BEFORE THE VIRGIN ISLANDS PUBLIC SERVICES COMMISSION

RE: THE VIRGIN ISLANDS WATER AND POWER AUTHORITY

APPLICATION FOR INCREASED RATES FOR THE ELECTRIC DEPARTMENT

VIPSC DOCKET 612

REPORT OF THE TECHNICAL CONSULTANTS

JAMSHED K. MADAN, LARRY R. GAWLIK, AND MICHAEL D. DIRMEIER

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VIPSC DOCKET 612

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I. STATEMENT OF QUALIFICATIONS

Q. WOULD YOU PLEASE STATE YOUR NAMES AND ADDRESSES?

A. My name is Jamshed K. Madan and my business address is 13 Grove Street, Ridgefield, Connecticut.

My name is Larry R. Gawlik and my business address is 17 Cousteau Lane Austin, TX 78746.

My name is Michael D. Dirmeier and my business address is 1902 Overlook Ridge Drive, Keller, TX 76248.

Q. ARE YOU ALL TESTIFYING AS A PANEL?

A. Yes. The specific areas of responsibilities are described below.

Q. MR. MADAN, BY WHOM ARE YOU EMPLOYED?

A. I am a principal of the Georgetown Consulting Group ("GCG"), which is a firm specializing in utility regulation.

Q. WOULD YOU BRIEFLY DESCRIBE YOUR FIRM'S SERVICES?

A. Georgetown Consulting Group ("GCG") was founded in 1979 and has provided expert testimony on behalf of various clients in the United States and internationally with specific concentration in utility regulation. GCG has represented numerous Public Utility Commissions and other interveners in several jurisdictions regarding matters involving electric, gas, water, wastewater and telephone utilities.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from the Massachusetts Institute of Technology with a Bachelor of Science Degree in Electrical Engineering. I continued my education at MIT and graduated with an MS degree in Management from the Alfred B. Sloan School of Management.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I have. The Virgin Islands Public Services Commission ("PSC" or "Commission") reappointed GCG as the Technical Consultant in Docket #533.[1] I have previously presented testimony in the Electric Phase of the rate investigation in Docket No. 533. I have also testified numerous times on matters involving the Virgin Islands Water & Power Authority ("WAPA" or "Authority") Levelized Energy Adjustment Clause ("LEAC") in Docket #289. In earlier years, I have testified in most WAPA matters, base rate proceedings, fuel adjustment proceedings and other WAPA-related matters brought before the PSC in the past 30 years as a member of GCG and prior to that as a Principal and employee of Touche Ross & Co. (currently Deloitte).

Q. PLEASE DESCRIBE YOUR EXPERIENCE IN UTILITY REGULATION.

A. I have testified and provided other services to Regulatory Commissions for over thirty years. I have been a witness before the Public Services Commission of the Virgin Islands on scores of other occasions in matters involving the Virgin Islands Water and Power Authority as well as VITELCO (currently d.b.a. Innovative Telephone) and other regulated entities.

[1] Docket No. 533 was set to hear the base rate cases for both the Electric and Water Departments in 2003.

Q. WHAT WERE YOUR RESPONSIBILITIES IN THE PREPARATION OF THIS TESTIMONY?

A. My responsibility as part of the panel was to provide analysis of the issues in the context of prior cases and to provide guidance on the policy regulatory issues in this proceeding as well as the end result.

Q. MR. DIRMEIER, BY WHOM ARE YOU EMPLOYED?

A. I am a principal of the Georgetown Consulting Group ("GCG"), which is a firm specializing in utility regulation.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from Texas A&M University with a Bachelor of Science Degree in Physics. I continued my education at the University of Chicago, from which I received a Master of Business Administration degree in finance.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I have. I have previously appeared before the PSC in matters involving VITELCO.

Q. PLEASE DESCRIBE YOUR EXPERIENCE IN UTILITY REGULATION.

A. I have analyzed utility companies' testimonies and managed the preparation of testimony or testified in the following jurisdictions: Alabama, Arkansas, Colorado, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, New Jersey, New Mexico, New

York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Vermont, Virginia, the U.S. Virgin Islands, the District of Columbia, the Federal Energy Regulatory Commission, the U.S. Nuclear Regulatory Commission, and before the Board of Commissioners for the City of Las Cruces. I have also testified before the Third Judicial District of the State of New Mexico.

Q. WHAT WERE YOUR RESPONSIBILITIES IN THE PREPARATION OF THIS TESTIMONY?

A. My responsibility as part of the panel was to review the filing, prepare discovery requests and analyze responses to discovery and other material relevant to the case, and to be primarily responsible for the development of the positions and schedules that support our position. I provided input into all aspects of the position.

Q. MR. GAWLIK, PLEASE STATE YOUR POSITION AND DESCRIBE YOUR EDUCATIONAL BACKGROUND?

A. I am an independent consultant and Associate of GCG. I graduated from the University of Florida with a Bachelor degree in Electrical Engineering. Subsequently, I was enrolled at the University of Texas at Austin in the Graduate School of Business and received a Master of Business Administration degree.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I have. In my role with GCG, Technical Consultant to the PSC, I provided testimony in the electric rate investigation in Docket #533. I have also testified numerous times on matters involving WAPA including Dockets 576, water rate investigation, and in numerous Docket #289, LEAC proceedings since 2003.

Q. PLEASE DESCRIBE YOUR EXPERIENCE IN UTILITY REGULATION.

A. I have on behalf of utility companies and regulatory agencies managed the preparation or participated in the preparation of testimony or testified in jurisdictions located in: Arkansas, California, Connecticut, Florida, Georgia, Louisiana, Illinois, Indiana, New Mexico, New York, Nevada, North Carolina, Nova Scotia, Oregon, Texas, Utah, the U.S. Territories of Guam, Northern Marinas Islands, and Virgin Islands, Washington, the Federal Energy Regulatory Commission, the U.S. Nuclear Regulatory Commission, and before over 30 foreign regulatory commissions, city councils and governing boards.

Q. WHAT WERE YOUR RESPONSIBILITIES IN THE PREPARATION OF THIS TESTIMONY?

A. My responsibility as part of the panel was to review the filing, prepare initial discovery requests and analyze responses to discovery and other material relevant to the case, and to as part of the panel in this proceeding focus on matters involving integrated resource planning, productivity and planning, the efficiency of WAPA's operations, the level of operations and maintenance expense included in WAPA's rate request, and the impact of the use of reverse osmosis units in WAPA's electric and water operations

Resumes of Messrs. Madan, Dirmeier and Gawlik have been provided to the PSC in several proceedings and can be produced on request in this proceeding.

Q. UPON WHAT HAVE YOU RELIED IN REACHING YOUR CONCLUSIONS IN FORMULATING THE COMMISSION'S OPTIONS DESCRIBED IN THIS TESTIMONY?

A. We have relied on WAPA's petition, responses to discovery requests, WAPA's internal financial reports and other documents, participation in related WAPA proceedings current and past, our experience in regulation and discussions with the Authority's personnel.

Q. IS THERE ANY OTHER TESTIMONY PREPARED ON BEHALF OF GCG IN THIS MATTER?

A. Yes, there is one additional testimony. The testimony of Mr. Bruce Oliver. Mr. Oliver will testify on issues including the cost of service and rate design, funding for rate design and load research, implementation and planning for rate design changes.

II. SCOPE AND PURPOSE

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. This testimony is filed in response to the Virgin Islands Water and Power Authority's November 2012 request ("filing") to increase the rates for electric service. WAPA is requesting an increase in revenues of an additional $18 million on an annual basis, in addition to the emergency rate relief of $8.6 million granted WAPA by the PSC on July 6, 2012. This total of $26.6 million, if granted, would be a significant increase of 37.9% on base rates prior to the emergency increase.

Q. WHAT IS THE SCOPE OF YOUR REVIEW AND TESTIMONY?

A. In the development of this testimony, we have relied on WAPA's filing, the information provided to us by WAPA in responses to written discovery and information provided through oral discussions with WAPA officials, and on information that we have gathered through prior proceedings involving WAPA.

III. <u>EXECUTIVE SUMMARY</u>

Q. WHAT ARE THE KEY ISSUES THAT YOU BELIEVE THE COMMISSION SHOULD ADDRESS IN THIS PROCEEDING?

A. WAPA has requested a rate increase totaling $26.6 million, including the $8.6 million interim increase that the Commission granted in July, 2012. We are recommending a total increase of $12.25 million, including the $8.6 million interim increase. Obviously, the Commission must address the overall level of WAPA's rates. Equally if not more importantly, however, is that the Commission should address factors that have led to the present condition of WAPA:

- its less than adequate service;
- the necessity for emergency measures to address its less than adequate service;
- the frequent occurrence of promises and / or assurances to take certain actions without successful follow-through.

We are increasingly concerned that the actions at WAPA are leading to the failure to meet their obligation to provide safe and adequate service at reasonable rates. Even though there are legislative limitations on the ability of the Commission to influence directly WAPA's activities, we propose and recommend measures, not restricted by these existing legislative limitations, that will enable the Commission to review WAPA's actions on a more current basis than in the past, and to rapidly adjust WAPA's revenue stream if WAPA fails to meet its regulatory and statutory obligations to provide reliable service at a reasonable cost. We believe that this will be in the interest of WAPA, its ratepayers, and the Virgin Islands.

Q. SHOULD SOME CONSIDERATION BE GIVEN TO THE LENGTH OF TIME THAT WAPA HAS STAYED OUT AND NOT INCREASED RATES?

A. No. First, the Legislature has mandated that all utilities be subject to rate investigations at least once every five years; it is now four years since the last rate investigation, and so this filing is not outside of the acceptable timeframe. Second, at the time of the most recent full rate case, in 2009, WAPA stated that it intended to return with a new rate case within three years. Third, as a result of the filing of WAPA's request for an emergency rate increase in 2012, the timing of this application was mandated by the Commission. Fourth and finally, recently the PSC awarded a surcharge (Rate Financing Mechanism, "RFM") to increase the electric rates charged through the LEAC for the purpose of providing sufficient revenues to enable WAPA to undertake much needed rehabilitation and deferred maintenance of its St. Thomas generating units, to pay for acquiring spare parts inventory on both Islands, and to provide for the temporary lease of an emergency combustion turbine to provide power on St. Thomas while these activities are underway. The additional revenues were provided through a $0.023 per kWh charge added to each LEAC rate, and which was estimated to produce approximately $16 million annually. Since maintenance is a base rate component, this was, in essence, a base rate increase. This rate is anticipated to continue for a while and, together with the $26.6 million requested, if granted, would be an annual increase of $42.6 million or approximately an overall 61% increase in base rates. The PSC should remember that this is on top of a LEAC rate that is in excess of $0.40 per kWh – one of the highest in the nation.

That WAPA has not filed for additional base rates should not necessarily be interpreted as a good thing. WAPA itself has indicated that not requesting additional rate relief, until the RFM surcharge was implemented, has resulted in inadequate cash flow, and created liquidity problems that have had several negative effects, including a reduction in the funding of critically required maintenance and prior deferred maintenance. The result is that LEAC charges have been increased by tens of millions of dollars[2]. The stay-out was not required or a result of any PSC action, but rather was due to the judgment and decisions of WAPA management and its Board. The WAPA CFO, Mr. Julio Rhymer states that this has had very negative consequences.[3] These actions have had a negative impact on WAPA's credit rating, as testified to by Mr. Rhymer. The consequences, in addition to higher monthly LEAC charges to consumers, are for less liquidity and more difficult access to the financial markets, and with higher borrowing costs.

As we mention above, the more significant impact of this stay-out is described by WAPA revenue requirement witness Craig Shepard. The low liquidity and slow paying government accounts have caused WAPA to defer prudent maintenance expenses, causing unreliable service and inefficient operations that have resulted in extraordinary LEAC rates that have been passed on to customers.[4] While it is very difficult for the PSC with the current authority provided by the Legislature to take proactive steps to respond

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[2] LEAC report and supporting data presented to the PSC dated May 15, 2013 detailing increased LEAC cost resulting from deferred maintenance and high heat rates during the stayout.

