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Public Utilities Commission
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BEFORE THE GUAM PUBLIC UTILITIES COMMISSION

IN THE MATTER OF:	**GPA DOCKET 11-09**
GUAM POWER AUTHORITY'S 2011 MULTI YEAR BASE RATE RELIEF FILING [PHASE II ISSUES]	**ALJ REPORT**

INTRODUCTION

1. This matter comes before the Guam Public Utilities Commission ["PUC"] as a part of the "PHASE II" issues in the Guam Power Authority's ["GPA's"] 2011 Multi Year Base Rate Relief Filing.

2. In the ORDER RE: PRELIMINARY ISSUES rendered by the Administrative Law Judge ["ALJ"] on February 8, 2012, certain issues, including the Self Insurance Surcharge and the formula for determination of the debt service coverage ratio on subordinate debt, were deferred until PHASE II of this proceeding.[1]

3. This Report will address the resolution of PHASE II issues concerning the Self Insurance Program Protocols and the formula for determining the debt service coverage ratio for subordinate debt.

BACKGROUND

4. The Self Insurance Program ["SIP"] was first established by the PUC in 1994. Its purpose was to create a surcharge on customers' bills which would provide a funding source so that GPA could react more quickly and efficiently to the natural consequences of significant storm events, particularly typhoons.[2] SIP was initially restricted for use for transmission and distribution related (T&D) costs. As GPA has set forth: "The cap for the SIP was initially set at $2.5 million; an amount that matched GPA's T&D insurance deductible. In 1995, the PUC expanded the use of the fund to include generation losses. The GPUC authorized an increase to the cap on the SIP from $2.5 million to $10 million, as well as an expansion of uses for the funds in the SIP. In GPUC Docket 11-04, the Commission authorized GPA to continue collecting the SIP amounts from customers pending completion of GPA's general rate case."[3]

[1] ORDER RE: PRELIMINARY ISSUES, GPA DOCKET 11-09, issued February 8, 2012.
[2] Letter from GPA General Manager Joaquin Flores to Frederick J. Horecky, PUC ALJ, Re: GPA Docket 11-09-Phase II Self Insurance Fund Protocols, dated April 15, 2013.
[3] Id. at p. 2.

5. Both GPA and the PUC Independent Consultant, the Georgetown Consulting Group ["GCG"] have filed reports on the Self-Insurance Program and the applicable protocols.[4] On April 15, 2013, both GPA and GCG also submitted their respective positions regarding subordinate debt service ratio coverage.[5]

6. GPA has requested that the PUC approve the use of a subordinate debt coverage ratio (SDCR) of 1.4 for GPA for rate making purposes, using the following method of calculation:

$$\frac{\text{[(Gross Revenue and Income) – (Operating \& Maintenance Expenses net of depreciation)}}{\text{[Total Debt Service Costs]}}$$ [6]

At least initially, GCG had proposed a different formula for debt service coverage for subordinate debt as follows:

$$\frac{\text{[(Net Revenues) – (IPP Debt Service) – (Senior Debt Service)]}}{\text{[(Subordinate Debt Service)]}}$$ [7]

7. GPA suggests that its formula "will allow the Commission to analyze the financial strength of GPA from the perspective of an investor in the entire utility organization, not simply from the view of an investor in subordinate bonds."[8]

8. Subsequent to conversations between GCG and GPA in April of 2013, the parties agreed that the methodology proposed by GPA for determining the subordinate debt service coverage ratio may be utilized. However, GCG believes the PUC should reconsider its current standard of 1.4x for subordinate debt service coverage: "The regulatory standard should be reset to 1.3x and the "S&P" Method should be used for the computation."[9]

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[4] SAIC, Report on SELF-INSURANCE PROTOCOLS, Guam Power Authority, GPA Docket 11-09, filed April 15, 2013. GCG Report of the Technical Consultants, GPA Docket 11-09 concerning the setting of self-insurance cap, possible protocols for accessing funds, and debt service coverage ratio requirements on subordinate revenue bonds, filed April 15, 2013.

[5] GCG Report, Id.; Black & Veatch, FINANCIAL MEMORANDUM: Debt Rating Criteria and the Utility Rate Making Process, GPA Docket 11-09, filed April 15, 2013.

[6] Letter from GPA GM Joaquin Flores to ALJ Fred Horecky, GPA Docket 11-09 Phase II, Re: Subordinate Debt Service Coverage Ratio Filing, filed April 15, 2013.

[7] Id. at p. 2.

[8] Id. at p. 1.

[9] Report of the Technical Consultants Madan, Gawlik & Margerison, GPA Docket 11-09, filed April 15, 2013.

