

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

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DIV. OF CONSUMER ADVOCACY  
DEPT. OF COMMERCE & INDUSTRY  
CONSUMER AFFAIRS  
STATE OF HAWAII

In the Matter of the Application of )  
HAWAIIAN ELECTRIC COMPANY, INC. )  
For Approval of Amendment No. 2 to )  
PPA with AES Hawaii, Inc. and to )  
Establish Rate Adjustment on Short )  
Notice. )  
\_\_\_\_\_ )

DOCKET NO. 03-0126

DECISION AND ORDER NO. 20292

Filed July 1, 2003  
At 4:15 o'clock P.M.

Karon Higashi  
Chief Clerk of the Commission

ATTEST: A True Copy  
KAREN HIGASHI  
Chief Clerk, Public Utilities  
Commission, State of Hawaii.

K. Higashi



that it does not object to our approval of the instant application. However, it further states that it cannot take a position on the reasonableness of the negotiated reduction in the capacity payment or the reasonableness of the option agreement that HECO obtained in exchange for its consent to AES Hawaii's proposed refinancing, because the Consumer Advocate believed that the record, at the time it filed its statement of position, did not contain enough information to quantify the savings that AES Hawaii would realize from the proposed refinancing.

On June 25, 2003, the commission issued information requests upon Applicant, to which Applicant responded on June 27, 2003.

## II. AES Hawaii Refinancing and Amendment No. 2

### A. HECO

HECO is a corporation duly organized under and by virtue of the laws of the Kingdom of Hawaii on or about October 13, 1891, and is now existing under and by virtue of the laws of the State of Hawaii. HECO is an operating public utility engaged in the production, purchase, transmission, distribution, and sale of electricity on the island of Oahu.

### B. The PPA

AES Barbers Point, Inc. ("AES-BP," now known as AES Hawaii)<sup>1</sup> and HECO entered into a PPA dated March 25, 1988 (the "Original PPA"). The Original PPA, as amended by

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<sup>1</sup>On September 12, 1997, AES Barbers Point, Inc. officially changed its name to AES Hawaii, Inc.

Amendment No. 1, dated August 28, 1989, was approved by Decision and Order No. 10448, filed on December 29, 1989, in Docket No. 6177 ("D&O No. 10448").<sup>2</sup> As a result of D&O No. 10448, the Original PPA, as amended, was modified by a letter agreement, dated January 15, 1990 (the Original PPA, as amended and modified, is referred to as the "PPA"). Under the PPA, HECO purchases 180 MW of capacity and associated energy from AES Hawaii for a 30-year term, which commenced in September 1992.

Pursuant to the PPA, AES Hawaii constructed, owns, and operates a 180 (net) megawatt ("MW") coal-fired, circulating fluidized bed electric and steam cogeneration unit (the "Facility") located on real property leased by AES Hawaii in the Campbell Industrial Park on Oahu (the "AES Hawaii Site"). AES Hawaii's Facility provides approximately 127,388,000 kilowatt hours ("kwhs") of energy to HECO on an annual basis.

C. AES Hawaii's Financing and Refinancing

AES Hawaii entered into a Credit and Reimbursement Agreement, dated March 20, 1990, to arrange secured financing, non-recourse to AES Corporation ("AES"), the 100 per cent owner of AES Hawaii, to construct and operate the Facility.

HECO has a security interest in the Facility, securing the performance obligations of AES Hawaii under the PPA. HECO's security interest in the Facility, which is subordinate to that of the project lenders, generally is documented by, among

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<sup>2</sup>By Decision and Order No. 10296, filed on July 28, 1989, in Docket No. 6177, the commission granted conditional approval for HECO to proceed under the Original PPA with AES-BP.

other things, an Assignment and Security Agreement; a Mortgage, Assignment of Rents, Security Agreement and Financing Statement; and a Stock Pledge Agreement, all of which are dated March 20, 1990. The relative rights, contracts, and property constituting the security are documented in a Consent and Recognition and Non-Disturbance Agreement, also dated March 20, 1990.

AES Hawaii desires to refinance the Facility on terms that (1) result in the full repayment of AES Hawaii's existing secured financing; (2) provide for a secured debt in an amount up to \$450 million, or up to \$525 million if AES Hawaii can use the additional proceeds to improve its cost structure, and sufficiently improve its cash flow; and (3) provide for HECO's subordinated security interest in the Facility as described in the PPA and related security documents (the proposed refinancing is hereinafter referred to as "AES Hawaii Refinancing").