[3] Page 6 of Julio Rhymer testimony:

- *Net losses in each of the fiscal years 2009 to 2012 (unaudited) totaling $40 million;*
- *Cash from customers has been insufficient to pay for operations and debt service by a combined shortfall of $92 million for fiscal years 2009 to 2012 (unaudited);*
- *Working cash shortfall for 2012 (unaudited) is negative $5.157 million[3];*
- *Recent downgrade of the Electric System's long term debt rating, to below investment grade with Negative Outlook, by the credit rating agencies.*

[4] Page 10 of Craig Shepherd testimony: *the Authority has to reduce or defer planned maintenance or to reduce or defer needed capital improvements or to continue to borrow money through the line of credit. The deferral of current fuel expenses and the slow payment of accounts receivable balances have an adverse impact in the Authority's cash flow and working capital.*

to the situation in a timely way to counter potential rate increases caused by these actions, LEAC rates are routinely reviewed by the PSC and set to pass through to consumers the funding necessary to reimburse WAPA for fuel purchases. In the absence of providing the necessary funds for the LEAC, the WAPA system would be forced to shut down.

Q. PLEASE EXPLAIN MORE ON THE OPTIONS FOR THE PSC.

A. As we understand from counsel, the PSC has the direct authority to set rates. The PSC cannot take or order WAPA to take direct action on an issue without the consent of WAPA. However, in reviewing and providing for prudent costs, the PSC can indicate that it would not provide rates unless WAPA undertook various actions that would be prudent and result in reasonable rates to its ratepayers. However, in the past, WAPA has promised to take actions that it then has failed to perform.

Q. COULD YOU PROVIDE EXAMPLES OF SUCH ACTIONS REQUIRED OF WAPA THAT HAVE NOT TAKEN PLACE?

A. Yes. In the resolution of the prior base electric rate case that took place in 2009, WAPA agreed to undertake a Management Audit with a scope to be jointly developed with PSC staff. However, even though revenues for the conduct of the audit were provided in the rate award and a draft scope developed,[5] the Request for Proposal (RFP) for the audit was never completed, and no offering was sent to potential bidders.

Another example is the establishment of the Rate Financing Mechanism (RFM). The RFM is a program to provide the funds necessary for conduct overdue generating unit rehabilitations, undertake specific deferred maintenance activities, purchase

[5] Complete agreement on the Scope document was not reached pending resolution on a couple of issues.

necessary spare parts, and to lease an emergency trailer-mounted generator to provide adequate generating capacity allowing WAPA to undertake these overdue and deferred activities resulting from the stay-out described above, which left WAPA with insufficient funds to perform required maintenance at the appropriate time. The RFM was established with the anticipation that it would provide significant relief to consumers through lower LEAC rates, through more efficient operation of the generating equipment when rehabilitated. The RFM is funded by PSC-approved rates charged to consumers through the LEAC at the rate of $0.023 per kWh. As with the Management Audit, WAPA has indicated in discovery in the most recent LEAC proceeding that it is not undertaking all of the requirements of the RFM, thereby partially defeating the principal purpose of providing the funds.[6] WAPA has the opportunity every quarter to inform the PSC as to how the RFM is working, but had not proactively informed the PSC of any deficit in funding until the response recently received in LEAC discovery.

A third example is WAPA's agreement in Docket #575 (2009 Electric Base Rate Case) to perform a load research study, and acceptance of consumer funding to perform such a study, followed by its failure to do the agreed-to study. This type of activity is not a rare occurrence, but it should be. WAPA's inability to meet its commitments was an

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[6] *Set 1-13* *Are we correct in our understanding of the "Rev & Surcharges" worksheet that WAPA has spent approximately $1.3 million on generation maintenance management activities, performance improvement activities, and spare parts since the inception of the RFM component of the LEAC? If we are correct, why did WAPA fail to undertake the level of activities authorized by the PSC when it approved the Generation Maintenance Stipulation in October 2011—the PSC approved approximately $7.0 million to be spent on these activities over the course of the first twelve months of WAPA collecting RFM surcharge from consumers?*

Response: *Once the rental expenses for the emergency unit is deducted, there isn't enough funds left over to spend the approved amount on maintenance activities. Of the 13.7 million that was collected, 9.5 million was used to pay for the rental of the emergency unit.*

important consideration in reaching our proposal to place within limited purpose surcharges a significant portion of WAPA's base revenue requirement.

Q. YOU INDICATED THAT A MANAGEMENT AUDIT WAS TO BE UNDERTAKEN BUT WAS NOT. WHAT IS THE IMPORTANCE OF A MANAGEMENT AUDIT?

A. A Management Audit is certainly a Best Practice that has been undertaken by utilities in many jurisdictions. They provide for independent evaluations of the operations of the underlying utilities and, depending on the scope, provide recommendations and implementation plans to improve operations and reliability, and reduce cost. A management audit could also provide independent advice to management and the WAPA Board of recommended improvements in policy. Generally the recommendations, if implemented, result in savings many times to cost of the audit. The Management Audit was not implemented, even though it was part of the final rate Stipulation in Docket 575. As a result, the PSC action to get the benefits of the audit for WAPA and for consumers was frustrated.

Q. YOU ALSO MENTIONED THAT WAPA HAS NOT PETITIONED FOR ADDITIONAL RATES SINCE DOCKET 575 IN 2009, IN SPITE OF THE CFO INDICATING THAT WAPA HAD SUSTAINED SIGNIFICANT LOSSES IN MOST OF THE INTERVENING YEARS. CAN YOU COMMENT ON THE SIGNIFICANCE OF THIS FAILURE TO ACT?

A. Yes. First, it is the duty of the utility to petition for the rates that it deems necessary to run the utility in a reliable and safe manner, and to provide service at a reasonable cost.

WAPA did not petition for additional rates in this timeframe during which most consumers would state that service has not been reliable and the costs have been extraordinary. Testimony from the Executive Director indicates that WAPA refrains from asking for the full amount that can be justified on the basis that it provides savings to its ratepayers from doing that.[7] This is a terribly false saving.

As noted above, the PSC has had to approve an infusion of $16 million annually to WAPA through the RFM to provide for necessary generating unit rehabilitations, much needed deferred maintenance, spare parts, and to lease a new temporary trailer mounted generator to provide adequate capacity and some reliability while the maintenance activities are undertaken and to anticipate significant LEAC savings as a result of these activities. At the same time, WAPA is passing on to customers increased fuel costs through the LEAC that it is incurring as a result of having not properly and timely performed required generation unit maintenance. In the joint Stipulation between WAPA and the Technical Consultant (GCG) that was presented to the PSC in support of requesting approval of the RFM stipulation and associated funding, it was estimated that RFM implementation would produce annual benefits through more efficient power production of $50 million after the program was completed. However, the Authority has stated that it is not fully meeting the requirements of the RFM. Stated another way, the stay-out by WAPA of requesting the necessary funds as well as government customers not paying their bills on time,[8] resulted in liquidity problems that resulted in non-timely

[7] Hugo Hodge testimony at page 15: *The Authority is purposely requesting a level of rate relief that is below the level required for long term financial stability of the Electric System in order to minimize the rate increase to our customers at this time. This is being done in recognition of the current difficult economic conditions and high cost of fuel.*

[8] Hugo Hodge testimony at page 4: *extremely slow payment of electric bills by certain Government entities which has resulted, until recently, in an increase in total accounts receivables;*

and deferred maintenance that is costing consumers $50 million in additional fuel costs that could have been avoided.

Q. WHAT CONCLUSIONS DO YOU DRAW FROM THE ABOVE AND WHAT ARE THE IMPLICATIONS FOR THIS CASE AND YOUR RECOMMENDATIONS?

A. We draw several lessons from the above:

1. WAPA has a demonstrated history showing it cannot be relied on to keep its commitment to Stipulations that it has signed and presented to the PSC.
2. The PSC's obligations are to represent and balance all the interests before it: the consumers; WAPA; and the Virgin Islands.
3. The notion that it does not request sufficient rates to fulfill WAPA's obligations is a false economy. The demonstrated result is poor service and high rates.
4. Revenues granted by the PSC should be directed to specific actions required of WAPA and should be frequently reviewed to ascertain that the required activities are indeed being undertaken and in the absence of compliance the PSC should use it authority to require compliance.

The guidance that this provides for this case is that the rate award should be targeted to specific actions required of WAPA that are essential to providing reliable service to consumers. As we will develop and discuss in more detail in our testimony, revenues should be granted to:

- specifically cover maintenance identified to improve reliability and efficiency;
- for deposit into a self-insurance fund up to a cap that is identified by an appropriate risk study;

- for deposit into an OPEB escrow account so that the funds provided are used only for these purposes;[9]

The rates provided for these three streams are critical for the provision of safe and reliable service and to enable WAPA to meet key obligations. Therefore we recommend that the adequacy of these rates be visited annually, and any required adjustment to increase or decrease these rates should be undertaken at that time and the compliance of funding restricted accounts should be reviewed. This would minimize the cost risk to consumers and maximize the probability of implementation of the programs.

Q. WHAT IS THE BASIS OF WAPA'S REQUEST FOR ADDITIONAL REVENUES IN THIS PROCEEDING, AS EXPLAINED BY WAPA?

A. WAPA's need for additional revenues is provided overall by Executive Director Hodge at page 4 of his testimony:

> *In the approximately three years since the Authority received a rate increase in 2009, several things have caused a revenue shortfall for the Authority. Specifically, the Authority is experiencing: (1) less than required revenues due to the approval by the PSC of a lower amount than requested in the 2009 rate case; (2) continuing increases in expenses, including operating expenses and fuel costs, and a regulatory lag in recovering those costs; (3) less than anticipated growth in energy sales in FY 2010 and negative growth in energy sales in FY 2011 and FY 2012; (4) increases in required debt service payments as a result of the issuance of the 2010 Bonds and the 2012 Bonds; (5) extremely slow payment of electric bills by certain Government entities which has resulted, until recently, in an increase in total accounts receivables; and (6) an increased amount of money owed to the Electric System by the Water System.*

[9] WAPA was to provide information on Board action regarding the setup of a restricted account but has not provided the information to date.

The first reason, of not receiving sufficient relief in the last rate case when WAPA stipulated to the amount awarded, does not make sense. The PSC awarded WAPA in the last rate case the exact amount in the stipulation that WAPA approved and recommended to the PSC. In addition, as pointed out above, nothing has prevented WAPA from requesting additional relief in the intervening years.

For items (2) and (3), all utilities face increases in expenses and the risk of declining sales. Some of this should be addressed by management action to manage the impact through cost reductions and, if it is determined that additional revenues are needed, as WAPA claims they are in this case and have been prior to this case, then WAPA has the right and responsibility to petition for additional revenues.

With regard to (5), slow pay by government entities, WAPA indicates that despite its best efforts the receivables increase, depriving it of much needed cash. When this causes liquidity problems for WAPA, consumers should be told that while they pay their bills on time, government agencies do not, and such delays in payment by a large customer has consequences. These consequences are the deferral by WAPA of required and, in some cases previously deferred maintenance, resulting in unreliable service and extremely high costs due to the unavailability of generating units and the need to rely on more inefficient units. Prior to the start of every year the Legislature should ensure WAPA and consumers that each agency has been provided sufficient funds to pay their utility bills. This should occur though an annual certification process that would ensure consumers that gone are the days of poor service and higher costs resulting from government entities not paying their utility bills in a timely manner. At the next legislative hearing and annually thereafter, WAPA should provide a history of each

Agency's consumption, bills and payments, and request that full funding for each agency be provided and that a process to provide for direct payment to WAPA be implemented.