9. On May 15, 2013, GPA and GCG entered into a STIPULATION RE: PHASE II ISSUES, with SELF INSURANCE PROGRAM PROTOCOLS attached. The Stipulation addressed the Self Insurance Program Protocols and the Subordinate Debt Service Coverage Ratio.[10]

10. On May 17, 2013, the parties met for a hearing conducted before the Administrative Law Judge at the PUC Conference Room. The parties, through their various representatives, were in attendance. The Navy, although not a party to the Stipulation, also appeared at the hearing. At that time the parties presented their positions concerning the two issues and the proposed Self Insurance Protocols. The ALJ conducted an inquiry into the provisions agreed to and also requested that the parties consider certain revisions to the Protocols.

ANALYSIS

11. On May 22, 2013, GPA and GCG submitted their revised SELF INSURANCE PROGRAM PROTOCOLS. Said PROTOCOLS are attached to the STIPULATION RE: PHASE II ISSUES filed herein. The Stipulation has been the result of extended negotiation between the parties, discussion, and further amendment. The Protocols define the scope, draw down procedures, review process, and other aspects of the Self-Insurance Program.

A. Scope

Originally, GPA's use of Self Insurance Funds was limited to losses resulting from natural disasters such as typhoons, earthquakes, and other events. However, Protocol I extends the scope of the program to "all unanticipated and extraordinary expenses associated with insurable events, including losses from accidents, explosions, fires and similar events." Pre-hazard preparation and mitigation projects are covered. A loss that would normally be covered by insurance, but for which insurance is not available, would also be covered.

The deductibles for insurance policies are included within the scope of covered matters. The broadening of "insurable events" (see Protocol II) to include equipment failures and similar hazards that would normally be covered by insurance is a positive step for GPA. GPA will have readily available financial resources to address such disasters in a timely manner. Losses covered by other GPA insurance policies and events occurring through normal wear and tear are not covered (Protocol III). There is a minimum threshold of $200,000 per insurable event required before the SIP Reserve can be accessed (Protocol IV).

[10] STIPULATION RE PHASE II ISSUES, GPA Docket 11-09, filed May 15, 2013.

B. Draw Down Procedure
A Draw Declaration (written self-certification) by the GPA General Manager that a loss associated with an insurable event has occurred, or that pre-hazard preparation is necessary, will enable the General Manager to make SIP draws for expenditures up to $5 Million per insurable event. The Consolidated Commission on Utilities ["CCU"] shall authorize all SIP draws above the $5.0 Million threshold (Protocol V).

C. Reporting Requirements
There are various reporting requirements that GPA must undertake to draw down funds from the SIP reserve. Within 60 days from the end of the month in which disbursements are made from the SIP reserve, GPA must provide a Draw Down Report to the CCU, with a copy to the GPUC, identifying the amount and purpose of the draw down in sufficient detail to allow auditing of the transaction (Protocol X). All SIP reserve draw downs and Draw Declarations in excess of $2.5 Million must be audited by an independent third party for SIPP compliance on an annual basis. The audit report must be provided to both the CCU and the GPUC (Protocol XV).

D. SIP Reserve Cap
The SIP Reserve will continue to accrue until it reaches the SIP Reserve Cap, which shall remain at $20,000,000 until changed by the GPUC (Protocol VIII). In GPA Docket 11-04, the Commission authorized GPA to continue to collect self-insurance surcharges even though the $10 Million cap had already been reached.[11] The Commission found that "the continuance of the current self-insurance surcharges in effect will help to insure that GPA has a sufficient reservoir of funds to cover catastrophic losses."[12]

Both the Consultants for the PUC and GPA gave their opinions at the scheduled hearing on this matter that the proposed cap of $20 Million represented a reasonable amount to protect GPA against potential losses. The ALJ notes certain disaster charge figures cited by SAIC in its report. In 2002, the total disaster charges to GPA work orders for Typhoons Chataan and Pongsona were $38,453,272. GPA Ratepayer Cost for those typhoons was $16,204,919.[13] The amount of damage incurred to Guam as a result of those storms, as well as the significant ratepayer

[11] PUC Order GPA Docket 11-04, dated May 16, 2011.
[12] Id. at p. 3.
[13] SAIC, Self-Insurance Protocols (Guam Power Authority) April 15, 2013.

cost, substantiate that the proposed level for the self-insurance cap approximates an amount that could be necessary for disaster repairs in a worst case storm scenario.

There is also a protocol provision requiring GPA to retain an outside expert to review the adequacy of the SIP Reserve Cap and to recommend changes if appropriate (Protocol VIII). Such risk assessment must be performed by a firm specializing in actuarial analysis taking into consideration certain factors. The risk assessment under this protocol must be prepared no later than June 2016, if acceptable to the PUC. The risk assessment must also be prepared if GPA seeks to raise the level of the SIP Reserve Cap.

