

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Petition of)
HAWAIIAN ELECTRIC COMPANY, INC.)
For a Declaratory Ruling on the)
Applicability of Hawaii Revised)
Statutes Section 269-17, for a)
Capital Lease Arrangement.)
_____)

DOCKET NO. 05-0084

DECISION AND ORDER NO. 21821

RECEIVED
2005 MAY 16 A 8:01
DIV. OF CONSUMER ADVOCACY
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STATE OF HAWAII

Filed May 13, 2005
At 3 o'clock P.M.

Karen Higashi.
Chief Clerk of the Commission

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

K. Higashi.

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DECISION AND ORDER

The commission declares that, based on the facts, circumstances, and HAWAIIAN ELECTRIC COMPANY, INC.'s ("HECO") representations, Hawaii Revised Statutes ("HRS") § 269-17 does not apply to HECO's new lease, as further described herein.

I.

Background

HECO requests a declaratory order by May 23, 2005, ruling that: (1) HRS § 269-17 does not apply to its capital lease arrangement with the Trustees of the Estate of Bernice Pauahi Bishop, for the lease of HECO's office building located at 233 South King Street, Honolulu, Hawaii; hence (2) the commission's approval of HECO's capital lease arrangement is not required under HRS § 269-17.¹ In the alternative, if the

¹HECO's Petition for a Declaratory Ruling, Verification, Attachments A and B, and Certificate of Service (collectively, the "Petition"), filed on April 6, 2005. A copy of HECO's lease is attached as Attachment A to its Petition.

commission finds that its approval of HECO's capital lease arrangement is required pursuant to HRS § 269-17, HECO requests that the commission approve the capital lease arrangement.²

HECO makes its underlying request pursuant to Hawaii Administrative Rules ("HAR") chapter 61, subchapter 16, relating to declaratory orders. HECO served copies of its Petition upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate") (collectively, the "Parties").

On May 5, 2005: (1) HECO responded to the commission's information requests; and (2) the Consumer Advocate filed its position statement. This Decision and Order addresses HECO's request for a declaratory ruling.

II.

HRS § 269-17

HRS § 269-17 states:

Issuance of securities. A public utility corporation may, on securing the prior approval of the public utilities commission, and not otherwise, issue stocks and stock certificates, bonds, notes, and other evidences of indebtedness, payable at periods of not more than twelve months after the date thereof, for the following purposes and no other, namely: for the acquisition of property or for the construction, completion, extension, or improvement of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the

²Id.

aforesaid purposes except maintenance of service, replacements, and substitutions not constituting capital expenditure in cases where the corporation has kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which the expenditures were made, and the sources of the funds in its treasury applied to the expenditures. As used herein, "property" and "facilities", mean property and facilities used in all operations of a public utility corporation whether or not included in its public utility operations or rate base. A public utility corporation may not issue securities to acquire property or to construct, complete, extend or improve or add to its facilities or service if the commission determines that the proposed purpose will have a material adverse effect on its public utility operations.

All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void.

HRS § 269-17 (underscore added).

The first and fourth sentences of HRS § 269-17 were enacted in 1933 as Section 2202-1 of the Revised Laws of Hawaii ("RLH") 1933.³ In 1969, the second and third sentences of HRS § 219-17 were added, defining "property" and "facilities," and prohibiting a public utility's issuance of securities if the proposed purpose will have a materially adverse effect on the

³Act 169, Laws of the Territory of Hawaii 1933, Section 4, at 189 - 190.

utility's operations.⁴ Since 1969, the text of HRS § 269-17 remains unchanged. Most notably, the "other evidences of indebtedness" language is unchanged since its inception in 1933.⁵

III.

Jones v. HECO

Jones v. HECO arises out of the commission's dismissal of a complaint (Docket No. 2703), which the Hawaii Supreme Court ("Court") subsequently affirmed on appeal (Appeal No. 6433).

A.

Docket No. 2703

HECO entered into a lease agreement with the Estate of Bernice Pauahi Bishop ("Bishop Estate") for 219 acres of land in Heeia Kea Valley, Kaneohe, for thirty (30) years, beginning October 1, 1964. The lease agreement provided that HECO purchase the property on September 30, 1994, or at any earlier date, by giving ten (10) days prior written notice to Bishop Estate. At

⁴Act 276, Session Laws of Hawaii 1969, Section 1, at 501. The purposes of these amendments were to: (1) broaden the scope of HRS § 291-17 to permit public utility corporation's to issue securities for non-utility operations and non-rate base items; and (2) preclude the issuance of securities in the event of a materially adverse effect upon the utility's operations. See House Stand. Comm. Rpt No. 552, House Journal 1969, at 839 - 840; and Senate Stand. Comm. Rpt No. 944, Senate Journal 1969, at 1240.

