



Government of the District of Columbia



Office of the City Administrator

Testimony of
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City Administrator

**Joint Public Hearing on the
B20-387 the “Electric Company Infrastructure
Improvement Financing Act of 2013”**

Before the
Council of the District of Columbia
Committee on Government Operations
The Honorable Kenyan McDuffie, Chairperson
&
Committee on Finance & Revenue
The Honorable Jack Evans, Chairperson

October 21, 2013
11:00 a.m.

Council Chamber
John A. Wilson Building
1350 Pennsylvania Avenue, NW
Washington, DC 20004

Good morning, Chairperson McDuffie, Chairperson Evans and members of the Committee on Government Operations and the Committee on Finance and Revenue. My name is Allen Y. Lew and I am the City Administrator of the District of Columbia. Patrick Allen, Assistant Attorney General (Tax and Finance), is joining me; and he is available to respond to specific questions about the Electric Company Infrastructure Improvement Financing Act of 2013.

As you know, following a series of powerful storms that hit the District in 2012 and caused significant property damage and prolonged power outages, Mayor Vincent C. Gray established the Power Line Undergrounding Task Force, which is co-chaired by me and Joseph Rigby, Chairman of the Board of Directors, President and CEO of Pepco Holdings, Inc.

The objective of the Task Force was to define practical options for power line system improvements to achieve reliable electric service, with an emphasis on needs during severe weather. The Task Force pooled the collective resources available in the District to produce an analysis of the technical feasibility, infrastructure options and reliability implications of undergrounding new or existing overhead distribution facilities in the District. Collaboration between the electric service-provider, District Government, the utility regulatory, and utility customer advocacy was essential in the formation of the Task Force.

Over a nine months period, the Task Force worked on an actionable strategy to improve reliability in the quickest timeframe possible and in a way that the District can afford without an undue financial burden to our residents.

We have accomplished that goal and the result is an undergrounding solution that will improve the most vulnerable overhead circuits, as well as, the legislation before your respective Committees today. The "Electric Company Infrastructure Improvement Financing Act of 2013" codifies the scope of the undergrounding strategy, establishes the project financing framework and explains the respective roles of the District (and its responsible agencies), Pepco, the Public Service Commission and the Office of the Peoples Counsel.

Before I proceed, I want to acknowledge the critical role played by the DC Public Service Commission and the Office of the People's Counsel, on the Task Force. Like Pepco, PSC and OPC are utility management specialists. The insight and guidance from PSC Chairman Betty Ann Kane and People's Counsel Sandra Mattavous-Frye was vital to the Task Force. Thank you, Betty Ann and Sandra. You have been steadfast partners in this historic effort to modernize our infrastructure.

Joseph Rigby, who you will hear from shortly, is also to be commended. Joe and his team, at Pepco, have committed countless hours to this effort over the last year and worked diligently, with us, to examine the electric supply system, and make honest evaluations about reliability issues and what it will take to realistically improve the system.

Joe, on behalf of Mayor Gray, I want to thank you and your team for all of the hard work that you put into the Task Force; and thank you in advance for the really hard work ahead, to successfully implement the undergrounding program.

Joe will provide more detail on the technical aspects of the plan. However, I’d just like to take a moment to provide a look at how the Undergrounding Task Force approached this effort and how we arrived at the recommended undergrounding program.

Decision-making regarding the undergrounding of the electric distribution system was predicated on analysis of the following components.

- The reliability improvements expected from the undergrounding activity in terms of number and duration;
- The benefits accrued to customers from avoided outages;
- The estimated cost of the underground conversion work and its impact on customer monthly bills; and
- The disruptions to communities caused by relocation work.

The Task Force reviewed engineering assessments of existing conditions and examined a range of technical solutions based on an evaluation of feeders throughout the District. This work has included an extensive review of costs and benefits scenarios. The undergrounding of power lines is expected to provide significant benefits in terms of electric

service reliability -- specifically, the reduction in outage frequencies and durations and overall public safety.

As you know, the Mayor’s Order establishing the Task Force defined improved electric service reliability for District consumers as the underpinning for our work. We have all seen the impact of disrupted electric service when heavy storms and severe weather events hit the District. Many communities are particularly vulnerable to prolonged outages, which can, for example, result in a significant expense for replacement of spoiled, unsafe food or danger when medical equipment is inoperable without power. Small businesses are not open-for-business when lighting, refrigeration, or other power dependent functions can’t be activated during an outage. These are just a few commonly understood examples.

