BEFORE THE

VIRGIN ISLANDS PUBLIC SERVICES COMMISSION

DOCKET NO. 613

REBUTTAL TESTIMONY OF JULIO A. RHYMER

ON BEHALF OF

THE VIRGIN ISLANDS WATER AND POWER AUTHORITY

REGARDING THE PETITION FOR PERMANENT RATE RELIEF

FOR THE WATER SYSTEM

JULY 26, 2013

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Julio A. Rhymer and my business address is: Virgin Islands Water and Power Authority, 9720 Estate Thomas, St. Thomas, Virgin Islands 00802.

Q. WHAT IS YOUR OCCUPATION?

A. I am the Chief Financial Officer of the Virgin Islands Water and Power Authority ("WAPA" or Authority").

Q. HAVE YOU HAD AN OPPORTUNITY TO REVIEW THE TESTIMONY FILED BY GEORGETOWN CONSULTING?

A. Yes. I have reviewed the combined/panel testimony of Mr. Jamshed K. Madan, Mr. Larry R. Gawlik and Mr. Michael D. Dirmeier, (the "Panel Testimony") as well as the testimony of Mr. Bruce Oliver (collectively, the "PSC Technical Consultants"), all of which was which was filed on July 3, 2013.

Q. DO YOU HAVE ANY CONCERNS RELATIVE TO THE TESTIMONY FILED BY GEORGETOWN CONSULTING?

A. Yes.

Q. WHAT IS YOUR CONCERN?

A. As the Chief Financial Officer of the Authority, it is of grave concern to me that the PSC Technical Consultants (Georgetown Consulting Group, "GCG" or "Georgetown" herein) are recommending disallowance of an aggregate of $12.5 million dollars in expenses on the part of the Electric System. I will discuss in detail why the recommendation for a disallowance is an extraordinarily irresponsible act on the part of the consultants, and why given the historical

context of the Authority's actions in allowing for the intra-company transaction, the recommendation is out of line.

Q. CAN YOU ELABORATE ON WHY THIS IS OF CONCERN TO YOU?

A. In my direct testimony, Exhibit JAR-4, Line 6, I recognized that there is a balance due to the Electric System of a little over $10 million, which balance has accrued over a period of years, and which the Authority proposes to recover over a six-year period. Georgetown, an entity that does not have to rely on the electric generating energy that the Authority provides to the ratepayers in our community, and which would not feel any of the devastating impact that its recommendation for disallowance would have on the Authority, its ratepayers or the community at large, has recommended the PSC not allow current funding of the entire $12.5 million dollars: $10 million of which is an intra-company loan, which GCG deems an expense for a prior period which is unrecoverable in this rate case *(See GCG Water Testimony at p. 16, 22),* and $2.5 million which is a line of credit *(See GCG Water Testimony at p. 22).* This position is simply not acceptable to the Authority.

Q. HOW DID THE ELECTRIC SYSTEM ACCRUE THE $10 MILLION INTRA-COMPANY LOAN?

A. As a means of keeping track of the separate expenses and receipts of the two systems, internally the Authority uses an allocation method. The expenses of the Water System are paid initially by the Electric System and then reimbursed by the Water System. Over a period of time, due to inadequate rates on the Water System, the Water System lagged behind in paying back the Electric System when those allocated expenses were due. It is important to note that $7million

of the $10 million loan to the Water System accrued through 2009, prior to the 2009 rate proceeding. An additional $3 million accrued from 2009 to the present. The intra-company loan transactions were prudent. The $10 million loan was a result of an allocation of expenses to the Water System that yielded results that were unanticipated and the Authority expected to correct over time upon the filing of a rate case. That filing has now occurred and it is the desire of the Authority to address this issue, and to adjust its allocation methodology to make sure this does not happen again.

Q. DID THE AUTHORITY PROPERLY ACCOUNT FOR THE INTRA-COMPANY LOAN ON ITS BOOKS?

The Authority has accounted for the $10 million and the $2.5 million line of credit on the books of both systems, and its audits reflect the transaction in the books for both systems. The Electric System and the Water System share one checkbook, one disbursement account. When a bill for fuel arises, there is insufficient time to calculate whether a portion of the cash balance allows the Water System to pay its share of the fuel cost. This is a matter for allocation between the two systems. What should be the only issue here is an accounting adjustment so that the accounting records and rates of both systems going forward are sound.

Q. ARE INTRA COMPANY LOANS FAIRLY TYPICAL?

A. In my experience, intra-company loans are fairly typical. The financial sustainability of the Water System dictated that its sister entity, the Electric System, provide the much needed financial relief. I am familiar with GAAP, GASB and regulatory accounting and am not aware of any regulation or principle that would restrict the intra-company loans transactions that the Authority has on its books. If that were the case, undoubtedly, its Auditors would have issued a finding against the Authority and would have cited this in any of its historic annual audits. This did not occur.