While we are very supportive that WAPA be paid timely by government customers, we have not seen WAPA put forward a proposal to the PSC to institute a late payment penalty or interest fee on slow-paying government customers, to be paid exclusively by late-paying government customers. Instead, in this proceeding, WAPA has proposed an adjustment that would raise rates for all consumers, including the vast majority who pay their bills on time, due to the burden of government accounts receivables. This is simply inequitable and bad regulatory practice, and should be rejected.

Item (6), amounts owed to the electric system from the water system, is also a major puzzler. While the electric system is testifying here that it has experienced operating losses for several years and that it is chronically short of cash, causing it to defer the required maintenance of critical generating equipment, resulting in increased fuel costs that it has recovered through its LEAC rates, it somehow during this same period rationalized that it should make loans of approximately $10 million to the water system! This gets even more interesting, in that the water system includes as a revenue requirement in the current proceeding a payment of approximately $1.6 million, representing a payback to the electric system over 6 years. No corresponding benefit to the electric system of $1.6 million is made in the electric base rate case, which would have the effect of reducing rates in this case by the same amount. We assume that this is just an oversight and have pointed this out to WAPA, but have not yet received any feedback as to whether they intend to adjust their electric rate increase request for the anticipated payments from the water system.

Q. ARE THERE OTHER DIFFERENCES BETWEEN THE PRESENTATION OF THE ELECTRIC AND WATER BASE RATE REQUESTS, AND IS THERE ANY EXPLANATION OF THE DIFFERENCES?

A. Yes, there are several important differences between the methods used in the development of the rate requests for the two systems. First, the base year, or "Test year" is different between the two. The Test Year is the foundation from which the revenue requirement is determined. For the electric case the actual audited results for FY 2011 are used as the test year starting point. For the water case the budget for FY 2013 is used. No real explanation has been provided for the difference. We point out that for the determination of the amount of emergency relief for the electric system, the FY 2013 electric budget was the basis. Further as we will develop in each of our testimonies in the electric and water rate cases, the "standard" upon which WAPA relies to determine the amount of relief requested is different.

Q. HAS WAPA STATED THE APPROPRIATE STANDARD FOR THE DETERMINATION OF THEIR RATE REQUEST?

A. Not clearly. In response to set 1-19A, WAPA seems to state that its filing is based on a coverage standard.

> *Based on Ex. CS-1 p.1 Line 45, and page 17 of Mr. Shepard's testimony the Authority affirms that it has based its revenue requirement claim on a desire to achieve a senior debt coverage of 2.58 and subordinated debt coverage of 1.73x adjusted test year costs.*

However, the testimony of CFO Julio Rhymer indicates that its rate request is tied to a computation of a cash deficiency total for the years 2009 through 2012.[10] The relevance of 2009, 2010 and 2011 data is questionable. The revenue requirement development witness, Craig Shepard, does not use any of the cash deficiency information to determine the revenue requirement. More importantly, the PSC has never used such a standard nor has any jurisdiction with which we are familiar.

Q. WHAT STANDARD HAS THE PSC SET FOR THE DETERMINATION OF REVENUE REQUIREMENTS?

A. The PSC must in general set rates that are sufficient to enable WAPA to provide safe and reliable service at reasonable rates. WAPA is not regulated on a "rate base rate of return" methodology. Rather, given that it is a public (government-owned) utility and has no direct stockholder, other than the government of the U.S. Virgin Islands, WAPA is regulated primarily on a Debt Service Coverage Ratio (DSCR) basis, while ensuring that there is also sufficient cash available to meet WAPA's prudent obligations.

Q. HAS A COVERAGE STANDARD BEEN ESTABLISHED FOR WAPA IN PRIOR PROCEEDINGS?

A. In Docket #533, WAPA sought a rate increase based on a 2.0x coverage standard. The Commission found that increasing the coverage from 1.75x to 2.0x would provide

[10] Rhymer testimony at page 7: *The total cash shortfall resulting from these adjustments is $43,523,000. The Authority's request is approximately 41 percent of this amount ($18,000,000); in effect, a two to three-year recovery period.*

minimal benefit to consumers, while imposing on them a substantial and unnecessary cost.[11]

After the conclusion of the rate investigation in 2003 (Docket # 533), WAPA issued subordinate bonds. The PSC set a standard of 1.50x coverage for WAPA's subordinate bonds.[12] The current rate proceeding logically should implement and respect the prior PSC decisions. Rather than implementing the agreed and adopted standards, in this case WAPA seeks to apply a 1.75x debt service coverage standard on all outstanding senior and subordinate bonds. This is easily seen in the following table showing the calculation of "coverage" as presented by WAPA witness Craig Shepard (Exhibit CS-1):

DEBT SERVICE COVERAGE	
Senior Bonds	2.58
Total Senior Bonds and 2007A Subordinated Bonds	1.73
Total "Debt Service"[13]	1.48

Q. DO YOU BELIEVE THAT THE DSCR STANDARDS AS DEVELOPED BY THE PSC FOR SENIOR AND SUBORDINATE BONDS ARE STILL APPROPRIATE IN THIS PROCEEDING?

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11 In the emergency portion of the Water Department rate proceeding (Docket 576), WAPA alleged that the standard of 1.75x coverage found for the Electric Department in Docket #533 should be the same standard that the PSC should set for the Water Department.

12 PSC Order 22/2007, Docket #533, Ordering paragraph #5.

13 This includes:
<u>Third Lien Subordinated Debt</u>
Line of Credit (LOC)
General Obligation Notes

A. Yes, as a starting point. In addition, a review of the adequate cash requirements has also been undertaken. As we will show later, our recommendation in this proceeding will exceed the standards set by the PSC because of revenue requirement considerations other than coverage. When all of the debt issues are looked at in aggregate, as it must in a rate proceeding, then all of the requirements must be met and increased rates provided. This requires that the recommendations now look at the PSC standard as being met or exceeded. The standards that we have looked to in making our overall recommendation in this proceeding are that the minimum ratios required by the Authority's bond indentures must be exceeded by a margin to provide for a cushion against contingencies, and to provide for a stronger financial picture when evaluated by the financial community. The requirements of the indentures and the results of our recommendations are in the table below:

DEBT SERVICE COVERAGE

	GCG Recommendation	Indenture Requirement
Senior Bonds	2.02	1.25
Total Senior Bonds and Subordinated Bonds	1.25	1.15
Total "Debt Service"	1.05	1.00

As mentioned above, there is a need to provide some cushion over the total debt service requirement that drives the coverage on senior bonds and the total senior and subordinate bonds to exceed the targets set by the PSC.

Q. PLEASE EXPLAIN WHAT COMPRISES THE DEBT OTHER THAN SENIOR AND SUBORDINATE BONDS?

A. These are comprised of lines of credit acquired by WAPA for working capital and a general obligation (GO) note that was acquired originally to finance a large balance in deferred fuel, as a result of a combination of either poor actual performance of the WAPA generating units and / or overly aggressive forecasting of generating unit performance, and the resulting large fuel bill payable for fuel to HOVENSA due to higher levels of fuel consumption. The GO note did smooth out the payment that would have been required of consumers over a short period of time for the poor performance of WAPA's generating units, which WAPA has alleged was caused by deferred maintenance resulting from slow collections of government bills. Meanwhile, consumers have been making payments for the GO Note through the LEAC rates for some time, and in this case there is an additional requirement to provide coverage for that obligation.

With regard to the lines of credit (LOC), WAPA does not seek PSC approval in acquiring the LOCs and does not seek approval for the projects financed with the LOCs. In 2007, the PSC requested and WAPA provided a Statement of Policy with regard to its Lines of Credit.[14] As can be seen from the policy, there is no role for PSC approval,

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[14] ***VIRGIN ISLANDS WATER AND POWER AUTHORITY***
ELECTRIC SYSTEM LINE OF CREDIT
CAPITAL PROJECTS

SUGGEST WE DELETE THE TITLE AND JUST START WITH THE STATEMENT OF POLICY

STATEMENT OF POLICY

Policy Statement: *It is the policy of the Virgin Islands Water and Power Authority to govern the use and administration of the proceeds of the Electric System Capital Projects Line of Credit. This policy ensures that all federal and territorial statutory requirements with respect to incurring debt for all capital purposes and the issuance of debentures and prescribed financial instruments for or in relation to the debt have been complied with by the Authority. Furthermore, this Policy will in no way supersede those specific rights and authority vested by law to the Governing Board and/or executive officers of the Virgin Islands Water and Power Authority.*

although it states that WAPA assumes that the PSC will provide rates for the underlying borrowing and for subsequent financing if the LOCs are refinanced into long-term bonds. This is another area where the current legislative requirements for the PSC prohibit normal review that is required in most jurisdictions, which forces the PSC into the role of providing a rubber stamp or the outright denial of the inclusion of all or a portion of the obligation in revenue requirements.

Q. ARE THERE ANY OTHER AREAS OF IMPORTANCE THAT YOU WISH TO ADDRESS?

A. Yes. In this proceeding, WAPA states that it wishes to include the impact of two "future" financings. The first is a projected US Department of Agriculture Rural Utilities Services (RUS) financing with a debt service of $1.006 million and another future more traditional bond issue with an annual debt service of $1.578 million. WAPA's position is that both of these future issues should be provided for in rates from this proceeding with a full

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Purpose*: The Electric System Capital Projects Line of Credit Proceeds shall provide the Authority with necessary funds for the capital project costs of water and electric production, distribution systems and related facilities.*

Uses of Funds: *The Capital Projects Line of Credit proceeds shall be applied to the Authority's purpose(s) as specified in the respective Loan Documents and Security Agreements. However, unless otherwise stated, the Authority reserves the right to modify, supplement or amend the use of these funds upon notification and filing with the Bank(s) and Bond Council; PROVIDED that the Governing Board for the Virgin Islands Water and Power Authority has previously approved such modifications, supplements, and amendments. Furthermore, the Capital Projects Line of Credit proceeds shall be managed in a manner consistent with other long-term planning, financial and management objectives.*

Sources of Repayment: *All loans obtained under the Electric System Capital Projects Line of Credit shall be repaid from rate revenue funds and/ or from the proceeds of bond financing, whichever comes first, and as authorized by the Governing Board of the Virgin Islands Water and Power Authority.*

Project Account: *Capital Project Line of credit withdrawals shall be deposited into an identified Project Fund Account. Withdrawals from these accounts shall be for payments relative to the purpose of the projects in accordance with the contracted payment plan.*

DSCR of 1.75 times. The increased rates requested related to this item are therefore approximately $4.522 million.

We recommend that these items be provided for in a different manner. First, details on these financings are sketchy and certainly do not rise to the level of certainty for inclusion in a base rate proceeding. For the RUS loan, there has been very little information shared with the PSC and it is unknown how current US government sequestration policies may impact this funding source. In spite of our request and assurance that it would be provided, the WAPA application and supporting information to the RUS have not been provided to us. In addition there is a possibility that some or all of the loan could be provided in the form of a grant that would not have a revenue requirement impact nor require increased rates.

For the future bond even less information has been provided concerning the projects to be paid by the underlying the financing. There is no firm date for the financing, no draft financing documents, no list of projects, uses and purposes, and no summary of discussions with underwriters or financial advisors. The Public Services Commission has previously shown a willingness to work with the Authority when such financings are sufficiently specific for the Commission to make the necessary determinations on reasonableness and prudency (see, e.g., Dockets 533 and 588).

There typically is also a period of time following the issuance of long-term debt in which interest costs are capitalized, during the period when the projects are under construction, so that rates can be initiated when the projects are operational and benefits are being derived concurrently with the rates. We recommend that the PSC express a policy that rates will be provided for financing determined to be necessary, and that rates to consumers will be implemented at the appropriate time, when the required information regarding the financing and projects is provided. Depending on the specific situation, the PSC could provide for rate approval prior to the financing being undertaken in order to provide for support in the marketing of any debt issuance.

Q. HAS WAPA ADEQUATELY ADDRESSED THE ISSUE OF IDENTIFYING THE PROJECTS REQUIRED AND THE SOURCES OF FUNDING OVER SOME REASONABLE PERIOD OF TIME?