Reliable electric service was Mayor Gray’s mandate. The proposed undergrounding strategy represents a responsible public-private partnership between the District Government and Pepco. The strategy has the support of the regulatory and consumer services that support the public interest.

Undergrounding Strategy

The undergrounding strategy offers the best balance between cost and reliability improvement. Based on the engineering assessment of feeder condition and the opportunity to achieve electric distribution system upgrades that will significantly improve dependability for residents and commercial customers, the Task Force determined that the

undergrounding of the primary mainline and lateral wires is the most prudent technical approach for the District, given the vulnerability of these circuits.

The high-voltage feeders most affected by overhead-related outages are in Wards 3, 4, 5, 7 and 8. In addition to the relocation of the overhead primary wires and equipment to underground, the pole mounted transformers will be removed from the poles.

However, there will still be secondary and service lines running overhead on the existing poles. Typically, these facilities are a small factor in outage events; and historically, outages on these circuits are not prolonged. Restoration time for low-voltage lines normally is much shorter than restoring the high-voltage primary lines, which can require several hours for repair. Further, leaving the secondary and service lines as overhead circuits means front lawns will not be disturbed with the digging and construction that would be necessary to replace the wires that connect the individual residents and other properties to electricity and telecommunication services.

While the core technical approach (i.e. relocating primary lines to underground) will be applied to the vast majority of feeders, the precise design will be determined on a case-by-case basis. The exact design may vary somewhat depending on conditions on the ground, and coordination with other utilities, road projects and economic development activities. One solution or template will not necessarily fit all circuits.

The undergrounding of primary and lateral lines is the most beneficial, both from a cost and improved reliability standpoint. It provides benefits to a very large number of customers and it has the least disruption. The technical approach will achieve nearly all of the reliability benefits of full undergrounding (relocating all overhead primary and secondary lines along each feeder), but at only 60% of the cost. Placing underground the feeders that are the most unreliable will reduce outage frequency 97% and outage duration 92%, for customers supplied by overhead lines.

There are expanded benefits of this undergrounding strategy. Overhead lines supply customers where their individual services are both overhead and underground. Transfer of the most vulnerable overhead lines to underground will benefit all customers on circuits both overhead and underground. Reduction of the number of overhead circuits decreases the damage during major storms, which is the most time consuming portions to repair – thereby allowing crews to respond faster to where outages do occur. Reduced storm damage will result in reduced restoration cost that is paid for by all customers.

The cost/benefit rationale provides direct and indirect improvements to District electricity consumers. While the reliability improvement is the primary driver, there will also be significant aesthetic benefits for all District residents. The removal of a substantial portion of overhead power lines and equipment will be a vast visual enhancement.

Project Financing

A Task Force priority was to create the funding strategy needed to achieve game changing electric reliability improvements. But, there was also a focus on identifying efficiencies and savings, leveraging resources, and keeping the cost to consumers as low as possible. The analysis of various financing models has been substantial. Working closely with the Public Service Commission, Office of the People’s Counsel, as well as, the District’s finance and budget office and the Pepco team, each financing alternative examined the potential impact on consumers.

The resulting financing proposal is based on a \$1 Billion, 7-year construction project. The cost estimates include the following elements:

- Construction – trenching, conduit and manhole installation, restoration and paving, and traffic control
- Electrical circuit installation – work related to connecting cables inside the conduits and manholes installed underground (including splicing and terminations at junction points, transformers, and switchgear)
- Engineering and planning – activities to coordinate and manage design, quality, cost and schedule, and to ensure reliability of service to customers during conversion of the overhead facilities to underground
- Retirement of existing facilities – removal of overhead facilities after installation of underground lines (unless third party leaseholders

such as cable television and telecommunications companies elect to leave their facilities overhead)

The financing alternatives for the \$1 Billion underground program considered traditional utility financing, as well as, a variety of other financing options. In considering these alternatives, the Task Force recognized the cost impact to Pepco’s customers, the potential for lower cost debt financing, and the business characteristics of Pepco and the District, including credit ratings. Through extensive financial analysis, the recommendation is a combination of utility financing and securitized revenue bonds, along with local capital improvement funds, to provide a balanced approach that will serve and protect the interests of consumers and provide the resources needed to efficiently perform the targeted work.