⁵See Act 169, Laws of the Territory of Hawaii 1933, Section 4, at 189 - 190; RLH 1935, Section 7955; RLH 1945, Section 4716; RLH 1955, Section 104-16; Act 276, Session Laws of Hawaii 1969, Section 1, at 501; and HRS § 269-17.

the time HECO entered into the lease agreement, HECO did not seek the commission's prior approval under HRS §§ 269-17 or 269-19.

In Docket No. 2703, a group of HECO's ratepayers (the "Complainants") filed a complaint against HECO, seeking to have the commission declare the lease agreement null and void based on the commission's lack of prior approval under HRS § 269-17.⁶

The commission rejected the Complainants' claim, reasoning that: (1) HRS § 269-17 deals with the issuance of securities, and the "other evidences of indebtedness" language refers to indebtedness as it relates to the issuance of securities; (2) both HECO and the Complainants agreed that a simple lease is not subject to HRS § 269-17, since it is not a form of indebtedness contemplated under the statute; (3) an executory contract is not an evidence of indebtedness or any type of security interest; and (4) the lease rental payments were at the expense of the stockholders and not the ratepayers.⁷ The commission also rejected Complainants' other causes of action, then granted HECO's motion to dismiss the complaint.

⁶In addition, the Complainants alleged other causes of action.

⁷Decision and Order No. 4412, filed on October 27, 1976, in Docket No. 2703. The commission also noted that under its provision governing the filing of capital expenditure applications by electric utilities (General Order No. 7, Section 2.3(g)(2)), HECO "has to submit a proposed capital expenditure that is in excess of \$500,000 for inclusion into its rate base. No such application can be filed for the Heeia Kea property since [HECO] will purchase the property in 1994 and then has to make an application to place said property in its rate base." Id. at 8 - 9.

B.

Appeal No. 6433: Jones v. HECO

Complainants appealed the commission's dismissal to the Court, contending that the lease agreement with the proviso to purchase the Heeia Kea property was an evidence of indebtedness under HRS § 269-17, and thus, void based on the commission's lack of prior approval of the lease agreement.

The Court reasoned that the lease agreement was not a loan and was never intended to be issued or sold to others, and thus, was not a method of generating capital. The Court, citing to the statutory rule of construction of *ejusdem generis*,⁸ then held:

Holding the rule of *ejusdem generis* applicable to HRS § 269-17, 'evidence of indebtedness' is limited to things of like character to stocks and stock certificates, bonds and notes. Stocks and stock certificates, bonds and notes are usually issued as a means of raising funds for the purposes specified in HRS § 269-17 and become part of the capital structure of the public utility. The lease agreement is not a means of raising funds for the purchase of the Heeia Kea property and is not part of the capital structure of HECO. Thus, the lease agreement is not of like character to a stock, bond or note.

The PUC's decision is also consistent with the principal purpose of HRS § 269-17. The Commission previously found that 'the main object of the legislature in enacting § 104-16 RLH 1955 (now HRS § 269-17) was to establish and preserve a proper rate base for regulation of rates and service, and the immediate design thereunder was

⁸"Under this established rule of statutory construction, where words of general description follow the enumeration of certain things, those words are restricted in their meaning to objects of like kind and character with those specified." *Jones v. HECO*, 64 Haw. at 294, 639 P.2d at 1108 (citations and footnote therein omitted).

to limit not only the capital of the utility as represented by its stock but also its other obligations as far as they were designed to supplement equity capital by borrowings of a permanent character.'

The lease agreement does not involve the issuance of stock or borrowings of a permanent nature designed to supplement equity capital. The agreement has no effect on the capital structure of HECO or on its utility expenses. Therefore, the legislature did not intend for the PUC to regulate such an agreement under HRS § 269-17.⁹

Accordingly, the Court: (1) concluded that the lease agreement was not an evidence of indebtedness under HRS § 269-17, and (2) affirmed the commission's decision to dismiss the complaint under HRS § 269-17.¹⁰

IV.

