BEFORE THE

VIRGIN ISLANDS PUBLIC SERVICES COMMISSION

DOCKET NO. 612

REBUTTAL TESTIMONY OF HUGO V. HODGE, JR.

ON BEHALF OF

THE VIRGIN ISLANDS WATER AND POWER AUTHORITY

REGARDING THE PETITION FOR PERMANENT RATE RELIEF

FOR THE ELECTRIC SYSTEM

July 31, 2013

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Hugo V. Hodge, Jr. and my business address is: Virgin Islands Water and Power Authority, 9720 Estate Thomas, Subbase, St. Thomas, U.S. Virgin Islands 00802. I am the Executive Director and Chief Executive Officer of the Authority.

Q. HAVE YOU HAD AN OPPORTUNITY TO REVIEW THE TESTIMONY FILED BY GEORGETOWN CONSULTING?

A. Yes.

Q. WHAT DO YOU WISH TO SAY IN RESPONSE?

A. The PSC's Technical Consultants, Georgetown Consulting Group ("Georgetown") have made certain recommendations to the PSC with which the Authority strongly disagrees. The Commission should reject those recommendations with which the Authority disagrees.

Q. WHY DO YOU URGE THEIR REJECTION?

A. Because some of the recommendations made by Georgetown invade the exclusive statutory province of the Authority and some will not serve the interests of the ratepayers or the Authority. Let us first examine the issue of the PSC's jurisdiction over the Authority. At page 11 of their testimony, Georgetown recognizes the fact that the PSC's role is limited by statute to setting the rates of the Authority:

> 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.

This is an accurate and true statement. But then Georgetown goes on to state:

> However, in reviewing and providing for prudent costs, the PSC can indicate that it would not provide rates <u>unless</u> WAPA <u>undertook</u> <u>various</u>

> actions that would be prudent and result in reasonable rates to its ratepayers.
>
> [Emphasis added].

This is an untrue and incorrect statement. Since 1972, Virgin Islands courts have consistently held that the PSC has no authority to order WAPA to take any action concerning the operation of its Water and Electric Systems.[1] The PSC's authority over it, unlike over other public utilities, is limited by statute to setting its rates pursuant to Title 30, Section 1(c) of the Virgin Islands Code.

Q. ARE YOU SURE YOU ARE NOT TAKING THIS STATEMENT OUT OF CONTEXT?

A. Yes, I am sure. To make matters worse, Georgetown reiterates at page 15 of their testimony their erroneous, expansive view of PSC jurisdiction:

> 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 [sic] authority to require compliance.
>
> [Emphasis added].

The Authority urges the PSC's counsel to review relevant case law and advise the PSC accordingly. The PSC simply cannot condition the grant of rates on a certain performance or on specific action of the Authority, either by action to be taken beforehand or afterwards. To do so is to attempt to direct specific actions of the Authority. The foregoing sentences run afoul of applicable law to the extent that they recommend a course of action to the PSC that is tantamount to attempting to do more than simply set the

---

[1] . Our counsel refers to *V.I. Public Services Commission v. V.I. Water and Power Authority*, 49 V.I. 478 (V.I.S.C. 2008).

Authority's rates. Conditional rate increases, or rate increase conditioned on specific subsequent performance the PSC or its consultants prefer, versus what the Authority Governing Board and management determine to be best the best course of action for the Authority, would infringe upon the statutory powers and ability of the Authority to manage the operations of the utility, something exclusively within its jurisdiction, and could adversely affect its operations and cash flow.[2]

Q. WHAT THEN CAN THE PSC DO?

The PSC can ask the Authority to agree to pursue a particular course of action and the Authority can consider it, and the Authority can consent to pursuing it, as it often does. The PSC can also ask the Authority to provide data to it that allows it to determine whether its concerns are being addressed in connection with such things as project requirements, the collection and use of funds, the status of the projects including the budgets, actual expenditures, variances in the expected cost and date of completion should be provided for review by the PSC. But the PSC cannot inject itself into the middle of the approval process for those projects or into the management and operations of the Authority pursuant to conditions precedent to rate increases or conditions subsequent.