Utility funding will comprise both debt and equity financing. District funding will comprise securitized revenue bonds – allowing us to access the low interest rate funds currently available – as well as, our capital improvement funds, which includes roadway reconstruction and federal highway resources. In order to maximize the capital improvement funding, there will need to be close coordination between the District and Pepco to schedule undergrounding and roadwork projects together. The recovery of the utility costs and revenue bonds will be through a surcharge on customers’ electric bills.

The “estimated” \$1 Billion project represents Pepco’s \$500 Million in rate base funding and the District’s \$500 Million in the form of \$375 Million for securitized revenue bonds and up to \$125 Million in capital improvement contributions from DDOT. Capital improvement funding reduces the financing requirements for the project; and the securitized bonds help to reduce the consumer surcharge.

With this public-private funding strategy, the project will only finance \$875 Million. The \$375 Million portion (District securitized revenue bonds) is amortized over 15 years while the balance of \$500 Million will be repaid over the 60 years useful life (and depreciation period) of the utility improvements. Under this financing arrangement, the residential rate structure starts at \$1.50 (Year 1) and it is at the peak monthly rate of \$3.25 in Year 7. But, by Year 15, after the \$375 Million is repaid, the rate drops to \$1.41 and continues to decline throughout the remaining finance period. Recipients of Residential Aid Discounts (RAD) will be exempted from surcharges, on their bills, to pay for undergrounding projects.

This public-private partnership leverages resources to achieve cost effective improvements to the District’s electric distribution system.

CBE and District Hiring Analysis

Resident hiring and contracting for District businesses are priorities for Mayor Gray and Pepco, in the undergrounding program. The undergrounding program has five funding sources that will drive CBE participation and District hiring. The sources are:

- DDOT Bond Proceeds;

- DDOT Federal Highway Match;
- Pepco Internal Workforce;
- Pepco Contracts; and
- Pepco Materials

Pepco and the District Government will work with the Department of Small and Local Business Development to identify appropriate categories of labor, contracting and procurement activities to match available funding sources.

Based on preliminary analysis, approximately \$625 million, consisting of the DDOT Bond Proceeds and the Pepco Contracts, is eligible for CBE participation.

The CBE projections start out at a goal of 35% CBE and 20% SBE participation, and the goals grow over the life of the project to 41% and 25% by the end of the project. For the overall project, CBE participation is projected at 38% and SBE participation is projected at 23% or \$238 million to CBEs and \$144 million to SBEs.

Given the long-term nature of this project, we believe that there is opportunity to develop capacity in the utility area.

The preliminary analysis estimates the percentage of hours to be worked by District residents is approximately 40% of the hours worked by Pepco Internal Workforce and DDOT and Pepco contractors. This translates to approximately \$155 Million in District wages and approximately 240 jobs per year.

Enabling Legislation

The legislation before the committees today, the Electric Company Infrastructure Improvement Financing Act of 2013, contains the statutory provisions necessary to implement the District’s undergrounding project.

The legislation first authorizes the issuance of \$375 Million in District revenue bonds to pay for DDOT’s construction of the infrastructure necessary for the undergrounding project. This infrastructure consists largely of subsurface conduit for electrical transmission lines and other subsurface space needed for electrical equipment, such as transformers.

The legislation also authorizes Pepco to implement a program to install the electrical lines and related equipment in these underground facilities, at a funding level of \$500 Million. This portion of the funding for the undergrounding project will be financed through debt and equity contributions of Pepco, not the District revenue bonds.

These DDOT and Pepco costs will be recovered by two charges on Pepco customer bills that are authorized by the legislation: the DDOT Underground Electric Company Infrastructure Improvement Charge (“DDOT Charge”), which will pay the principal and interest on the District’s bonds, and the Underground Project Charge (“UP Charge”), which will pay Pepco’s share of the construction costs.

Under the legislation, Pepco will collect both the DDOT Charge and the UPC charge. Pepco will retain the UPC charge to reimburse its costs and will remit the DDOT charge to the bond trustee to pay the principal and

interest on the bonds. The bonds are not based on the faith or credit of the District government, and therefore no governmental funding source is required to make these payments.

