



**GOVERNMENT OF THE VIRGIN ISLANDS
OF THE
UNITED STATES**

Public Services Commission

**Committee on Energy and Environmental Protection
Statement by Donald G. Cole, PSC Executive Director**

**On WAPA Management Audit Report
Conducted by Vantage Energy Consulting, LLC**

October 5, 2015

HONORABLE MEMBERS OF THE MEMBERS OF THE COMMITTEE ON ENERGY AND ENVIRONMENTAL PROTECTION: CHAIR SAMMUEL SANES, VICE CHAIR MARVIN BLYDEN, SENATE VICE PRESIDENT JANETTE MILLIN YOUNG, SENATOR CLIFFORD F. GRAHAM, SENATOR KURT VIALET, SENATOR ALMANDO LIBURD AND SENATOR TERRANCE "POSITIVE" NELSON OTHER MEMBERS OF THE 31ST LEGISLATURE WHO ARE PRESENT, STAFF OF THE LEGISLATURE AND MEMBERS OF THE LISTENING AND VIEWING PUBLIC

IT IS A PLEASURE, PRIVILEGE AND HONOR TO APPEAR BEFORE YOU TO ADDRESS THE ISSUE OF THE RECENT 2015 COMPREHENSIVE MANAGEMENT AUDIT OF WAPA UNDERTAKEN BY VANTAGE ENERGY CONSULTING, LLC ("VANTAGE") – A CONSULTANT CHOSEN BY WAPA THROUGH A COMPETITIVE REQUEST FOR PROPOSAL (RFP) PROCESS. THERE HAS BEEN A LOT DISCLOSED IN THE MEDIA OF THE RESULTS OF THIS AUDIT AND I AM SURE THAT YOU ALL HAVE RECEIVED COPIES OF THE COMPLETED AUDIT. IN ADDITION TO THE COMPLETED AUDIT YOU SHOULD ALSO HAVE COPIES OF THE RECOMMENDATIONS OF THE IMPLEMENTATION PLAN PREPARED BY VANTAGE WITH COMMENTS INSERTED BY WAPA RELATIVE TO THOSE RECOMMENDATIONS. FINALLY YOU SHOULD ALSO HAVE THE PSC STAFF ANALYSIS OF THE AUDIT AND THEIR EVALUATION OF THE RECOMMENDATIONS PUT FORTH BY VANTAGE. THESE THREE DOCUMENTS FORM THE BASIC PACKAGE RELATIVE TO THE MANAGEMENT AUDIT AND I HAVE FORWARDED TO THE CHAIR FOR YOUR PERUSAL.

OVERVIEW

BEFORE WE GET INTO THE DETAILS OF THE AUDIT, I WOULD LIKE TO PROVIDE A BRIEF OVERVIEW OF THE MANAGEMENT AUDIT HISTORY AND PROCESS. FIRST, THIS IS NOT THE FIRST MANAGEMENT AUDIT PERFORMED REGARDING WAPA. THE MOST RECENT AUDIT PRIOR TO THIS WAS COMPLETED IN 1996 USING A SIMILAR PROCESS AND WAS CONDUCTED BY STONE & WEBSTER – A NATIONALLY RECOGNIZED CONSULTING COMPANY THAT HAS PERFORMED NUMEROUS AUDITS. THEY WERE ALSO CHOSEN BY WAPA USING A RFP PROCESS.