Q. WHAT ARE THE AREAS WHERE THE AUTHORITY AGREES WITH THE RECOMMEDATIONS OF GEORGETOWN?

A. At page 15-16 of Georgetown's testimony, it recommends that revenues should be granted to the Authority 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; and for deposit into an OPEB escrow account so

[2] The enumerated statutory powers of the Authority are set forth at 30 V.I.C. Section 105. The lack of jurisdiction of other agencies of government over its management and operations is set forth at 30 V.I.C. Section 121.

that the funds provided are used only for these purposes. The Authority agrees that "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." However, the Authority does not agree that the adequacy of these rates should be visited annually, and any required adjustment to decrease them should be undertaken annually. First, such rate decreases would adversely affect, and indeed undermine, the Authority's ability to undertake multi-year projects. Second, the Authority believes that Virgin Islands ratepayers already pay a higher per capita cost of regulation than ratepayers anywhere else on the U.S. mainland and its territories. Rather than annual rate reviews-- which would typically take eight months or more to complete and involve significant regulatory cost, the PSC should seek a less expensive regulatory solution. One way to reduce the Authority's regulatory costs, which ultimately must be passed on to ratepayers, is to decide now the base rate increase required to support the three areas at issue and then conduct annual compliance reviews. Those reviews can be performed with the objective of ascertaining at that time whether the Authority is performing prudently. An annual compliance review is more limited, and less expensive, than a rate review. Such compliance reviews will then lead to greater focus on the issues. If an unsatisfactory result from a compliance review remains unaddressed by the next annual review, then and only then may a rate review be in order, with the understanding that the Authority's ability to meet a commitment to a multi-year project depends on the certainty of the source of funding.

Q. WHAT IS THE AUTHORITY'S POSITION REGARDING A MANAGEMENT AUDIT?

At page 13 of their testimony, Georgetown recommends the conducting of a management audit:

> [The] 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.

The Authority agrees with this recommendation. The Authority consented to it in 2009 and it was to have been performed as part of the 2009 Global Settlement. Paragraph 6 of the Global Settlement provided that:

> [A] Management Audit of the Authority should be performed by an independent management auditor. The Authority agrees to develop the scope of the Management Audit **with collaborative input from the Technical Consultants and** to award a contract for such work 270 days after the execution of this Settlement or the approval and implementation of the revised rates in this proceeding, which ever is later. The audit shall be completed within 545 days (18 months) and filed with the PSC with a report on the proposed action the Authority will take as a result of the Management Audit and the estimated impact of such actions on future electric rates. The Authority shall file with the PSC within 180 days of the completion of the Management Audit a strategic business plan for the Electric Department. [Emphasis added].

While Georgetown and the Authority have worked collaboratively to develop a scope of work for the Independent Advisory Contractor for the Richmond Harley plant, both have failed to initiate the process to work collaboratively on developing the scope of work for the management audit. The Authority agrees that it is a useful management tool that may provide independent advice to management and the WAPA Board of recommended improvements in policy and practice, and commits itself to working collaboratively with Georgetown to develop a scope of work for the audit and to procuring the performance of the audit.

Q. IS THERE ANYTHING OTHER GEORGETOWN RECOMMENDATION WITH WHICH YOU DISAGREE?

A. Yes. Georgetown faults the Authority at page 13 of its testimony and again at page 31 for failing to file for a rate increase since 2009. However, it is no secret that the Virgin Islands economy, and indeed economies all over the world, including that of United States and the Virgin Islands, experienced the Great Recession starting in early 2009. Many people lost their jobs, livelihood and homes and have had difficulty making ends meet which continues to this very day. Government workers who were able to keep their jobs experienced an eight percent pay cut. Thus, in this docket, the Authority has sought a rate increase that would not create a “rate shock” to the nervous system of its ratepayers. While Georgetown suggests that this is a “false economy” and that the Authority instead should have sought a rate increase sooner and/or should have requested sufficient (i.e. larger increases in) rates in this docket to fulfill all of its obligations. The Authority flatly does not agree with Georgetown’s assertion that this creates a “false economy”. Frankly, the Authority is surprised by the recommendation of Georgetown. As a publicly owned utility, however, the Authority takes into consideration the impact of its rates on its ratepayers. Charged with the exclusive statutory authority to manage and operate its electric system and facilities in the interest of the Virgin Islands, it sought to avoid “rate shock” to its ratepayers while it pursued an alternative source of fuel for its generating units that would lower its costs. The anticipated reduction in fuel cost resulting from the conversion of its generating units to propane, which should occur within the next 18 to 24 months from now, will help to mitigate the rate shock to the ratepayers from the rate increase requested in this docket.

