December 25, 2013

**Jeffrey Johnson, Chairman**

Guam Public Utilities Commission

Suite 207, GCIC Building

Hagatna, Guam 96932

**Docket 14-02: Petition of Contract Review of Extension of R.W. Armstrong PMO Contract**

Dear Chairman Johnson,

Lummus Consultants International, Inc. (Lummus Consultants) is pleased to submit this letter report to the Public Utilities Commission in response to Mr. Fred Horecky’s request to evaluate and submit a short report with respect to GPA’s petition to approve a $3.9M contract extension for the PMO services of R.W. Armstrong to assist the GPA in implementing the PUC’s ordering provisions in connection with GPA’s 2012 IRP and to recover the cost through the Levelized Energy Adjustment Clause (LEAC).

**Introduction**

In Docket 13-04, issued July 30, 2013, the PUC conditionally approved GPA’s 2012 Integrated Resource Plan (IRP). The thrust of the direction and findings in the IRP was that as an alternative to making investments needed to meet EPA emissions requirements, GPA could invest in the order of $650M to transition most of its generation units to LNG and achieve a present value savings over 30 years of approximately $900M. The PUC order, in accordance with Lummus Consultants’ findings, determined, among other things, that the conversion to LNG requires a cautious approach, with multiple checkpoints along the project development path. One of the salient ordering provisions was that GPA shall submit a detailed Resource Implementation Plan to the PUC for approval within 120 days of the Order.

In its Resolution 2013-50, dated November 12, 2013, the Consolidated Commission on Utilities (CCU) responded with a Resource Implementation Plan prepared by its Strategic Planning Operations Research Division (SPORD), titled “IRP Implementation Strategy Decisions”[[1]](#footnote-1). In the current application, with supporting details included in its Resolution, GPA is petitioning the PUC to:

* Approve the extension of the R.W. Armstrong contract at a cost of $3.9M for services in fiscal year 2014[[2]](#footnote-2) so that it can utilize its existing PMO contract with R.W. Armstrong (RWA) to support and facilitate its execution of the Resource Implementation Plan and LNG strategy and other project level services; and
* Recover the $3.9M cost of the PMO contract through the LEAC.

GPA’s Base Rate Filing, which was recently concluded, for rates effective in fiscal year 2014, did not budget any costs for the PMO or LNG-related activities. The CCU anticipates that recovery of costs associated with the Resource Implementation Plan and IRP strategy decisions will be eligible for LEAC expenses, subject to PUC approval[[3]](#footnote-3). GPA expects to propose that one-half of the $3.9M ($1.95M) be included in its next LEAC to be effective to be effective during the six-month period beginning February 2014. The principal justification provided by GPA for putting the PMO’s costs in the LEAC is that it is an essential element in providing future fuel savings.

**Discussion and Recommendations**

The LEAC protocol was established by the Guam PUC Order in Docket 95-001 on January 29, 1996 by way of a stipulation between GPA and the PUC’s consultant, Georgetown Consulting Group (GCG)[[4]](#footnote-4). The purpose of the LEAC was to stabilize the cost to customers during periods of fluctuating fuel prices and to reduce the lag associated with the recording of fuel and certain fuel-related expenses for the timely computations required for the then-monthly fuel adjustment factor. The LEAC was to be set each year and reviewed on a semi-annual basis each year to recover all prudently incurred fuel costs through a level fuel surcharge over the next six-month period. The LEAC costs included in the stipulation included:

* Fuel oil mix and fuel oil cost compared with the projections for the six-month period most recently recorded, by generating plant;
* Transmission and distribution losses and station use compared with projections for the same period;
* Over- or under-recovery of fuel costs for the same period (deferred fuel); and
* A projection of the LEAC factor for the upcoming period.

The stipulation further provided that in addition to direct fuel and fuel handling costs to be recovered through the LEAC, no other costs will be permitted, without an express order and approval by the PUC.

Since its inception, certain changes and deviations to the LEAC have been made.

* In Docket 94-04, dated March 14, 2002, GPA’s LEAC (Rate Schedule Z) was amended to confirm the Commission’s authority to prohibit GPA from passing unreasonable fuel expenses through to its customers;
* In the same docket the ALJ provided authorization to adjust the LEAC factor to address projected fuel hedging expenses during the period;
* In Docket 99-12, dated September 24, 2003, the PUC approved the recovery of lube oil expense for the Cabras baseload units 3 and 4 as an allowable expense under the LEAC protocol;
* The LEAC was also amended to include bank charges for lines of credit to purchase fuel, as well as a fuel-related working capital fund surcharge;

Perhaps the most notable deviation of the LEAC, as it pertains to GPA’s current application, is that from November 2008 through April 2009, the LEAC recovered $400,000 in costs for a wind study that was approved by the PUC for developing an alternative energy source that could lead to a reduction in fuel oil use.