THERE WAS ALWAYS PSC INVOLVEMENT IN INITIATING THE AUDIT AS THE PSC PROVIDED RATES TO COVER THE EXPENSES ASSOCIATED WITH THE AUDIT. HOWEVER, VERY FEW, IF ANY, OF THE RECOMMENDATIONS OF THE 1996 AUDIT WERE ACTUALLY IMPLEMENTED. NO FURTHER ATTENTION WAS FOCUSED ON THE MANAGEMENT AUDIT UNTIL 2009. IN SETTLEMENT OF 2009 WAPA BASE ELECTRIC RATE THERE WAS AGREEMENT THAT ANOTHER MANAGEMENT AUDIT WOULD BE UNDERTAKEN, AND FUNDING WAS AGAIN PROVIDED. THIS AUDIT WAS DELAYED FOR A NUMBER OF YEARS AND THEN WAS INITIATED WHEN WAPA SOUGHT ADDITIONAL RATES IN THE 2012 BASE RATE PROCEEDING. THE FINAL REPORT WAS PROVIDED BY THE AUDITOR ON FEBRUARY 10, 2015. WAPA'S RESPONSE TO THE RECOMMENDATIONS WAS PROVIDED ON SEPTEMBER 2, 2015.

NOW I WANT TO TURN MY ATTENTION TO WHAT WAS ACCOMPLISHED WITH THE AUDITS. FOR THE FIRST ONE IN 1996, THE RECOMMENDATIONS APPEARED SOLID AND WAPA AGREED IN HEARINGS BEFORE THE PSC TO IMPLEMENT MANY RECOMMENDATIONS. UNFORTUNATELY NOT MUCH GOT IMPLEMENTED.

THE IMPLEMENTATION OF THESE RECOMMENDATIONS RESTED SQUARELY ON THE WAPA BOARD AND MANAGEMENT. AS ALL OF YOU KNOW, THE PUBLIC SERVICES COMMISSION DOES NOT HAVE THE AUTHORITY TO COMPEL WAPA TO IMPLEMENT ANY OF THESE RECOMMENDATIONS. THE PSC CHALLENGED THAT AUTHORITY AND LOST IN COURT. IN ACCORDANCE WITH JUDGE ROSS OPINION AND UPHELD BY THE APPELLATE COURT. THE APPELLATE COURT STATED THAT ONLY THE LEGISLATURE CAN CHANGE THAT.

JUDGE MARIA M. CABRET IN THE CASE OF *VIRGIN ISLANDS WATER AND POWER AUTHORITY V VIRGIN ISLANDS PUBLIC SERVICES COMMISSION*, THE COURT STATED:

“...this ruling also enables WAPA to disregard PSC orders that seek to enjoin it; severely curtailing any gains that might have been anticipated by the expansion of PSC's

regulatory power over WAPA...without amendments to the current law, PSC's power to protect public interest is significantly curtailed. This, however, is a matter beyond this court's capacity to address. Rather, it is a matter that must be left to the branch of government with the power to address policy issues and pass laws—the legislature.”

THUS IN THE ABSENCE OF WAPA'S COMPLIANCE AND THE LACK OF PSC IMPLEMENTATION AUTHORITY, THE ONLY CURRENT AUTHORITY THE PSC HAS IS VESTED IN ITS RATE SETTING. LOTS OF GOOD RECOMMENDATIONS WAITING TO BE IMPLEMENTED AND THROUGH THEM, BETTER SERVICE AND LOWER COSTS! THE PSC HAS NO AUTHORITY TO ORDER IMPLEMENTATION – ONLY TO SET RATES. IN THE ABSENCE OF WAPA'S COMPLIANCE, THE PSC CAN LOWER THE RATES.

NOW WHAT HAS HAPPENED WITH THE CURRENT MANAGEMENT AUDIT? THE AUDIT REPORT RESULTED IN NUMEROUS FINDINGS AND THIRTY-FOUR (34) SPECIFIC RECOMMENDATIONS WITH THE RECOMMENDATIONS BEING PRIORITIZED IN THE REPORT AS FOLLOWS: HIGH PRIORITY – OFFERING AN IMMEDIATE IMPACT TO SAFETY, RELIABILITY OR SIGNIFICANT COST SAVINGS; MEDIUM PRIORITY – OFFERING LONG-TERM COST SAVINGS, IMPROVED OPERABILITY, OR IMPROVED MANAGEMENT CAPABILITY; AND, LOW PRIORITY – OFFERING OVERALL IMPROVEMENT IN OPERATIONS, RATE STRUCTURE AND COMMUNICATION OF INFORMATION. AFTER A SEVEN (7) MONTH REVIEW WAPA INDICATED THAT IT ACCEPTED TWENTY-FIVE (25) OF THEM COMPLETELY AND REJECTED NINE (9) WHILE THIS MAY SOUND LIKE WAPA ACCEPTED THE MAJORITY OF THE RECOMMENDATIONS I WILL DESCRIBE LATER THAT THE ONES REJECTED HAVE THE GREATEST IMPACT ON THE COST OF ELECTRICITY AND THE LEVEL OF RELIABILITY. AFTER THE EXPERIENCE OF THE 1996 MANAGEMENT AUDIT WHEN NOT MUCH WAS ACCOMPLISHED FROM GOOD RECOMMENDATIONS. IT IS NOW INCUMBENT ON ALL THE STAKEHOLDERS TO

