

DIRECT TESTIMONY OF ALTON MIYAMOTO

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Q. Please state your name, title, and current business address.

A. My name is Alton H. Miyamoto; I am President and Chief Executive Officer of Kauai Island Utility Cooperative (KIUC) located at 4463 Pahee Street, Lihue, Kauai, 96766.

Q. What are your duties and responsibilities?

A. I am responsible for overseeing and managing the operations of KIUC.

Q. What education, training and experience do you have incident to the work you are doing?

A. I attended public school in Hawaii. In 1972, I graduated from the University of Portland with a Bachelors of Science degree in Electrical Engineering. In 1974, I graduated from the University of Hawaii at Manoa with a Master of Science degree in Electrical Engineering.

Upon graduating from the University of Hawaii, I spent four years on active duty with the U.S. Air Force in the Military Airlift Command, Air Weather Service as Program Manager for the development and installation of meteorological equipment on U.S. bases throughout the world.

In 1978, Amfac Sugar employed me as a Power Systems Engineer, where I gained experience in power generation by assisting in the design and construction of a 21.76 megawatt (MW) biomass plant at the Lihue Plantation on Kauai.

1 After the successful start-up of the biomass plant in 1981, Kauai Electric
2 (KIUC's predecessor) employed me as their first Systems Engineer. During
3 my twenty-one years of service with Kauai Electric prior to the purchase of its
4 assets in 2002 by KIUC, I held various positions of increasing responsibility
5 including Manager of Engineering, Manager of Transmission & Distribution,
6 Assistant to the Vice President, Manager of Strategic Planning, Director of
7 Administration and Vice President & General Manager. During those periods,
8 I gained experience related to distribution and transmission facilities along
9 with construction, contracting, operations, public utility regulation, legislative
10 processes, economics and finance and accounting.

11 Q. What subject matter areas will you be covering in your testimony?

12 A. My testimony will cover the following areas:

- 13 o KIUC's cooperative structure.
- 14 o KIUC's obligations to its lenders.
- 15 o KIUC's obligations to its regulators.
- 16 o KIUC's obligations to its members.
- 17 o What KIUC is doing to meet these obligations.

18 Q. What other testimonies will be submitted at this time on behalf of KIUC with
19 respect to the subject proceeding?

20 A. KIUC's consultant, Mr. N. Richard Friedman, will be providing testimony on
21 behalf of KIUC specifically addressing the various issues set forth by
22 Prehearing Order No. 20922.

1 Q. Please describe KIUC's ownership structure?

2 A. KIUC is a Hawaii non-profit cooperative association owned by its members
3 and formed pursuant to the provisions of Hawaii Revised Statutes,
4 Chapter 421C. KIUC was formed by a group of Kauai business leaders and
5 professionals for the purpose of acquiring Kauai Electric. Under this
6 structure, all electric customers on Kauai are members of KIUC unless that
7 customer elects not to become a member. Substantially all of Kauai's current
8 electric customers are members of KIUC.

9 Q. When did KIUC acquire the assets of Kauai Electric?

10 A. November 1, 2002

11 Q. How was the purchase price financed?

12 A. The purchase price was financed by the United States Department of
13 Agriculture, Rural Utilities Service. The Rural Utilities Service assists in
14 financing electric, telecommunications, and water and wastewater projects,
15 and makes loans and grants for rural distance learning and telemedicine
16 projects. It also provides a variety of programs to provide loan funds to
17 cooperatives such as KIUC.

18 Q. What coverage ratios are required of KIUC by the Rural Utilities Service?

19 A. The loan covenants require KIUC to attain at least the following coverage
20 ratios in 2 out of the 3 most recent years of operations:

21 TIER = 1.25

22 DSC = 1.25

1 OTIER = 1.1

2 ODSC = 1.1

3 Q. Please define the TIER coverage ratio.

4 A. The term TIER stands for Times Interest Earned Ratio. The TIER ratio is
5 determined by KIUC's loan documents as follows: for each calendar year,
6 add (i) patronage capital or margins of the Mortgagor and (ii) Interest
7 Expense on Total Long-Term Debt of the Mortgagor and divide the total so
8 obtained by Interest Expense on Total Long-Term Debt of the Mortgagor,
9 provided, however, that in computing Interest Expense on Total Long-Term
10 Debt, there shall be added, to the extent not otherwise included, an amount
11 equal to 33-1/3% of the excess of Restricted Rentals paid by the Mortgagor
12 over 2% of the Mortgagor's Equity.

13 Q. Please define the DSC ratio.

14 A. The term DSC stands for Debt Service Coverage. The DSC ratio is
15 calculated by KIUC's loan documents as follows: for each calendar year add:

16 (i) Patronage Capital or Margins of the Mortgagor,
17 (ii) Interest Expense on Total Long Term Debt of the Mortgagor, and
18 (iii) Depreciation and Amortization Expense of the Mortgagor, and
19 divide the total so obtained by an amount equal to the sum of all
20 payments of principal and interest required to be made on
21 account of Total Long-Term Debt during such calendar year
22 increasing said sum by any addition to interest expense on

1 account of Restricted Rentals as computed with respect to the
2 TIER ratio.

