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October 27, 2011

Jeffrey Johnson, Chairman
Guam Public Utilities Commission
Suite 207, GCIC Building
Hagatna, Guam 96932

Re: Contract Review GPA FY2012 CIP cap – Docket 11-10

Dear Chairman Johnson,

This letter is in response to Guam Power Authority's ("GPA") September 15, 2010 petition seeking Public Utilities Commission ("PUC") approval of a Capital Improvement Project ("CIP") "cap." This is an annual requirement under the terms of the contract review process (formerly Docket 94-04). Simultaneously, GPA filed a second petition in which it sought PUC approval of the entire construction budget for FY2012, including the internally funded CIP and projects funded with bonds. The PUC's Legal Counsel instructed us to evaluate both filings. The letter addresses our evaluation of the CIP cap filing and a separate letter will follow evaluating the construction budget filing. Specifically, your Legal Counsel instructed GCG as follows:¹

The above matters have been assigned GPA Dockets 11-10 and 11-11 respectively.

As you have done for prior fiscal years, I would request that you review the GPA petitions in the above dockets. It does not appear to me that the CIP petition includes any requests out of the ordinary, but I would appreciate your evaluation. As for the Construction Budget, at least some of the projects are not yet approved under the contract review protocol, such as the New Office project. Smart Grid has been approved for the amount of \$3.277M. I am including some of the relevant PUC Orders approving projects under the contract review protocol.

I hope to bring these matters for the consideration of the PUC at a meeting on November 7. Would it be possible for you to provide me with reports by November 1, 2011? Thank you for your assistance in this regard.

¹ Email of October 14, 2011

Regulatory Background

The contract review protocol (“protocol”) requires that all contracts in excess of a PUC-established threshold (currently \$1.5 million for GPA) be approved by the PUC. The protocol also requires that an annual level (“cap”) of internally funded Capital Improvement Projects (“CIP”) be set by the PUC before November 15th of each fiscal year.² GPA’s September 15, 2011 filing was submitted in order to obtain the required PUC approval for the cap in Fiscal 2012. GPA is also required by the protocol to submit a capital cost projection for the upcoming fiscal year plus two additional years.

Summary of GPA CIP Filing

Based upon its FY12 internally funded capital budget, GPA is requesting a CIP ceiling of \$8.5 million. While the total internally funded capital budget for FY12 is \$13.6 million, the protocol does not require approval of the internally-funded line extensions (and blanket job orders),³ which for FY12 is \$5.1 million. The \$8.5 million request is substantially lower than prior years’ CIP budgets, but above the amount approved by the PUC for Fiscal 2011 (\$5 million).⁴

Both the Fiscal 2011 and Fiscal 2012 CIP programs (internally funded) were reduced from prior levels, since there is funding available from bond proceeds that could be used for GPA engineering and PMC projects (Cabras Units 1-4), while in prior years engineering projects and PMC projects were internally funded at least in part. The following table summarizes the internally funded CIP program for Fiscal 2012:

Table 1
Fiscal 2012
Internally Funded
Capital Program

LINE EXTENSIONS	\$5,108,000
ENGINEERING PROJECTS:	933,000
GENERAL PLANT:	<u>7,540,000</u>
TOTAL REVENUE CIP:	\$13,581,000

In prior CIP ceiling requests, GPA included projects to be performed on Cabras Units 1-4 and financed (short-term) by the performance management contractors (“PMCs”). In both Fiscal 2011 and projected in Fiscal 2012, GPA financed these projects through the Fiscal 2010 revenue bonds rather than making payments to the PMC through revenues from rates. In the simultaneous construction budget filing, PMC projects are shown on Exhibit A.2 as the third and fourth items totaling over \$20 million. These items will need PUC approval, once the requirements of the contract review protocol (justification) are met. GPA has not as yet made such a filing. We will discuss this further in our evaluation of the construction budget filing. Another reason that the internally-funded CIP budget is relatively small is the small amount of engineering projects as shown below:

² Contract Review Protocol, May 2007, ¶ 1.f.

³ Contract Review Protocol, May 2007, ¶ 1.a

⁴ PUC Order, October 29, 2010, Ordering ¶ 1.