Furthermore, the legislation establishes a process for the approval of DDOT's use of the bond proceeds and the imposition and collection of the DDOT and UPC charges. These approval processes take place through Public Service Commission ("PSC") proceedings and financing orders.

In order to initiate the PSC proceedings, Pepco must file an application with the PSC that describes the planned bond issuance and includes a calculation of the DDOT Charge necessary to pay the principal and interest on the bonds and to allocate the DDOT Charge among customer classes. A mandatory public comment period is provided by the legislation, and the PSC must issue a decision not later than 60 days following the close of the public comment period.

The PSC order will establish the maximum amount of bond proceeds that may be expended and will authorize the imposition and collection of the DDOT Charge and its allocation among customer classes. The DDOT Charge is subject to "true up" at least annually to ensure that it generates sufficient funds to pay the principal and interest on the bonds.

With respect to the construction of the facilities themselves, Pepco and DDOT must jointly file a triennial Underground Infrastructure Improvement Projects Plan (Plan) within 45 days of the effective date of the legislation. The Plan must identify the feeders to be placed underground and must also include the estimated construction time, an estimate of

Pepco’s costs, a calculation of the charges to Pepco customers necessary to pay the costs, and an allocation of the charges among Pepco’s customer classes.

The legislation mandates a 60-day public comment period on the filing, and PSC must issue a decision not later than 45 days after the close of the comment period. The PSC order approving the Plan will authorize the underground construction activity and the imposition and collection of the UP Charge to pay for Pepco’s costs. The UP Charge may be adjusted annually, upon application to the PSC by Pepco, in order to ensure that the charge generates adequate funding to cover Pepco’s construction costs. The legislation also includes a mechanism for amendments to the Plan, upon application to PSC.

Finally, the legislation includes provisions related to protests and appeals of PSC decisions. Generally, PSC’s decisions may be appealed to the D.C. Court of Appeals, which is to hear the appeal as expeditiously as practicable.

Attorneys, professional financial advisors and policy experts from the Office of the City Administrator, Office of the Attorney General, Pepco, Office of the Chief Financial Officer, Office of Budget and Finance, the Public Service Commission, Office of the People’s Counsel, and the Department of Transportation have been working – almost weekly – since June 2013 to develop this enabling legislation, which is necessary to authorize the undergrounding program. This group has been turning-over

every sentence and dissecting each paragraph to examine definitions and implications. Like all effective negotiations, the legislation is a win/win.

As I wrap-up my testimony, I would like to recognize the Task Force members, who not only attended monthly meetings, but actively participated on the working committees that were charged with the rigorous examination of technical, financing, planning, and legislation and regulatory issues. In addition to Joe, Betty Ann, Sandra, and me, the Task Force members are:

- DC Councilmember Yvette Alexander
- Keith Anderson, Director, Department of the Environment
- Terry Bellamy, Director, Department of Transportation
- Karen Campbell, Vice President, State Government Affairs, Mid-Atlantic Region, Verizon
- Matthew Frumin, Resident Representative – Ward 3
- Dr. Natwar Gandhi, Chief Financial Officer, Office of the Chief Financial Officer
- Eric Goulet, Budget Director, Office of Budget and Finance
- Herbert Harris, Jr., Resident Representative – Ward 7
- William Howland, Director, Department of Public Works
- Brian McDermott, Engineering Supervisor, DC Water and Sewer Authority
- Steven Price, Division Head, Construction & Field Operations, Washington Gas

- Paul A. Quander, Jr., Deputy Mayor, Office of the Deputy Mayor of Public Safety and Justice
- Donna Rattley-Washington, Vice President, Government Affairs, Comcast Cable
- Thomas K. Steel, Jr., Vice President and Regulatory Counsel, RCN

Their staffs, along with my core team on this initiative, Phyllis Love, Management and Program Analysis Officer and Barry Kreiswirth, OCA Legal Counsel, have also contributed to the development of the undergrounding program.

In conclusion Chairman McDuffie and Chairman Evans, when the Mayor announced the Undergrounding Task Force he said he wanted a game changer. I’m proud of the monumental effort that has produced this solution. The legislation is the mechanism that will propel us to make these historic infrastructure improvements in record time and I urge your support.

Thank you for the opportunity to testify today, my team and I are available for any questions that you may have.