3 Q. Please define the OTIER coverage ratio and how it is calculated.

4 A. The term OTIER stands for Operating Times Interest Earned Ratio. The
5 OTIER is calculated by KIUC's loan documents as follows:

$$6 \quad \text{OTIER} = [(A+B)/A]$$

7 A = Interest Expense on Total Long-Term Debt of the Electric

8 System, except that such Interest Expense shall be increased

9 by 1/3 of the amount, if any, by which the Restricted Rentals of

10 the Electric System exceeds 2 percent of the Mortgagor's

11 Equity.

12 B = Patronage capital & operating margins of the Electric System,

13 (which equals operating revenue and patronage capital of

14 Electric System operations, less total cost of electric service,

15 including Interest Expense on Total Long-Term Debt of the

16 Electric System) plus cash received from the retirement of

17 patronage capital by suppliers of electric power and by lenders

18 for credit extended for the Electric System.

19 Q. Please define the ODSC ratio and how it is calculated.

20 A. The term ODSC stands for Operating Debt Service Coverage. The ODSC
21 ratio is calculated by KIUC's loan documents as follows:

$$22 \quad \text{ODSC} = [(A+B+C)/D]$$

1 A = Depreciation and Amortization Expense of the Electric System.

2 B = Interest Expense on Total Long-Term Debt of the Electric
3 System, except that such Interest Expense shall be increased
4 by 1/3 of the amount, if any, by which the Restricted Rentals of
5 the Electric System exceeds 2 percent of the Borrower's
6 Equity.

7 C = Patronage capital & operating margins of the Electric System,
8 (which equals operating revenue and patronage capital of
9 Electric System operations, less total cost of electric service,
10 including Interest Expense on Total Long-Term Debt of the
11 Electric System) plus cash received from the retirement of
12 patronage capital by suppliers of electric power and by lenders
13 for credit extended for the Electric System.

14 D = Debt service billed which equals the sum of all payments of
15 principal and interest required to be made on account of Total
16 Long-Term Debt of the Electric System during the calendar
17 year, plus 1/3 of the amount, if any, by which Restricted
18 Rentals of the Electric System exceed 2 percent of the
19 Mortgagor's Equity.

20 Q. Does KIUC have any other loan agreements in addition to those with the
21 Rural Utilities Service?

1 A. Yes. KIUC have four other loan agreements, as described below:

2 1) A \$25M Secured Perpetual Line of Credit from the National Rural
3 Utilities Cooperative Finance Corporation to finance daily
4 operations. No amounts are currently drawn on this line of credit.

5 2) A \$60M Secured Perpetual Line of Credit from the National Rural
6 Utilities Cooperative Finance Corporation to finance emergency
7 repairs in the event of natural disasters. No amounts are currently
8 drawn on this line of credit.

9 3) An \$8.24M Loan Agreement from the National Rural Utilities
10 Cooperative Finance Corporation as a permanent loan for KIUC's
11 purchase of a 26.4 MW power plant, which purchase was approved
12 by the Public Utilities Commission in Docket No. 03-0223.

13 4) A \$32.96M Loan Agreement from the National Rural Utilities
14 Cooperative Finance Corporation as an interim loan for the
15 purchase of said 26.4 MW power plant. KIUC's application to the
16 Rural Utilities Service for a permanent loan to replace this interim
17 loan has been approved and is currently being processed.

18 Q. Besides the above coverage ratios, what other key financial measures does
19 KIUC focus on?

20 A. KIUC considers its equity level as a primary measure for decisions. KIUC is
21 aware that one of the primary concerns of its regulators in approving KIUC's
22 purchase of the Kauai Electric assets was the fact that 100% of the purchase

1 price was being financed. As such, KIUC has a significant interest in building
2 up its equity, especially during its formative years of ownership and operating
3 the electric utility on the island of Kauai. KIUC's current objective is to reach
4 27% equity within its first 10 years of ownership.

5 Q. What is the significance of KIUC's equity position?

6 A. In connection with the Commission's approval of KIUC's purchase of the
7 Kauai Electric assets and the continuation of the existing rate structure, KIUC
8 agreed and is required to use its best efforts to attempt to return 25% of its
9 previous years' margins to its members as a patronage capital retirement.
10 This effectively reduces KIUC's members' cost. However, under KIUC's loan
11 covenants, until KIUC reaches a 20% equity level, KIUC is required to seek
12 approval from its lenders before making any patronage capital retirements.
13 Once KIUC attains an equity position of 20%, it is allowed to return up to 25%
14 of its previous years' margins to its members without lender approval.
15 Moreover, once KIUC attains an equity position of 30%, it has the right to
16 return up to 100% of its previous years' margins to its members as a
17 patronage capital retirement without lender approval, provided that following
18 such retirement KIUC's equity remains above 30%.

