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	

SUPPLEMENTAL TESTIMONY

OF

SEAN FOLEY

ON BEHALF OF THE

VERMONT DEPARTMENT OF PUBLIC SERVICE

November 12, 2024

Summary: In this supplemental testimony, Mr. Foley hereby responds to the Hearing Officer's request during the October 8, 2024 Evidentiary Hearing for the above-referenced proceeding that the Vermont Department of Public Service consider alternative accounting treatments to facilitate sustainable capital funding for Woodstock Aqueduct Company.

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 Vermont Department of Public Service ("Department"). My office is located at 112 State Street, Montpelier, Vermont.

Q2. Have you previously submitted testimony in this case?

A2. Yes, I submitted prefiled direct testimony on August 7, 2024 and prefiled surrebuttal testimony on October 2, 2024.

Q3. What is the purpose of your supplemental testimony?

A3. The purpose of this supplemental testimony is to respond to the Hearing Officer's requests made at evidentiary hearing for this proceeding.

Q4. What requests did Hearing Officer Andrea Poppiti provide regarding accounting treatments to support Woodstock Aqueduct Company's ("WAC") capital funding needs?

A4. During the October 8, 2024, evidentiary hearing, Hearing Officer Andrea Poppiti recommended that the Department consider alternative accounting treatments to facilitate sustainable capital funding for WAC. Specifically, she suggested exploring the possibility of categorizing collected capital funds as regulatory assets or liabilities. This approach would help structure fund allocation for compliance-driven upgrades, such as the $150,000 planned pipe replacement required to meet Vermont Department of Environmental Conservation ("DEC") standards. Hearing Officer Poppiti's guidance emphasized balancing regulatory oversight with financial sustainability to ensure that WAC can manage essential DEC-mandated improvements without excessive rate impacts on customers.[1]

Q5. What is the basis and purpose of the Department's recommendation for establishing capital improvement funds for WAC?

A5. The Department's recommendation to establish capital improvement funds is guided by Hearing Officer Andrea Poppiti's recommendation, as described in her October 8, 2024, guidance, to explore alternative accounting treatments for sustainable capital funding. Building on this guidance, the Department's objective is to ensure that WAC can responsibly fund and manage critical infrastructure projects needed to maintain safe, reliable water service while protecting ratepayers. To accomplish this, we recommend that WAC establish three dedicated capital improvement funds: (1) the Pipe Replacement Fund, (2) the Elm Street River Crossing Fund, and (3) a DEC Hydrant Deficiency Fund. Each of these funds will be supported through targeted surcharges, allowing WAC to secure capital for these specific projects transparently, in compliance with Generally Accepted Accounting Principles (GAAP).

Q6. Could you describe the structure and purpose of the Pipe Replacement Fund?

A6. Certainly. The Pipe Replacement Fund will accumulate the capital required to replace WAC's aging pipes, meeting a $150,000 annual mandate set by the DEC for infrastructure renewal. Funded through a specific surcharge, this dedicated account will ensure that WAC has the resources to address critical pipe replacements each year. To promote transparency, the Department recommends independent audits and annual reporting to both the Vermont Public Utility Commission ("Commission") and DEC, detailing the surcharge collections and how funds are used.

[1] In re: Tariff Filing of Woodstock Aqueduct Company for a Change in Rates, pursuant to 30 V.S.A. Section 225, Case No. 24-0969-TF, Transcript of Evidentiary Hearing, October 8, 2024, at pp. 22, 61 (Vt. P.U.C. 2024).

Q7. What specific conditions are recommended to ensure the Pipe Replacement Fund is used appropriately?

A7. The Department requires that all funds collected be held in a segregated account, subjected to independent audit, with detailed annual reports submitted to the Commission and DEC. These conditions will ensure that the funds are used solely for pipe replacement projects and protect against any redirection of resources to unrelated activities.

Q8. How will the DEC Hydrant Deficiency Fund be structured, and why is it necessary?

A8. The DEC Hydrant Deficiency Fund is a critical addition to support system upgrades required to comply with DEC standards, specifically addressing fire flow deficiencies that impact hydrant performance across WAC's service area. This fund will be created through a surcharge on the hydrant tariff, allowing WAC to address over $4 million in necessary upgrades. By dedicating funds through this mechanism, WAC ensures the system complies with Vermont's Water Supply Rule, which mandates that hydrants maintain a minimum flow rate and pressure. The fund will be separately accounted for, with full transparency and annual reporting to the Commission and DEC.

Q9. How does the DEC Hydrant Deficiency Fund impact the hydrant charge?