The inclusion of costs other than directly fuel related have, from time to time been included in the LEAC of other utilities. Two examples are:

* Virgin Islands Water Authority – In 1998, in order to recover costs associated with the utility’s Payment in Lieu of Taxes (PILOT ) to the government, the Authority temporarily included the PILOT in the LEAC until it could receive permanent rate relief from the PSC.
* Jersey Central Power & Light Company - In December 1994 the company filed a request with the New Jersey Board of Public Utilities for an increase in the LEAC component of rates to include the cost of its demand side management programs.

Since its inception, the Guam PUC has endeavored to maintain the LEAC as reasonably close as possible to costs that are directly related to fuel oil consumption in the current period. In Docket 99-12, dated October 14, 2004, in connection with a discussion relating to whether lube oil should continue as an allowable expense under the LEAC protocol, the PUC noted[[5]](#footnote-5):

*Levelized fuel adjustment clauses [LEAC] are an exception to traditional regulation. Normally, a utility is prohibited from charging any rate other than the last rate approved by the Commission in a base rate case. Commission approval of the use of LEAC permits GP A to make adjustments in its charges to customers without the level of scrutiny and public notice applied in base rate proceedings. Accordingly, PUC should carefully examine any cost which GP A seeks to fund under LEAC.*

In terms of support for the $3.9M requested for the contract extension of the PMO, on December 20, 2013, GPA provided Mr. Horecky with a qualitative breakdown of what is included in each of three PMO tasks and a summary of costs that GPA negotiated with the PMO for each task. GPA’s submission is attached to this report. The cost breakdown in that submission is shown in the table below.



In examining the qualitative breakdown of what is contained within each task, we note that there are a diversity of sub-tasks relating to the recommendations in GPA’s 2012 IRP some of which are directly relate to LNG and others that do not. Lummus Consultants believes that only those tasks that are directly related to the conversion to LNG should be eligible for possible recovery through the LEAC. For example, Task 1 ($1.855M) does not appear to include much of any LNG-related work, while Tasks 2 and 3 ($2.045M) are largely LNG-related.

Lummus Consultants notes that there are additional steps to be made before the final decision is made to convert to LNG and based on the possibility that future fuel oil savings could offset the cost of making the transition does not for that sole reason justify inclusion in the LEAC. We do not believe that including LNG-study related costs should set a precedent for inclusion in the LEAC, as other activities such as increasing generating unit efficiency or decreasing system losses could also offset future energy costs.

Lummus Consultants also notes that aside from what portion of the $3.9M should be in the LEAC versus base rates, no real breakdown of costs within each task or justification for each sub-task activity has been provided to enable the Commission to make an informed judgment.

After careful review and consideration of GPA’s filing, Lummus Consultants offers the following recommendations:

1. GPA should not approve the entire $3.9M unless GPA provides the PUC with a more detailed cost breakdown of the sub-tasks in each major task, along with justification;
2. For fiscal year 2014, GPA should delineate the cost of those activities in Tasks 2 and 3 that are clearly related to LNG for recovery in the LEAC;
3. Beyond fiscal year 2014, the recovery of all PMO and LNG-related costs should properly be budgeted for in base rates and not in the LEAC;
4. No capital projects should be included in the LEAC.

Lummus Consultants hopes that this review has been helpful in assisting the Commission in this matter. If you have any questions or need further assistance, please do not hesitate to call or write.

Very truly yours,

1. The IRP Implementation Strategy Decisions document is Attachment A in CCU’s Resolution 2013-50. [↑](#footnote-ref-1)
2. PMO services to be performed for GPA are included in Attachment C to Resolution 13-50 as a descriptive scope of services with only a lump sum fee of $3.9M. [↑](#footnote-ref-2)
3. CCU Resolution 2013-50, page 3, lines 22-23. [↑](#footnote-ref-3)
4. The stipulation between GPA and Georgetown Consulting Group is Appendix D in Docket 95-001. [↑](#footnote-ref-4)
5. Commission Determinations, page 4, Section 5f. [↑](#footnote-ref-5)