A. No. This is a very important issue and goes to the heart of WAPA's mandate, as well as the PSC obligation to provide adequate rates. There are well-established industry formats that should be used to provide acceptable data. WAPA has been recently preoccupied in catching up with deferred maintenance in attempting to provide reliable service, as well as locating an alternative fuel to oil and the related projects. The condition of existing plants has caused a crisis throughout the WAPA organization. This seems to have taken the focus off the normal planning that should be undertaken, especially in the area of power production.

For WAPA, a crisis scenario is not a new phenomenon. WAPA's requests to purchase Units 22 and 23 in the late 19902 and 2000s on St. Thomas were both petitioned for under "emergency" conditions. Generation was unreliable and the purchase and installation of a new combustion turbine was seen to be the "only" solution that could be implemented in a timeframe to avoid rotating blackouts. Since their installation, these units have had a checkered history of performance. The purchase of unit 22, the second newest unit, has been criticized by successive WAPA managements as not being the appropriate choice for WAPA. Unit 23 was the subject of much litigation, when the PSC questioned the effects on dispatch and reliability of inserting such a large unit into the generation for St. Thomas/St. John – a problem that has come to fruition in the past several years. Normally a utility the size of WAPA would have an ongoing capital budgeting program, inclusive of an integrated resource plan (IRP), for capital projects that would guide their planning. We do not believe that such a plan exists for WAPA. Recently the Executive Director indicated that WAPA would be embarking on producing an IRP. While this is a very positive step, if it happens in a timely manner, no details have been provided or made available to the PSC, consumers, or other stakeholders.

With regard to financing, we have discussed the uncertain nature of the proposed future bond issue and RUS loan financing. In addition, discussions with CFO Rhymer indicate that WAPA is studying the possibility of securitization of the revenues from the gasoline tax recently imposed by the VI government. These revenues are estimated to be approximately $6 million annually, and as we understand the law, can only be used for WAPA power production projects that improve efficiency and fuel diversification. Under appropriate conditions this could provide the revenue stream for a sizable bond issue. Depending on generation technologies, this could easily fund tens of megawatts of new generators.

In order for the PSC to make an informed decision on providing adequate rates for capital projects, all of this information is necessary and should be provided before rates to support any bond issues should be approved.

Q. DO YOU HAVE OTHER PLANNING CONCERNS THAT HAVE NEGATIVELY IMPACTED VI UTILITY CONSUMERS AND, IF SO, PLEASE SUMMARIZE THESE CONCERNS AND ANY RECOMMENDATIONS?

A. Yes, we have a number of planning concerns that we believe have adversely impacted VI consumers. In a government-owned utility like WAPA, ineffective planning results in a situation where consumers are ultimately responsible for any planning failures—there are no private shareholders to absorb the risks of these failures. Clearly, WAPA's power production facilities are not fuel diversified (100% dependent on oil), and are highly inefficient by any reasonable performance benchmark. As a result, VI consumers are exposed to a highly volatile world fuel oil market and the inefficiencies in power production resulting from generation units that are either old and technologically antiquated, not properly maintained, or not properly matched to WAPA's demand profile, and for whatever reason consume far more fuel than should be required to produce electricity.

Improving WAPA's fuel diversification and the efficiency of its existing resources will take considerable effort and capital. The first step is planning. With respect to fuel diversification, WAPA is currently planning on the implementation of a tri-fuel program that will, within a year, incorporate propane into is fuel mix and ultimately Liquified Natural Gas (LNG) as well, leading to an anticipated 30% reduction in fuel prices within the next 12 months. This is a great first step; however, it only addresses part of WAPA's fuel cost equation—fuel price. Left unchanged in WAPA's current plan is the high level of inefficiency associated with WAPA's existing power production facilities—the amount of fuel required to produce a kWh. This has a direct and major impact on the ultimate costs of fuel passed to consumers.

While related to the technological obsolescence of its power production facilities, WAPA's power production inefficiency is really the direct result of WAPA's lack of a formal planning process and timely outputs from such processes to identify proper resource selection (i.e., an optimal 5 to 10-year resource plan inclusive of identifiable production technologies, construction budget and schedule for implementation). While WAPA has undertaken various single-focused planning efforts, it has not undertaken a continuous and comprehensive approach to planning its production facilities—often in regulated markets lacking customer choice referred to as integrated resource planning (IRP). Instead WAPA has relied on planning processes that are more ad-hoc as opposed to well-disciplined with objective criteria of optimal resource selection. Clearly, IRP activities are not an institutionalized process within the Authority. Resource planning is not routinely undertaken or updated nor does there appear to be any rigorous screening criteria (i.e., fuel diversification, renewable portfolio selection criteria, over capacity, reliability, and economics) to determine the optimal resource path[15]. There is no evidence in this proceeding to indicate that WAPA has developed an optimal resource plan that is efficient. Belatedly, WAPA has identified the funding of an IRP process for inclusion in its proposed revenue requirement in this proceeding. This is a positive step and given the impact of power production inefficiencies should be accelerated to the highest priority.

Critical to the development of a successful IRP is the need to address the substantial risks and uncertainties associated with WAPA's existing production facilities.

[15] We must note that Act 7075, however, does impose requirements for renewable energy and fuel diversification. We also note that Act 7075 includes energy planning requirements.

In the development of WAPA's first IRP, it is critical that WAPA incorporate third-party facilitation with considerable public involvement including territory energy agencies, the PSC, customer and industry advocacy groups, project developers, and other stakeholders. The key focus should be on quickly determining a viable resource plan that focuses on a reasonable planning period, and that will identify a highly efficient portfolio of supply-side and demand-side resources that can be implemented in a two to four year timeframe. We recommend that this process begin at the earliest date possible.

Q. BASED ON YOUR COMMENTS HAVE YOU SUMMARIZED THE CONCLUSIONS AND RECOMMENDATIONS OF THE PANEL IN THIS PROCEEDING?

A. Yes we have; they are presented in the next section. As previously mentioned there is an additional witness, Mr. Bruce Oliver, testifying on rate design and cost of service issues. His recommendations will be contained in his stand-alone testimony.

IV. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE THE CONCLUSIONS AND RECOMMENDATIONS OF THE PANEL?

A. We believe that as a result of this proceeding WAPA should be provided clear direction concerning the PSC's requirements for rate relief. The PSC has stated, and we believe that WAPA agrees that WAPA needs to provide consumers safe and reliable service at affordable rates. Further, we believe WAPA does not, at the current time, meet this standard – it does not provide safe and reliable service at affordable rates. This is a problem for consumers, a problem for the Territory and its economic health, and a difficult environment in which to conduct a rate case.

As we stated in the Executive Summary, there is a fundamental difference in understanding of what WAPA's role is or should be. WAPA indicates that in a situation where it receives less than adequate revenue from a rate award over several years, it will simply live within that award and take such actions as deferring required and already deferred maintenance. These actions are taken regardless of whether they cause a significant increase in WAPA's fuel expenses that are passed on to consumers. Similar thinking has also found its way into the petition in this proceeding. WAPA says that it did not ask for all the rates that could be justified. However, there is no indication, or even discussion, of whether the proposed action to put in place lower rates than it could justify will result in higher or lower total cost to consumers in the long run.

Further, in addition to not undertaking actions that would reduce consumers' costs as described above, WAPA in the past has agreed to undertake certain tasks, then has failed to undertake the tasks, but has not informed the PSC of its posture in real time, but only after the fact in a subsequent rate proceeding such as this. This procedure puts on the table a discussion that should have taken place years ago.

Our conclusions and recommendations are as follows:

1. The PSC should establish that it will support all reasonable and prudent revenue requirements of WAPA. Rates will be provided for activities agreed to and the appropriate use of rates will be monitored.
2. The PSC should indicate that it will continue to support reasonable standards for WAPA's access to financial markets on reasonable terms. As such, it should affirm that it will supply adequate revenues to support the indenture requirement for WAPA's debt, which is currently 1.25x DSCR on senior bonds and 1.15x on combined senior and subordinate bonds. The PSC should reaffirm that it will provide revenues adequate to meet a senior bond DSCR of 1.75x and a subordinate DSCR of 1.5x using the methodology previously adopted by the PSC[16]. In addition, in this proceeding, we recommend that a combined senior and subordinate DSCR of 1.25x be adopted.
3. The PSC should closely monitor that revenues awarded are being used as approved by the PSC. This includes all base revenues, LEAC revenues, surcharge revenues for the RFM and maintenance, Other Post-Employment Benefits (OPEB) self-insurance and line loss revenues. For each one of these special surcharges a special protocol should be adhered to as described in the sections following.

[16] This will meet and exceed the minimum requirement of the indenture. However, that assurance is limited to those bonds and debt instruments for which the PSC has provided prior approval. It should not be assumed that the PSC will automatically approve for inclusion under these DSCR standards or under the prudence and reasonableness tests debt not subject to prior approval.

4. For the RFM, we recommend that the current surcharge should be combined with all other maintenance required by WAPA. This proceeding includes in rates $16.65 million of RFM revenues and $16.9 million of maintenance expense[17]. A maintenance surcharge for the combined amount of approximately $33.56 million should be established, and the RFM protocol should be expanded to include these revenues. No change should be made to the requirements for the surcharge; there should continue to be depositing of surcharged maintenance revenues in a separate account and withdrawing only for the purposes of maintenance. The surcharge should be reviewed quarterly to determine the adequacy, and adjusted as required. This proposal is being made to appropriately fund all maintenance, which WAPA has discussed as being key and absolutely essential for efficient generation, and which WAPA has been unable to undertake in the past.

As part of this proposal to adequately fund, and keep funded, all maintenance between rate cases, WAPA should provide no later than February 15, 2014 a detailed maintenance plan based on both WAPA analysis as well as independent advice. Such a plan should also provide for performance improvement projects (PIPs), and for capital improvements projects (CIPs) tied to routine maintenance. There should be quarterly reviews provided to the PSC during each LEAC hearing, with an assessment of performance of the plants and the conduct of the maintenance and PIPs and

[17] $16.65 million from WAPA Ex. CS-1 p.1. $16.9 million of maintenance is from July 2012 monthly financial report, data for FY 11.

CIPs. Quarterly, the funding requirements should be reviewed and rates adjusted if necessary.

5. For OPEB, we recommend that all the OPEB-related revenues in this proceeding be deposited into a separate account from which the pay-as-you-go requirement can be withdrawn. The revenue requirement associated with OPEB in this proceeding is $5.269 million [see Exhibit GCG-4]. Quarterly reports for the separate account should be provided at LEAC hearings and rates adjusted annually, as required.

6. For self-insurance, the PSC should authorize the re-initiation of a surcharge. Weather-related activity has been severe and it is prudent to provide for resources. WAPA's proposal to collect $1.310 million annually should be adopted, but the amount should be collected through a surcharge and not base rates. These revenues should also be deposited in the already established separate self-insurance fund account. We recommend that the parameters of the fund and the protocol for use of funds be revisited. We recommend that WAPA provide, by February 15, 2014, a study to determine what the floor and cap of the fund should be based on an appropriate risk analysis. WAPA and the Technical Consultant should work collaboratively to agree to a set of protocols for the operation of the self-insurance program that should be recommended to the PSC for adoption.

7. WAPA should provide to the PSC no later than April 1, 2014 a plan for financing its capital program. Specific actions requested for bond or RUS financing must be accompanied by a detailed filing of the projects being

financed, summary of discussions with financial advisors and underwriters, estimated financing rates and pro-forma financial projections, terms and conditions, and draft Preliminary Official Statements (POS), if available. The filing should detail what specific rate actions, if any, are or will be requested of the PSC.

8. The PSC should state explicitly that rate applications should be made when necessary, and not wait for an arbitrary three or five year term.

