce the $2,900,000 prepayment premium to $500,000 in exchange for Interstate again refinancing its debt with the WTC (Id.). The variable rate terms would be prime + ½% (currently 5.25%) for fifteen years (Id., Schedule WEE-1). Additionally, the WTC loan would permit Interstate a one-time option to convert the proposed 15-year variable rate loan to a 15-year fixed rate loan, with a rate that automatically adjusts every five years (Interstate Exh. 4). Mr. Edge opined that the negotiated refinancing terms with the WTC now offer Interstate the most favorable debt reduction option (Interstate Exh. 2, p. 5 and Schedule WEE-2).

To quantify the savings and to justify the decision to select variable rate terms, Mr. Edge explained that if Interstate were to opt for the best fixed rate now available, it would take almost seven years before Interstate would break even. However, by using the variable rate loan, Mr. Edge opined that Interstate would break even in less than two years (Id., p.5). He predicated this conclusion on the following analysis:

> *If…Interstate chose the variable rate of prime plus ½% (5.25%) the savings would be $351,500 ($7,400,000 * (10% - 5.25%)) in the first year less the increase in interest for the $500,000 ($26,250). If the variable rate stayed at 5.25%, Interstate would be whole in less than two years.* (Id.).

Mr. Edge also opined that the proposed refinancing would have "no immediate impact on the ratepayers" (Id.). He explained that even though the

$500,000 prepayment premium cost must be rolled into the current principal amount of the new loan, the substantially lower interest rate under the proposed refinancing will result in lower debt service payments and a lower cost of capital for Interstate's ratepayers (Id.). Mr. Edge further explained that Interstate's ratepayers would receive the benefit of the lower interest rates when Interstate files its next rate case. He related that benefit would be reflected in Interstate's weighted cost of debt and equity (Id., p. 6). He also related that ratepayer's will presently benefit from the savings generated from the refinancing because the reduced debt service will be used to off-set expense increases which may delay the need for a rate increase filing (Id.).

Mr. Edge also noted that the proposed refinancing would have only a minor effect on Interstate's debt/equity ratio, which will increase from 1.96 to 1 to 2.08 to 1. He opined that a 2 to 1 debt/equity ratio "is a sign of a strong utility" (Id.).

In his final comments, Mr. Edge emphasized that Interstate will not receive any proceeds from this refinancing. He related that Interstate's intent is to borrow only enough money to refinance the existing loan and pay the prepayment premium (Id., p.7). He additionally opined that Interstate's financial health has improved since the Company last borrowed money in 1997. He pointed to the fact that Interstate's total capital has increased from $3,100,000 to $4,125,242 since May 31, 1998 (Id.).

The Division's Advocacy Section did not present any witnesses in this docket. It did, however, submit an analysis of the savings that would be

realized under Interstate's proposal (Advocacy Section Exh. 1). The Advocacy Section thereupon stated for the record that it was satisfied from the evidence presented that the proposed refinancing was in the public interest.

FINDINGS

In examining the terms and conditions of the proposed financing, the Division became quite troubled with the $2.9 million prepayment penalty left over from Interstate's last borrowing with the WTC. While the Division accepted Interstate's arguments in support of the 1997 WTC loan, which was unfortunately the best financing option available to Interstate at that time, the Division now finds that the original WTC loan impedes Interstate from realizing the best refinancing terms and conditions available today. Moreover, the matter is further complicated by the prepayment penalty associated with the new WTC variable rate loan, a penalty that none of the other financial institutions contacted by Interstate would impose for a variable rate borrowing. The Division has reservations about this new prepayment penalty provision due to the influence it will invariably present in any future refinancing concomitant with the instant debt.

It was this concern that lead the Division to question Interstate's witness at length regarding the impact of the proposed WTC loan on future ratepayers. In response to the Division's concerns, Interstate's witness offered a thorough quantification of the financial implications associated with the new loan. He calculated the maximum potential prepayment penalty under the new loan terms to be $350,000, which he contended still offers Interstate a substantial

savings compared to the terms and conditions contained in the current loan. Mr. Edge opined that the $350,000 prepayment penalty would also not create the same impediment for Interstate in a future refinancing as the prepayment penalty attached to the current WTC loan. Accordingly, Mr. Edge related that Interstate would remain vigilant with respect to interest rate changes for the purpose of determining the efficacy of another refinancing in the future.

Predicated on a careful examination of the record in this matter, the Division finds that Interstate's application seeking approval to refinance debt with the Washington Trust Company in an amount not to exceed $7,400,000, is reasonable and in the best interest of ratepayers. The Division does, however, find that the ratepayers of public utilities are generally better served by fixed rate rather than variable rate loans. Accordingly, the Division will direct Interstate to remain attentive to exploring all future fixed rate refinancing options.

Now, therefore, it is

(16944) ORDERED:

1. That the Interstate Navigation Company's January 25, 2002 application, which seeks Division approval under R.I.G.L. §39-3-15, to refinance debt with the Washington Trust Company in an amount not to exceed $7,400,000, is hereby approved as filed.
2. That the Division hereby limits approval of the instant application to the terms and details identified in the record.

3. That Interstate is hereby directed to remain attentive to prevailing interest rates and exercise its option to convert to a fixed rate under the variable loan approved herein or, if available, pursue more favorable terms from other financial institutions when such refinancing would be in the interests of ratepayers.

DATED AND EFFECTIVE AT WARWICK, RHODE ISLAND ON MARCH 13, 2002.

John Spirito, Jr., Esq. Hearing Officer	Thomas F. Ahern Administrator