Q. DO YOU AGREE OR DISAGREE WITH GEORGETOWN REGARDING THE COLLECTION OF GOVERNMENT RECEIVABLES?

The Authority disagrees with the following recommendation of the Georgetown at pages 17-18 of their testimony to the extent that it implies that the Authority does not diligently pursue the collection of government receivables:

> 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.

In fact, the Authority regularly seeks from the legislative and executive branch of government full funding by each agency, including the implementation of direct payment to the Authority. It has met with success in getting lump sum payments from the government and in securing the gasoline tax, estimated to be approximately $6 million annually. It will continue to pursue the possibility of direct payment of its bills through appropriation or otherwise. Currently before the Virgin Islands Senate is a bill to allow the Office of Management and Budget to pay utility bills for every agency of the Virgin Islands government, thereby making it difficult for government agencies to divert the funds to other needs. If the bill becomes law, it will significantly and positively improve the Authority's cash flow position. Finally, Georgetown incorrectly implies that the Authority does not impose a late payment penalty fee on slow-paying government customers. Government accounts already pay the same late payment penalty as non-governmental accounts.

Q. WHERE ELSE DO YOU AGREE OR DISAGREE WITH GEORGETOWN?

A. The Authority disagrees with Georgetown's recommendation at page 25-26 of their testimony recommending the deferral of base rate relief with respect to the Authority's anticipated RUS loan and bond financing. Their recommendation is based on the lack of certain information such as not having been provided with a copy of the application for an RUS loan or information concerning bond financing, no firm date set for the financing, no draft financing documents, no list of projects, uses and purposes of the financing, and no summary of discussions with underwriters or financial advisors. Georgetown states:

> 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.

Basically, Georgetown has recommended to the PSC that it not provide any rate relief to the Authority at this time related to its need to borrow money in the bond market in order to undertake capital projects. It recommends instead that the PSC defer allowing a rate increase to the Authority related to its need to issue board during the next three to five years. The Authority asks the PSC to reject this recommendation.

A copy of the RUS application has since been provided to Georgetown. It was provided as soon as the Authority became aware that an oral request had been made informally but that the informal request had not been acted upon. More importantly, regular recurring expenses of the Authority should be included in base rates and the cost of bond financing is a regular, recurring activity of the Authority in order to undertake needed capital projects. The list of projects is set forth in the Authority's five year capital improvement plan, a copy of which was provided to Georgetown. These capital projects are important because they increase the efficiency and reliability of the Electric System**.**

In addition, the Authority made itself available to answer any questions pertaining to its capital improvement plan. The fact that there is not a firm date for the financing, or draft financing documents, or established financing costs does not mean that these regular, recurring costs cannot be estimated and recovered in base rates. Bond financing costs are a regular, recurring base rate cost of an electric utility, like insurance, salaries, etc. They therefore should be projected and allowed now in base rates and not be decided at a later date at yet another PSC hearing. Scheduling another proceeding at a later date adds more regulatory expense and defeats the purpose of a comprehensive base rate filing and case.

The Authority is open to working with the PSC to address its needs provided that the PSC does not seek to implement surcharges without its consent that infringe on its statutory powers. The Authority will not consent to surcharges that attempt to encroach on its management authority. The operation of the Authority is defined by statute as WAPA's responsibility alone.

The PSC cannot implement surcharges for regular, recurring base rate items and call them surcharges without the Authority's consent. A surcharge should be for a limited purpose and supplement base rates. The Authority rejects the creation of surcharges in lieu of base rates and refuses to consent to the characterization of base rate revenue as surcharge revenue. The Hearing Examiner should recommend to the Commission that "surcharge proposed revenue" instead be included in base rates in instances where the Authority does not consent to the proposed surcharge.

Q. WHAT ABOUT THE RECOMMENDATION THAT YOU FILE A PLAN FOR FINANCING YOUR CAPITAL PROGRAM BY APRIL 1, 2014. DO YOU DISAGREE WITH THAT RECOMMENDATION?

The Authority has no objection to providing to the PSC an up-to-date plan for financing its capital program no later than April 1, 2014, and it will provide details regarding the projects, as recommended at page 34 of the Georgetown testimony. However, as stated above, rate revenue related to the financing of the projects should be included in base rates.

Q. WHAT IS YOUR POSITION ON GEORGETOWN'S RECOMMENDATION OF A MAINTENANCE SURCHARGE?

At page 32 of its testimony, Georgetown recommended:

> 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.