9. We are recommending a total base rate increase in this proceeding of $12.25 million, as compared to the requested increase of $26.6 million. This is a 17.4% increase over existing base rates (measured excluding the interim rate increase). Including the rate increase, we are recommending non-fuel revenues of $85.1 million, of which we recommend that a substantial $41.9 million be collected subject to surcharges [see Exhibit GCG-10]. We believe that this significant level of surcharged revenue will motivate WAPA management to undertaking the actions that are necessary to begin to move toward achieving the appropriate utility standard of safe and adequate service at reasonable rates, and to provide the Commission with the information necessary to perform its duties in moving toward that status, as well.

10. The coverages produced by our recommendations exceed WAPA bond indenture requirements and exceed the standards set by the PSC. The PSC should explicitly state its commitment to support the surcharge policy until such time as normal efficient operations of the generating equipment is achieved by WAPA. The coverages are as follows:

DEBT SERVICE COVERAGE

	GCG Recommendation	Indenture Requirement
Senior Bonds	2.02	1.25
Total Senior Bonds and Subordinated Bonds	1.25	1.15
Total "Debt Service"	1.05	1.00

The DSCR for senior debt proposed under our recommendations is well above the existing PSC standard of 1.75x. This is necessary, because in order to get the coverage for all debt service to a reasonable level of 1.05x in this proceeding, additional revenues are required above a DSCR of 1.75x on senior bonds. The PSC should make clear that WAPA should not expect automatic approval of the total LOC funding level unless the rates for the projects included therein have been approved by the PSC. (See Fn. 16, above)

11. The PSC should adopt and send a Resolution to the Legislature that there are specific actions that the Legislature can take to reduce utility costs to consumers. These actions include full funding of utility bills for all departments of government, so that there are funds available to pay their bills on time. It should be made clear that late payment of bills is a completely false economy when viewed from the impact on consumers. WAPA's deferral of maintenance has cost consumers tens if not hundreds of millions of dollars through increased LEAC rates, to say nothing of poor utility service, and continues to do so.

12. Charging WAPA customers for the interest associated with the late payments of government accounts is not fathomable. This asks customers who pay their

high cost bills on time under harsh economic conditions to pay for the interest costs of the government, which does not pay its bills on time. The proposal should be denied.

13. The PSC should ensure that commitments made by WAPA in prior stipulations are honored. This includes conducting a Management Audit with the terms and conditions previously agreed to. As with our other recommendations, the PSC should make clear the consequences of not complying.

The development and details of the issues and related adjustments that we have made to WAPA's petition are contained in the following sections of this report. All of our calculations have been provided to WAPA in executable workbooks and comprise all of our work-papers relative to this testimony.

Q. HAVE YOU EXAMINED HOW YOUR RECOMMENDATION AFFECTS WAPA'S CASH FLOW AND EARNINGS?

A. Yes, we have. As shown on Exhibit GCG-2 line 46, we estimate that the amount available for capital improvements, including our recommended rate increase and expense adjustments, will be $4.3 million, which is comparable to the $4.3 million that WAPA calculated would be available in its filed position. This does not include the estimated $6 million per year available through the gasoline tax.

The Fiscal Year 2013 budget assumed a rate increase of $11.25 million and projected positive net income. We are recommending that the Commission grant a rate increase that is greater than the budget assumed. Accordingly, we believe our position, if accepted by the Commission, will produce positive net income.

Q. AFTER ACCEPTING, REJECTING OR MODIFYING THE TEST YEAR AND ADJUSTMENTS AS YOU DISCUSS IN THIS TESTIMONY, WHAT IS YOUR CONCLUSION?

A. We conclude that WAPA should be provided a rate increase that achieves total base revenues of $85.087 million. [See Exhibit GCG-2 lines 1 and 2a. through 5, and Exhibit GCG-10 line 5]. Of this amount, we recommend that $43.195 million be collected as permanent base rates and $41.892 million be collected as surcharges, subject to adjustment (higher or lower) in future annual proceedings in which WAPA justifies its actions and expenses with respect to the surcharge areas:

- Line Loss
- OPEB
- Self-insurance
- Maintenance and RFM

Q. WHAT LEVEL OF RATE INCREASE RESULTS FROM YOUR RECOMMENDATION?

A. At this time, as identified in Mr. Oliver's testimony, there is a very significant issue relating to the calculation of revenues, based on multiplication of existing rates by billing determinants.[18] This is an issue that WAPA has been asked to address but which, thus far, it has failed to do satisfactorily.

In the format of WAPA's filing, our recommended position would increase rates by $12.25 million over those in effect prior to the interim award. From the perspective of the panel's position, which has as its purpose the determination of WAPA's total revenue requirement, it is not necessary to have a highly accurate calculation of WAPA's revenues, because the panel recommendation of revenue requirement is based on operating expenses plus an appropriate allowance to cover debt service. Accordingly, while we propose adjustments to revenues in our testimony, the Commission should refer to Mr. Oliver's testimony for a complete discussion of all revenue-related issues.

[18] WAPA has agreed that it had a programming error in its calculations as filed with its petition. Updated information provided still raises serious question with regard to the calculations and will be dealt with in the testimony of Mr. Oliver.

V. FISCAL YEAR 2011 TEST YEAR AND ADJUSTMENTS

Q. WHAT IS A TEST YEAR?

A. A test year is a twelve month period used to calculate operating results for the utility on a normalized basis. The purpose of the test year is to investigate the total revenue requirement of the utility based upon the ongoing level of expenses and other financial requirements of the utility. The test year should reflect a level of efficient operations and the costs required to maintain and operate the utility in the test year and should be representative for a period of time thereafter.

Q. WHAT TEST YEAR DID WAPA USE IN THIS FILING?

A. WAPA chose Audited Fiscal Year 2011 (July 1, 2010 – June 30, 2011)[19]. This creates a significant lag in information between the timing of the data and the increase based on such data, considering the fact that WAPA's new rates, if approved by the PSC, will not go into effect until sometime during Fiscal Year 2014.

Q. HOW DID WAPA PREPARE ITS TEST YEAR INFORMATION?

A. WAPA's filing starts with the assumption that Fiscal Year 2011 was a representative indicator of its operations on an on-going basis. With that as the premise, WAPA made sixteen adjustments to that information to reflect conditions that it believes have changed since 2011. This is a common technique and is generally acceptable when historic data is stale and done in conformance with established regulatory precedent.

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[19] At the time the WAPA electric department filing was being prepared, the Authority did not have the final audited results of Fiscal Year 2012 which has since been received and provided in this proceeding.

Q. PLEASE DESCRIBE THE ADJUSTMENTS PROPOSED BY WAPA TO THE FISCAL YEAR 2011 FINANCIAL RESULTS.

A. We have replicated the WAPA exhibit showing the impact(s) of the sixteen adjustments as shown on Exhibit GCG-3, pages 1 and 2. The PSC should note that several of the proforma adjustments reflect decreased sales. While some of this decrease may be caused by the soft economy in the Territory, we believe it also is reflective of the elasticity of rates that are excessive and service that is of poor quality and sometimes not available. Given the options available to consumers, who may have expended considerable sums on energy saving equipment and / or independent generation, it is an open question how much of these decreased sales can be recaptured if WAPA ultimately succeeds in lowering costs. At the present, we are discussing a further rate increase, which will only exacerbate such losses.

Q. DID YOU PROVIDE AN ALTERNATE SUMMARY EXHIBIT FOR FISCAL YEAR 2011?

A. Yes, we did. On Exhibit GCG-2, we begin with WAPA's adjusted position, but then further adjusted it to correct omissions, and to present adjustments to WAPA's position.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS THAT YOU PROPOSE IN THIS PROCEEDING.

A. We propose nine adjustments to WAPA's revenue requirement. In addition, because of the manner in which WAPA presented certain information that does not affect coverage, but which does affect cash flow, we have proposed several adjustments that affect cash flow without directly affecting the revenue requirement.

The revenue requirement adjustments that we propose are:

		Revenue Requirement
	Revenue increase per Authority	
1.	Interim	$ 8,600,000
2.	Base rate case	18,000,000
3.	Total rate increase	$ 26,600,000
4.	Classify OPEB, self-insurance and PILOT above the line	7,897,643
5.	Set subordinate debt coverage at 1.50x	(14,544,918)
6.	Set combined senior/subordinate coverage at 1.25x	2,008,620
7.	Eliminate debt service cost for RUS and future loans	(3,230,428)
8.	Reduce debt costs to FY13 levels	(1,105,794)
9.	Reduce OPEB accrual to current FY 2014 levels	(2,488,166)
10.	Apply kWh sales adjustment applies to revenues billed on kWh sales	(464,721)
11.	Eliminate IDE personnel cost	(2,298,127)
12.	Use load research reserve to offset part of cost of other studies	(120,000)
18.	Recommended increase	$ 12,254,109

Q. PLEASE BRIEFLY SUMMARIZE THE ABOVE ADJUSTMENTS.

A. **Classify OPEB, Self-Insurance and PILOT above the line**

While WAPA's schedules reflect an expense for the above three costs, the manner in which WAPA calculated revenue requirement excludes those costs from the revenue requirement. That is because those costs are not included in WAPA's DSCR calculation, and the revenue requirement is based on a DSCR calculation [see next section]. We recommend that the Commission allow these costs in rates and include them in the calculation of the revenue requirement using a DSCR formula. Accordingly, as shown on Exhibit GCG-2, while we have retained the same line numbering as used in WAPA's summary schedules, we have moved lines 39 through 41 up, so that they are included in total operating expenses and, thereby, subtracted from revenues in calculating the "total available for debt service", which is the numerator in the coverage calculation.

<u>Set subordinate debt coverage at 1.50x</u>

As will be discussed more fully in the following section, WAPA has proposed to set rates by applying a 1.75x coverage requirement to the combined value of senior and subordinated debt. This is contrary to prior Commission precedent, and inflates the rate increase. We recommend that the Commission continue to apply the standard of 1.75x coverage for senior debt, and 1.50x coverage for subordinated debt.

<u>Set combined senior/subordinate coverage at 1.25x</u>

Under WAPA's Senior Bond Resolution, the authority is required to maintain coverages of: (1) 1.25x on senior debt, (2) 1.15x on combined senior and subordinated debt, and (3) 1.00x on total debt. The Commission previously has set standards for the first, but has not established a standard for combined senior and subordinated debt or total debt. Applying the Commission's previously-established standards to WAPA's debt costs in this proceeding produces a result of an expected combined coverage of 1.00x on total debt. While this meets the Resolution standard, it provides no margin. Accordingly, we have applied a 1.25x combined senior/subordinate coverage, for purposes of this proceeding only, to provide some margin for the total debt combined coverage standard. We recommend at this time that the Commission not adopt this as a firm standard to be applied in future proceedings.

<u>Eliminate debt service cost for RUS and future loans</u>

WAPA's filing includes a total of $2.6 million of debt cost for loans that have not been entered into, or agreed to, with lenders. The filing does not adequately address the uses to which the associated borrowings would be put. Accordingly, we recommend that these speculative issuances be removed from the calculation of revenue requirement in this proceeding. However, we also recommend that the Commission inform WAPA that it is willing to undertake rapid reviews of applications seeking to increase rates for the limited purpose of new borrowings.

<u>Reduce debt costs to FY13 levels</u>

In addition to including the speculative borrowings discussed above, WAPA's filing is based on a projection of Fiscal Year 2014 debt service costs. Based on a comparison of those costs to costs budgeted by WAPA for Fiscal Year 2013, and a presentation that WAPA made in September, 2012, to rating agencies, we believe the Fiscal Year 2014 debt service cost estimate is excessive, and we recommend that the Commission set rates at this time based on the Fiscal Year 2013 budget.

OPEB accrual

In the past, WAPA's expenses for other post-employment benefits has equaled its out-of-pocket cash payments for those benefits. This has caused concern on the part of WAPA's actuaries and auditors, both of whom state that the out-of-pocket expense under-recovers actual costs, which are based on projections of future obligations promised to WAPA's present and past employees. Accordingly, WAPA has requested the full test year OPEB cost as determined by an actuary as an expense in this proceeding. While we agree that the full cost should be in rates, the Fiscal Year 2011 cost that WAPA requests is more than 30% greater than current FY 2014 cost estimations. We recommend that the OPEB allowance in this proceeding be based on the actuary's projection of cost for Fiscal Year 2014.