New Lease

HECO leases its office building located at 233 South King Street in Honolulu ("King Street building" or "building") from Bishop Estate, the owner of the building and underlying land. HECO has occupied the King Street building since 1927, and presently uses the building primarily for office and

⁹Id. at 295, 639 P.2d at 1108 - 1109 (citation omitted).

¹⁰The Court also examined the other issues raised by the Complainants on appeal, and ultimately held that the commission did not err in dismissing the complaint.

business-related purposes.¹¹ Two (2) system transformers are located in the basement of the building.

The prior lease arrangement between HECO and Bishop Estate expired on November 30, 2004, and HECO is presently on a month-to-month lease term, "at the same monthly rate just prior to the expiration of the previous lease of \$64,583.34 per month."¹² HECO has negotiated a new twenty (20)-year lease agreement, which: (1) is classified as a capital lease for accounting and financial reporting purposes ("new lease" or "capital lease arrangement");¹³ and (2) HECO and Bishop Estate plan to execute following the commission's action in this proceeding.

¹¹In addition to certain HECO departments and divisions, HECO's executives and the executives of its parent corporation, Hawaiian Electric Industries, Inc. ("HEI"), occupy the King Street building. HEI reimburses a portion of rental payments, common area costs, and capital improvements paid by HECO. HEI's portion is determined based on the square footage occupied by HEI, i.e., approximately fifteen (15) per cent. HECO states that "[t]his arrangement is expected to continue." HECO's Petition, at 4, footnote 1.

¹²Id. at 4.

¹³HECO states that its accounting treatment of its new lease is governed by generally accepted accounting principles, in particular, the Financial Accounting Standards Board's ("FASB"), Statement of Financial Accounting Standards 13, *Accounting for Leases* ("Statement 13"), paragraph 7. Pursuant to Statement 13, Paragraph 7(d), HECO will record the new lease as a capital lease. See HECO's Petition, Section VI, Accounting Treatment for Financial Reporting Purposes, and Attachment B. Under its analysis, HECO concludes: "Since the NPV [net present value] of the minimum lease payments exceeds 90% of the estimated fair value of the leased property at the lease inception, the proposed King Street lease appears to be a capital lease for financial reporting purposes." HECO's Petition, Attachment B.

On April 13, 2005, HECO produced a copy of Statement 13 for the docket record, in response to the commission's request.

The new lease includes:

1. Monthly lease rents of \$64,583.34 from the effective date of the new lease through November 30, 2009; \$71,041.67 from December 1, 2009 through November 30, 2014; \$78,145.84 from December 1, 2014 through November 30, 2019; and \$85,960.42 from December 1, 2019 through November 30, 2024; and

2. Nine (9) million dollars Bishop Estate is providing "for improvements to be used for replacing the elevators, air conditioning system, windows, electrical system and other similar projects."¹⁴

In justifying the new lease provisions, HECO asserts that:

1. The ten (10) per cent escalations every five (5) years, equivalent to less than a two (2) per cent annual escalation rate, are reasonable and eliminate its exposure to potentially volatile market conditions.

2. Bishop Estate is providing the nine (9) million dollars for improvements, in recognition of: (A) the need to sustain and upgrade the building due to its age; and (B) the term of the new lease.

3. "Based on the convenience of the current location for its customers, to minimize disruption to operations, the rental payment terms being consistent with the current King Street lease, and the commitment from Bishop Estate to provide

¹⁴HECO's Petition, at 6.

funds for building improvements, the proposed lease is reasonable."¹⁵

V.

Parties' Position

HECO states that: (1) the capital lease arrangement will primarily involve the recording of HECO's King Street building, and a corresponding long-term obligation, onto HECO's financial records; and (2) it is unclear as to whether HRS § 269-17 applies to a capital lease arrangement determined as such under Statement 13. Thus, HECO essentially asks whether its new lease constitutes "other evidences of indebtedness" "for the acquisition of property[,] " such that HRS § 269-17 applies, thus requiring the commission's prior approval.

HECO cites to the Court's decision in *Jones v. HECO*, and a decision by the Vermont Public Service Board, *In re Green Mountain Power Corp.*, 76 PUR 4th 270 (Vt. Pub. Serv. Bd., July 24, 1986), in suggesting that HRS § 269-17 is inapplicable to a capital lease arrangement determined as such under Statement 13.¹⁶ HECO states that it intends to address the ratemaking treatment of its capital lease in Docket No. 04-0113, HECO's pending 2005 calendar test year rate case.

¹⁵Id.