In particular, Georgetown recommended that a maintenance surcharge be created and that the Rate Financing Mechanism (RFM) surcharge in the LEAC be included in the maintenance surcharge, which would provide funding for all maintenance of the

Authority. Georgetown recommended that maintenance surcharge revenues be placed into a separate account, with withdrawals made only for funding the projects approved annually by the PSC. The Authority does not completely agree with this recommendation.

Q. WHY NOT?

A. Because maintenance is a regular, recurring base rent cost and the recovery of this cost should be included in base rates. However, the Authority nevertheless can accept that a maintenance surcharge is appropriate for addressing maintenance needs for a limited period. It will therefore consent to the creation of a maintenance surcharge until the next base rate case--provided that the impact of the maintenance surcharge is reviewed on an annual basis.

Quarterly review for the maintenance surcharge is not meaningful because it is too short a period of time in which to evaluate performance. The Authority does not consent to quarterly reviews for the maintenance surcharge. Also, the Authority does not consent to maintenance surcharge revenues being placed into a separate restricted account, with withdrawals only for the purpose of maintenance. This process would infringe upon the statutory powers and exclusive ability of the Authority to manage the operations of the utility, and could adversely affect its operations and cash flow. The Authority must be able to allocate its funds where its highest priority dictates. Restricted funds do not allow this. While project requirements for maintenance, the collection and use of funds, the status of the projects including the budgets, actual expenditures, variances in the expected cost and date of completion can be tracked and provided for review by the PSC, the PSC, by statute, is not allowed to inject itself into the approval process for maintenance projects or dictate how the Authority uses its funds for maintenance. The Authority therefore recommends that the PSC review the maintenance program annually, to determine compliance with the objectives of the maintenance surcharge, but with the understanding that the Authority's ability to meet a commitment to a multi-year project depends on the certainty of the source of funding. If the maintenance surcharge is implemented as consented to by the Authority, it will agree also to provide no later than February 1, 2014, a detailed maintenance plan based on both its analysis and as well as independent advice. Such a plan will also provide for performance improvement projects (PIPs), and for capital improvements projects (CIPs) tied to routine maintenance. As indicated above, there should not be a requirement for quarterly reviews to be provided to the PSC during each LEAC hearing, as this compressed time frame would detract from the Authority's ability to manage these projects. The Authority also agrees to provide to the PSC an assessment of the performance of the power plants and the conduct of the maintenance and PIPs and CIPs on an annual basis.

Q. WHAT IS THE AUTHORITY'S RESPONSE TO THE GEORGETOWN RECOMMENDATION ON THE TREATMENT OF OTHER PERSONNEL EMPLOYEE BENEFITS?

Regarding the Authority's Other Personnel Employee Benefits ("OPEB") funding, Georgetown recommended at page 34 of its testimony:

> 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.

The Authority accepts this recommendation. While we do not agree that the Commission can order the Authority to create a separate account, because its role by statute is limited solely to setting the Authority's rates, nevertheless, the Authority believes the recommendation is reasonable and would be required by its auditors. It therefore consents to the creation of the separate account. Our rate consultant will address the issue of whether the revenue should be provided in a surcharge as recommended by Mr. Oliver in his rate design testimony. Also, annual review and annual rate adjustment should be sufficient.

Q. ARE THERE OTHER GEORGETOWN RECOMMENDATIONS WITH WHICH YOU AGREE?

A. Yes. Georgetown has recommended at page 34 of its testimony:

> 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.

The Authority agrees with this recommendation.

Q. ARE THERE ANY OTHER GEORGETOWN RECOMMENDATIONS WITH WHICH YOU AGREE?

A. Yes. At page 36 of its testimony, Georgetown recommended:

> 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.

The Authority agrees with this recommendation committing the PSC to be proactive with regard to attempts to reduce utility costs to its consumers and it applauds the recommendation.

Q. DO YOU AGREE WITH THE AMOUNT OF RATE RELIEF RECOMMENDED BY GEORGETOWN?

A. Not at all. The Authority strongly disagrees with the amount of the rate relief recommended by Georgetown. On the one hand, Georgetown faults the Authority for attempting to avoid "rate shock" to its ratepayers by delaying the filing of a rate case in the past and/or not seeking sufficient revenue, but on the other hand has recommending disallowing the Authority the rate relief it has requested. The Authority's detailed explanation in response to the Georgetown recommendation on the amount of the rate relief required will be provided by CFO Julio Rhymer and the Authority's rate consultant.