HOLD WAPA'S BOARD AND MANAGEMENT TO IMPLEMENT THE RECOMMENDATIONS OF THE AUDIT.

SUMMARY OF 2015 RECOMMENDATIONS

YOU ALL HAVE A COPY OF THE VARIOUS DOCUMENTS ASSOCIATED WITH THE AUDIT. THE PSC STAFF HAS SUMMARIZED FOR YOUR BENEFIT THE MAJOR RECOMMENDATIONS AND WAPA'S POSITION ON EACH. I WOULD HIGHLY RECOMMEND A DIRECT PRESENTATION FROM THE LEAD AUDITOR, WALTER DRABINSKI, PRESIDENT OF VANTAGE ENERGY CONSULTING, LLC. GOVERNMENT AUDITING STANDARDS SPECIFY THAT AN AUDITOR IS RESPONSIBLE TO MONITOR THE IMPLEMENTATION OF AUDIT RECOMMENDATIONS AND TO REVIEW THE RESULTS ACHIEVED. MR. DRABINSKI HAS STATED THAT HE IS PREPARED TO MAKE A FORMAL PRESENTATION TO THIS LEGISLATURE AND RESPOND DIRECTLY TO YOUR QUESTIONS ABOUT THE AUDIT, AS YOU REPRESENT THE OWNERSHIP OF WAPA AND THE RATEPAYERS. WITH THE ABSENCE OF THE PERSON WHO HAS THE MOST KNOWLEDGE OF THE AUDIT THE LEGISLATURE MISSES A SIGNIFICANT OPPORTUNITY. THE AUDIT PROCESS WAS CONDUCTED VIA AN AUDIT STEERING COMMITTEE THAT CONSISTED OF 5 PERSONS – 3 FROM WAPA AND 2 APPOINTED FROM THE PSC. AS EXECUTIVE DIRECTOR, I WAS NOT INVOLVED IN THE DAY TO DAY PROTOCOLS OF THE AUDIT.

HERE ARE SOME OF THE MAJOR RECOMMENDATIONS:

SUMMARY OF RECOMMENDATIONS

<u>Priority</u>	<u>Recommendations</u>	<u>Accept/Reject</u>	<u>Consumer Savings¹</u>
High	III-R1 Implement a comprehensive strategic planning process.	Accepted.	

¹ In most cases WAPA did not provide any benefit – costs analysis of consumer savings. In the cases of rejected recommendations it provided no analysis of the alternative it is pursuing and potential consumer benefits.