Table 2
Engineering Projects
(\$000s)

Capital Improvement Project Name	FY2012 Projected	FY2013 Projected	FY2014 Projected
Automatic Generation Control - Revenue	\$ 518,000	\$ 536,000	
Program Management Services	-	1,071,000	1,109,000
Backup Line Relay Protection	311,000	321,000	333,000
Transportation Building Improvements	104,000	-	-
Geographic Information System	-	343,000	532,000
Upgrade Fire Protection Transportation	-	-	194,000
U/G Reconstruction Latte Heights Phase I and II	-	-	471,000
U/G Reconstruction - Sinajana Phase I, II and III	-	-	1,663,000
TOTAL ENGINEERING PROJECTS	<u>\$ 933,000</u>	<u>\$ 2,271,000</u>	<u>\$ 4,302,000</u>

The final category of projects is termed “General Plant” in the budgeting process of GPA. “General Plant” is a term that encompasses items such as desks, chair, cabinets, personal computers, vehicles and other equipment, tools and materials and a myriad of other items. A complete and detailed list is attached to the GPA filing as Attachment 1 of the September 15, 2011 filing.

Table 3
General Plant

	FY2012 Projected	FY2013 Projected	FY2014 Projected
General Plant	\$ 7,540,000	\$ 7,076,000	\$ 7,616,000

We did not go through the details nor propound any discovery requesting the justification of the line items of general plant. It appears that one of the larger items over this three year period is the replacement of existing vehicles. We also did not cross check the purchased items to see if these were a part of previously approved projects. While none of the engineering projects for Fiscal 2012 require specific PUC approval, you can see that at least two projects listed in **Table 2** appear to require specific approval before the procurement process begins, since current projected costs for these projects will exceed the \$1.5 million threshold. Likewise the vehicle budget in the General Plant category will likewise need specific approval when justification is provided. GPA is aware of this requirement and when asked whether specific approval of items within the Fiscal 2012 budget were required, GPA indicated “yes.” Specifically the discovery and response were as follows:

Q. Are there any projects listed in the FY12 internal CIP budget that will exceed the \$1.5 million requirement for separate approval? If so, please identify and provide justifications pursuant to the contract review protocol.

A. Yes, fleet replacement program of bucket trucks and associated light and heavy vehicles (general plant budget) and program management services (Engineering budget).

GPA has not yet sought approvals for the above items, so no PUC action on those items is required at this time.

In support of the overall level of the costs of the internally funded CIP, GPA submitted with its CCU Resolution 2011-45 that approved the level of both the operating and capital budgets for FY11. There is a statement in the CCU Resolution indicating that during the construction of the capital budget the General Manager of GPA ensured that the budget conformed to the strategic goals of GPA. No other justification was provided. Viewed on its own, the general plant budget in FY12 is slightly more than was approved by the PUC for FY11. We have not inquired as to the level of CIP (General Plant) that did occur or whether some of these items were deferred to FY2012. GPA is required to submit a full reconciliation of Fiscal 2011 expenditures on or before December 1, 2011.

We note that in the GPA petition requesting approval of the CIP cap, it provided the CCU approved budget for FY12. In that budget it indicates that the following levels of debt service coverage are projected for FY12 will be 1.79x (Bond Method) and 1.26x S&P (PUC) method. This includes \$15 million of addition revenues.⁵ As you are aware, GPA is in the process of preparing to file a base rate case and anticipates that filing within a week or so. At that time, GCG and the PUC will be able to further explore the total construction and operational plans for the near term. One of the revenue requirements will be the internally funded projects, including line extensions.

Summary of Recommendations

Based on the above we would recommend the following:

1. The requested Fiscal 2012 CIP cap at the \$8.5 million level should be approved. The engineering and general plant budgets are consistent with prior budgets and appear reasonable. No prudence concerns were noted by GCG and as stated above we did not review the justifications. We did not review the specific circumstances or justifications of any of the projects listed.
2. GPA should file a complete reconciliation of the Fiscal 2011 expenditures on or before December 1, 2011, as required by the contract review protocol.

⁵ We have informally been advised that the base rate case is in the \$18 million range.

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October 27, 2011
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If you wish to discuss any and all of the above, please do not hesitate to call.

Regards,

Edward R Margerison

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cc: Lou Palomo, PUC
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