AES Hawaii's desire to refinance the Facility is based on the expected benefits to AES Hawaii and AES of refinancing the existing debt at today's lower interest rates, and using the additional proceeds presumably to pay down higher cost AES debt. The original permanent financing to construct and operate the Facility was bank-financed debt of approximately \$383 million, to be amortized over a 15-year period. The existing long-term debt, after amortization over the course of the debt's existence, is approximately \$200 million as of May 1, 2003.

D. Amendment No. 2

Amendment No. 2 provides for a reduction of \$0.0019 per kwh ("Capacity Charge Reduction"), resulting in a reduced

capacity charge from \$0.045995 kwh to \$0.044095 for each hour in which the capacity is available from June 1, 2003 through the end of the PPA term (i.e., August 31, 2022). HECO states that the primary consideration for its consent to AES Hawaii's refinancing proposal was the reduction in the cost of power supplied to HECO pursuant to the terms of the PPA. At present, HECO pays a capacity charge of \$0.045995 per kwh for each hour in which the capacity is available under the terms of the PPA. HECO estimates that the total capacity cost reduction over the remaining term of the PPA will amount to approximately \$55.9 million, or an annual reduction of \$2.9 million.

Pursuant to the terms of Amendment No. 2, the Capacity Charge Reduction will not be effective until the initial closing date for the AES Hawaii Refinancing, but will be effective retroactive to June 1, 2003, even if the AES Hawaii Refinancing closes on a date after June 1, 2003.

Paragraph 4 of Amendment No. 2 provides that if the commission's decision and order in this docket is not obtained on or before July 1, 2003,<sup>3</sup> or such later date as the parties may agree to by a subsequent written agreement, then either party may terminate Amendment No. 2. Paragraph 5 of Amendment No. 2 established the closing deadline for the AES Hawaii Refinancing

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<sup>3</sup>Paragraph 4 of Amendment No. 2 established the date by which the commission must render its decision and order in this docket as June 17, 2003. On June 23, 2003, HECO transmitted an Agreement Re: Amendment No. 2 to the commission, which provided for an extension of the date for obtaining the commission's decision and order from June 17, 2003 to July 1, 2003.

as July 14, 2003,<sup>4</sup> with an allowance to extend the deadline to September 15, 2003, if, prior to July 15, 2003, AES Hawaii provides HECO with a written notice stating that AES Hawaii is pursuing in good faith the AES Hawaii Refinancing and reasonably believes that such refinancing could be completed by September 15, 2003.

E. HECO's Consent to Refinancing

Section 24.12 of the PPA states, in relevant part, that AES Hawaii,

prior to entering into any amendment or modification of the Financing Documents or any refinancing shall make copies of the Financing Documents, amendments or modification thereto, and any documents providing for a refinancing available to HECO and shall obtain HECO's consent that its rights under this Agreement and the Security Agreement are not unreasonably impaired by the Financing Documents, amendments, modifications or refinancing documents. Such consent shall not be unreasonably withheld...

HECO recognizes that its potential risks relating to the AES Hawaii Refinancing arise out of the magnitude of the refinancing. If AES Hawaii proposed to refinance only the existing debt, HECO states that it would not expect to be compensated for its consent beyond the repayment of its incurred

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<sup>4</sup>Paragraph 5 of Amendment No. 2 originally established June 30, 2003 as the Refinancing Closing Deadline (as that term is defined in Amendment No. 2), with an allowance to extend the deadline until August 31, 2003 if, prior to July 1, 2003, AES Hawaii provides HECO with a written notice stating that AES Hawaii is pursuing the AES Hawaii Refinancing and reasonably believes that such refinancing could be completed by August 31, 2003. On June 23, 2003, HECO transmitted an Agreement Re: Amendment No. 2 to the commission, which provided for an extension of the Refinancing Closing Deadline from June 30, 2003 to July 14, 2003 (as stated above, each Refinancing Closing Deadline could be extended with written notice).

costs. However, since the AES Hawaii Refinancing will substantially affect the cost of exercising HECO's "step-in" rights if AES Hawaii defaults on its obligations under the PPA, HECO requested a dollar benefit in a form that could be passed on to its ratepayers. HECO emphasizes that if it (or its nominee) takes over the Facility in the event of AES Hawaii's default, HECO would have to assume or pay off the existing debt at the time. The current principal balance of the long-term debt is approximately \$200 million, and would be paid off in another five years. The AES Hawaii Refinancing could increase the secured debt up to \$525 million, with a repayment period of up to 20 years.

HECO states that its willingness to consent to the refinancing primarily results from the willingness of AES Hawaii and AES to substantially share the benefit created by the refinancing with HECO's customers, which in HECO's judgment is adequate compensation for the additional risk.

