

October 24, 2012

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

Docket 12-11: Review of GPA FY2013 CIP Ceiling Cap

Dear Chairman Johnson,

Shaw Consultants International, Inc. (Shaw Consultants) is pleased to submit this letter report in response to Mr. Fred Horecky's request on October 5, 2012, to evaluate and submit a short report with respect to GPA's amended filing to the Guam Public Utilities Commission (PUC) on September 14, 2012 that seeks approval of its FY 2013 internally funded CIP Ceiling Cap. In the same timeframe GPA also filed a second petition for which it seeks PUC approval of the entire construction budget for FY 2013, including the internally funded CIP and projects funded with bonds. This letter report addresses our evaluation of the CIP cap filing (PUC Docket No. 12-11), and a separate letter report will follow that provides our evaluation of the construction budget filing (PUC Docket No. 12-10).

Regulatory Background

The requirement for the annual contract review process of capital expenditures is pursuant to the PUC's authority under 12 GCG Section 12004, with provisions set forth in a PUC Order dated February 15, 2008, titled Contract Review Protocol for Guam Power Authority.

The protocol provides that PUC approval be obtained before the procurement process has begun for each Capital Improvement Project (CIP) in excess of \$1.5M, regardless of whether the project extends over a period of one year or several years, except that no regulatory review is required for blanket job orders and line extensions. The protocol also requires that an annual cap level of internally funded Capital Improvement Projects (CIPs) be set by the PUC before November 15th of each fiscal year. GPA's September 14, 2012 filing was submitted in order to obtain the required PUC approval for the Fiscal 2013 cap. GPA is also required by the protocol to submit a capital cost projection for the upcoming fiscal year plus the next two successive years.

Discussion of CIP Filing

The Consolidated Commission on Utilities (CCU) has approved GPA's FY 2013 CIP budget for internally funded Capital Improvement Projects at a level of \$14,897,000, which includes the requested ceiling cap of \$10.136M, as shown in Table 1, below.

Table 1: Fiscal Year 2013 Internally-Funded Capital Improvement Program

General Plant (CIP Ceiling Cap)	\$ 10,135,760
Line Extensions	4,761,240

Total Approved CIP Budget	\$ 14,897,000

The Contract Review Protocol does not require regulatory review/approval for the \$4.761M covering line extensions. The protocol also excludes blanket work orders (not specifically identified as such in the CIP cap filing) from the \$1.5M threshold review requirement.

General plant, which is comprised of FERC accounts 390 to 398, includes plant such as structures & improvements, office furniture & equipment, stores equipment, laboratory and miscellaneous equipment. We note, however, that of the \$10.136M labeled as general plant, approximately \$3.88M is associated with generation, substation and other capital improvement projects that are not in the FERC general plant series of accounts.

Table 2, below, shows that GPA's FY 2013 CIP ceiling cap is generally consistent with the amount approved for FY 2012. In comparing FY 2013 with FY 2012, it should be noted that the FY 2013 budget includes \$0.43M, which is a carry-over from FY 2012 that is principally related to an overdue major generator inspection. In terms of a longer-term perspective, we understand that the CIP ceiling cap in FY 2011 was \$5M, but was substantially higher in years prior to FY 2011 (about three times higher in both of those years - \$15.4M in 2009 and \$16.4M in 2010).

We note that whereas in FY 2012 CIP Ceiling Cap request, GPA budgeted \$0.933M for engineering projects, with projections of \$2.271M in FY 2013 and \$4.302M in FY 2014, in its current FY 2013 budget there is no amount showing for engineering projects. In a call with GPA, it was indicated that their engineers were still working on the 2010 bond-funded projects and therefore there is no amounts budgeted for FY 2013 under the CIP Ceiling Cap.

Table 2: GPA Internally-Funded Capital Improvement Program – FY 2012 and FY 2013

	FY 2012	FY 2013
General Plant	7,540,000	10,135,760
Engineering	933,000	-
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Sub-Total (CIP ceiling cap)	\$ 8,473,000	\$ 10,135,760
Line Extensions	5,108,000	4,761,240
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Total	\$ 13,581,000	\$ 14,897,000

Shaw Consultants also notes that the protocol prescribes that all capital improvement projects require regulatory review for all projects in excess of \$1.5M, whether or not a project extends over a period of one year or several years. In this regard, in its FY 2012 submission to the PUC, GPA has provided a budget forecast for FY 2013 and FY 2014, but has not provided such a forecast in its FY 2013 submission. In a telephone call, GPA indicated that as the CIP Ceiling Cap budget was predominately general plant, the projects budgeted for FY 2013

were solely in that year and did not span more than one year. Other than one exception for revenue-funded Smart Grid, discussed below, we were unable to confirm those projects that could exceed the \$1.5M threshold, simply because we did not have the amounts estimated for associated projects in future years. However, looking at only the amounts provided for FY 2013, none of the listed projects exceed the \$1.5M threshold.

The one notable exception, however, pertains to GPA's Smart Grid project that includes a revenue-funded budget of \$1.04M in FY 2013 for meter repairs, which is not covered by the grant and is over the GPA's total estimated Smart Grid budgeted amount. In a follow-up email, GPA indicated that these meter repairs will be financed over a five-year period with the total amount expected be between \$0.8M and \$5.5M.

Shaw Consultants have also reviewed GPA's FY 2012-FY 2013 pro forma income and cash flow statements and notes that with respect to its annual coverage targets, while the PUC's senior bond coverage ratio just exceeds the target (1.75 target versus 1.77 earned), the measure GPA uses to calculate long-term rating agency times interest earned produced a coverage ratio of 1.16 times, which is significantly below the goal of 1.75 times.

It is also noteworthy that in the PUC's order pertaining to GPA's bond restructuring/refunding that was just completed, the PUC mandated that there be a roll-back of a portion of GPA's recent \$9.1M increase by the amount of reduction in debt service resulting from the bond transactions just completed. However, in its pro forma income statement, there is no amount showing for the anticipated roll-back. In our follow-up call with GPA, they indicated that although there is no entry showing for the roll-back, the debt service payments on the expense side are based on the pre-bond restructuring/refunding that just took place. GPA is still working out the figures, but believes that since the reduction in debt service due to the restructuring/refunding will be approximately \$11M and the roll-back will be approximately \$9M, effective December 1, 2012, the net effect will be to increase its income by approximately \$2M with an attendant increase in its times coverage ratios.

We also note that in its FY 2012 filing, GPA reported \$3.5M for PILOT (Payment in Lieu of Taxes), however no PILOT payment was shown in the current FY 2013 filing, which results in higher net revenues than what they would have been if a PILOT payment had been included in the FY 2013 estimates. In our follow-up call with GPA, they indicated that legislation was being introduced that would eliminate the PILOT and that if the legislation was not passed, GPA would be able to implement a surcharge to cover this payment.

Recommendations

With recognition that the FY 2013 general plant budget is consistent with that of prior fiscal years, and subject to GPA's ability to carry out the capital improvement projects using internally-funded dollars, Shaw Consultants recommends that the \$10.136M ceiling cap be approved. It must also be noted that we did not review the prudence or justification of any of the capital improvements included in the ceiling cap.

In accordance with the Contract Review Protocol, GPA should file a report on the contracts and obligations approved by the PUC for the prior fiscal year reconciling the amount approved by the PUC with the actual expenditures during the preceding fiscal year.

Sincerely,



Kathleen A. Kelly

Vice President

Shaw Consultants International Inc.