19 Q. Is the patronage capital retirement a typical concept and benefit of
20 cooperatives?

21 A. Yes.

22 Q. Have any patronage capital refunds been made to KIUC's members?

1 A. Yes. In May of 2004, with the approval of its lenders, KIUC made a refund of
2 approximately \$1.7M to its members, covering its net margins during the
3 14 month period from when it purchased the Kauai Electric assets
4 (November 1, 2002) through the end of its first full year of operations (2003).

5 Q. What makes KIUC's commitment to distribute patronage capital refunds
6 unique?

7 A. Typically, the Board of Directors of a cooperative sets a retirement cycle for
8 patronage capital refunds of approximately 15-20 years. This means that,
9 although the cooperative's previous year margin is allocated to the members'
10 accounts, it is not retired or returned for approximately 15-20 years, with the
11 Board determining annually how much, if any, of this amount should be
12 retired and distributed to the members. Despite this typical arrangement,
13 KIUC has made a commitment to its members to return 25% of the previous
14 years' margins annually beginning from its first year of operation, subject to
15 lender approval.

16 Q. Doesn't retirement of patronage capital reduce equity build-up?

17 A. Yes.

18 Q. If KIUC's goal is to reach 27% equity, and cooperatives typically retire
19 patronage capital after 15-20 years, why would KIUC continue to retire
20 patronage capital on an annual basis?

1 A. KIUC has made a commitment to attempt to retire patronage capital on an
2 annual basis to provide its members with more immediately refunds and
3 benefits to reduce their cost of energy.

4 Q. How will KIUC decide if, when and how patronage capital should be retired
5 while remaining fiscally responsible?

6 A. The Board of Directors of KIUC has asked management to begin a long-term
7 strategic review of the financial goals and needs of the cooperative and to
8 submit a proposed equity management plan (EMP) to the Board by the end
9 of November 2004 for their approval.

10 Q. What is the scope and purpose of the EMP?

11 A. The goal of the EMP process is to attempt to determine an optimum mix
12 between built-up equity that should be retained for KIUC's operations and
13 requirements, and equity that should be returned to its members as early as
14 possible and in as large amounts as possible, taking into consideration at
15 least the following: (1) what is necessary for the prudent, sound and
16 conservative fiscal management of the cooperative, (2) KIUC's ability to
17 comply with regulatory and lender requirements and approvals, and (3) the
18 strategic interests of the membership base (including but not limited to
19 undertaking possible alternative production resources, distributed generation,
20 demand side management programs, and other energy conservation
21 projects). KIUC believes that the development of such a plan that properly
22 takes into consideration KIUC's obligations as a regulated utility as well as its

1 obligations to its lenders and its members is a reasonable and prudent
2 manner for it to proceed as a cooperative under regulatory oversight.

3 Q. How is KIUC planning to take into consideration the above factors in
4 preparing the EMP?

5 A. Various scenarios of operations and potential financial results for the near
6 and long-term taking into account the above factors either individually or
7 collectively will be incorporated into the EMP process. It is anticipated that
8 the EMP will be the basis for continual updating and evaluation in the future.
9 As part of that process, input from KIUC's members will be welcomed. Focus
10 groups will be asked for views on priorities members would like the Board of
11 Directors to consider for the future. For example, if members would prefer
12 more renewable resources in KIUC's generating mix, the planning process
13 will include an evaluation of that preference and how it may impact KIUC's
14 ability to accumulate equity, which, as indicated above, is one of the key
15 performance factors watched by the Board of Directors and KIUC's lenders
16 and regulators. The Board of Directors intends to use the information from
17 the EMP in its review of the operating and capital budgets for subsequent
18 years, beginning in 2005. The planning process will also invite input from
19 KIUC's lenders and the Consumer Advocate. KIUC will submit the plan to the
20 Commission as an informational filing upon its adoption by the Board.

21 Q. Is distributed generation given any consideration in the EMP process?

22 A. Yes. Distributed generation is one of the scenarios of the EMP.

1 Q. How will the EMP impact KIUC's implementation of distributed generation?

2 A. The results of the EMP will be given consideration by the Board of Directors
3 in deciding what KIUC's role should be in the distributed generation process.
4 In doing so, KIUC notes that distributed generation by any member of KIUC
5 will have an impact on the entire community. For example, if one of KIUC's
6 members were to install a distributed generator, KIUC's sales and revenues
7 will correspondingly reduce. Because KIUC as a cooperative is owned by its
8 members (comprising basically all of KIUC's customers), this will cause a
9 greater impact to the entire community than if KIUC were an investor-owned
10 utility. Some of the impacts that may result are a slower build-up of equity,
11 reduced margins, and ultimately a reduction in patronage capital retirements
12 to the members. The Board, with input from its members and with the
13 guidance of the EMP, will decide on how best it believes distributed
14 generation should be implemented or initiated. In doing so, as discussed in
15 Mr. N. Richard Friedman's Direct Testimonies, it is KIUC's position that utility
16 ownership of DG facilities should be allowed and even encouraged on the
17 island of Kauai.

18 Q. Does this conclude your testimony?

19 A. Yes.