AES Hawaii estimates that the net present value of the Capacity Charge Reduction is roughly one-half of the net present value of the benefit that it would have obtained from the refinancing, if it met the condition for borrowing the entire \$525 million at the lower interest rates that were expected to result from the proposed bank financing.

HECO asserts that its judgment as to the adequacy of the compensation to its customers is not based on the value of the refinancing to AES and AES Hawaii, but is based on the value of the Capacity Charge Reduction to its customers, which can be

calculated based on the estimated availability of the Facility's capacity.

In addition to an approval of Amendment No. 2, HECO requests that the commission find that its consent to the AES Hawaii Refinancing is reasonable given the consideration for such consent. As stated above, HECO recognizes that the magnitude of the AES Hawaii Refinancing results in increased risk to HECO, since the cost of exercising its "step-in" rights in the event of an AES Hawaii default would be significantly increased. The commission is also concerned with the magnitude of the AES Hawaii Refinancing (i.e., up to \$525 million), particularly when asked in this docket to find that HECO's consent to the entire AES Hawaii Refinancing is reasonable, since there is a possibility that HECO would ultimately request to include any amounts that it may be required to pay to cure AES Hawaii's default in its rate base for ratemaking purposes.

Thus, based upon the information provided in the record, the commission is unable to determine at this juncture whether the benefit to the ratepayers and HECO, obtained in exchange for HECO's consent, is commensurate with the increased risk associated with the full amount of the proposed AES Hawaii Refinancing. For this reason, among others, we can only find that HECO's consent to the AES Hawaii Refinancing is reasonable, but only to the extent that the existing principal balance (approximately \$200 million as of May 1, 2003) is refinanced and the amount financed does not exceed the existing principal

balance and unpaid interest.<sup>5</sup> We are unable to determine whether HECO's consent to the AES Hawaii Refinancing, to the extent it exceeds the existing principal balance, is reasonable, since there is not enough information in the record to sufficiently demonstrate that the increased risk of the AES Hawaii Refinancing is correlative to the benefits obtained in exchange for the consent.

Notwithstanding our qualified finding as to the reasonableness of HECO's consent to the AES Hawaii Refinancing, we find, after a careful review of the record, that Amendment No. 2 is reasonable. Thus, we conclude that HECO's request for approval of Amendment No. 2 should be granted, subject to certain conditions stated in Section IV, below.<sup>6</sup>

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<sup>5</sup>The commission recognizes that paragraph 2 of Amendment No. 2 provides that Amendment No. 2 and HECO's consent to the entire AES Hawaii Refinancing are contingent upon, among other things, the commission's finding that HECO's consent to the AES Hawaii Refinancing is reasonable.

<sup>6</sup>HECO requested an Option Agreement ("Option") in addition to the dollar benefit (the Capacity Charge Reduction) that AES Hawaii was willing to offer in exchange for its consent to the AES Hawaii Refinancing. Under the Option, AES Hawaii grants to HECO the exclusive option, but not the obligation, to acquire an interest in certain portions of the AES Hawaii Site (the "U2 Site") for the potential development by HECO of a second, 180 (net) MW, coal-fired, electrical generating unit utilizing circulating fluidized bed technology (referred to as "U2") and coal pile, conveyor, hopper, limestone storage area, and ash pile for U2, subject to the terms and conditions set forth in the Option. The Option also includes the easements, setbacks, and rights to access over and across the portion of the AES Hawaii Site not within the U2 Site necessary for the development and operation of U2.

HECO contends that a second coal-fired unit located on the unused portions of the AES Hawaii Site could take advantage of its proximity to AES Hawaii's Facility and would benefit from the

### III. Rate Adjustment

When the AES Hawaii Refinancing closing occurs and Amendment No. 2 becomes effective, HECO proposes to reduce its rates for electric service, based on a percentage of a customer's "base revenues," to reflect the estimated reduction in capacity payments HECO will be paying to AES Hawaii (as a result of the Capacity Charge Reduction). The rate reduction would be made effective on short notice on the day following the closing of the AES Hawaii Refinancing. The percentage will be based on the estimated annual reduction in capacity payments (approximately \$2.9 million) and related revenue taxes, divided by the forecast base revenues for the year. The percentage will

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utilization of the existing land and certain coal delivery infrastructure associated with the Facility.

In order to exercise the Option, the AES Hawaii's Site would need to be subdivided, at HECO's expense, and HECO and AES Hawaii would have to negotiate a definitive agreement for the acquisition by HECO of an interest in the U2 Site with its accompanying easements. In addition, HECO would need to obtain the consent of the AES Hawaii Site landowner and of the AES Hawaii Refinancing lenders.

