STATE OF VERMONT
PUBLIC UTILITY COMMISSION

Case No. 24-0969-TF

Tariff filing of Woodstock Aqueduct Company for a change in rates, pursuant to 30 V.S.A. § 225, effective for service rendered on or after May 16, 2024	

SURREBUTTAL TESTIMONY OF SEAN FOLEY

ON BEHALF OF THE VERMONT DEPARTMENT OF PUBLIC SERVICE

October 2, 2024

Summary: Mr. Foley's surrebuttal testimony on behalf of the Vermont Department of Public Service ("Department") responds to Woodstock Aqueduct Company's ("WAC") rebuttal testimony. Mr. Foley addresses WAC's arguments regarding the application of the "used and useful" standard, the recovery of debt service and principal payments, their ability to raise capital, adjustments to operating expenses, capital project financing, and equity-related concerns, with particular reference to Vermont State Law, 30 V.S.A. § 108.

Q1. Please state your name, title, and business address.

A1. My name is Sean Foley. I serve as the Chief of Finance and Economics at the Department. My office is located at 112 State Street, Montpelier, Vermont.

Q2. Have you previously submitted testimony in this case?

A2. Yes, I submitted direct testimony on August 7, 2024.

Q3. What is the purpose of your surrebuttal testimony?

A3. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of WAC. I will address WAC's arguments regarding the application of the "used and useful" standard, the recovery of debt service and principal payments, WAC's ability to raise capital, adjustments to operating expenses, capital project financing, and equity-related concerns, with particular reference to Vermont state law, 30 V.S.A. § 108.

Q4. WAC argues that applying the "used and useful" standard prevents the utility from making necessary capital investments. How do you respond?

A4. The "used and useful" standard is a fundamental regulatory principle that ensures ratepayers only pay for assets that are operational and delivering service. This protects customers from bearing the costs of projects that are incomplete or not yet in use.

In WAC's case, the company argues that this standard impedes its ability to finance capital improvements. However, this overlooks existing regulatory mechanisms—such as deferred accounting—that can address such concerns. Deferred accounting allows utilities to track capital expenditures and recover those costs when the project becomes "used and useful." This balances the utility's need to make investments with the protection of ratepayers from premature cost recovery.

The "used and useful" standard remains essential to ensuring that ratepayers are not unfairly charged for projects that have yet to provide them with tangible benefits. WAC's financial position should not be used as a justification for weakening this protection.

Q5. WAC claims that it must recover both interest and principal payments through rates to avoid defaulting on its debt. How do you respond?

A5. The Department's position is grounded in established ratemaking practices, which exclude principal payments from the cost of service. Principal is recovered through depreciation, ensuring that customers pay for the portion of the asset that benefits them over its useful life.

Allowing WAC to recover both principal and interest in rates would place an undue short-term burden on ratepayers and result in rate volatility. Depreciation-based recovery ensures a stable and predictable rate structure, as it spreads the cost of capital investments over time. Recovering principal directly from ratepayers would not align with this principle and would lead to unfair rate increases in the short term, placing an unnecessary burden on customers.

Q6. WAC claims that its high debt-to-equity ratio prevents it from raising additional capital, which forces it to rely on recovering principal payments through rates. How do you respond, particularly in the context of Vermont state law, 30 V.S.A. § 108?

A6. WAC's financial difficulties are largely a result of its own financial management, particularly its over-reliance on debt without incorporating equity contributions. 30 V.S.A. § 108 requires utilities to obtain approval from the Vermont Public Utility Commission ("Commission") before issuing any securities, including both debt and equity. This statute ensures that utility financing decisions are made in the public interest and that the utility remains financially sound.

WAC's existing debt, as a matter of public knowledge, has been approved by the Commission under 30 V.S.A. § 108. However, WAC has not yet petitioned the Commission for approval of the new debt it proposes to take on for its upcoming capital projects. The fact that WAC has not taken this essential step is crucial. The statute is in place precisely to ensure that any proposed debt is evaluated for its impact on the utility's financial health and ratepayer interests.

WAC's failure to petition for new debt approval suggests that it has not yet sought regulatory oversight to ensure the prudency of its proposed investments. Until such a petition is filed, it is premature to recover costs for projects that have not yet been financed. Ratepayers should not be asked to bear the burden of premature cost recovery when WAC has not taken the formal steps required to secure financing for these projects.