A9. To finance these essential upgrades, a surcharge will be to hydrant charge, assessed to the Town of Woodstock, where hydrants serve the larger community. The increased hydrant charge will fund approximately $292,759 in annual debt service for a $4.3 million loan required to address these DEC deficiencies. This proposed hydrant surcharge would be approximately $3,050 per hydrant, with surcharge revenues held in escrow specifically for DEC compliance efforts.

Q10. Can you describe the purpose and structure of the Elm Street River Crossing Fund?

A10. The Elm Street River Crossing Fund is intended to support essential repairs to the river crossing damaged by recent flooding. This fund will be created through a dedicated surcharge for the Elm Street River Crossing project, with collected funds held in escrow. Annual reports to the Commission and DEC will outline both the fund balance and progress toward project completion. This structure ensures that ratepayer contributions are strictly used for river crossing repairs.

Q11. How does the Department recommend WAC manage these funds in compliance with GAAP?

A11. The Department advises that WAC adhere to GAAP, specifically FASB ASC 980 standards, which pertain to regulated operations. By treating surcharge revenues as regulatory assets, WAC can defer the recognition of costs associated with each of these projects until they are complete. This approach provides rate stability and ensures that ratepayers only incur charges once the infrastructure upgrades are complete, and they begin receiving the associated benefits.

Q12. Could you clarify the benefit of treating surcharge revenues as regulatory assets?

A12. Deferring cost recognition allows WAC to align ratepayer contributions with the infrastructure's useful life, providing a more stable and predictable rate structure. By recording these projects as regulatory assets and depreciating them over time, WAC can recover costs gradually, rather than imposing an immediate financial burden on ratepayers. This method balances necessary funding with a stable, long-term rate.

Q13. What protections are in place for ratepayers if WAC is sold before the projects are completed?

A13. In the event that WAC is sold prior to project completion, the Department recommends two key protections: (1) any unspent funds will either be refunded to ratepayers or transferred to the new owner under the condition that the funds are solely used for completing the specified projects, and (2) the Commission should stipulate that the new owner assumes full responsibility for fulfilling these project commitments, ensuring that the funds collected to date are applied as intended.

Q14. Why does the Department recommend a surcharge instead of embedding these costs in WAC's Cost-of-Service study or implementing a general rate increase?

A14. A surcharge approach provides a clear advantage by making the purpose of each charge transparent to ratepayers. With a surcharge, each project's cost appears as a dedicated line item on customer bills, ensuring that ratepayer contributions are exclusively allocated to the specified capital improvements. Additionally, a surcharge is temporary—it can be removed once sufficient funds have been collected, unlike a general rate increase, which could remain in effect indefinitely. This flexibility also provides for reallocation or refunding of funds if project needs change or WAC's ownership structure shifts.

Q15. Could you explain the structure and visibility of surcharges on utility bills?

A15. Each surcharge will appear as a distinct line item on ratepayers' bills, labeled for each specific project. For example, customers may see line items such as "Pipe Replacement Surcharge," "Elm Street River Crossing Surcharge," and "DEC Hydrant Deficiency Surcharge." The temporary nature of each surcharge ensures that it will be removed from bills once the required funding level is achieved, promoting clarity and enabling ratepayers to see exactly how their contributions are being used.

Q16. How does the Department's recommendation support WAC's financial responsibility and ratepayer protection in the long term?

A16. By establishing these capital improvement funds, the Department is enabling WAC to address critical infrastructure needs transparently and responsibly. The structured surcharges and adherence to GAAP principles help ensure that ratepayer contributions are used as intended, with robust oversight through audits and annual reporting. Additionally, these protections allow WAC to move forward on necessary infrastructure improvements, while preserving ratepayer interests even in the event of a sale or ownership change.

Q17. In conclusion, what outcomes does the Department anticipate from implementing these recommendations?

A17. The Department anticipates that these capital improvement funds, along with the associated surcharges, will enable WAC to undertake critical projects in a way that balances financial stability, regulatory compliance, and ratepayer protection. This structure provides transparency for ratepayers, ensures funds are used as intended, and addresses vital infrastructure improvements that will serve the community effectively in the years ahead.

Q18. What concerns does the Department have about WAC's reliance on debt and ratepayer contributions for capital funding, given its current debt-to-equity ratio?

A18. The Department has significant concerns regarding WAC's approach of funding essential infrastructure projects almost entirely through debt and ratepayer-funded surcharges, with little to no owner equity contributions. WAC's debt-to-equity ratio is already extremely poor, indicating a high reliance on debt relative to the owners' investment in the company. This heavy dependence on debt and ratepayer contributions, rather than owner equity, places a substantial and ongoing financial burden on ratepayers while making the utility financially vulnerable.