Q. DO YOU SEE AN INCONSISTENCY BETWEEN GEORGETOWN'S TREATMENT OF THE WATER SYSTEM AND THE ELECRIC SYSTEM?

A. Yes. Georgetown recognizes that the Water System owes the Electric system a little over $10 million for prior period operations, which the Authority proposes to recover over 6 years. However, Georgetown recommends disallowance of this debt of the Water System in the Water System Docket 613 for rate-setting purposes. Conversely, Georgetown has recommended to the PSC, in calculating the rate increase for the Electric System, that it recognize that the Electric System will receive the very same $10 million loan which it has recommended that the Water System not be allowed a sufficient rate increase to repay this debt. Georgetown cannot have it both ways.

Georgetown's Electric System recommendation allows for the probability that the Water System will pay back the Electric System the $10 million loan, which then would allow the Electric System to undertake $10 million in capital projects it planned to undertake with the funds. However, their recommendation in the Water System docket, effectively prevents implementation of $10 million worth of capital projects planned by the Electric System, unless the cost of those projects is recovered by some means other than the repayment of the $10 million owed by the Water System—such as an additional rate increase to make up for the shortfall. The Authority, however, does not believe that recommendation would be in the best interest of the electric ratepayers, who can ill afford to bear the brunt of the disallowance of the Water System's debt to the Electric System. If the Electric System's loan to the Water System is disallowed and not repaid, the Electric System will need additional rate relief to cover the cost of $10 million required to fund the capital improvements necessary for the continued improved reliability of the Electric System. This incremental rate relief would need to be added to what has already been requested in the Electric System rate case.

Q. WHAT DO YOU MEAN?

A. Georgetown's disallowance approach in the Water System docket is totally inconsistent with its allowance position in the Electric System base rate case (Docket 612). In Docket 612, Georgetown's position is to allow receipt of the same $10 million loan by the Electric System which it recommends disallowance of in the Water System rate case (Docket 613). If the Water System's rates are not increased to allow repayment to the Electric System, then electric rates will need to be increased beyond the amounts requested by the Authority in this rate case. This increase in rate would need to be sufficient to cover the costs for the Electric System to borrow $10 million in additional bond financing. The Electric System would need the funds from additional bond financing to undertake the capital projects that it would have otherwise undertaken with the funds from repayment of the Electric System's $10 million loan to the Water System. This means that Electric System rates will have to be increased beyond what the Authority requested in its petition for an electric rate increase. The Authority rejects this recommendation as proposed by Georgetown.

Q. IS THERE ANY OTHER RECOMMENDATION OF GEORGETOWN WITH WHICH YOU DISAGREE?

A. Yes. Georgetown has also recommended that the Authority engage in a cost of service study and a load research study. The Authority has engaged in a cost of service study. Additional responses to this recommendation by Georgetown are provided by the Authority's rate consultant. However, a detailed load research study is not something that even much larger utilities than the Authority on the U.S mainland require. For our small community, the benefit of a detailed load research study is grossly outweighed by its cost. However, the Authority is willing to work collaboratively with Georgetown to reduce the cost associated with a load research study. The Authority is committed to completing the ongoing cost of service study based on available load data and will incrementally update the study as more detailed load research information becomes available.

Q. IS THERE ANYTHING ELSE YOU WOULD LIKE TO ADD?

A. Yes. The Authority is making great strides in transitioning away from the exclusive use of fuel oil to produce electricity and the result of which will significantly lower the cost of electricity to its ratepayers in years to come, and reduce plant emissions as well. On July 25, 2013, the Authority signed an agreement with the Vitol Group, one of the largest traders of propane in the world, that will transition the Authority from relying on fossil fuel to generate electricity to using propane. This agreement will move the Authority from a dependence on fossil fuel, and is projected to reduce fuel prices for consumers by up to 30 percent, with a 20 percent improvement in emissions of greenhouse gases. Vitol is financing all upfront capital costs associated with the project – including the construction of infrastructure necessary to deliver, receive and store the propane, and the conversion of WAPA's turbines by General Electric to burn both propane and diesel fuel. The Authority will only begin paying for propane once the propane is delivered. At that point, the Authority's propone use will be metered and it will be charged for whatever fuel is used to make power. The Authority will also undertake a number of projects that will improve the reliability and efficiency of its Electric System if the requested rate relief is granted.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.