Moreover, WAC's reliance solely on debt without seeking equity financing further exacerbates its financial position. 30 V.S.A. § 108 allows WAC to issue equity securities with Commission approval, yet the company has chosen not to pursue this option. A balanced capital structure with both debt and equity would mitigate financial strain and reduce reliance on ratepayer funding. By not utilizing this regulatory mechanism, WAC's financial difficulties are self-imposed, and this should not justify departing from standard ratemaking practices.

Q7. WAC challenges the Department's use of five-year historical averages to adjust its operating expenses, arguing that recent cost increases are a better indicator of future costs. How do you respond?

A7. The Department's use of five-year historical averages for adjusting operating expenses such as heat, electricity, and operating supplies is standard ratemaking practice. It provides a more reliable and stable forecast of future costs by smoothing out short-term fluctuations.

WAC claims that recent increases in operating expenses better reflect future costs, but it has not provided sufficient evidence or projections to support this. Basing rates solely on one year's test data—particularly if that year represents an anomaly—would risk overinflating future rates. The five-year averaging approach ensures that rates are based on long-term trends, protecting ratepayers from sudden and unwarranted increases.

If WAC anticipates specific cost increases in the Rate Year, it should provide detailed projections and justifications for those increases, rather than relying on anecdotal assertions.

Q8. WAC argues that its proposed investments in the SCADA system and annual pipe replacement should be included in the rate base immediately. How do you respond?

A8. WAC's proposed investments in the SCADA system and pipe replacement should not be included in the rate base until they meet the "used and useful" standard—meaning the projects must be fully operational and providing service to customers. Including these costs prematurely would result in ratepayers being charged for projects that are incomplete.

Furthermore, WAC has not yet sought Commission approval for the debt it proposes to finance these projects, as required by 30 V.S.A. § 108. The Commission's role in approving debt is critical to ensuring that financing decisions are prudent and will not adversely affect the utility's financial stability or place undue pressure on ratepayers. Until WAC follows the statutory process for seeking Commission approval of this new debt, it is inappropriate to recover these costs from ratepayers.

WAC could utilize deferred recovery or regulatory asset treatment for these investments, allowing it to recover costs once the projects are in service and providing value to customers. This approach would balance the utility's need to move forward with capital projects while protecting ratepayers from premature cost recovery.

Q9. WAC claims that it has never earned a return on equity ("ROE") and that applying traditional equity-based ratemaking concepts is inappropriate for its financial structure. How do you respond?

A9. WAC's failure to earn an ROE is not due to regulatory limitations but rather its own financial management decisions. The Commission has never prohibited WAC from earning an ROE, and WAC could have sought one in previous rate cases. Instead, WAC has chosen to rely almost exclusively on debt, foregoing opportunities to build equity through rates.

By not pursuing an ROE, WAC has weakened its financial structure, leaving it with little flexibility to fund future investments. A more balanced capital structure with equity contributions would have reduced WAC's reliance on debt and improved its financial health. The absence of an ROE should not be used to justify departing from standard ratemaking practices that protect ratepayers from unnecessary financial risk.

Q10. WAC contends that its proposed rate structure, which includes both interest and principal recovery, is necessary to avoid rate volatility and better serve customers. How do you respond?

A10. WAC's proposal to recover both principal and interest through rates is not consistent with sound regulatory practices. The Department's recommendation to recover interest and spread principal recovery over time through depreciation ensures rate stability and aligns with established regulatory standards.

Recovering principal directly from ratepayers would lead to short-term rate spikes and unnecessary volatility. Depreciation ensures that customers pay for assets over their useful life, spreading costs in a manner that is fair and predictable. The Department's approach provides a stable rate structure while ensuring WAC can recover its investment over time.

Q11. Does this conclude your surrebuttal testimony?

A11. Yes, it does.

Affidavit of Sean Foley

I, Sean Foley, do hereby swear and affirm under the penalty of law that the information provided in my surrebuttal testimony filed on behalf of the Vermont Department of Public Service on October 2, 2024 is true and accurate to the best of my knowledge and belief, and that I have personal knowledge of, and am able to testify as to, the validity of the information contained in my testimony. I understand that if the above statement is false, I may be subject to sanctions by the Commission pursuant to 30 V.S.A. § 30.

Date: October 2, 2024 By: /s/ Sean Foley