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High	<i>III-R2</i>	Complete IRP as defined.	<i>Accepted.</i>	
	<i>III-R3</i>	Redevelop generation fleet to meet:		
High		<ul style="list-style-type: none"> • Reliability and availability; • Efficiency; • Operational effectiveness; • Organizational effectiveness. 	<i>Unknown.</i>	\$30 - \$45 M
High	<i>IV-R1</i>	Retain experienced generation expert or retain IAC or sell generation assets to Independent Power Producer.	<i>Rejected.</i>	
High	<i>V-R3</i>	Restructure maintenance staff at Richmond and Harley plants.	<i>Rejected.</i>	\$3.0 - \$6.8 M
Medium	<i>V-R4</i>	Conduct evaluation of Transmission & Development operations	<i>Unknown.</i>	\$1.0 - \$1.8 M
Low	<i>VI-R2</i>	Review schedule and progress on the Advanced Metering Initiative implementation.	<i>Unknown.</i>	\$0.6 - \$1.1 M
High	<i>VII-R1</i>	Create a position of Chief Water Operations reporting to the CEO.	<i>Unknown.</i>	
Low	<i>VII-R2</i>	Conduct an independent study to determine the risk to the RO system from hurricanes, the cost for backup using the IDE's versus other options.	<i>Unknown.</i>	\$1.5 - \$2.5 M
Medium	<i>VII-R3</i>	Consider eliminating the Assistant Superintendent positions.	<i>Unknown.</i>	
Low	<i>VII-R5</i>	Consider discontinuing standpipe service or find ways to reduce costs.	<i>Rejected.</i>	\$0.3 - \$0.7 M
Medium	<i>VII-R6</i>	Delay the start of the Nazareth Water Line Expansion until major decisions can be made.	<i>Rejected.</i>	

I HAVE PRESENTED THIS TABLE FOR A COUPLE OF IMPORTANT REASONS. FIRST YOU CAN SEE THAT WAPA HAS REJECTED OR NOT CLEARLY ACCEPTED MANY

OF THE MAIN RECOMMENDATIONS THAT WOULD LOWER COST AND IMPROVE SERVICE. TIMELY IMPLEMENTATION IS CRITICAL TO CONSUMERS OBTAINING THE EFFICIENCY GAINS AND COST SAVINGS IDENTIFIED IN THE AUDIT REPORT. LOST TIME REPRESENTS LOST SAVINGS AND A DELAY IN IMPROVED SERVICE. THE AUDIT REPORT IDENTIFIES ANNUAL SAVINGS IN THE RANGE OF \$36.3 - \$59.4 MILLION ABOVE AND BEYOND THE PROJECTED SAVINGS IN THE ON-GOING PROCESS OF SUBSTITUTION OF PROPANE FOR FUEL OIL, OR THE SHORT-TERM SAVINGS CURRENTLY ENJOYED AS A RESULT OF THE COLLAPSE OF OIL PRICES.

IT IS IMPORTANT TO POINT OUT THAT WHILE VANTAGE CONCLUDES THAT WAPA CURRENT MANAGEMENT HAS THE CAPABILITIES TO IMPLEMENT THE AUDIT REPORT RECOMMENDATIONS TO PRODUCE THE SIGNIFICANT SAVINGS IDENTIFIED AND THE CONCURRENT IMPROVED SERVICE, THERE IS NO EXPLANATION AS TO WHY THE RECOMMENDATIONS IN THE AUDIT REPORT COULD NOT HAVE BEEN IDENTIFIED AND IMPLEMENTED BY MANAGEMENT PRIOR TO THIS DATE. IT HAS BEEN ALMOST TWENTY (20) YEARS SINCE THE CONDUCT OF THE LAST AUDIT. SINCE THEN THE CONDITION OF THE PLANT HAS SIGNIFICANTLY DETERIORATED. THE AUDITOR HAS CONCLUDED THAT SINCE THE LAST AUDIT DECISIONS ON THE ACQUISITION OF PLANT HAVE BEEN INAPPROPRIATE CAUSING INCREASED COST AND POOR SERVICE OVER A VERY PROLONGED PERIOD OF TIME. ENERGY PRODUCED BY WAPA HAS DECLINED WHILE THE WORK FORCE HAS INCREASED. SIGNIFICANT PROCESSES KEY TO THE EFFICIENT FUNCTIONING OF A UTILITY ARE STILL NOT IN EXISTENCE. THERE IS NO STRATEGIC PLAN. THERE IS NO INTEGRATED RESOURCE PLAN (IRP). A FULLY FUNCTIONING MAINTENANCE MANAGEMENT SYSTEM IS STILL NOT INSTALLED.