Q. WHAT IS YOUR UNDERSTANDING OF WHY GEORGETOWN IS RECOMMENDING THE DISALLOWANCE OF THESE EXPENSES?

A. According to the Georgetown, the payment of Water System expenses by the Electric System should have been addressed within the year in which they occurred or shortly thereafter. Thus, they take issue with addressing 2011 expenses now. However, the PSC consultants' approach appears to be overly -technical. They cite to no accounting principle that prevents a short-term intra company loan by the Electric System to the Water System in order to cover a cash shortfall, or requires that it be addressed within a fiscal year or shortly thereafter.

Q. WHAT IS THE EFFECT OF THE GEORGETOWN'S RECOMMENDATION FOR DISALLOWANCE?

A. Currently, the $10 million is reflected on the books of the Electric System as an asset, however disallowance of the $10 million and the $12.5 million means that the entire $12.5 million dollars would have to be written off by the Authority and could no longer being referenced on the books as an asset of the Electric System, but rather as an expense. The

immediate implication of disallowance is the current recognition of the entire $12.5 million on the Authority's books at one time. It is an extraordinary entry in accounting terms for a $12.5 million asset to be reclassified, at one time, as an expense. The Authority would have to explain to its bondholders why disallowance is necessary. There would be mistrust by the bond market or the banks with whom the Authority's does business. The Authority would be forced to restate its financial statements for the past ten years representing the period that the intra-company loan existed on its books. The restatement of financial statements is a very time consuming and costly event, with ramifications that extend beyond the recasting of the financial footprint for the Authority. The risks involved in restating the Authority's financial statements, to the extent of the disallowance recommended by Georgetown could effectively bankrupt the Authority. The risks involved in re-stating the Authority's financial statements for a ten-year period can result in a downgrade of the Authority's bonds, not to exclude a downgrade to junk bonds. The Authority's ability to secure future financing would be significantly higher in cost or simply not available. Finally, there could be a call on the Electric Systems' bonds because of the negative credit rating. We are unclear why Georgetown, a seasoned professional organization, would offer a recommendation which has the potential impact of resulting in a call on the Electric System's bonds, a particularly catastrophic event for the Authority, and one which would render the Authority bankrupt. Simply put, disallowance is not in the interests of the Authority or its ratepayers.

Q. ARE THERE INCONSISTENCIES IN GEORGETOWN'S RECOMMENDATIONS IN THE ELECTRIC SYSTEM BASE RATE CASE AND IN THE WATER SYSTEM BASE RATE CASE?

A. Yes. Georgetown has taken the position in this docket that the PSC should disallow base rates to repay the Electric System the $10 million owed to it and to pay off the Water Systems $2.5million line of credit. This approach is inconsistent with Georgetown's position in the Electric System base rate case (Docket 612) to allow receipt of the $10 million loan to the Electric System, which intends to use the funds for capital projects. If the revenue from rates to pay the Electric System back is not allowed to the Water System, then electric rates will have to be increased to generate sufficient funds to allow it to borrow and pay back $10 million in order to undertake the capital projects it would have undertaken upon repayment of its loan to the Water System.

Q. WHY DO YOU URGE THE PSC TO REJECT GEORGETOWN'S RECOMMENDATION?

A. The PSC's consultants have recommended to the PSC disallowance of a base rate increase sufficient to allow the Water System to repay a $10 million loan owed to the Electric System by the Water System, and to allow the Water System to repay its use of $2.5 million from its line of credit. We do not believe that Georgetown's recommendation offers a fiscally responsible approach, or an approach which is in the best interests of the Authority and its ratepayers. The Authority urges the Commission to reject this approach for the following reasons. The short-term loan was interest free to the Water System. It was made to it by the Electric System without the delay and expense associated with going to a commercial lender or going through the regulatory process. Leveraging the financial resources of the Electric System to cover the operating expenses of the Water System, was seen as a viable option without the need for

incurring additional carrying charges, which would attain with a commercial loan. The PSC consultants' approach would suggest that it is per se imprudent for one system to lend to another for a period beyond the end of the fiscal year. Neither the Hearing Examiner nor the PSC should accept the extraordinary approach recommended by Georgetown. In order to provide safe and reliable power, the $2.5 million line of credit of the Water System was utilized to pay operating expenses. The alternative would have been to effectively shut the system down while the Authority sought a rate increase. Typically, getting a base rate increase takes at least 8 months. Thus, it was prudent for the Electric System to assist the Water System with a short-term loan.