HECO neither requests, nor is required to seek at this time, the commission's approval of the Option, since the Option does not amend, modify, or limit AES Hawaii's or HECO's rights or obligations under the PPA. Accordingly, we neither approve, nor make any finding or conclusion as to the reasonableness or appropriateness of the Option. HECO states that it would exercise the Option in conjunction with any plans to develop and install U2. At present, HECO's generation resource plan contemplates that a coal-fired unit could be the preferred generating option in 2016. See, Figure 5.3-1 on page 76 of HECO's 2002 Evaluation Report for its Integrated Resource Plan (1998 - 2017), which was filed with the commission on December 31, 2002, in Docket No. 95-0347. HECO notes that an application requesting approval for the commitment of capital expenditures for any U2 project would be filed pursuant to paragraph 2.3(g)(2) of the commission's General Order No. 7.

be adjusted annually effective January 1 of each year to reflect a revised forecast of base revenues for the year.

For 2003, the rate adjustment will be calculated on 7/12 of the annual rate reduction to reflect Capacity Charge Reduction, which will be retroactive to June 1, 2003, and estimated base revenues for the remainder of the year (depending on when the AES Hawaii Refinancing closes). If the AES Hawaii Refinancing closes on or after July 31, 2003, the rate adjustment for 2003 will be recalculated based on the shorter period in which the prorated annual rate reduction will be passed through to customers.

The commission finds good cause to allow the rate reduction to become effective on short notice upon HECO's filing of its revised tariff sheets. Thus, we conclude that HECO's request to allow the rate reduction to become effective on short notice should be granted.

#### IV.

##### THE COMMISSION ORDERS:

1. Amendment No. 2, dated May 8, 2003, between HECO and AES Hawaii is approved and is effective upon the closing of the AES Hawaii Refinancing, subject to the conditions set forth in Section IV, paragraphs 4 and 5, below.

2. HECO's consent to the AES Hawaii Refinancing is reasonable, to the extent the amount financed does not exceed the existing principal balance (approximately \$200 million as of May 1, 2003) and unpaid interest due and owing as of the closing

of the AES Hawaii Refinancing, subject to the conditions set forth in Section IV, paragraphs 4 and 5, below.

3. HECO's rate reduction to adjust for the Capacity Charge Reduction, as described in the instant application, is approved, and shall take effect upon HECO's filing of its revised tariff sheets. Applicant shall submit revised tariff sheets and revised rate schedules to appropriately reflect the rates authorized by this decision and order.

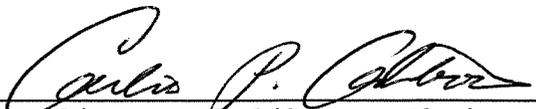
4. The commission reserves the right to review the prudence of HECO entering into the PPA and its amendments and the reasonableness of the PPA terms, including the reasonableness of the energy and capacity charges HECO is required to pay under the PPA upon a showing that HECO (a) procured the commission's approval in this docket through fraud or deception or through conscious or deliberate misrepresentation of facts or manipulation of data; or (b) HECO failed to disclose at the time of the commission's decision in this docket facts known to HECO or of which HECO should reasonably have known, which bear on the prudence of HECO's decision to enter into the PPA or on the reasonableness of the terms of the PPA.

5. The commission, further, reserves the right (a) to monitor and review HECO's administration and implementation of the PPA, including the exercise of options available to HECO within or without the PPA; (b) to ensure HECO takes such actions as are prudent and in the public interest,

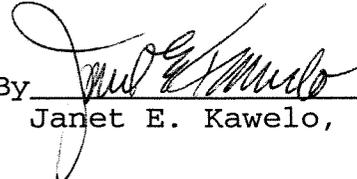
which may become appropriate or necessary as a result of performance under the PPA; (c) to review and determine how the cost consequences of the failure of AES Hawaii to perform under the PPA will be shared by HECO and the ratepayers; and (d) to consider what adjustments should be made in the event capacity in excess of that required by HECO develops in the future.

DONE at Honolulu, Hawaii this 1st day of July, 2003.

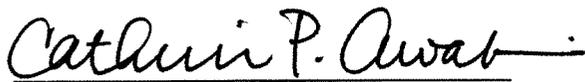
PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By   
Wayne H. Kimura, Commissioner

By   
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

  
Catherine P. Awakuni  
Commission Counsel

03-0126.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 20292 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
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Karen Higashi

DATED: July 1, 2003