THE PSC STAFF HAVE SUMMARIZED BELOW THE KEY FINDINGS OF THE AUDIT THAT SHOULD BE IMPLEMENTED AS SOON AS POSSIBLE. UNDER THE CURRENT SITUATION THIS WILL BE LEFT TO WAPA TO IMPLEMENT – SUBJECT TO ALL THE UNCERTAINTIES I HAVE ALREADY ENUMERATED. AGAIN, I PRESENT THESE FOR

YOUR CONSIDERATION AND I WOULD BE THE WRONG INDIVIDUAL TO DISCUSS THESE IN DETAIL. HERE THEY ARE:

- *"Implement comprehensive strategic planning and integrated resources planning."*
- *"Redevelop the generation fleet so as to meet four key objectives: (i) reliability and availability; (ii) efficiency; (iii) operational effectiveness; and (iv) organizational effectiveness."*
- *"The capacity of the existing generators is too large to economically operate ...; and the fleet of combined cycle generation ... can only be run in an inefficient, simple cycle mode when load conditions are low."*
- *"..., the heat rate of the existing WAPA units is not likely to be reduced to levels that can be achieved ... with new technologies."*
- *"..., WAPA should consider replacing the aged, inefficient fleet of combined cycle Units with highly efficient reciprocating internal combustion engine (RICE) units properly sized to meet the current and future load requirements and patterns... typical RICE units operate at a heat rate of 8,100 btu/kWh ... and can be installed in blocks of 7 mw ... it is estimated that the heat rate of the fleet would be reduced by 38% resulting in a commensurate reduction in fuel costs. In addition, there would be reductions in staffing and maintenance costs."*
- *"Perform a thorough organizational assessment leading to an optimal organizational structure and right sized staffing plan that can better align the organization with future needs."*
- *"As WAPA's business shrinks, it has not effectuated a corresponding reduction in its labor force." "The nearly 10% growth in total WAPA staffing levels over the past thirteen years indicates significant missed opportunities to take advantage of efficiencies due to the implementation and adoption of new technologies, systems and practices."*
- *"..., the late payments by various government entities and hospitals have resulted in significant receivables and led to serious cash flow constraints..., the elasticity associated with rising energy rates has caused revenue to fall despite increased rates... these two problems has resulted in limits on the ability for WAPA to pay its creditors on a timely basis."*
- *"Accounts receivable continues to be an albatross for WAPA. It has impacted its credit ratings, access to capital resources, ability to fund necessary maintenance and replace antiquated or obsolete equipment."*

THE INDEPENDENT ADVISORY CONTRACTOR (IAC)

THE IAC IMPLEMENTATION WAS AGREED TO BY WAPA IN PART TO IMPLEMENT THE RATE FINANCING MECHANISM (RFM) PROGRAM THAT PROVIDED WAPA \$16 MILLION ANNUALLY; A PORTION OF THAT FUNDING WAS SPECIFICALLY ALLOCATED TO THE IAC. WAPA DID NOT COMPLY WITH THE AGREEMENT.

ALTHOUGH VANTAGE FOUND AN IAC MAY NOT BE NECESSARY, THE CONSULTANT CONCEDED THAT IF WAPA MANAGEMENT AND THE GOVERNING BOARD DO NOT MAKE THE CHANGES NECESSARY AT THE SENIOR MANAGEMENT LEVEL AND MODIFY THE FLEET SUCH THAT IT CAN OPERATE IN TODAY'S ENVIRONMENT, EITHER AN IAC WITH BROAD DISCRETION TO OPERATE OR THE SALE TO AN INDEPENDENT POWER PRODUCER (IPP) MAY BE WARRANTED.

ULTIMATELY, THE ONLY RECOURSE FOR THE PSC, IF NEITHER THE IAC NOR QUALIFIED GENERATION PERSONNEL ARE INSTALLED AS RECOMMENDED BY THE AUDITOR, TO PROVIDE A REMEDY FOR RATEPAYERS WOULD BE TO REDUCE RATES TO THE LEVEL OF REASONABLE AND EFFICIENT OPERATIONS BASED ON IMPLEMENTING THE RECOMMENDATIONS.

