



Virgin Islands Water and Power Authority
SUMMARY REQUEST FOR GOVERNING BOARD ACTION

November 14, 2012

1. **SUBJECT:** Authorize the Executive Director to file a petition associated with the Water System rate case to the Virgin Islands Public Services Commission (PSC).
2. **JUSTIFICATION:** On July 6, 2012, the Authority received approval for emergency rate relief effective August 2012 for the Water System from the Virgin Islands Public Services Commission. The PSC order approving the emergency rate relief was intended to cure the Water System's failure to meet the Debt Service Coverage requirement of the Bond Resolution associated with the Series 1998 Revenue Bonds. The PSC Order No 28-2012 further required the Authority to file a petition for permanent rates no later than November 16, 2012. This request is intended to meet the requirements of PSC Order No.28-2012.

The Authority is in the process of implementing a water supply/production strategy based on purchasing its water supply requirements from Seven Seas, Inc. To date, the Authority has negotiated and executed agreements with Seven Seas, Inc. to provide 3.3 MGD of water capacity on St. Thomas and 3.3 MGD of water capacity on St. Croix. The purchased water supply arrangement is based on utilizing sea water reverse osmosis (RO) treatment technology which will allow the Authority to retire its aging IDE water production units. This will result in increased reliability and lower production costs in the future.

The project construction schedule estimates the full implementation of the new water supply arrangement by March 2013 on St. Thomas and January 14, 2014 on St. Croix. At that time the Authority will purchase 100% of its water supply requirements.

- As a result of the new water supply arrangement, the Authority has updated its Water System Business Plan (the "Water Business Plan") and a copy of the business plan summary is included as Attachment A to this request.
- The Water Business Plan addresses a number of operating, accounting and rate changes that are associated with implementation of the new water supply arrangement and that are addressed in the permanent rate filings. These proposed changes include:
 - 1) A new LEAC formula designed to recover purchased water costs and the cost of electricity provided to Seven Seas, Inc. to power the R/O treatment plants. In addition, the formula allows for the recovery of gross tax receipts associated with the LEAC and certain regulatory expenses. Consistent with the current approach, the LEAC formula also provides for the true-up of prior period over- and under-recovery of LEAC-related costs. The amount of electricity used in the R/O water treatment plants will be metered and billed under the LEAC portion of the rate based on the Electric System's average

production cost (i.e., excluding distribution and administration and general costs). This cost is currently approximately \$0.32 per KWH. The agreement with Seven Seas, Inc. also guarantees the plants' efficiency with a maximum usage of 12.5 KWH's per 1,000 gallons produced. The new water supply arrangement is estimated to result in a significant reduction in the LEAC portion of the water rate.

- 2) Since the Authority will no longer produce water using the IDE technology, certain electric production expenses which are currently allocated to the Water System will be eliminated. These expenses include both direct and indirect costs that were incurred under the joint electric/water production process. In addition to certain direct personnel expenses that will remain with the electric system an adjustment will also be made to OPEB expenses that will no longer be allocated to the Water System.
- The Water System Business Plan and rate filing also includes the payment of certain deferred fuel and administrative and general expenses to the Electric System to eliminate these liabilities, as well as a \$2.5 million line of credit. It is estimated that the deferred fuel expense will be recovered through the LEAC and paid off by Fiscal Year 2014 and the deferred administrative and general expense of \$10.1 million will be paid to the Electric System over a five year period beginning in Fiscal Year 2014. Similarly we have assumed repayment of the line of credit over five years beginning in FY2014.
 - The Water System cash reserves are almost entirely restricted to certain capital projects as such funds were provided through grants to fund capital needs. Therefore, the Authority's current working capital (unrestricted cash balance) is deficient. The Water System Business Plan and rate filing includes an allowance to replenish the working capital fund over five years with a targeted working capital balance of \$2 million or 30 days of operating expenses.
 - The Water System capital plan is currently being funded significantly through EPA grant and future borrowing once the Series 1998 Bonds are paid off in 2017. The Authority has identified over \$68 million dollars in prioritized capital investment needs which are shown in Attachment B to this request.

As shown in Attachment B, the capital plan includes \$33,000,000 in high priority investments aimed at reducing Water System line losses and ensuring public health and safety. The benefit of these projects will directly reduce purchased water costs and the resulting LEAC charge. Currently line loss/unaccounted for water equals approximately 38% of water production on St. Croix and approximately 12% of water production on St. Thomas. A major strategic goal of the Water System Business Plan is to reduce the percentage line loss on St. Croix to under 20% and to 10% on St. Thomas over the next five years. Of the \$33,000,000 in line loss reduction projects included in the Capital Improvement Program, \$25,000,000 are funded from grants and \$8,000,000 are anticipated to

be funded internally from rates in FY2014 through FY2018. The proposed rate filing requests that the PSC allow the Authority to establish a line-loss reduction capital surcharge for the purpose of funding these critical capital projects.