Q. DOES DISALLOWANCE MEANS THAT THE INTRA-COMPANY LOAN TO THE WATER SYSTEM IS VOIDED?

A. No. Georgetown's recommendation of disallowance literally means that the $12.5 million is not accounted for as a component of the Authority's new rate structure; however the $12.5 million does not vanish from the Authority's books. Disallowance of rates to the Water System allowing it to pay back the Electric System will not mean that the $10 million loan is voided internally. The Water System will continue to owe this sum to the Electric System and disallowance by the PSC or rates to recovery this debt will have to be disclosed to holders of Water System bonds. However, disallowance has the greatest impact on the Electric System, in that it will jeopardize the Electric System's bond ratings.

Q. WHAT CAPITAL PROJECTS OF THE ELECTRIC SYSTEM WILL BE AFFECTED BY THE FAILURE TO RECOGNIZE THE $12.5 MILLION FOR PURPOSES OF SETTING THE AUTHORITY'S RATES FOR THE WATER SYSTEM?

A. Among the capital projects that the Authority will not be able to fund if Georgetown's recommendation of disallowance are accepted by the PSC are the design and construction of the following:

- St. Croix
- Mid-Islands Substation
- Installation of 69 KV Transmission Lines
- Christiansted Underground Project, Phase 2
- Annaly – Line Retirement of Old Cables
- Fiber Optic Cable Project
- Cruzan Rum Underground Project
- New Underground Services Line
- FDR 2 Underground Express Cable Installation
- Fredenborg Line Upgrade
- Feeder 6 & 10 Double Circuit

- St. Thomas and St. John
- Relocation of the Transmission & Distribution Department

- New 15KV St. John Feeder
- Main Street Enhancement (Secondary Line)
- Feeder No. 11 Underground to Long Bay Sub
- Frenchman's Bay Underground
- Harley Substation
- 7E Feeder Upgrade
- Main Street Underground
- Market Square
- New Underground Service to Customers
- Medical Arts Complex/PWD Sewer Station
- Tools and Electrical Equipment
- Radio Equipment for vehicles

Q. IS THERE ANY PRECEDENT THAT YOU ARE AWARE OF THAT SUPPORTS THE AUTHORITY'S POSITION WITH RESPECT TO THE INTRA-COMPANY LOAN?

A. Yes there is. In 1998, the Water System borrowed funds from the bond market in order to leverage those resources to acquire a boiler that was necessary for the Electric System.

The transactions that resulted in the use of $2.5 million from the Water System line of credit is the reverse to transactions that have occurred in the past, and has been and still is an acceptable practice. With respect to the 1998 transactions which resulted in an intra-company loan from the Water System for the benefit of the Electric System, there were no recommendations by Georgetown at that time for the disallowance of that loan in the Authority's rates.

Q. ARE YOU AWARE OF ANY REGULATORY PRECEDENT IN DISALLOWING AN INTRA-COMPANY LOAN?

A. No. If the repayment of the $10 million loan to the Water System and $2.5 million line of credit loan are disallowed, this would be without precedent in the area of public utility regulation. Georgetown can point to no instances where such disallowance has occurred for a publicly owned utility. Neither the Authority's consultant, nor the financial team has seen any publicly owned utility which would support a disallowance of the $10 million or the $2.5 million. Disallowance of the loans would require that the books and records of both the Electric System and the Water System be restated for a number of prior fiscal years. The cost of doing so does not warrant the benefit. The Water System is extremely small relative to the Electric System and would have to share this unnecessary cost.

Q. ARE THERE OTHER REASONS TO REJECT GEORGETOWN'S RECOMMENDATIONS?

A. Yes. Virgin Islands ratepayers already pay a higher per capital cost of PSC regulation than ratepayers anywhere else on the U.S. mainland and its territories. The PSC should seek solutions to reducing this cost. As you are aware, the Authority has made major strides forward

in diversifying its reliance on fossil fuels towards the goal of reducing the cost of electric energy to the ratepayers. The PSC has said publicly that its supports the efforts of the Authority and should continue to look for ways to extend its support. It should not accept a recommendation from Georgetown that based on this rebuttal testimony, would deal a crushing financial blow to the Authority and would set the Authority back in its efforts to provide relief to the ratepayers.

Q. IS THE AUTHORITY WILLING TO CONSIDER OTHER ALTERNATIVES?

A. The PSC's consultants have indicated that they are open to resolving the $12.5 million loan amount allowable as a regulatory matter if the Authority can provide assurance that the issue will not set a precedent or happen again. As the CEO has indicated, the Authority can represent that it has no intention to set a precedent or cause this issue to arise again. The Authority, is interested in working towards a resolution of the water rate proceeding while balancing its need to give full deference to the legislative grant of authority that resides with the Authority's Board of Directors. We believe that the recommendations of the Authority as set forth in my direct testimony as to how the $12.5 million should be addressed to be reasonable and the Authority stands by that recommendation.