THE ROLE OF THE LEGISLATURE AND THE GOVERNMENT

THE GOVERNMENT NOW OWES WAPA ABOUT \$45 MILLION FROM VARIOUS AGENCIES OF THE GOVERNMENT. THIS CAUSES GREAT HARDSHIP TO WAPA. IT CANNOT PAY ITS FUEL BILLS IN THE AMOUNTS IT NEEDS RISKING UNCERTAINTY. IT CANNOT UNDERTAKE THE ROUTINE MAINTENANCE SCHEDULED FOR THE YEAR SINCE THE CASH REQUIRED FOR THE MAINTENANCE IS NOT PAID BY THE GOVERNMENT. THIS CAUSES POOR PERFORMANCE WITH HIGH FUEL COSTS THAT ARE PASSED ON TO RATEPAYERS. OVER THE YEARS IT HAS BEEN ESTIMATED THAT THESE ADDITIONAL COSTS ARE IN THE HUNDREDS OF MILLIONS OF DOLLARS. CLEARLY THIS SITUATION CANNOT GO ON. THE PAST ACCRUED INVOICES NEED TO BE PAID TO WAPA AND ON A GOING FORWARD

BASIS THE PAYMENTS SHOULD BE CURRENT AS WITH ALL OTHER CUSTOMERS. THE AUDITOR (AND THE EXECUTIVE DIRECTOR OF WAPA) HAS INDICATED THAT THIS IS ONE OF THE BIGGEST ROADBLOCKS TO EFFICIENT OPERATIONS.

IMPLEMENTATION

THE OBJECTIVES CONTAINED IN THE VANTAGE AUDIT REPORT ARE CLEAR AND UNAMBIGUOUS—TO REDUCE CONSUMER COSTS, IMPROVE WAPA MANAGEMENT AND OPERATIONS, AND PROVIDE RELIABLE AND CONTINUOUS SERVICE. THE AUDIT REPORT RECOMMENDATIONS PAINT A PICTURE OF WHAT SHOULD BE ACHIEVED; BUT IT IS NOW UP TO WAPA TO TAKE ACTION ON THESE RECOMMENDATIONS—SPECIFICALLY THE “HIGH” PRIORITY RECOMMENDATIONS SHOULD BE AFFORDED THE UPMOST ATTENTION.

THE MANAGEMENT AUDIT REPORT IS NOW AT ITS MOST CRITICAL PHASE. EVERYONE RECOGNIZES THAT THE RECOMMENDATIONS THEMSELVES ARE NOT GOING TO DO ANYTHING TO LOWER COST, IMPROVE MANAGEMENT AND OPERATIONS OR IMPROVE SERVICE QUALITY. EFFECTIVE OVERSIGHT AND FOLLOW UP IS ESSENTIAL TO THE STAKEHOLDERS ACHIEVING THE FULL BENEFITS OF THE AUDIT REPORT. IT IS THIS LACK OF OVERSIGHT AND FOLLOW UP THAT LED TO THE FAILURE OF THE 1996 STONE & WEBSTER MANAGEMENT AUDIT TO FULLY ACHIEVE THE BENEFITS FROM ITS RECOMMENDATIONS. IT SHOULD BE ONE OF THE HIGHEST PRIORITIES OF WAPA BOARD, THE LEGISLATURE, THE EXECUTIVE BRANCH AND THE PSC TO INSURE THAT THE VANTAGE AUDIT REPORT DOESN'T MEET THE SAME FATE. GETTING ACTION OF THE VANTAGE AUDIT REPORT RECOMMENDATIONS WILL BE CRITICAL TO ACHIEVING A SUCCESSFUL OUTCOME OF THE AUDIT REPORT.

THANK YOU FOR YOUR ATTENTION. I WELCOME YOUR QUESTIONS AND COMMENTS.