Apply kWh sales adjustment applies to revenues billed on kWh sales

As noted earlier in this testimony, WAPA has experienced a decline in kWh sales. In making an adjustment to the Fiscal Year 2011 results for this decline, WAPA adjusted not only those revenues that are based on kWh sales, but also those that are based on customer counts and demand—these do not change with kWh sales. We have corrected WAPA's calculation.

Eliminate IDE personnel cost

As the Commission is aware, the water system is converting from the production of desalinated ("IDE") water, to purchase of water from a third-party (Seven Seas) that has been produced by a less expensive reverse osmosis (RO) process. The cost of the electric system personnel who previously worked on the IDE water production equipment was charged to the water system. WAPA now proposes to retain those employees, but to charge them in electric department where there has been no such expense in the past. While we have no opinion concerning the retention of these employees, we believe their costs have not and will not be incremental to the electric system; rather, their costs can be covered best through attrition. In fact, information received from WAPA the day before this testimony was filed shows that our position concerning these employees is extremely conservative. Therefore, we recommend the elimination of their added costs from the electric system revenue requirement.

Use load research reserve to offset part of cost of other studies

In prior proceedings, WAPA has recovered as much as $547,000 to perform a load research study, but has not actually done the study. It has reserved approximately $360,000 for the study. Since WAPA no longer seeks to perform a significant load research study, we recommend that the Commission amortize over three years the $360,000 that has been reserved as a reduction in rates.

a. Debt Service Coverage Ratio

Q. WHAT DEBT SERVICE COVERAGE RATIO ("DSCR") DID WAPA USE IN THE DEVELOPMENT OF ITS PROPOSED REVENUE REQUIREMENT?

A. WAPA's filing proposes a DSCR of 1.73x **on total senior and subordinated debt**. In response to set 1-19, WAPA stated:

> Based on Ex. CS-1 p.1 Line 45, and page 17 of Mr. Shepard's testimony the Authority affirms that it has based its revenue requirement claim on a desire to achieve a senior debt coverage of 2.58 and subordinated debt coverage of 1.73x adjusted test year costs.

On page 17 of his testimony, Mr. Shepard stated:

> *[A]fter giving effect to the requested rate relief, the Authority is projected to have approximately $4,300,000 available for capital improvements and working cash and the Authority is projected to have approximately 1.75 times debt service coverage ratio on senior and subordinated indebtedness.*

It thus appears that WAPA has, as it did in Docket No. 575, requested rate relief based on standards that are significantly higher than approved by the PSC in Docket 533 of 1.75x for senior debt and 1.50x for subordinate bonds.

Q. WHAT COVERAGE IS ACHIEVED IN WAPA'S CALCULATION OF THE REVENUE DEFICIENCY IN THIS DOCKET?

A. With WAPA's proposed rates, the debt service coverage ratios in WAPA's filing are estimated to be:

Senior debt	2.59x
Senior & subordinate debt	1.73x
Total debt	1.49x

Q. IS THE USE OF A 1.75X DSCR ON SENIOR AND SUBORDINATE DEBT AN APPROPRIATE STANDARD TO BE USED IN SETTING RATES IN THIS PROCEEDING?

A. No, it is not. There are several reasons why this is an inappropriate standard. No satisfactory reason, evidence or testimony has been presented as to why the previous standard adopted by the PSC, requiring a 1.75x coverage for senior debt only should be amended. In addition, it is inappropriate to accord to subordinate debt parity treatment with senior debt. Doing so artificially inflates the revenue requirement and provides an additional benefit to the lenders, but without a commensurate reduction in costs to the Authority and its consumers.

The PSC did adopt and set a standard for subordinate debt alone, and this standard was 1.50x coverage measured in a specific way. When the debt service for the senior debt is removed from the earnings available, a DSCR calculated on subordinate debt only can be calculated. In WAPA's filing, that subordinate debt coverage is 3.22x, which is more than double the subordinate debt standard set by the PSC in Docket 533. Approximately $9.8 million of excess revenue requirement is required to provide the 3.22x subordinate coverage, rather than the standard of 1.50x.

Q. WHICH ITEMS INCLUDED IN THE CALCULATION OF WAPA'S DEBT SHOULD BE ELIMINATED PRIOR TO THE RECALCULATION OF ITS RATE REQUEST AT THE APPROPRIATE LEVEL OF COVERAGE?

A. The following items show the debt and associated debt service that WAPA requests be covered 1.75x. The highlighted items in the table should be removed from the calculation and application of the approved coverage standard for senior debt:

Per WAPA

Series 1998 Bonds	$ 0
Series 2003 Bonds	5,000,125
Series 2010A Bonds	6,153,000
Series 2010B Bonds	446,250
Series 2010C Bonds	2,525,000
Series 2012A Bonds[20]	695,600
Future Bonds	1,578,343
Rural Utilities Service Loan[21]	1,006,000
Subtotal Senior Bonds	$ 17,404,318
Series 2007A Subordinated Bonds	**$ 2,879,250**
Series 2012B Subordinated Bonds	**3,842,781**
Series 2012C Subordinated Bonds	**1,846,592**
Subtotal Subordinated Bonds	**$ 8,568,623**
Total Senior and Subordinated Bonds	$ 25,972,941

Based on the prior order of the Commission, only the $17.4 million of senior bond debt service cost is subject to the 1.75x standard, not the entire $26.0 million of senior and subordinated debt service.

Q. HOW DO YOU PROPOSE TO INCORPORATE COVERAGE CONSIDERATIONS IN THE REVENUE REQUIREMENT DETERMINATION IN THIS PROCEEDING?

A. As we prepared this testimony, it became clear that WAPA's issuances of third tier debt, and the debt service cost flowing from that debt, affects the overall coverage achieved on all debt. The indenture calls for a total debt coverage of 1.0x. Setting rates in this proceeding at a level designed to achieve the previously agreed to and Commission-approved DSCRs of 1.75x on senior debt and 1.50x on subordinate debt results in the following coverage ratios:

[20] The 2012 Bonds were issued without prior approval from the PSC, but at this time we are not recommending removing these items from the Senior Debt classification.

[21] Again, we note that the RUS and the Future Bond loans have not occurred, and are recommended for removal from this rate case.

Senior debt	1.92x
Senior & subordinate debt	1.19x
Total debt	1.00x

While the DSCRs relating to senior and subordinate debt exceed the minima in the indenture requirement, the total debt barely achieves the indenture requirement. In these circumstances, we have recommended that the Commission set rates in this proceeding only at a 1.25x standard for combined senior and subordinate debt. This approach produces the following coverage ratios:

Senior debt	2.02x
Senior & subordinate debt	1.25x
Total debt	1.05x

Q. DO YOU BELIEVE THE ABOVE RECOMMENDATION PROVIDES SUFFICIENT COVERAGES FOR WAPA AT THIS TIME?

A. The above coverages, coupled with our recommendation that WAPA should be afforded the opportunity to come before the Commission when it has obtained loan commitments, to seek rate increases to provide additional revenues to cover the costs of the anticipated loans, is sufficient.

Q. WITH YOUR RECOMMENDATIONS, WHAT IS THE COVERAGE ON DEBT?

A. As shown on Exhibits GCG-1 and GCG-2, our recommendations achieve the following coverages:

Senior debt	2.02x
Subordinate debt	1.66x
Senior and subordinate debt	1.25x
Total debt	1.05x

Q. PLEASE EXPLAIN WHY YOUR SENIOR DEBT COVERAGE EXCEEDS THE AGREED STANDARD OF 1.75X.

A. To calculate the required level of revenue requirements and coverages, we apply the same methodology as applied and used in the prior proceeding:

Senior debt coverage = Total available for debt / Senior debt cost

Subordinate debt coverage =

(Total available for debt - Senior debt cost) / Subordinate debt cost

As calculated on Exhibit GCG-1, 1.50 times the cost of subordinate debt is more than 75% of the senior debt cost. As a result, revenues that are sufficient to cover senior debt cost at 1.75x does not provide sufficient income to provide for a coverage of 1.50x on subordinate debt; additional revenues of $2.4 million are provided to achieve the 1.50x standard for subordinate debt. These additional revenues provide additional security for senior debt and produce the senior debt coverage of 1.92x. In this case the standard set by the PSC has been met or exceeded because of the particular requirements in this proceeding.

b. RUS and Future Loans

Q. WHAT IS DEBT SERVICE?

A. Debt service is the annual payment of principal and interest for WAPA's obligation to the bond holders or the banks.

Q. DOES WAPA'S FILING INCLUDE DEBT SERVICE ONLY FOR LOANS THAT EXIST AS OF THIS TIME?

A. No, WAPA has included an additional $1.0 million of debt service for a loan to be obtained from the Rural Utilities Service ("RUS"), and $1.6 million from a future loan.

Q. DO YOU INCLUDE THESE LOANS IN YOUR CALCULATION OF REVENUE REQUIREMENT?

A. No. These loans are speculative as of this time. They haven't been approved by any lending agency and it is apparent that no debt service cost will be recorded in Fiscal Year 2014.

Q. WHAT IS THE STATUS OF THE RUS LOAN?

A. It is our understanding that data has been submitted to the RUS. WAPA officials informed us that there is no indication as to when the RUS will decide on the loan, and the RUS is not required to provide approval under any particular time frame.

Q. WHAT IS THE STATUS OF THE FUTURE LOAN?

A. WAPA informed us that they had spoken to a rating agency concerning the possible future loan issuance, but they also indicated that there is no time line for the loan and that capital market conditions would dictate the timing. There is no indication that WAPA has prepared a financing package including a Preliminary Offering Statement (POS) to support the claimed future loan.

Q. WHAT IS YOUR RECOMMENDATION?

A. We recommend that the Commission determine the revenue requirement in this proceeding without debt service costs for either the RUS or the future loan. In addition, we believe and recommend that the Commission develop a procedure through which WAPA could receive a rate increase, without a full base rate filing, when the debt is issued, so that revenues are afforded to debt at the same time that debt service cost, net of capitalized debt service, begins to affect WAPA's financial condition. Such a proceeding should involve some consideration of changes in WAPA's total debt from this base rate proceeding, so that debt which is extinguished is considered at the same time that new debt is being considered. It should also consider and take into account WAPA's general practice of capitalizing debt service cost for some period during which projects funded by the borrowing are under construction, so that customers do not end up paying rates for costs that are capitalized.

c. Other debt-related cost

Q. EARLIER, YOU STATED THAT THE TEST YEAR FILED BY WAPA IN THIS PROCEEDING IS FISCAL YEAR 2011, WITH NUMEROUS ADJUSTMENTS FOR LATER PERIODS. OTHER THAN FOR THE POTENTIAL RUS AND FUTURE LOANS, DID WAPA FURTHER ADJUST ITS FY 2011 DEBT COST?

A. Yes, it did.

Q. EARLIER, YOU MENTIONED THAT WAPA'S PROPOSED DEBT COST CONSIDERED FOR REVENUE REQUIREMENTS IS BASED ON FISCAL YEAR 2014 INFORMATION. DO YOU AGREE WITH THAT DATA?

A. No, we do not. First, the Fiscal Year 2013 debt service coverage computation provided by WAPA reflects a total debt service, excluding the RUS loan, of $26.798 million, which is below the $27.70 million debt service included in WAPA's filing after removal of the RUS and future loan.

Second, page 36 of the September 2012 presentation that WAPA made to the rating agencies reflects a $27.11 million debt service in Fiscal Year 2014, when adjusted to exclude the RUS loan. This, too, is below the level projected by WAPA in its filing. We have asked WAPA to explain this difference but, as of this time, have not received an explanation.