With an already poor debt-to-equity ratio, WAC's ability to secure additional future funding at reasonable terms is compromised. Such a financial structure limits WAC's flexibility to respond to future capital needs, whether for ongoing maintenance, new regulatory requirements, or emergency repairs. This dependency also risks increasing costs for ratepayers in the long term, as high debt levels typically lead to higher interest expenses, which ratepayers ultimately bear.

Despite these financial concerns, the Department supports the proposed capital funding structure described above as a necessary step to address urgent infrastructure needs. The Department emphasizes, however, that a more balanced funding approach—including meaningful owner equity contributions—is essential for WAC to sustainably manage future capital needs. A stronger debt-to-equity balance would not only reduce the financial risk to ratepayers but also improve WAC's financial health, enabling it to responsibly meet infrastructure demands over the long term.

Q19. Does the Department have concerns about WAC's lack of owner funding in its capital projects?

A19. Yes, the Department is concerned that WAC's owners have not contributed any significant equity to fund critical capital projects, relying instead on debt and ratepayer surcharges. This lack of owner investment places an undue financial burden on ratepayers, who are effectively covering the costs of infrastructure improvements that would normally be shared by both owners and customers in a balanced utility funding model.

The Department emphasizes that capital projects, particularly those that enhance the long-term value of the utility, should be supported by a reasonable level of owner equity. When owners do not contribute to these necessary investments, it reflects a concerning lack of commitment to the utility's financial stability and future viability. The Department urges WAC to consider meaningful equity contributions as a fair and responsible approach to funding essential projects, promoting a healthier financial structure that ultimately benefits both ratepayers and the utility's long-term sustainability.

Q20. What concerns does the Department have about any potential departures from the Commission's "known and measurable" and "used and useful" standards in this case?

A20. The Department is concerned that departing from the Commission's established "known and measurable" and "used and useful" standards could set a precedent that affects regulatory consistency and transparency. These standards are foundational in ensuring that only costs directly benefiting ratepayers, and verified through reliable data, are included in rates. The "known and measurable" standard requires that costs are clearly defined and supported by concrete data, while the "used and useful" standard ensures that only assets actively providing service to ratepayers are included in the utility's rate base. In situations where the Commission finds it necessary to deviate from these standards—

potentially due to unique or urgent circumstances affecting the utility—it is crucial that the Commission's order clearly articulates the reasoning behind such a decision. A well-documented rationale would not only clarify why the departure is necessary in this particular case but would also provide guidance for how similar situations should be handled in the future.

The Department emphasizes that clear and transparent guidance in the Commission's order will help maintain regulatory integrity while acknowledging the specific challenges WAC faces. This clarity would ensure that all parties understand the context and limitations of any deviation from these established principles, preserving confidence in the regulatory framework and protecting ratepayer interests.

Q21. Why does the Department insist on applying the "used and useful" standard to WAC's capital projects?

A21. The Department supports the "used and useful" standard to ensure that ratepayers only pay for assets that are fully operational and delivering benefits. Deviating from this principle would require ratepayers to fund assets not yet in service, setting a problematic precedent. To address WAC's capital needs, the Department recommends deferred accounting treatment, aligning cost recovery with asset usage and protecting ratepayers from early financial obligations.

Q22. Why is the Department opposed to including principal payments in the Cost of Service rather than relying solely on depreciation?

A22. The Department believes that including principal payments in rates would place a high immediate burden on ratepayers, leading to rate volatility. By using depreciation-based cost recovery, principal repayment is spread over an asset's useful life, ensuring a stable, predictable rate impact. This method aligns with regulatory best practices, allowing ratepayers to cover costs gradually as they benefit from the assets over time.

Q23. Why does the Department recommend using a five-year historical average for operating expenses?

A23. The Department's position is that a five-year historical average provides a stable, long-term view, minimizing the risk of inflated cost estimates. WAC's reliance on recent data could overstate future costs, particularly in categories with temporary fluctuations. Using an average protects ratepayers by preventing overestimated expenses and better reflects ongoing operational conditions.

Q24. What is the Department's position on WAC's debt cost calculation?

A24. The Department recommends that only interest costs, not principal, be included in WAC's COS for debt expenses. This approach reduces rate volatility and avoids a significant rate increase resulting from WAC's high debt-to-equity ratio. The Department views this as essential to maintain rate stability, with principal recovered gradually through depreciation.

Q25. Why does the Department advocate for historical averaging of professional services costs?

A25. The Department holds that using a historical average for professional services expenses is more equitable for ratepayers, smoothing out temporary cost spikes. While recognizing WAC's immediate needs, the Department believes that moderating these costs through an average approach will prevent ratepayer impact from short-term infrastructure.

Q26. Does this conclude your surrebuttal testimony?

A26. 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 supplemental testimony filed on behalf of the Vermont Department of Public Service on November 12, 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: November 12, 2024 By: /s/ Sean Foley