¹⁶In *Green Mountain Power Corp.*, the Vermont Public Service Board ("VPSB"), in interpreting the "other evidence of indebtedness" phrase in a similar statute as HRS § 269-17, held that capital leases are not subject to the VPSB's prior approval.

The Consumer Advocate finds that under the commission's and Court's respective decisions in *Jones v. HECO*:

. . . both maintain that HRS § 269-17 applies only to things of like character to stocks, stock certificates, bonds, notes, and other securities usually issued as a means of raising funds for the purposes specified in HRS § 269-17 and to become part of the capital structure of the public utility. Both of these decisions do not view leases as "evidence of indebtedness" similar to stocks, bonds, and other securities mentioned, and are not intended to be issued or sold as a means to supplement equity capital. This would appear to be applicable to both ordinary and capital leases since both contain no characteristics of an issued negotiable security instrument to supplement equity capital.¹⁷

Based on these findings, the Consumer Advocate does not object to the commission's decision to declare that HRS § 269-17 is not applicable to the new lease. That said, the Consumer Advocate emphasizes that: (1) no part of the Consumer Advocate's position should be construed as a determination that the new lease is reasonable; and (2) all ratemaking and accounting treatment issues relating to the new lease should be addressed in HECO's pending rate case (Docket No. 04-0113).

V.

Declaratory Ruling

HAR § 6-61-159 provides in part that, upon the petition of an interested person, "the commission may issue a declaratory order as to the applicability of any statute . . . of the

¹⁷Consumer Advocate's position statement, at 5 (underscore in original).

commission." The dispositive issue, thus, is whether HRS § 269-17 applies to HECO's new lease, necessitating the commission's prior approval. This Decision and Order is: (1) premised on HECO's representation that its new lease is a capital lease under Statement 13, Paragraph 7(d); and (2) based on the facts and circumstances as represented by HECO in this docket.

The commission reaffirms its ruling that HRS § 269-17 deals with the issuance of securities, and the "other evidences of indebtedness" language refers to indebtedness as it relates to the issuance of securities.¹⁸ Likewise, the Court held: (1) that "other evidences of indebtedness" is limited to things of like character to stocks, stock certificates, bonds, and notes, usually issued as a means of raising funds for the purposes specified in HRS § 269-17, and become part of the utility's capital structure; and (2) HRS § 269-17 involves the issuance of stock or borrowings of a permanent nature (i.e., payable at period of more than twelve (12) months), designed to supplement equity capital.

Based on HECO's representations, the new lease: (1) is a long-term lease of real property; (2) is not a loan or method of generating capital for the purposes specified in HRS § 269-17, including the purchase of the leased property; (3) does not involve the issuance of stock or borrowings of a permanent nature designed to supplement HECO's equity capital; and (4) is not a

¹⁸Decision and Order No. 4412, at 8.

security instrument for any payment owed by HECO to Bishop Estate.¹⁹

Under these circumstances, the new lease does not involve indebtedness as it relates to the issuance of securities for the purposes specified in HRS § 269-17. Accordingly, the commission finds and declares that HRS § 269-17 is inapplicable to HECO's new lease.

VI.

Orders

THE COMMISSION DECLARES that, under the facts and circumstances of this case, HRS § 269-17 does not apply to HECO's new lease, as long as the facts presented and representations made to the commission in this docket remain true and accurate.

THE COMMISSION ORDERS that this docket is closed.

¹⁹See HECO's response to PUC-IR-203. Concomitantly, HECO explains that: (1) for financial reporting purposes, the new lease will affect HECO's capital structure, in that it will be shown on its financial statements as a long-term obligation; (2) it proposes to include: (A) amortization of the property and interest expense of the new lease obligation as utility expenses; and (B) the net present value of the lease payments in rate base; and (3) for accounting purposes, the new lease will be capitalized. See HECO's responses to PUC-IR-201 to PUC-IR-203.

As the Consumer Advocate notes, all ratemaking and accounting treatment issues relating to the new lease is deferred to HECO's pending rate case (Docket No. 04-0113). Accordingly, the scope of this Decision and Order is specifically limited to HECO's request for a declaratory ruling on the applicability of HRS § 269-17, pursuant to HAR § 6-61-159.

DONE at Honolulu, Hawaii MAY 12 2005 .

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By *Carlito P. Caliboso*
Carlito P. Caliboso, Chairman

By *Wayne H. Kimura*
Wayne H. Kimura, Commissioner

By *Janet E. Kawelo*
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

05-0084.cs

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21821 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: **MAY 12 2005**