E. <u>Self-Insurance Surcharge</u>
Under the proposed protocol, the Self-Insurance Surcharge remains the same as the present surcharge: $0.0029 per kilowatt hour (kWh) sold by GPA to civilians and $0.0007 per kWh sold by GPA to U.S. Navy customers. The Self-Insurance Surcharge shall remain in effect until the amount in the SIP Reserve reaches the SIP Reserve Cap, and shall be reinstituted at any time the balance in the SIP Reserve thereafter falls to less than $18,000,000 (Protocol IX). Allowable expenditures which GPA may charge as cost to the SIP Reserve are specified in Protocol XII. They include normal labor, vehicle and transportation costs, materials and supplies, overtime, fuel, increased power generation costs, infrastructure hardening activities and others (Protocol XII).

F. <u>Loss Mitigation</u>
GPA may seek to use the SIP Reserve to fund activities associated with infrastructure hardening activities intended to mitigate future damage not directly associated with an impending insurable event. However, use of the SIP Reserve for such mitigation activities requires the prior approval from both the CCU and the GPUC.

12. With regard to Debt Service Coverage Ratio, GPA and GCG have essentially agreed to use the methodology proposed by GPA to calculate debt service coverage ratio on subordinate debt. The agreed upon formula in the Stipulation is as follows:

$$\frac{\text{(Net Revenues as defined by the PUC or S\&P Method)}}{\text{(total debt service for senior and subordinate debt)}}$$ [14]

13. It makes sense to utilize a formula for the calculation of the debt service coverage ratio on subordinate debt in a manner that analyses the financial strength of GPA in

[14] Stipulation Re: Phase II Issues, GPA Docket 11-09, filed May 23, 2013.

the perspective of overall strength of the utility organization, not merely from the view of an investor in subordinate bonds.

14. The Stipulation indicates that the parties have not reached an agreement at the present time as to the proper DSCR standard to be adopted by the PUC for regulatory purposes for subordinate debt. GPA believes that a DSCR standard of 1.4x is appropriate. GCG believes that a slightly lower DSCR standard of 1.3x would be adequate, but that any standard should be flexible and subject to possible adjustment depending on relevant circumstances.

15. In its ORDER dated June 3, 2010, in GPA Docket 10-01, the PUC approved issuance by GPA of the 2010 Revenue Bonds, including subordinate bonds. Specifically, the Commission stated as follows: "The Commission affirms its commitment to support a debt service coverage ratio of 1.75 times on senior debt including the proposed Revenue Bonds <u>and 1.4 times on the Subordinate Revenue Bonds proposed."</u> (Emphasis added).

16. At the hearing before the ALJ on this matter, GPA, through its Consultant Joseph Trainor, suggested that it would not, in any event, be appropriate to change the current debt service coverage ratio for subordinate debt without examining all of the new data and rate information submitted in the pending petition for the FY2014 rate case.

17. Mr. Jim Madan of GCG did not disagree with this consideration and indicated that the necessity to change the current subordinate debt service coverage ratio could be considered in the context of the FY2014 rate case. The ALJ notes that the PUC has already established a standard of 1.4x for subordinate debt. It would not be appropriate to change that standard without a full consideration of that issue and within the context of consideration in a larger rate proceeding. Therefore, the parties will be permitted to further examine this issue, and to present their respective positions, in the context of the FY 2014 rate petition case.

<u>RECOMMENDATION</u>

The ALJ recommends that the PUC adopt the Revised Self-Insurance Program Protocols attached as Exhibit A to the STIPULATION RE: PHASE II ISSUES. The ALJ believes that the protocols were deliberatively arrived at through an appropriate negotiated process. The parties have reasonably concluded that the Self-Insurance Cap should be raised, and that the coverage scope of the program should be expanded to include matters other than natural disasters such as accidents, explosions, fires, equipment failures, etc. The proposed procedure for withdrawal of SIP Reserve Funds has adequate safeguards that will allow for full review by the PUC. There are appropriate audit and reporting requirements, and the PUC will reserve all of its powers to determine whether any expenditures under the Self-Insurance Program are prudent or should be disallowed. The current Self-Insurance Surcharge amounts to civilian and Navy customers will remain the same. The PUC should approve the Protocols as stipulated.

Furthermore, as stipulated by the parties, the PUC should adopt the formula recommended for calculation of the debt service coverage ratio on subordinate debt. Such method is the determination of net revenues as defined by the PUC or S&P Method divided by Total Debt Service for senior and subordinate debt. This is the most appropriate standard for determining the overall strength of the utility. As to the current DSCR standard of 1.4x, such standard shall remain in effect as it has previously been approved through PUC Order. If they choose, the parties may revisit this issue in the context of the current rate petition filed for the establishment of FY2014 rates. A proposed Order for consideration of the Commissioners has been submitted with this Report.

Respectfully submitted this 23rd day of May, 2013.

Frederick J. Horecky
Frederick J. Horecky
Administrative Law Judge