Q. WHAT IS YOUR RECOMMENDATION?

A. In view of the lower debt service in the Fiscal Year 2013 calculation provided by WAPA and the lower debt service that WAPA has presented to the rating agencies, we recommend that the Commission adopt the Fiscal Year 2013 debt service amount as being appropriate in this proceeding. Any difference to that amount should be considered by the Commission in future applications by WAPA to adjust rates for additional financing costs.

d. <u>Other Post-Employment Benefits ("OPEB"), Self-Insurance and Payment in Lieu of Taxes ("PILOT")</u>

Q. FOR RATE MAKING PURPOSES, HOW DID WAPA HANDLE OPEB, SELF-INSURANCE AND PILOT IN ITS FILING?

A. While WAPA included these expenses in its filing, it did so in such a way that they don't affect the revenue requirement as determined on the basis of the DSCR formula. In effect, in WAPA's presentation, while these costs reduce the "Amount Available for Capital Improvements and Working Capital", line 42 of Exhibit CS-1 p.1, they do not affect the revenue requirement calculated using the DSCR.

Q. HOW DO THESE EXPENSES NOT AFFECT THE REVENUE REQUIREMENT CALCULATED USING THE DSCR?

A. The DSCR formula applied by WAPA is "Total Available for Debt Service" divided by debt service for Senior and Subordinated Bonds. Since the Total Available for Debt Service is calculated without regard to these three expenses in WAPA's presentation and, in particular, since these three expenses do not reduce the Total Available for Debt Service, these expenses do not affect the DSCR or revenue requirement.

Q. DO YOU AGREE WITH THAT TREATMENT?

A. No, we do not. We agree with the inclusion of these expenses in WAPA's rates and believe that not only should WAPA recover these expenses from customers, it should pay or reserve appropriate amounts for them. That is why, particularly for the large OPEB cost, we have recommended a surcharge treatment. If WAPA recovers the expense through rates, but does not appropriately reserve and escrow it, then it should not be allowed to recover it. However, since we recommend that WAPA both recover and pay or reserve the expense, we have included it in our calculation of revenue requirement. As shown on Exhibit GCG-2, lines 39-41 have been moved up between lines 14 and 15, so as to be reductions in the Total Available for Debt Service.

Q. DO YOU AGREE WITH WAPA'S PROPOSED EXPENSE FOR OTHER POST-EMPLOYMENT BENEFITS AS INCLUDED IN REVENUE REQUIREMENTS IN THIS PROCEEDING?

A. No, we do not, for the reason that the amount WAPA has requested is in excess of current cost for OPEB (FY 2013) and in excess of the cost it will incur during the rate-effective period (FY 2014). As shown on Exhibit GCG-4, WAPA's OPEB claim in this proceeding consists of two parts: (1) the pay-as-you-go contribution that it made during Fiscal Year 2011 and which is included in the unadjusted expense, and (2) the excess of total estimated cost over the pay-as-you-go contribution for FY 2011. The total cost that

WAPA seeks to include in this proceeding is $7.8 million for the electric system. That is the cost determined by the actuary for Fiscal Year 2011 [see page A-3 of actuary report, Exhibit 1-27A].

While $7.8 million was the Electric System's cost during Fiscal Year 2011, the actuary's report shows that the cost declined in Fiscal Year 2012 by approximately 40%, and continued at a level substantially below the cost incurred in Fiscal Year 2011. Page 44 of the Fiscal Year 2012 audit report for the Electric System states: "The Authority's annual OPEB cost for fiscal years 2012 and 2011 was $5.8 million and $9.7 million, respectively."[22] Furthermore, while the test year in this proceeding nominally is Fiscal Year 2011, WAPA states, "The proposed rate filing is based on the Historical Period FY2011 actual operating results adjusted to reflect a FY2014 implementation date." [See page 1 of Exhibit A to Electric System Petition]. With regard to a host of expenses, WAPA reached beyond Fiscal Year 2011.[23]

Q. IS THIS REDUCTION IN OPEB REFLECTED ON WAPA'S FINANCIAL STATEMENT?

A. Yes, it is. The accrued OPEB liability in the 10 months ending April, 2013 was $3.07 million, or less than one-half of the accrual in all of 2012, which was $7.04 million.

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[22] For both the electric and water systems combined.

[23] <u>Fiscal Year 2014</u>

Debt Service	Exhibit CS-2 page 6
Other Operating Expense	Exhibit CS-2 page 12

<u>Fiscal Year 2013</u>

Allocation to Water System	Exhibit CS-2 page 11

<u>Fiscal Year 2012</u>

Carrying Costs on Def. Fuel	Exhibit CS-2 page 7

Q. WHAT IS YOUR OPEB RECOMMENDATION?

A. In view of the data provided by WAPA, the cost of OPEBs has declined to a permanent level significantly below that included by WAPA in its filing. While the treatment of OPEBs should differ from WAPA's filing, so that it is included in revenue requirement and actually paid or reserved, the amount that customers pay should be reflective of the actual cost that WAPA will incur during the test period (the period that rates will initially be in effect). Accordingly, we have adjusted the OPEB cost to reflect the lower actual cost in FY 2014.

In this proceeding, WAPA seeks to increase customers' charges for OPEB by $6.1 million. With our adjustment, the increase to charges due to OPEB continues to be substantial, at $3.6 million, which is a $2.5 million smaller increase than WAPA requests.

Q. DOES YOUR RECOMMENDATION PROVIDE FOR RECOVERY OF UNFUNDED PRIOR COSTS?

A. Yes, it does. As shown on page B-1 of the actuary report, the total annual OPEB cost for Fiscal Year 2012 includes an amortization over 26 years of the unfunded actuarial accrued liability. Page A-3 of the report states, "The results presented herein have been derived using the Entry Age Actuarial Cost Method with an amortization of the Unfunded Actuarial Accrued Liability as a level percent of expected payroll. This is the most common such method used for government Pension valuations and spreads the costs evenly as a percent of pay throughout the collective careers of those in the covered workforce." Accordingly, previously incurred but unpaid costs are included in the total amount that we recommend for inclusion in rates in this proceeding.

e. kWh Sales Adjustment

Q. DID WAPA MAKE ADJUSTMENTS TO REDUCE REVENUES AND EXPENSE BASED ON CHANGES IN KWH SALES?

A. Yes, it did. Exhibit CS-2 pages 1, 2, 3, 4, 10 and 15 adjust base revenues, LEAC revenues, line loss surcharge revenues, fuel expense, and the generation surcharge to reflect total system sales in Fiscal Year 2012, which were 4.2% below sales in Fiscal Year 2011.

Q. WHAT ASSUMPTION DID WAPA USE TO MAKE THE ADJUSTMENT TO BASE AND SURCHARGE REVENUES?

A. WAPA started with the Kilowatt Hour ("kWh") sales in Fiscal Year 2011 and compared those to the Kilowatt Hour sales for Fiscal Year 2012. WAPA calculates that the Fiscal Year 2012 sales are 95.78% of Fiscal Year 2011 sales. It then adjusted the base and surcharge revenues in the test year by multiplying that percentage times the recorded revenues from base rates, LEAC rates and Line Loss surcharges. The lost revenues from the Line Loss Surcharge are relatively minor. However, lost base revenues from reduced sales are significant. WAPA estimates that $3.1 million of base revenues are permanently lost.

Q. DO YOU AGREE WITH WAPA'S ADJUSTMENT?

A. We agree that there has been a noticeable decline in sales from 2011. However, we do not agree with WAPA's adjustment, for the reason that it lowers all revenues on the basis of the kWh sales reduction, including revenues that are not billed on the basis of kWh sales such as customer charges. The kWh sales adjustment should not be applied to rate categories that are billed on the basis of customer counts, billing demand or other non-usage based billing determinant.

Q. WHAT ADJUSTMENT DID YOU MAKE?

A. Based on information provided by WAPA, we separated revenues into two categories: (a) revenues billed on basis of kWh sales and, (b) revenues not billed on the basis of kWh sales. We then calculated the adjustment by applying the percent reduction in kWh sales by those revenues billed on kWh sales. This adjustment lowers the reduction in base revenues due to the kWh sales decline by $465,000.

As noted earlier, the Commission should refer to Mr. Oliver's testimony for a complete discussion of all issues relating to WAPA's calculation of revenues.

f. <u>IDE Personnel</u>

Q. DOES WAPA'S FILING INCORPORATE THE EFFECTS OF COMPLETE TRANSITION TO REVERSE OSMOSIS ("RO") FOR THE PRODUCTION OF WATER?

A. No, it does not. In Docket 613, WAPA Exhibit HLT-5 shows that the WAPA has assumed 100% RO in Fiscal Year 2014 on St. Thomas, but only 83% purchase of water in Fiscal Year 2014 on St. Croix ("STX"). This assumption in the water case affects the electric proceeding, since it affects the water system's payments to the electric system for electric personnel working on the water system's IDE equipment located at WAPA electric power plants, and other costs associated with the production of water.

Q. SHOULD RATES BE ESTABLISHED ASSUMING THE CONTINUED PRODUCTION OF WATER IN THE IDE PLANTS, EVEN ON A PARTIAL BASIS?

A. No, they should not. In Docket 613, Mr. Hodge has testified that 100% RO production on St. Thomas and St. Croix will be implemented before rates are effective in this proceeding. Therefore WAPA will be purchasing all of its potable water needs from a third-party rather than self-producing potable water when rates are implemented. Accordingly, it would be inappropriate to assume continued IDE production of potable water.

Q. WHAT HAS WAPA ASSUMED CONCERNING THE COSTS OF ELECTRIC PERSONNEL WORKING ON THE IDE EQUIPMENT?

A. WAPA has assumed that those personnel would be retained by the electric system, and that these costs would no longer be charged to the water system, but would be included in rates for the electric system.

Q. DO YOU AGREE THAT THE IDE-RELATED ELECTRIC PERSONNEL SHOULD NOW BE CHARGED TO ELECTRIC CUSTOMERS?

A. No. The mere fact that the work these employees were doing is no longer necessary for the water system does not justify the proposition that they should now be utilized in the electric system and charged to electric customers. However, data provided by WAPA supports the conclusion that the cost of these formerly IDE-related employees is not going to be an incremental expense to WAPA.

Q. WHAT DATA IS THAT?

A. A data response from WAPA shows that electric department employment levels declined from FY11 to FY12, and is projected to decline further in FY13. The formerly IDE-related employees can be retained by WAPA without materially affecting WAPA's financial condition, because they can fill positions otherwise rendered empty due to attrition.

In addition to being able to use these employees to fill positions that become available due to attrition, WAPA has stated that it has not performed any study within the past five years to determine the appropriate employment level, nor has it participated in employee benchmarking studies in that time period. [See Set 1-32C and D]. Accordingly, WAPA's position in this proceeding is that customers should pay more for employees even though it has not identified a proper need for them, and even though attrition establishes that there has been no incremental employee cost.

Q. HAVE YOU RECEIVED ADDITIONAL EMPLOYEE INFORMATION CONFIRMING YOUR APPROACH?

A. Yes, we have. The day before filing this testimony, we received information from WAPA establishing that WAPA's employee count had declined from 618 at the end of Fiscal Year 2011 to 596 at the end of Fiscal Year 2013. The employee count declined by 13 in Fiscal Year 2013. In this connection, it must be recalled that WAPA's position is that salaries and wages in this proceeding begin with Fiscal Year 2011, go up from there by 2.01% for a salary and wage increase, and then further go up by allocating the IDE employees cost to the electric system. We believe our position, which eliminates only the additional cost of the IDE employees, is therefore conservative in view of the substantial employee reductions achieved by WAPA.

Q. WHAT IS YOUR RECOMMENDATION?

A. The allocation study provided by WAPA indicates that the cost of the formerly IDE-related employees, including OPEB, is $2.3 million. This $2.3 million cost is included in WAPA's filing through the operation of Exhibit CS-2 p.11. It should be removed from the electric revenue requirement.

g. <u>Load Research Reserve</u>

Q. DID WAPA REQUEST AN ALLOWANCE FOR A LOAD RESEARCH STUDY IN DOCKET 575?

A. Yes, they did. WAPA requested an allowance of $400,000, to be recovered over three years, for a load research study. The Technical Consultant took the position that WAPA should undertake both a load research and a class cost of service study, but that WAPA's request overlooked the fact that it already had collected $343,000 for the purpose of performing a load research study from an allowance in a prior rate proceeding which funds were confirmed by WAPA. Accordingly, Staff recommended no additional revenues for the load research study.