- The proposed rate filing is based on the Test Year FY2011 actual operating results adjusted to reflect a FY2014 implementation date. The revenue requirements analysis indicates that a base rate increase of \$1,400,000 or 5.4% increase and a line loss reduction capital surcharge of \$900,000 or \$0.71/kgal sold is required to meet the Water System's operating, capital investment and financial needs. The \$2.3 million increase is in addition to the rate increase approved in the interim rate relief.
- While the Water Business Plan indicates the need for an increase in base rates, the resulting decreases in water supply costs of the new purchased water arrangement along with the pay-off of deferred fuel expense is projected to result in a \$2.01 decrease in the LEAC charge in FY2014 compared to the current LEAC charge. Further reductions are expected to be achieved through the line-loss reduction program. As shown in the Water Business Plan summary, the projected decrease in the FY2014 LEAC charge will result in an overall net rate reduction of \$0.43 for the typical bill of 2400 gallons when the base rate increase is also included.
- The Authority has experienced a very significant reduction in standpipe water sales during FY2012. Water sales from the Stand-pipe declined from 73.6 million gallons in FY2011 to 11.5 million gallons in FY2012 due to a number of issues that include: i) the loss of Hovensa on St. Croix (Hovensa purchased significant amounts of water from the Stand-pipe); ii) water rationing on St. Thomas; iii) water quality issues; and iv) lower prices charged by competitors. In addition to the issues discussed above, the Authority's rate case filing will address the need for more competitive pricing to recover the lost standpipe sales. Based on competitive pricing considerations the rate request includes an 18% reduction the base rate of standpipe customers.
- The Authority has made significant accomplishments with respect to a new purchased water arrangement with Seven Seas Corporation. Contracts for future water supply have been negotiated and finalized for both St. Thomas and St. Croix that will result in lower and more stable water production costs compared with the existing IDE production technology.

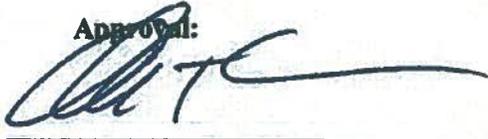
The lower water production costs will pass through directly to the Authority's customers through the LEAC formula included in the water rates. The next critical initiative is to lower distribution system line-losses, which will further reduce the LEAC charge, and to improve the Authority's financial position.

The rate case filing proposes a line loss reduction capital surcharge to address high line loss levels and includes allowances to repay deferred liabilities to the Electric System and pricing adjustments for standpipe customers that will help improve the Authority's financial position.

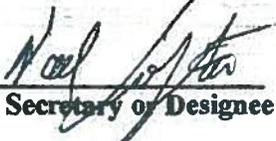
3. **BENEFITS:** If approved by the WAPA Governing Board and the PSC, the proposed rate request would allow the Authority's Water System to have a rate structure that fully funds the operating, capital investment and financial needs of the System. The funding level would allow for repayment of outstanding liabilities associated with deferred expenses, help pay for much needed capital projects to improve the water distribution system to increase efficiency, reduce line losses, fund certain systems expansions to increase revenue and ultimately ensure public health and safety resulting in a more economically and financially viable Water System. It should be noted that the permanent rate increase along with the anticipated reduction in future associated LEAC charges will result in bills that will be less than comparable bills based on the rates in place prior to the interim rate increase and the current LEAC charges.
4. **PERMITS REQUIRED/STATUS:** N/A
5. **COMPLIANCE WITH PURCHASING REQUIREMENTS:** N/A
6. **COST:** N/A
7. **BUDGET AUTHORITY & WORK ORDER NO:** N/A
8. **INITIAL COMPLETION DATE:** Rates to be effective July 1, 2013.
9. **SPONSOR:** Julio Rhymer, Chief Financial Officer 
10. **CHIEF OPERATING OFFICER'S APPROVAL:**
11. **CHIEF FINANCIAL OFFICER'S APPROVAL:** 
12. **EXECUTIVE DIRECTOR (CEO)'S APPROVAL:**  11/15/12
13. **GOVERNING BOARD ACTION REQUIRED:** Authorize the Executive Director to file a Water System Rate Case, requesting a base rate increase of \$1,400,000 or 5.4% increase and a line loss reduction capital surcharge of \$900,000 or \$0.71/kgal sold, to meet the Water System's operating, capital investment and financial needs. The combined \$2.3 million increase is in addition to the rate increase approved in the interim rate relief.

14.

Approval:



Chairperson



Secretary or Designee

Disapproval:

Chairperson

Secretary or Designee

Date:

11/15/12