Q. DID THE SETTLEMENT IN DOCKET 575 ADDRESS THE LOAD RESEARCH ISSUE?

A. Yes, it did. Paragraph 4F of the Settlement states:

> (The Parties agree)... To jointly submit to the PSC an implementation schedule and funding mechanism for the load research program using the funds that are currently escrowed for that purpose within 180 days of the Order in this proceeding.

At the time of Docket #575, WAPA had reserved $343,000 to perform a load research study. In Docket #575, it was authorized an additional $50,000 per year for load research. It was also supposed to perform a cost of service study before this rate case was filed. Neither study has been performed. As of the estimated rate-effective date for this case, WAPA should have collected approximately $547,000 for load research, consisting of the $343,000 already available in Docket #575 and the $50,000 per year recovery over the four years since then. However, WAPA stated in discovery in this case that it has reserved only approximately $360,000 for load research activities.

In addition to the $360,000 for the COS, WAPA also has a cash reserve of $68,000 for the completed asbestos abatement program and another $250,000 for a Demand Side Management program. The last two reserves have remained constant for many years.

Q. DOES WAPA ACKNOWLEDGE HAVING RECEIVED OVER $500,000 FOR LOAD RESEARCH?

A. No, it does not. Specifically we asked and WAPA responded:

> Question: The cost of the load research and cost of service study included in the Authority's filing in the 2009 rate case [See Hodge page 7] as a revenue requirement. Has WAPA reserved any amount based on the allowance in the 2009 rate case? If not, why not.

> Response: The Authority has an amount of approximately $360,000 reserved for the load research activities. This amount does not include funding for the cost of service study.

When asked why they had stopped reserving for load research activities, we were told that the allowance in Docket #575 was for a target value, and when that target value was reached, the Authority stopped reserving. What that means is, about one-half year after the award in Docket #575, although WAPA was continuing to receive $50,000 per year for load research, it wasn't doing load research, it wasn't preparing a load research study, and it wasn't reserving for a future load reserve study. Instead, it was using the load research allowance for other purposes.

Q. WHAT HAS WAPA REQUESTED IN THIS CASE FOR NEW STUDIES?

A. WAPA requests funding, over three years, for studies costing a total of $995,000:

Cost of service	$ 120,000
Depreciation	125,000
Generation planning	750,000
Total	$ 995,000

In making the Cost of Service study request, Mr. Hodge testifies at pages 7-8:

> *Q. IN 2009, THE AUTHORITY RECEIVED A RATE INCREASE AND PROMISED TO PERFORM A LOAD RESEARCH AND COST OF*

> *SERVICE STUDY. HAVE THEY BEEN COMPLETED? IF NOT, WHY NOT?*
>
> *A. Instead of a detailed load research study, the Authority prefers to conduct a cost of service study using more conventional methods which could be performed less expensively and more quickly. Given current economic conditions, the Authority encourages the Commission to reconsider and* ***permit it to do a cost of service study using more conventional methods utilizing the funds that the Commission made available for load research.*** *If the Commission remains committed to the Authority performing a detailed load research study, such a study will require at least a three year time frame to accomplish. The Authority acknowledges that it received funding to conduct load research. However, dedicated funds were not provided for a cost of service study, nor were funds available from internally generated funds primarily because of the deferred fuel balance. The Authority would need funding to perform a cost of service study. [Emphasis added]*

Q. WHAT DO YOU CONCLUDE FROM THIS?

A. WAPA seeks to recover $120,000 for a cost of service study, "utilizing the funds that the Commission made available for load research," without recognizing either that it already had collected $343,000 at the time of Docket 575, that it will have collected an additional $200,000 by the time new rates go into effect, or even that WAPA acknowledges reserving approximately $360,000 of the above collections for load research studies [see Set 1-48F].

Q. WHAT IS YOUR RECOMMENDATION?

A. We do not object to the proposal of doing a conventional cost of service study. We do, however, object to the idea that WAPA can request additional funds for this study without recognizing, at a minimum, the $360,000 already reserved for a load research study that will not be performed. Accordingly, we propose to amortize the $360,000 that has been reserved for load research as a reduction of revenue requirements, over three years.

h. Carrying Costs on Deferred Fuel and Government Receivables

Q. DO YOU AGREE WITH THE WAPA PROPOSALS TO INCLUDE A CHARGE, IN RATES, FOR THE CARRYING COSTS OF DEFERRED FUEL AND GOVERNMENT ACCOUNTS RECEIVABLE?

A. No, we do not agree that these are costs that should be added to the overall revenue requirement. We agree that carrying these balances imposes a cost on WAPA and more importantly on consumers from the deferral of maintenance activities as discussed earlier. We further note that other customers could not continue to receive services from WAPA without payment of bills – they would simply be disconnected. However, we have previously discussed that requiring those consumers who do timely pay to also pay for the charges related to the government not paying their utility bills timely should not be considered. If appropriate, WAPA should petition to have an appropriate carrying charge placed on government late payments,

Q. WHAT IS YOUR RECOMMENDATION?

A. As shown on Exhibit GCG-2 lines 36 and 37, we recommend that these proposed carrying cost adjustments be removed from the calculation of the overall revenue requirement.

i. Water System Payments

Q. IN DOCKET 613, DOES THE WATER SYSTEM INCLUDE IN ITS REQUEST AN INCREASE IN RATES TO FUND THE REPAYMENT OF AMOUNTS OWED BY THE WATER SYSTEM TO THE ELECTRIC SYSTEM?

A. Yes, it does. As shown on Exhibit HLT-11 lines 43-45 in Docket 613, the water system proposes to repay, in Fiscal Year 2013 and 2014, $3.3 million for a fuel LOC and $612,000 for prior period fuel costs. The Fiscal Year 2013 payment has not been made. In addition, WAPA's water system proposes to pay $8.4 million to the electric system, beginning in Fiscal Year 2014 and spread over five years, for unpaid past cost allocations.

Q. HOW HAVE YOU TREATED THESE PAYMENTS IN THE CONTEXT OF THE ELECTRIC PROCEEDING?

A. While we have not adjusted the electric revenue requirement to reflect receipt of these payments, we have included them in Ex. GCG-2 lines 43-45 to develop an illustrative calculation of the "Adjusted amount available for capital improvements." In making that calculation, we have recognized that the Fiscal Year 2013 payment has not been made. Accordingly, for the fuel-related amounts, we have combined the Fiscal Year 2013 and 2014 payments, and amortized the resulting total over three years. We have also included the projected the amortization of the FY 2014-2018 payments for cost allocations. To the extent that the amounts in question are included as a revenue requirement for the water system and rates are provided by the PSC, there should be monitoring that these amounts are actually paid. As we stated in our water system testimony we are very surprised and unclear as to why the electric system that was short of cash and short of liquidity would first provide a loan to the water department, and further why the loan would be to cover operating expenses. This is certainly not an arm's length transaction and WAPA and its board should be forthcoming on the reasons for such actions.

j. <u>The RFM and Maintenance Expense</u>

Q. HAS WAPA INCLUDED THE RATE FINANCING MECHANISM ("RFM") IN ITS FILING?

A. Yes, it has. Since the RFM was not in effect during Fiscal Year 2011, WAPA has proposed an adjustment to increase both revenues and maintenance expense by $16.65 million for the RFM. See Exhibit CS-2 page 16.

Q. DO YOU PROPOSE ANY ADJUSTMENT TO THE RFM EXPENSE?

A. While we do not propose any adjustment, the Commission should be aware of and concerned that WAPA appears to be reducing its "normal" maintenance expense, i.e. maintenance expense other than RFM expenses, to levels substantially lower than they were prior to the RFM.

As shown on Exhibit GCG-9, total maintenance expenditures in Fiscal Year 2011 were $16.9 million. These increased to $19.4 million in Fiscal Year 2012. Excluding the RFM, it appears that non-RFM maintenance expenditures in Fiscal Year 2013 will be on the order of $12 million, which represents a significant reduction from normal maintenance. This reduction is also inconsistent with the concept that the RFM was to provide "supplemental financing for approved emergency power generation, spare parts, performance improvement projects, capital improvement projects, and routine preventative maintenance activities for the purpose of improving the availability and efficiency and reliability of its generating units." [See paragraph 2.c of the September 27. 2011 RFM Stipulation].

Q. IN VIEW OF THIS DECLINE, DO YOU RECOMMEND THAT THE COMMISSION TAKE ANY ACTION IN THIS PROCEEDING TO ADJUST THE RFM?

A. No, we do not, other than making it quite clear that the RFM is a surcharge, that WAPA is to provide information as indicated in this testimony in support if its RFM-related activities, and that if the Commission finds that WAPA is not meeting its commitments, it can and should adjust the RFM appropriately on the basis of the nature of the RFM as a surcharge, subject to immediate rate adjustment at any time, upon proper notice and consideration of evidence. To implement this recommendation, we are proposing that the Commission make WAPA's entire maintenance expense subject to adjustment, as a surcharge. We recommend that the Commission include the RFM expenditures in that surcharge.

V. <u>SUMMARY OF ORDERING RECOMMENDATIONS</u>

Q. COULD YOU SUMMARIZE FOR THE PSC YOUR PROPOSED ORDERING RECOMMENDATIONS?

A. As a result of this proceeding we recommend the PSC find and include in its final order in this docket the following:

1. An approved revenue requirement for the test year for non-fuel revenues of $85.087 million, which represents a $12.25 million increase.
2. The awarded increase should be collected on the basis of test year non-fuel revenue requirements for base rates of $43.195 million, and $41.892 million for the surcharge components consisting of: (i.) maintenance, inclusive of the RFM, (ii.) OPEB, (iii.) self-insurance, and (iv.) line loss, subject to approved protocols for each of the surcharges.
3. Maintenance surcharge revenue requirement, inclusive of the RFM, for the test year of $33.57 million,
4. OPEB surcharge revenue requirement for the test year of $5.269 million.
5. Self-insurance surcharge revenue requirement for the test year of $1.31 million.
6. Line-loss surcharge revenue requirement for the test year of $1.74 million.
7. WAPA should provide quarterly reports in formats approved by the PSC concurrent with each of its LEAC filings on revenue collection and expenses for the: (i.) maintenance surcharge, (ii.) OPEB surcharge, (iii.) self-insurance surcharge, and (iv.) line loss surcharge.
8. Eliminate in this proceeding from revenue requirements all debt service costs for future financings. WAPA should file by April 1, 2014 a capital plan for the

financing of required delivery system and generations infrastructure improvements inclusive of fuel diversified and high efficiency production technologies, performance improvement projects and capital improvement projects in sufficient detail including identification of any specific rate actions requested of the PSC.

9. Continue to set as the debt service coverage standards for revenue requirement purposes in all future rate proceedings 1.75x for Senior debt and 1.50x for Subordinated debt.
10. Deny allowing WAPA to charge consumers the carrying costs of deferred fuel and any costs associated with the late payment by government accounts.
11. WAPA should honor all prior commitments and terms and conditions made to the PSC and consumers in prior rate stipulations. WAPA should issue the RFP for the Management Audit stipulated to in Docket 575 before By April 1, 2014.
12. Provide to every VI government agency on an annual basis and prior to finalization of agency budgets an estimate of their expected utility consumption and estimates of charges for the upcoming fiscal year together with the history of billing and payments for the past three fiscal years. Formally, provide lawmakers with a summary of the expected utility cost for every government agency.

Q. DOES THAT CONCLUDE YOUR PRE-FILED TESTIMONY IN THIS PROCEEDING?

A. Yes, it does.